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China Adopts Measures to Counter Foreign Laws Banning Transactions With Chinese Firms

The Ministry of Commerce (MOFCOM) released Order No. 1 of 2021 on *Rules on Counteracting Unjustified Extraterritorial Application of Foreign Legislation and Other Measures* (the Rules) effective on January 9, 2021. The Rules, which are based upon the *National Security Law*, have 16 articles in total and seek to prevent companies from complying with foreign laws prohibiting transactions with Chinese firms. It is our belief that the Rules are a direct response to the ongoing sanctions imposed upon Chinese tech companies, particularly to U.S. actions against Chinese companies including Huawei and Tencent, despite the official Ministry of Commerce claims that the Rules are not directed at a specific country or specific industry.

These Rules apply to situations where the extraterritorial application of foreign legislation and other measures, in violation of international law and the basic principles of international relations, unjustifiably prohibits or restricts the citizens, legal persons, or organizations of China from engaging in normal economic, trade, and related activities with a third state (or region) or its citizens, legal persons, or organizations. (Article 2) According to the Rules, MOFCOM and the National Development and Reform Commission are required to jointly establish a working group (the Working Group) to take charge of counteracting unjustified extraterritorial application of foreign legislation and other measures. (Article 3) Under the Rules, Chinese firms and individuals are required to report sanctions imposed by foreign governments within 30 days. (Article 5)

The Working Group will review sanctions and decide whether they are an unjustified extraterritorial application of foreign legislation by taking into consideration the following: (1) whether international law or the basic principles of international relations are violated; (2) the potential impact on China's national sovereignty, security, and development interests; and (3) the potential impact on the legitimate rights and interests of the citizens, legal persons, or other organizations of China. (Article 6) If unjustified, the Working Group will issue a prohibition order to the effect that the foreign sanctions are not recognized, enforced, or complied with; (Article 7) However, a Chinese party may apply for exemption from compliance with such prohibition order by submitting a written application to provide reasons and scope to the relevant MOFCOM for such exemption. MOFCOM will make decision within 30 days or in a timely manner after acceptance of the application. (Article 8)

Any person who complies with prohibition order sanctions is subject to a damages claim before the People's Court in China unless an exemption is obtained. Any Chinese party incurring losses as a result of a verdict made in accordance with the foreign laws targeted in the prohibition order can initiate legal proceedings to seek compensation. A Chinese party can apply for enforcement in China if the related party refuses to execute the decision of the Chinese People's Court. (Articles 9)

The Rules provide that the Working Group will support Chinese firms and individuals by providing guidance and services. (Article 10) The Working Group will also provide necessary support to Chinese firms and individuals who incur significant losses as a result of the relevant foreign legislation at issue; however, the Rules fail to clarify what such supports will be, such as diplomatic support with the foreign government at issue or financial support to offset losses. (Article 11) The Rules authorize the government to take countermeasures against foreign governments. (Articles 12) For those Chinese firms and individuals who fail to perform the required reporting and prohibition order compliance obligations, MOFCOM may issue a warning first followed by a rectification order and imposition of a concurrent fine, if necessary. (Article 13) The Rules do not apply if China has signed any treaties or international agreements which are governed by foreign laws or regulations. In such situations, China shall continue to follow those particular foreign laws. (Article 15)

Several other countries, including Canada, Mexico, and Argentina, have formulated similar countermeasures. The EU formulated the *Protecting Against the Effects of the Extra-territorial Application of Legislation Adopted by a Third Country and Actions Based Thereon or Resulting Therefrom* in November 1996 and later amended it in 2018. The Rules formulated by the Chinese government now follow a similar practice.

Takeaways

This is new territory and we believe the Rules will target companies that agree to follow U.S. sanctions, especially those that cancel a supply contract and cause harm to a Chinese company. The overriding issue with the Rules is that they are likely to be implemented in a highly politicized environment. Because the PRC judiciary is not independent from the political processes, a foreign company caught up in an enforcement action has few remedies against regulatory overreach. The same goes for foreign companies that are drawn into civil litigation for compensation as a result of sanctions. It remains to be seen how this will play out. If the Biden administration moves forward with the sanctions imposed by the Trump administration, the Chinese will likely reciprocate and implement the Rules against U.S. companies caught in the middle.

Foreign parties to contracts with Chinese companies would be wise to review their agreements to ensure there is an ability to exit should U.S. sanctions negatively affect the arrangement. A general force majeure provision might not be sufficient, and it is still to be seen whether a Chinese party can contractually waive its rights to damages in the event that U.S. sanctions prevent a U.S. party from performing.

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