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Focus on China: New and Evolving International Risks

In recent months, the relationship between the United States and China has come under “extreme duress.”¹ The U.S. government has implemented new regulations—and amended others—in an effort to curtail China’s growing international influence, as well as to punish and deter China over conduct perceived as inconsistent with U.S. national security interests.

Individually and collectively, these changes have significant implications for China-U.S.

commerce and investments, and it is therefore essential that U.S. and non-U.S. companies alike keep abreast of the emerging regulations and restrictions.

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Export Restrictions on Military End Users

On April 28, 2020, the U.S. Department of Commerce’s Bureau of Industry and Security (“BIS”) issued a final rule amending the Export Administration Regulations (“EAR”) to impose new export restrictions on China relating to military end users and military end uses (the “MEU Rule”).² Among other changes, the MEU Rule:

- broadens 15 C.F.R. § 744.21 of the EAR to impose stringent export licensing requirements on exports of covered items to military end users in China;
- broadens the scope of the items subject to the licensing requirement by amending § 744.21 to add a range of additional Export Control Classification Numbers (“ECCNs”) to the rule; and
- imposes a requirement to file Electronic Export Information (“EEI”) through the Automated Export System (“AES”) for virtually all shipments to China.³

Referring to the MEU Rule, BIS observed, “this expansion [of export controls] will require increased diligence with respect to the evaluation of end users in China, particularly in view of China’s widespread civil-military integration.”⁴ In addition, BIS has published Frequently Asked Questions (“FAQS”) regarding the MEU Rule, which underscore that:

- exporters bear the burden of determining whether Chinese entities with both civil- and military-related activities qualify as military end users;
- subsidiaries and affiliates of military end users may or may not themselves be deemed military end users; and
- exporters can be held liable if they export products to a third party distributor with knowledge (including reason to know) that the distributor will in turn export the products to military end users.⁵

¹ Michael D. Swaine, *A Relationship Under Extreme Duress: U.S.-China Relations at a Crossroads*, The Carnegie Center (Jan. 16, 2019), <https://carnegieendowment.org/2019/01/16/relationship-under-extreme-duress-u.s.-china-relations-at-crossroads-pub-78159>.

² Expansion of Export, Reexport, and Transfer (in-Country) Controls for Military End Use or Military End Users in the People’s Republic of China, Russia, or Venezuela, 85 Fed. Reg. 23,459 (Apr. 28, 2020).

³ *Id.* at 23,460-23,461.

⁴ *Id.* at 23,460.

⁵ BIS, Frequently Asked Questions – *Expansion of Export, Reexport, and Transfer (in-Country) Controls for Military End Use or Military End Users in the People’s Republic of China, Russia, or Venezuela. Final Rule. (85 FR 23459) (April 28, 2020)*, available at <https://www.bis.doc.gov/index.php/documents/pdfs/2566-2020-meu-faq/file>.

Companies that export EAR-controlled products to China, directly or indirectly, are therefore advised to enhance their export compliance programs, and educate their third-party distributors, to mitigate the risk of inadvertent violations of the EAR. Because U.S. export control laws regulate items, as opposed to specified classes of individuals or entities, these new requirements are potentially relevant to any company—regardless of location or nationality—engaged in the export of EAR-controlled items to China. Parties exporting items subject to the EAR to China must now perform heightened due diligence to ensure that the items are not being shipped to a military end user. In addition, exporters must file EEI for all such transactions (potentially notifying the U.S. government of transactions and, foreseeably, increasing regulatory scrutiny of such shipments).

Hong Kong-Related Sanctions and Export Restrictions

China has enacted a new law (the “National Security Law”), effective July 1, 2020, that accords China greater authority to address perceived separatist activity within the Hong Kong region. Citing concerns that the National Security Law will allow China to infringe upon Hong Kong’s autonomy and punish political dissidents, the United State Congress passed, and on July 14 President Donald Trump signed, the Hong Kong Autonomy Act (the “Autonomy Act”). The Autonomy Act authorizes the imposition of sanctions against:

- any non-U.S. person that “is materially contributing to, has materially contributed to, or attempts to materially contribute to” China’s efforts to undermine Hong Kong’s autonomy; and
- any non-U.S. financial institution that “knowingly conducts a significant transaction with a foreign person” sanctioned pursuant to the Autonomy Act.

If the U.S. government were to enforce the Autonomy Act aggressively, Chinese government officials, as well as major Chinese financial institutions, could become subject to U.S. sanctions.

The U.S. government also has moved to tighten export restrictions in response to the National Security Law. On June 29, U.S. Secretary of State Michael Pompeo announced that the U.S. government would halt exports of defense articles—controlled under the International Traffic in Arms Regulations (“ITAR”)—to Hong Kong. The same day, U.S. Secretary of Commerce Wilbur Ross announced that the export exceptions available to Hong Kong under the EAR would be suspended.⁶

Sanctions Related to Treatment of Uyghur Muslims

In recent years, China has been the target of international criticism for its perceived mistreatment of Uyghurs and other ethnic and religious minorities in the Xinjiang region of China.⁷

On June 18, 2020, President Trump signed into law the Uyghur Human Rights Policy Act (the “UHRP Act”), which “requires the U.S. government to compile a report about the extent of the Chinese crackdown in Xinjiang and provide

⁶ Press Release, Michael R. Pompeo, U.S. Sec’y of State, U.S. Government Ending Controlled Defense Exports to Hong Kong (June 29, 2020), <https://www.state.gov/u-s-government-ending-controlled-defense-exports-to-hong-kong/>; Press Release, Wilbur Ross, U.S. Sec’y of Commerce, Statement from U.S. Secretary of Commerce Wilbur Ross on Revocation of Hong Kong Special Status (June 29, 2020), <https://www.commerce.gov/news/press-releases/2020/06/statement-us-secretary-commerce-wilbur-ross-revocation-hong-kong>.

⁷ *China is creating concentration camps in Xinjiang. Here’s how to hold it accountable*, The Washington Post (Nov. 24, 2018, 1:07 PM), https://www.washingtonpost.com/opinions/china-is-creating-concentration-camps-in-xinjiang-heres-how-we-hold-it-accountable/2018/11/23/93dd8c34-e9d6-11e8-bbdb-72fdbf9d4fed_story.html.

potential individual targets for sanctions under the Global Magnitsky Act.”⁸ The UHRP Act authorizes the U.S. government to impose sanctions against any non-U.S. person, including Chinese officials, determined to be responsible for certain actions related to Uyghurs and other minority groups in the Xinjiang Uyghur Autonomous Region, including torture, cruel and inhumane punishment, prolonged detention, participation in disappearances, or other “flagrant denial of the right to life, liberty, or the security of persons.”

Relatedly, on July 1, the U.S. Departments of State, Commerce, Homeland Security, and the Treasury jointly published an advisory (the “Xinjiang Advisory”) cautioning “[b]usinesses with potential exposure . . . to the Xinjiang Uyghur Autonomous Region (Xinjiang) or to facilities outside of Xinjiang that use labor or goods from Xinjiang [to] be aware of the reputational, economic, and legal risks of involvement with entities that engage in human rights abuses, including but not limited to forced labor in the manufacture of goods intended for domestic and international distribution.”⁹ The Xinjiang Advisory highlights activities that may inadvertently support “human rights abuses,” such as:

- assisting in developing surveillance tools for the Chinese government in Xinjiang;
- relying on labor or goods that are the product of forced labor in Xinjiang; and
- aiding in the construction of internment facilities.¹⁰

The Xinjiang Advisory sets forth specific due diligence recommendations, and underscores that the U.S. government has a broad range of tools at its disposal to address perceived misconduct.

The Xinjiang Advisory suggests that companies conducting business with a nexus to the Xinjiang region risk penalties, sanctions, import restrictions, and reputational harm if their activities are inconsistent with U.S. policy.

Finally, on July 9, the U.S. Department of the Treasury’s Office of Foreign Assets Control (“OFAC”) imposed sanctions against the Xinjiang Public Security Bureau and four Chinese individuals, suggesting that the U.S. government intends to use its authorities under the UHRP Act to penalize Chinese parties involved in purported human rights abuses, as well as U.S. companies that provide goods or services to those parties.

Department of Defense Guidance and Targeting of Chinese Companies

On June 24, 2020, the U.S. Department of Defense (“DOD”) identified a list of twenty companies that meet the criteria set forth in section 1237 of the National Defense Authorization Act for FY 1999, as amended (“Section 1237”).¹¹ Section 1237 directed DOD to identify (and periodically update) “persons operating directly or indirectly in the United States or any of its territories and possessions that are Communist Chinese military companies.” Although inclusion on the DOD list does not, in itself, impose any legal restrictions, designation pursuant to Section 1237 means that OFAC may impose sanctions against the listed entities. If OFAC were to designate one or more of these parties to the SDN List, the

⁸ Gerry Shih, *Trump signs Uighur sanctions bill amid Bolton criticism, drawing fury from China*, The Washington Post (June 18, 2020, 6:47 AM), https://www.washingtonpost.com/world/asia_pacific/trump-signs-uighur-sanctions-bill-amid-bolton-criticism-drawing-fury-from-china/2020/06/18/df27ba4c-b10e-11ea-98b5-279a6479a1e4_story.html.

⁹ Xinjiang Supply Chain Business Advisory, Risks and Considerations for Businesses with Supply Chain Exposure to Entities Engaged in Forced Labor and other Human Rights Abuses in Xinjiang (July 1, 2020), https://www.treasury.gov/resource-center/sanctions/Programs/Documents/20200701_xinjiang_advisory.pdf.

¹⁰ *Id.* at 3.

¹¹ Letter from David Norquist, Deputy Sec’y of Defense, to Tom Cotton, United States Senator (June 24, 2020), available at <https://www.cotton.senate.gov/files/documents/Sen%20Cotton%20NDAA%20FY%201999%20Sec%201237%20Response%2006242020.pdf>.

designated Chinese company would be effectively cut off from the U.S. marketplace altogether (a significant escalation of the status quo).

Some of the 20 companies on the DOD list have already been added to the Entity List administered by BIS, which means that U.S. and non-U.S. entities alike are prohibited from exporting, reexporting, or transferring any items subject to the EAR to these companies (or their listed affiliates) without a license from BIS. However, outside of these restrictions, companies are not prohibited from conducting business with companies on the Entity List under U.S. law.

Similarly, it is not yet clear whether or how the DOD list may inform BIS's application of the MEU Rule. If, for example, BIS deferred to DOD's determination and treated all entities on the DOD list as military end users, a broad range of export transactions involving entities not currently on the Entity List could become prohibited.

Proposed Amendments to CFIUS Process

The Committee on Foreign Investment in the United States ("CFIUS"), the interagency committee of the U.S. government with authority to review investments by foreign parties in U.S. businesses that implicate national security considerations, has been carefully scrutinizing Chinese investment in the United States for several years. This increased scrutiny—as well as recent changes to the CFIUS regulations—has contributed to what is reportedly the lowest level of Chinese direct investment in the United States since the 2008 global financial crisis.¹²

On May 21, 2020, the U.S. Department of the Treasury published a Proposed Rule that could further expand the scope of mandatory CFIUS filings for Chinese investors in U.S. critical technology companies.¹³ Specifically, the Proposed Rule would eliminate the current industry nexus for mandatory filings related to non-passive investments in critical technology companies, in favor of a requirement based solely on export licensing requirements. As discussed in our prior [alert](#), the Proposed Rule thereby would expand the mandatory filing requirement for certain investors—*i.e.*, investors who are nationals of, or maintain their principal place of business within, countries subject to a broad range of export control restrictions.¹⁴

Because BIS has been imposing new and expanded export restrictions on China and Hong Kong, the Proposed Rule—if implemented in its current form—would expand the number of transactions and investments by Chinese and Hong Kong-based investors subject to a mandatory filing requirement with CFIUS, with implications for both prospective investors and U.S. businesses seeking foreign investment.

Conclusion

In recent months, the U.S. government has embarked on a coordinated effort to ratchet up pressure on China, with significant implications on trade between China and the United States. Particularly if new and existing authorities are wielded aggressively, the evolving relationship between the United States and China will become even more challenging to navigate. As such, it has never been more important for companies to have a sophisticated and comprehensive understanding of the international risks facing their businesses.

¹² Anna Zhang, *Traffic Jam: CFIUS Is Slowing Chinese Investment in the U.S. to a Crawl*, *The American Lawyer* (April 16, 2020, 10:26 AM), <https://www.law.com/americanlawyer/2020/04/16/traffic-jam-cfius-is-slowing-chinese-investment-in-the-u-s-to-a-crawl/>.

¹³ Provisions Pertaining to Certain Investments in the United States by Foreign Persons, 85 Fed. Reg. 30,893 (May 21, 2020)

¹⁴ Ama Adams, Brendan Hanifin, and Emerson Siegle, *Proposed Rule Could Affect Scope of Mandatory CFIUS Filings*, *Ropes & Gray Alert* <https://www.ropesgray.com/en/newsroom/alerts/2020/05/Proposed-Rule-Could-Affect-Scope-of-Mandatory-CFIUS-Filings>.