Can China's New "Blocking Statute" Combat Foreign Sanctions?

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1. **Background**

A blocking statute is adopted by a country to hinder the extraterritorial application of foreign legislation.[1] For example, the EU adopted Council Regulation No 2271/96 (hereinafter "EU Blocking Statute") in 1996 to protest the US's extraterritorial sanctions legislation concerning Cuba, Iran and Libya.[2] Since Donald Trump became the US president, the US government officially defined China as its competitor.[3] Consequently, China has been increasingly targeted by US sanctions. For example, in 2018, the US imposed broad sanctions on China's Equipment Development Department (EDD), the branch of the military responsible for weapons procurement and its director for violating the US law on sanctions against Russia.[4] In 2020, the US announced new sanctions on Chinese firms for aiding North Korea's nuclear weapons program.[5] A number of "Belt and Road" countries are targeted by US primary sanctions, which means that Chinese entities may face a high risk of secondary sanctions for trading with these countries. In these contexts, Chinese scholars and policy makers explore the feasibility to enact blocking law to counter foreign sanctions.[6] On 9 January 2021, China's Ministry of Commerce (hereinafter "MOFCOM") issued "Rules on Counteracting Unjustified Extraterritorial Application of Foreign Legislation and Other Measures" (hereinafter "Chinese Blocking Rules"), which entered into force on the date of the promulgation.[7]

2. **Analysis of the Main Content**

Competent Authority: Chinese government will establish a "Working Mechanism" led by the MOFCOM and composed of relevant central departments, such as the National Development and Reform Commission. The Working Mechanism will take charge of counteracting unjustified extraterritorial

application of foreign legislation and other measures (Art. 4).

Targeted extraterritorial measures: The Chinese Blocking Rules target foreign legislation and other measures unjustifiably prohibit or restrict Chinese parties from engaging in normal economic, trade and related activities with third state's parties (Art. 2), which is the so-called "secondary sanction". Namely, if China considers sanctions unilaterally imposed by the US against a third country unjustified and violating international law, it may nullify such sanctions and allow Chinese companies to continue to transact with the third country. These Rules do not impact restrictions on business activities between China and the sanctioning country.

Unlike the EU Blocking Statute, the Chinese Blocking Rules do not provide an annex listing the legislation subject to the blocking but grant the Working Mechanism discretion. To determine whether foreign legislation or other measures fall within the application scope of the Chinese Blocking Rules, the Working Mechanism shall consider (1) the international law and fundamental principle of international relations; (2) potential impact on China's national sovereignty, security and development interests; (3) potential impact on the legitimate interest of the Chinese party and (4) all other factors (Art. 6). On the one hand, the non-exhaustive list grants the Working Mechanism broad flexibility to analyse on a case-by-case basis. China has repeatedly become the target of US secondary sanctions. An exhaustive list of foreign legislation and other measures is insufficient to deal with the changing situations. On the other hand, China is prudent in confrontation with other countries. In a press conference, the MOFCOM spokesman stated that "the working mechanism will closely follow the inappropriate extraterritorial application of relevant national laws and measures."[8] Therefore, the response of other countries will influence the enforcement of the Chinese Blocking Rules.

It is noteworthy the Chinese Blocking Rules will not affect China's performance of its international obligations. These Rules shall not apply to such extraterritorial application of foreign legislation and measures as provided for in treaties or international agreements to which China is a party (Art. 15).

Information reporting system: A Chinese party prohibited or restricted by foreign legislation and other measures from engaging in normal economic, trade and related activities with a third state's party shall report such matters to the

MOFCOM within 30 days (Art. 5). Otherwise, the Chinese party may be warned, ordered to rectify or fined (Art. 13). To encourage the information report, Art. 5 of the Chinese Blocking Rules also provides that the competent authority shall keep such report confidential at the request of the Chinese party. The staff of the competent authority may undertake administrative penalties if they fail with such obligation (Art. 14).

Concerning the Information reporting system, when the report obligation is triggered is unclear. Should the Chinese party report within 30 days after the foreign legislation is published or other measures are taken or after its actual operation is restricted? Moreover, since the Chinese Blocking Rules do not list targeted foreign legislation and other measures, the Chinese party should rely on their judgment to report. Finally, who should report on behalf of the legal person remains to be answered.

Prohibition order: Once the unjustified extraterritorial application of foreign legislation and other measures is confirmed, the Working Mechanism may decide that the MOFCOM shall issue a prohibition order to ban the effect of relevant foreign legislation and other measures (Art. 7). A Chinese party that fails to observe the prohibition order will be punished (Art. 13). Therefore, Chinese parties are forced to comply with either Chinese or foreign laws. In other words, they will be punished by one or the other. To free the party from the dilemma, a Chinese party may apply for exemption from compliance with a prohibition order (Art. 8). China-based subsidiaries of foreign companies are formed under Chinese law. They are considered to be Chinese entities. Therefore, unless otherwise provided by law, they are subject to the prohibition order issued under the Chinese Blocking Rules and can apply for the exemption.

One major uncertainty is whether third state's parties are subject to the prohibition order. These Rules do not stipulate that foreign entities will be punished by violating the prohibition order or can apply for the exemption. However, it is suggested that the prohibition order may bind the third state's party for two reasons. Firstly, the US may issue secondary sanctions to prohibit Chinese parties from trading with third state's parties (Iran as an example), or to prohibit third state's parties (EU as an example) from trading with Chinese parties. According to Art. 2 of the Chinese Blocking Rules, both situations may obstruct the normal economic, trade and related activities between the Chinese party and the third state's party. If the prohibition order merely applies to the

Chinese party, it cannot protect Chinese businesses from being prejudiced by the US secondary sanctions in the latter situation. Secondly, a Chinese party can bring a lawsuit before the People's Court against the party who infringes the legitimate interest of such Chinese party by complying with the foreign legislation and other measures covered by the prohibition order (Art. 9). This article does not limit the defendant to "a Chinese party." Thus it shall include the third state's party. If the prohibition order does not bind the third state's party, it is doubtful that such third state's party is liable for not complying with the prohibition order.

The prohibition order refrains relevant parties from complying with specific foreign legislation and other measures. A question is how should the prohibition order be observed. According to the European Commission's Guidance Note, the purpose of the EU Blocking Statute is to ensure that business decisions on trading with third States remain free. It does not oblige EU operators to do business with Iran or Cuba. Also, the Chinese Blocking Rules cannot and should not oblige the Chinese party and the third state's party to engage with each other. Therefore, it raises the worry that these Rules may apply better for breach of existing contract but be more difficult to "force" someone to enter into a contract or in terms of the pre-contractual obligation.

Judicial Remedy: A Chinese party can bring a lawsuit before the People's Court of PRC against the party who infringes its legitimate interest by complying with the foreign legislation or measures covered by the prohibition order. A Chinese party may also suit the party who benefits from the judgment or ruling made under such foreign legislation or other measures before the People's Court (Art. 9). Problems may arise if the losing party has no asset in China seized for enforcement by the Chinese court. Other countries may be reluctant to recognize and enforce such judgment.

Government support: Members of the Working Mechanism shall provide guidance and service to Chinese parties to deal with unjustified extraterritorial application of foreign legislation and other measures (Art. 10). Suppose a Chinese party that observes the prohibition suffers significant losses resulting from non-compliance with the relevant foreign legislation and measures. In that case, relevant government departments may provide necessary support based on specific circumstances (Art. 11). Which government department is responsible for these matters? Does "Necessary support" include financial compensation or support on litigation in the sanctioning country? These questions remain to be

answered.

3. **Impact of the Blocking Statute**

Considering that China has long suffered from secondary sanctions issued by the US government, promulgating the Chinese Blocking Rules is not a surprise. Overall, the Chinese Blocking Rules attempt to establish three core institutions anticipated by Chinese scholars: (1) blocking the effect and enforcement of specific foreign legislation in China; (2) prohibiting relevant parties from complying with specific foreign legislation and other measures; (3) enabling relevant parties to recover the damage from the party who complies with the foreign legislation and measures covered by the prohibition order. Therefore, a blocking statute serves as both shield and sword to fight against foreign sanctions.

But the function of blocking statute shall not be overemphasized. The same as the EU Blocking Statute, the Chinese Blocking Rules create a quandary for relevant parties.

For Chinese parties, if they comply with the Chinese prohibition order, they have to deal with US penalties. Chinese parties may invoke "foreign sovereign compulsion"[9] as a defence to insulate themselves from certain US sanctions penalties. In determining whether to buy such argument, US courts often consider whether foreign states actively enforce them.[10] The Chinese Blocking Rules can provide a legal basis for Chinese parties to exempt from the US sanctions by strategic enforcement actions. If so, Chinese parties will be relieved to transact with third state's parties. But the Chinese government may not be willing to provide the same exemption. Out of self-interest, Chinese parties may be more likely to comply with the Chinese Blocking Rules.

These Rules have not yet stipulated the legal result if third states' parties violate the Chinese prohibition order. In principle, prescriptive jurisdiction can be extraterritorial, but enforcement jurisdiction must be territorial. Therefore, China cannot always extend the effect of Blocking Rules to a third state's party even if it has the will. However, it is reasonable to assume that third state's parties may be added to the "unreliable entities list"[11] for disregarding the Chinese prohibition order. It may prompt third state's parties to observe the Chinese prohibition order

voluntarily to preserve their assets and reputation in China. But even if third state's parties value the Chinese market, it is uneasy for them to choose China over the US.

China has become more active in exploring countermeasures against the US. On 19 September 2020, MOFCOM released provisions on establishing "unreliable entity list."[12] Promulgation of the Chinese Blocking Rules is another proactive attempt. However, both are departmental rules, which are at a relatively low-level in the Chinese legal system. Predictably, higher-level legislation concerning the extraterritorial effect of foreign legislation and other measures will be enacted in the future. It may prompt China and the US back to the negotiating table.

[1] Menno T. Kamminga, "Extraterritoriality", Max Planck Encyclopedia of Public International Law, November 2012, para. 26.

[2] COUNCIL REGULATION (EC) No 2271/96, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:01996R2271-20140220.

[3] White House, National Security Strategy of the United States of America, December 2017.

[4] CAATSA – Russia-related Designations, available at: https://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20180920_33. aspx.

[5] North Korea Designations, available at: https://home.treasury.gov/policy-issues/financial-sanctions/recent-actions/20201208.

[6] Ye Yan, "On the EU Blocking Statute", Pacific Journal, Vol. 28, No. 3, Mar. 2020, pp. 50-66; Huo Zhengxin, "Extraterritoriality of Domestic Law: American Model, Jurisprudential Deconstruction and Chinese Approach", Tribune of Political Science and Law, Vol. 38, No. 2, Mar. 2020, pp. 173-191.

[7] Rules on Counteracting Unjustified Extraterritorial Application of Foreign Legislation and Other Measures, available at: http://www.mofcom.gov.cn/article/i/jyjl/e/202101/20210103032421.shtml.

[8] The Head of the Department of Treaty of Law of Ministry of Commerce

answers press on “Rules on Counteracting Unjustified Extraterritorial Application of Foreign Legislation and Other Measures”, available at: http://www.mofcom.gov.cn/article/news/202101/20210103029779.shtml.

[9] “Foreign Sovereign Compulsion” means that if a party is obliged to do or not to do an act by a state, it may constitute a defence for not complying with the obligation specified by the US law before the US court. See American Law Institute, Restatement of the Law, Third, The Foreign Relations Law of the United States, American Law Institute Publishers, 1990, p. 341.

[10] M. J. Hoda, “The Aerospatiale Dilemma: Why U.S. Courts Ignore Blocking Statutes and What Foreign States Can Do About It”, California Law Review, Vol. 106, No. 1, 2018.

[11] The entity added to the list will be restricted on China-related trade, investment in China and travel or work permits. See “MOFCOM Order No. 4 of 2020 on Provisions on the Unreliable Entity List”, available at:

http://www.mofcom.gov.cn/article/b/fwzl/202009/20200903002593.shtml.

[12] Ibid.