

## CHINA'S NEW DRAFT EXPORT CONTROL LAW AND ITS IMPLICATIONS FOR INTERNATIONAL TRADE

To Our Clients and Friends:

### 1. Introduction

On December 28, 2019, China's Standing Committee of the National People's Congress ("NPC") published the draft Export Control Law of the People's Republic of China ("**2019 Draft**"), a revised version of an earlier draft first published by the Chinese Ministry of Commerce ("**MOFCOM**") on June 16, 2017 ("**2017 Draft**").<sup>[1]</sup> On July 3, 2020, the NPC published a further revised draft Export Control Law of the People's Republic of China ("**2020 Draft**") (the 2019 Draft and the 2020 Draft collectively the "**Draft Laws**"). The resultant set of draft legislation is China's first step towards a comprehensive and unified export control regime.

Against this backdrop, we take this opportunity to (i) summarize the current status quo of China's export control regime; (ii) discuss in depth the key features of both Draft Laws; and (iii) analyze their potential impact on our clients around the globe.

### 2. Status Quo of China's Export Control Regime

#### 2.1 Overview

Currently, China's export control regime is scattered across multiple laws, administrative regulations, and other guidelines, including but not limited to: (i) the Foreign Trade Law (rev. 2016); (ii) the Customs Law (2017); (iii) the Administrative Regulations on Import and Export of Goods (2001); (iv) the Administrative Regulations on Import and Export of Technologies (2019); (v) the Regulations on Control of Arms Export (2002); (vi) the Regulations on Control of Nuclear Export (2006); (vii) the Administrative Regulations on Monitored Chemicals (2011); (viii) the Regulations on Control of Nuclear Dual-Use Items and Related Technologies Export (2007); (ix) the Regulations on Control of Missiles and Missile-related Items and Technologies Export (2002); and (x) the Regulations on Control of Biological Dual-Use Items and Related Equipment and Technologies Export (2002). Apart from the foregoing, the Criminal Law (as amended) and the Customs Law (2017) as well as the Implementation Regulations on Customs Administrative Penalties (2004) prescribe criminal liability and administrative penalties for violations of Chinese export control regulations.<sup>[2]</sup>

## 2.2 Scope

### 2.2.1 General

Through the various regulations described above, China's export control laws and regulations cover items ranging from finished goods (such as products and equipment), components, and raw materials, to intellectual property (such as technologies and software). Generally speaking, China's current export control regime regulates a wide range of activities such as "*the export for trade purpose [...], gifting, exhibition, scientific and technological cooperation, assistance, services and [...] transfers by other means.*"[3]

To date, China's export control regulations have been focused on equipment, technologies, and services relating to sensitive items, including but not limited to missiles, arms, nuclear, certain chemicals, biological dual-use items, and explosives. In addition, MOFCOM, sometimes together with other authorities, has announced interim export control measures from time to time on items not specifically covered by the existing regulations upon approval of the Chinese State Council and other competent authorities. For example, in 2015, MOFCOM, China's General Administration for Customs (the "**China Customs**"), the former State Administration for Science, Technology and Industry for National Defense ("**SASTIND**"), and the People's Liberation Army General Armaments Department ("**PLA Armaments**") jointly announced restrictions on the export of certain military and civil dual-use unmanned aerial vehicles.[4]

### 2.2.2 Extraterritoriality

Unlike some components of the U.S. export control regime and U.S. secondary sanctions, China's export control regime currently generally does not purport to extend to re-exports by foreign persons that are not subject to Chinese jurisdiction.

However, as more fully described in Section 2.5 below, the end user and end-use requirements with respect to certain items effectively already have some (limited) extraterritorial effect. In addition, for clarification purposes, transit, transshipment and through shipment of dual-use items and technologies and export of the same via special customs supervision areas or bonded supervision areas are also subject to current Chinese export control law.[5]

## 2.3 Registration of Exporters

Article 9 of the Foreign Trade Law requires all exporters (whether or not the relevant products are subject to export control measures) to file and register with the "department of the State Council in charge of foreign trade" (currently MOFCOM), or any authorities entrusted by it, unless such filings and registrations are otherwise exempted. Failure to submit the necessary filings or be duly registered will be an impediment to obtaining clearance or relevant declarations from China Customs. This is especially the case for exporters of items subject to export control, and is a requirement that is duplicated in other export control regulations. For example, the Regulations on Control of Missiles and Missile-related Items and Technologies Export require relevant exporters to register with the "department of the State Council in charge of foreign economy and trade" (currently MOFCOM). Likewise, the Regulations on

Control of Nuclear Dual-Use Items and Related Technologies Export also require relevant exporters to register with MOFCOM.

## **2.4 Quota Restrictions and Export Licenses**

Pursuant to Article 19 of the Foreign Trade Law, quota restrictions and export licenses are the most powerful and widely used tools in China for exerting export control over controlled items and technologies.

Where a quota restriction applies to the export of any item, applications are required to be made to governmental authorities in charge of export quota administration, currently MOFCOM (including its local counterparts) in early November each year to apply for such quota for next year. Successful applicants will each receive a quota certification and then may be able to apply for an export quota license again at MOFCOM.

For controlled items that are not subject to a quota (e.g., nuclear, arms, explosives), export licenses are required. Typically, exporters are required to apply to MOFCOM or other competent authorities. For proposed exports that may have a material influence on national security, public interests or likewise, the application may even be subject to approval by the State Council.[6]

To export restricted technologies, exporters are required to apply for export licenses through a two-step process. First, an exporter shall apply to the department of State Council in charge of foreign economy and trade, currently MOFCOM, which will examine the technologies to be exported along with certain agencies in charge of science and technology. With MOFCOM's approval, as evidenced by issuing a letter of intent for a technology export license, the exporter may then negotiate the terms of and enter into a technology export agreement with the counterparty. Then, following the execution of the technology export agreement, such exporter will again have to apply to MOFCOM for a formal export license.

## **2.5 End User and End-Use Certification**

For export of missile, nuclear, certain chemical and biological dual-use related products and technologies, exporters are generally required to submit end user and end-use certifications and other application documents to competent governmental authorities. Recipients of such products or technologies shall also undertake that the exported products and technologies will not be (i) used for any purpose other than the declared end-use, or (ii) transferred to any third party other than the declared end user, unless otherwise approved by the Chinese government. In case of violation of such end user and end-use certification, any export licenses already issued may be suspended or cancelled.

## **2.6 Lists of Items and Technologies Restricted from Free Export**

China has maintained controlled items lists setting forth details on the items and technologies that are subject to export restrictions, such as: (i) the Missiles and Missile-related Items and Technologies Export Control List; (ii) Arms Export Control List and Nuclear Export Control List; (iii) Certain Chemicals and

Related Equipment and Technologies Export Control List; and (iv) Biological Dual-Use Items and Related Equipment and Technologies Export Control List.

Upon approval of the State Council, MOFCOM and other competent authorities may jointly announce interim export control measures against items and technologies that are not already included in these lists.

## **2.7 Liabilities for Violations under the Current Export Control Regime**

Violations of China's current export control laws and regulations may be subject to administrative penalties and criminal liability.

Pursuant to the customs-related laws and regulations, as well as the abovementioned export control regulations, administrative penalties range from a warning, confiscation of products to be exported and/or illegal income (if any), and/or a fine up to five times the illegal income, to cancellation of export licenses. In addition, local counterparts of China Customs may take temporary measures to detain suspected perpetrators as well as products to be exported and vehicles used for transportation. Criminal liabilities include a monetary penalty, confiscation of all assets and even imprisonment for severe violations that constitute crimes relating to smuggling, illegal business operations, and license forgery.

## **3. Reform of China's Export Control Regime**

### **3.1 Overview**

The introduction of the new comprehensive Draft Laws comes on the heels of the U.S.-China trade war, which seemed to have culminated in both countries signing the “*Phase One*” trade deal on January 15, 2020.[7] Much ink has been spilled over the trade war, which featured the U.S. Bureau of Industry and Security's (“**BIS**”) inclusion of Huawei onto the Entity List, the U.S. House of Representatives passing legislation in December 2019 in response to the Uighur conflict in Xinjiang, a move which could impose export controls on U.S.-made items used by the Chinese government for certain surveillance and repressive activities (as elaborated [here](#)[8]), recent designations of Chinese entities, and new export controls rules on military end uses and end users in China. In response, China has threatened to publish an “*Unreliable Entity List*” that could lead to trade sanctions against U.S. companies[9] and also recently imposed sanctions on four U.S. politicians, one congressional committee and one U.S. company.[10] The implementation of the 2020 Draft could arguably provide China with ammunition to counter U.S. export control measures targeting China, and spell wider implications for the international business community in dealing with Chinese goods. This includes potential further complications for European companies that may be caught in the middle of the U.S.-China trade war.

According to Minister of Commerce Zhong Shan at the 15th Session of the 13th National People's Congress Standing Committee on December 24, 2019, the 2019 Draft drew inspiration from a “common international practice” to regulate trade, and therefore enhances China's obligations to fulfill its international commitments as well as to safeguard national security interests. This sentiment is also echoed in Article 1 of both Draft Laws.[11]

Broadly speaking, the 2019 Draft addressed key matters such as: (i) the formal establishment of an export control system; (ii) the requirement for exporters to establish an internal compliance review system to monitor export controls; (iii) end user and end-use certifications; and (iv) enhanced penalties for violations of the 2019 Draft.

The 2020 Draft largely resembles the 2019 Draft but is also different in a few ways. For example, (i) the 2020 Draft explicitly applies to foreign entities and individuals who violate such law; (ii) it is no longer a mandatory obligation for exporters to establish an internal compliance review system; and (iii) it is now unclear how long it would take to apply for an export license, among others.

## **3.2 Scope**

### **3.2.1 General**

#### **(a) The 2019 Draft**

The 2019 Draft comprised 48 articles that are set out over six chapters. This represents a considerable streamlining of the 2017 Draft that contained 70 provisions.[12] We detail the areas we consider most relevant below. The 2019 Draft provided for the establishment of a unified export control system with extraterritorial reach and several additional new features.

The 2019 Draft specifically targeted China's nuclear, military, and dual-use items,[13] as well as other goods, technology, and services that could have an impact on China's international obligations and national security.[14] The State Council and the Central Military Commission are the primary enforcers of the legislation, though responsibility for regulating and licensing the various controlled items will be shared between different state agencies.[15]

#### **(b) The 2020 Draft**

The 2020 Draft also has 48 articles that are set out in only five chapters – the second chapter (control policy and list) and the third chapter (control measures) in the 2019 Draft have been consolidated to one chapter in the 2020 Draft, namely, control policy, list and measures. There is no material change to the general scope and coverage of the 2019 Draft, except as described below.

### **3.2.2 Extraterritoriality**

#### **(a) Re-exports, Deemed Exports and Likewise**

The 2017 Draft defined “*re-export*” as the transfer of an item from a jurisdiction outside of China to a third country, and provided that the export control provisions would apply to certain Chinese-origin controlled items or foreign-made items that contain Chinese-origin controlled items that are determined with reference to a “*percentage test*.”[16]

The above definition of “*re-export*” has been removed in both Draft Laws, although the reasons for doing so are unclear.[17] As stands, the relevant Article 45 of both Draft Laws states: “The transit,

transshipment, through shipment, or re-export of a controlled item, or the export of a controlled item to overseas from special customs supervision areas such as bonded areas and export processing zones, as well as bonded supervision places such as export supervision warehouses and bonded logistics centers shall be governed by the relevant provisions of this Law.”

Yet, while the definition of “re-export” and the *de minimis* rule were removed in the Draft Laws, a reference to “re-export” remained.

Accordingly, it remains to be seen whether Article 45 of the Draft Laws will include extraterritorial reach and expand to all re-exports of controlled items, such as a U.S. company re-exporting a controlled item that originates from China to Mexico.

Under Article 2 of both Draft Laws, “*deemed exports*” refers to the provision of regulated goods and technologies to non-Chinese citizens, legal persons, and organizations.[18] Ostensibly, this provision was included to regulate the trade activities of foreign entities based in China with access to controlled equipment or sensitive technical data. Although unlike the 2017 Draft, neither the 2019 Draft nor the 2020 Draft includes the language that it also applies to exports to Taiwan, Hong Kong and Macau, we believe it may still capture exports to such regions based on China’s geopolitical understanding and prior export control practice.

Other trade activities that are captured under the Draft Laws include transit, transshipment and through shipment of controlled items and export via special customs supervision areas and bonded supervision areas and the above noted re-exports.[19]

We expect China to address these questions, specifically whether “re-exports” will include re-exports from a non-Chinese country to a third country, either in a revised draft or in implementing regulations that provide more details and guidance after the 2020 Draft is enacted.

## **(b) Legal Liabilities of Foreign Perpetrators**

The 2020 Draft, however, has brought clarity to legal liabilities of foreign entities and individuals engaged in China, by introducing Article 44, which reads: “*An organization or individual outside the territory of the PRC which violates the provisions (...) of the Export Control Law, hinders the performance of non-proliferation and other international obligations (...), or endangers China’s national security and interests, shall be (...) held legally liable.*”

### **3.3 Registration of Exporters**

While the requirement of exporters’ filing and registration obligations remains unchanged, the first new feature of the export control system under both Draft Laws is the introduction of a licensing regime for exporters who wish to export controlled items, as well as any other items that exporters know or should know : (i) may threaten national security; (ii) are used in the design or development of weapons of mass destruction or their delivery vehicles; or (iii) are used for terrorism purposes.[20] According to the Draft Laws, the following eight factors will be taken into consideration in assessing a license application: (i) international obligations and commitments; (ii) national security; (iii) type of export; (iv) sensitivity

of items; (v) countries or regions the items are destined for; (vi) end user and end-use; (vii) credit history of the exporters; and (viii) any other circumstances as prescribed by laws and regulations.[21]

### **3.4 Controlled Items List**

Another novel feature of the Draft Laws is the creation of a controlled items list. To that end, Article 9 of the 2019 Draft states that three separate lists will be generated for dual-use items, military items, and nuclear items respectively.[22] However, according to Article 9 of the 2020 Draft, it appears only one list is contemplated to include all covered items.

Article 10 of the 2019 Draft contains a further catchall provision that provides that goods, technology, or services that are *not otherwise* on a controlled items list may nevertheless be placed on a temporary restriction list for up to two years.[23] The 2020 Draft has also prescribed the same[24] but has introduced a new assessment regime prior to the expiration of the two-year temporary restriction period.[25] Items that are subject to a temporary restriction will not be automatically exempted from such restraint. Instead, such temporary restriction may be cancelled, extended or turned into a permanent restriction by including such items into the controlled items list, depending on the result of the assessment.

Neither the 2019 Draft nor the 2020 Draft contains an initial list of controlled and/or restricted items. Although the controlled items list(s) referenced in both Draft Laws is expected to include largely the same items on the existing lists subject to the current export control regime,[26] this could still prove worrying for businesses based in China due to the uncertainty of goods that will eventually make it onto the controlled items lists or the temporary restriction list.

While both Draft Laws primarily cover dual-use items, military items, and nuclear items, we do not expect the 2020 Draft, once enacted, to affect China's current export quota administration primarily regulating the export of certain plants and livestock.

### **3.5 End User and End-Use Certifications**

Unlike the 2017 Draft that gave regulatory authorities the power to request exporters or importers to provide end user and end-use certifications, Article 17 of the 2019 Draft and Article 15 of the 2020 Draft now make it mandatory for exporters to submit end user and end-use certifications to the national export control authorities.[27] In effect, this appears to be a uniform requirement regardless of the sensitivity of the controlled items exported, which is a significant departure from Article 25 of the 2017 Draft that limited the requirement for certification "based on the degree of sensitivity of controlled items and end users." [28] The end-use and/or end user certificates may be issued by either end users themselves, or the governments in countries or regions where such end users are located.

Furthermore, to add on an additional layer of compliance requirements, exporters who are aware of changes to the end user or end-use of controlled items must immediately report the changes to the national export control authorities.[29] However, both Draft Laws are unclear on what the consequences are of violating these disclosure obligations.

In addition, importers and end users who violated either end user or end-use certifications may be placed on a controlled list. National export control authorities may impose bans or restrictions on transactions with entities on the list, among other sanctions.[30]

## 3.6 Entity Lists

### 3.6.1 Proposed “Unreliable Entity List”

In the midst of the China-U.S. trade war, MOFCOM announced on May 31, 2019 that China will introduce an “unreliable entity list” with an aim to “safeguard the international economy and trade rules and multilateral trading regime” and “object to unilateralism and trade protectionism.”[31] This announcement has been seen as a reaction to BIS’s inclusion of Huawei Technologies Co., Ltd. and its 70 affiliates (collectively, “**Huawei**”) to its Entity List on May 15, 2019 (as described [here](#)[32]). Over the course of several press conferences convened by MOFCOM and the Ministry of Foreign Affairs (“**MFA**”) in late 2019, spokesmen for the respective agencies repeatedly responded that such a list will be published soon.[33] However, there has not been any further development to date.

Nonetheless, we compare China’s proposed “unreliable entity list” against BIS’s Entity List in the table below.

	China’s Proposed “Unreliable Entity List”	BIS’s Entity List
<b>Background and Purpose</b>	<p>“Certain foreign entities have cut off the supplies or taken other discriminating measures, impairing Chinese companies’ legitimate interests, endangering China’s national security and interests, posing a threat to global industry chain and supply chain, as well as negatively affecting the global economy.”[34] The “unreliable entity list” will be introduced to “safeguard the international economy and trade rules and multilateral trading regime, in objection to unilateralism and trade protectionism, safeguard China’s national security, public interests and companies’ legitimate rights and interests.”[35]</p>	<p>BIS first published the Entity List in February 1997 as part of its efforts to inform the public of entities that have engaged in activities that could result in an increased risk of the diversion of exported, re-exported, or transferred (in-country) items to weapons of mass destruction (WMD) programs. Since its initial publication, grounds for inclusion on the Entity List have expanded to activities sanctioned by the State Department and activities contrary to U.S. national security and/or foreign policy interests.[36]</p>

<p><b>Grounds for Inclusion</b></p>	<p>When weighing which entities might be included, the following factors will be taken into consideration:</p> <ul style="list-style-type: none"> <li>(i) whether such entities have implemented a blockade, cutoff of supplies, or other discriminating measures targeting Chinese entities;</li> <li>(ii) whether such entities’ conducts are based on non-commercial purpose and violate market rules and the spirit of contract;</li> <li>(iii) whether such entities’ conducts have caused substantial damage to Chinese companies or relevant industries; and</li> <li>(iv) whether such entities’ conducts pose a threat or potential threat to national security.[37]</li> </ul>	<p>Pursuant to Section 744.11(b) of the Export Administration Regulations (the “<b>EAR</b>”), the Entity List identifies persons or organizations reasonably believed to be involved, or to pose a significant risk of being or becoming involved, in activities contrary to the national security or foreign policy interests of the United States.[38]</p>
<p><b>Legal Basis</b></p>	<p>Foreign Trade Law; Anti-Monopoly Law; and National Security Law.</p>	<p>Export Control Reform Act of 2019; International Emergency Economic Powers Act; the EAR.</p>
<p><b>Effect after Inclusion</b></p>	<p>It is unclear what effect inclusion to such list will have. We expect China to at least impose restrictions on import from and export to the included entities, and such restrictions may even extend to their respective affiliates.</p>	<p>The Entity List imposes specific license requirements for the export, re-export, or transfer (in-country) of specified items to the persons named on it. The persons on the Entity List are subject to individual licensing requirements and policies supplemental to those found elsewhere in the EAR. BIS considers that transactions of any nature with listed entities carry a “red flag” and recommends that U.S. companies proceed with caution with respect to such transactions.[39]</p>

<b>Relief</b>	Listed entities will be entitled to object. After corrective measures are taken, relevant authorities may consider adjusting the “unreliable entity list.” <sup>[40]</sup>	Listed parties may seek removal from such list.
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### **3.6.2 Introduction of Embargo, “Blacklist,” and National/Regional Risk Assessment**

The 2017 Draft, the 2019 Draft and the 2020 Draft formally introduce trade concepts such as embargoes, “blacklists,” and national/regional risk assessments into China’s export control regime. Article 8 of both Draft Laws allows national export control authorities to conduct an assessment of countries and regions where controlled items are exported, identify the level of risks, and take corresponding control measures. Article 10 of both Draft Laws now makes it possible for national export control authorities to ban the export of certain items or to certain countries or regions or to certain persons (both individuals and entities), in order to “fulfill ... international obligations and safeguard national security.” Article 18 of the 2020 Draft and Article 20 of the 2019 Draft also introduce a controlled list of importers and end users which (i) violate end user or end-use certifications as stated above, (ii) may impair national security, or (iii) use controlled items for terrorism purposes. Pursuant to the 2020 Draft, transactions with those on the controlled list will be restricted, banned or suspended.<sup>[41]</sup> These additions arguably will provide a legal framework and broad discretion for China to impose export control measures on an ad hoc basis.

## **3.7 Liabilities for Violations under the Draft Laws**

### **3.7.1 Enhanced Penalties in Both Draft Laws**

Finally, both Draft Laws significantly ratchet up the penalties for violations in contrast to the 2017 Draft by providing for stiffer fines. Examples of violations under the Draft Laws include, but are not limited to: (i) unauthorized export of controlled items; (ii) obtaining an export license for the export of controlled items through bribery or other improper means; (iii) falsifying or trading an export license; or (iv) conducting business with controlled importers or end users in violation of the Draft Laws.<sup>[42]</sup> Article 30 of the 2019 Draft and Article 28 of the 2020 Draft provide Chinese authorities with enforcement powers if they suspect violations of the new export control laws. Penalties for violations include confiscation of illegal income (if any) and a fine up to a multiple of the amount of illegal income if such amount is greater than a certain threshold or, if lower, a cap, in each case depending on the specific type of violation. Other administrative penalties include but are not limited to suspension of business for rectification as well as cancellation of export licenses.<sup>[43]</sup>

The enforcement powers given to Chinese authorities under the 2019 Draft, which now largely remain the same in the 2020 Draft, have been criticized by international organizations. For example, the Federation of German Industries (“**BDI**”) believes the missing independent judicial oversight is a key problem of the new export control regime.<sup>[44]</sup> It views the Chinese authorities’ enforcement powers

available upon suspicion of a violation as highly problematic. The BDI also suggests publishing decisions about further export controls and measures in order to increase transparency.[45]

### **3.7.2 China's Export Control Enforcement Actions**

China's export control enforcement actions result in liabilities ranging from administrative penalties imposed by China Customs to criminal fines and imprisonment.

Existing regulations[46] relating to export control do not specifically authorize China Customs to impose administrative fines. Instead, China Customs usually does so under Articles 14 and 15 of Implementation Regulations of Customs on Administrative Penalties (2004) when parties are seeking to export controlled items without export licenses[47] or when violations would compromise "the accuracy of China Customs' statistics," "China Customs' supervision and administration," or "China's administration of licenses." [48] Pursuant to these articles, a fine would range from RMB1,000 to RMB30,000 (approximately US\$ 140 to US\$ 4,200) or no more than 30% of the value of exported goods.[49] The value of goods sought to be illegally exported without the required export license, in most administrative cases we were able to find from publicly available information, was under RMB 0.5 million (approximately US\$ 70k), with a few at around RMB 2 million (approximately US\$ 280k), and one at around RMB 4 million (approximately US\$ 560k). Fines imposed by China Customs ranged from a few thousand RMB (approximately a few hundred US dollars) to RMB 284k (approximately US\$ 40k), representing 1% - 18% of the value of goods at issue.

Exporters, export agencies and their agents may be held criminally liable in severe violations, for example, when large amounts of valuable controlled items are illegally exported. Fines imposed on exporters may be as high as RMB 14 million (approximately US\$ 2 million), and individuals in charge of such exporters or export agencies facilitating the illegal export are typically sentenced to less than five years in prison and fined for a few hundred thousand RMB. The most severe penalty against individuals we were able to find in the public domain was a fine of around RMB 1 million (approximately US\$ 156k)[50] and imprisonment of 13 years.[51]

### **3.7.3 Potential Impact of the Draft Laws on Future Enforcement Actions**

As discussed above, the existing export control laws and regulations do not themselves authorize China Customs to impose administrative penalties. Accordingly, China Customs has to resort to other regulations where the prescribed penalties are generally inconsequential. Once the 2020 Draft is enacted, China Customs will be authorized to impose significantly higher fines. In the case of exporting controlled items without an export license, the fine will range from five to 10 times the illegal income with a minimum of RMB 500k (approximately US\$ 70,625 at the prevailing exchange rate) even if there is no illegal income,[52] almost twice the administrative fine imposed by China Customs in the most serious violation noted above. If exporters transact with those on the "blacklist" described in Section 4.5 below, the fine can be as high as 10 to 20 times the illegal income with a minimum of RMB 500k.[53]

Most severe export control violations will continue to be subject to criminal liabilities under China's criminal law.

## **3.8 Internal Compliance Review System**

### **3.8.1 2019 Draft**

More significantly, the 2019 Draft made it mandatory for all exporters to establish an internal compliance review system to monitor their export control obligations. An internal compliance review system is required in order to be eligible for certain licenses – this is in contrast to the 2017 Draft which simply “encouraged” the establishment of an internal compliance program.[54] It is worth noting that under the current export control laws and regulations, only exporters of nuclear dual-use items and technologies are required to establish an internal control system. However, the 2019 Draft did not specify how regulators should evaluate this internal compliance review system and what constitutes a significant violation of this obligation.

### **3.8.2 2020 Draft**

In contrast to the 2019 Draft, establishing an internal compliance system is no longer a mandatory obligation under the 2020 Draft. Article 14 of the 2020 Draft encourages, instead of mandating, exporters to establish such system by granting simplified export measures to those that have established such internal compliance review system that works well.

## **4. Impact of the Draft Laws on International Trade Relations**

The reference to extraterritoriality of the Draft Laws means that China’s new export control regime, if and when the extraterritoriality is enacted, will impact businesses within and outside China that deal with Chinese controlled items.[55] That said, the vagueness of several of the Draft Laws’ provisions creates a layer of uncertainty within the international business community, specifically regarding its extraterritorial application and as to which activities specifically will be affected. This could be a deliberate move on China’s part in order to create sufficient room to augment the scope and reach of this export control regime through the issuance of supplementary regulations.[56]

For example, even with the abolishment of the definition of “re-exports” (but not the concept itself) and references to a *de minimis* rule, it is unclear if the 2020 Draft will apply to the re-export of foreign-made items that contain Chinese-origin controlled items to a jurisdiction outside of China. Following a public consultation, various trade associations from the U.S., Europe, and Japan have made calls for the 2019 Draft to clarify the scope of the affected re-export activities,[57] while the 2020 Draft remains unchanged in this regard.

Furthermore, the requirements to determine end-use and end-users for exporters may also give rise to increased compliance costs for businesses in China as they now have to undertake more stringent third-party due diligence into their trade counterparties, in order to avoid a potential violation of any controlled items list or restricted list that is published pursuant to the 2020 Draft.

Notwithstanding the above, both Draft Laws appear to be a more conciliatory version of the 2017 Draft in a move that is arguably designed to ease U.S.-China trade tensions. Of note is the removal of a clause that referred to retaliatory measures that China could take in response to “discriminatory export control

measures” taken by other countries against it.[58] It therefore remains to be seen if Beijing will ever follow through with publishing an “Unreliable Entity List” in retaliation against U.S. trade sanctions.

## **4.1 U.S.-China Trade Relationship**

For U.S. companies, what may prove most worrying about China’s new export control regime may be the highly publicized “unreliable entity list” and the “blacklist” to be formulated pursuant to the Draft Laws, in China’s apparent attempt to counter the U.S. sanctions, as well as the risk of leaks of trade secrets and other intellectual property in the case of investigations by China’s national export control authorities.

Based on the principle of reciprocity, a term frequently used by both countries’ governments as justification for its hostile actions against one another, if the U.S. government continues to target Chinese technology companies using its “Entity List” or similar tools, it is conceivable that China will follow through its original announcement for the establishment of the “unreliable entity list” and following the enactment of the 2020 Draft, the “blacklist,” and use these legal measures to counter U.S. export control measures targeting China.

The Draft Laws specify what measures China’s national export control authorities may take in order to investigate a suspected violation, and therefore raising concerns for potential leaks of trade secrets and other intellectual property.[59] Perhaps anticipating such concerns, both Draft Laws also require the authorities and their staff to maintain confidentiality of trade secrets obtained during such investigations.[60]

## **4.2 EU-China Trade Relationship**

The 2020 Draft will likely have an impact on EU-China trade relationships and European companies in particular.

In the past, EU companies had to deal with the extraterritoriality of U.S. sanctions and political pressure from both the U.S. and China, as exemplified by the inclusion of the Chinese telecommunications company Huawei and its named affiliates on the U.S. Entity List in May 2019.[61]

In the future, EU companies will have to deal with the extraterritoriality of U.S. and Chinese sanctions and political pressure from both the West and East.

On the legal front, any Sanctions and Export Compliance Management System of an EU company will have to cover not only national law and EU law, but also be mindful of the extraterritorial reach of both the U.S. and the Chinese Sanctions and Export Controls.

If an entity were to be blacklisted or greylisted by the U.S., but not by China, or vice versa, EU companies would have to decide with whom to do business. As many companies might not have the resources to continuously monitor both the U.S. and the Chinese regime, they might choose to reorganize their supply chain in a way to only source U.S. or Chinese products to limit their legal exposure.

When it comes to export controls in the EU, power usually rests with the various national governments to implement their own laws.[62] Despite the lack of ability to implement EU-wide export controls, EU governments could, on a national level, align with U.S. export controls to ensure a common approach towards China.[63] Otherwise, there is an increasing risk for European companies to be subject to U.S. sanctions. One suggested approach for the EU would thus be to work together with the U.S. to restrict China's ability of gaining access to advanced technologies.[64]

However, if China uses export controls to counter U.S. sanctions, and if, at the same time, the U.S. imposes further tariffs on EU goods, this could drive European companies closer to China.[65]

On the political front, European manufacturers could also find themselves sidelined by the U.S.-China Phase One deal as elaborated above. A study by the American Chamber of Commerce, for example, predicted that German and French manufacturing sectors may be the most adversely affected by China's commitment to buy \$200 billion more in goods from the U.S. in the Phase One deal.[66]

Finally, this conflict could also lead to European companies diversifying their portfolios by using goods from other third countries.

Overall, after the 2020 Draft is enacted, European companies could find themselves in the difficult position of having to choose between imports from the U.S. or China and evaluating where the larger legal risks and economic and political benefits are.

## 5. Conclusion

Both the 2019 Draft and the 2020 Draft change the 2017 Draft in many ways and provide for a comprehensive Chinese export control regime. Besides a few clear requirements, the 2020 Draft remains opaque as to its exact scope & specifically regarding its contemplated extraterritorial reach, and has the potential of making it challenging for companies to navigate through China's new export control regime.

It is expected that, as is common with the introduction of a new law in China, the Chinese authorities will, in time, issue implementing regulations that provide more details and interpretation of this law, specifically relating to the concept and application of extraterritoriality.

Companies should monitor the current developments, prepare their Sanctions and Export Compliance mechanisms to be able to cope with a comprehensive Chinese Export Control regime and pay special attention to further supplementary Chinese regulations.

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[1] Export Control Law of the People's Republic of China (Draft), available at [https://www.cistec.or.jp/service/china\\_law/202001\\_pubcom2\\_souan.pdf](https://www.cistec.or.jp/service/china_law/202001_pubcom2_souan.pdf).

[2] See Xiaoming Liu, Royal United Services Institute, *Upgrading to a New, Rigorous System - Recent Developments in China's Export Controls* (Mar. 2016), [https://rusi.org/sites/default/files/201603\\_op\\_upgrading\\_to\\_a\\_new\\_rigorous\\_system\\_en.pdf](https://rusi.org/sites/default/files/201603_op_upgrading_to_a_new_rigorous_system_en.pdf).

[3] See Article 2 of the Regulations on Control of Missiles and Missile-related Items and Technologies Export (2002), Article 2 of the Regulations on Control of Nuclear Dual-Use Items and Related Technologies Export (2007), and Article 2 of the Regulations on Control of Biological Dual-Use Items and Related Equipment and Technologies Export (2002) for example.

[4] See Announcement on Imposing Interim Export Control Measures on Military and Civil Dual-Use Unmanned Aerial Vehicles issued on June 25, 2015 with effect from July 1, 2015.

[5] See Article 28 of the Regulations on Control of Nuclear Dual-Use Items and Related Technologies Export (2007).

[6] See Article 11 of the Regulations on Control of Nuclear Export (2006), Article 16 of the Regulations on Control of Arms Export (2002), and Article 11 of the Regulations on Control of Missiles and Missile-related Items and Technologies Export (2002) for example.

[7] See China Briefing, *The US-China Trade War: A Timeline* (Feb. 26, 2020), <https://www.china-briefing.com/news/the-us-china-trade-war-a-timeline/>.

[8] See Gibson, Dunn & Crutcher LLP, *2019 Year-End Sanctions Update* (Jan. 23, 2020), <https://www.gibsondunn.com/2019-year-end-sanctions-update/>.

[9] Jeff Black/Daniel Flatley, Bloomberg News, *China Hints U.S. Blacklist Imminent in Threat to Trade Talks* (Dec. 3, 2019), <https://www.bloomberg.com/news/articles/2019-12-03/china-hints-u-s-blacklist-imminent-in-threat-to-trade-talks>.

[10] Michael O’Kane, EU Sanctions, *China Designates 4 US Politicians & Congressional Commission* (July 13, 2020), <https://www.europeansanctions.com/2020/07/china-designates-4-us-politicians-congressional-commission/>; and Michael O’Kane, EU Sanctions, *China Designates Lockheed Martin for Taiwan Arms Deal* (July 14, 2020), <https://www.europeansanctions.com/2020/07/china-designates-lockheed-martin-for-taiwan-arms-deal/>.

[11] Xiaolei Pu, Legal Daily, *Proposed Inclusion of Military Items and Nuclear into Covered Items* (Dec. 24, 2019), <http://www.npc.gov.cn/npc/ckgzlf003/201912/03bf295574ad4d5caba56c2fd7a9af24.shtml>.

[12] Leian Kae Naduma, Business Times, *China Releases Draft Export Control Law, The Country’s First* (Jan. 17, 2020), <https://www.btimesonline.com/articles/125133/20200117/china-releases-draft-export-control-law-countrys-first.htm>.

[13] This refers to “goods, technologies and services that have civil uses, and also have military use or enhanced military potential, particularly those which could be used for the design, development, production, or use of weapons of mass destruction.” See Article 2 of the 2019 Draft.

[14] <http://www.npc.gov.cn/npc/ckgzlf003/201912/1c9cab8e27874d51ae79196802b1d894.shtml>; see also Article 2 of the 2019 Draft.

[15] Article 5 of the 2019 Draft.

[16] Article 64 of the 2017 Draft.

[17] Pursuant to the 2017 Draft, “re-export” is defined as “the export of controlled items or foreign products containing controlled items whose value reaches a certain percentage from overseas to other countries (regions).”

[18] Article 2 of the 2019 Draft and Article 2 of the 2020 Draft.

[19] Article 45 of the 2019 Draft, which states the provisions of law also apply to these trade activities. As such, we expect national export control authorities (or jointly with China Customs) to still regulate these trade activities. Article 45 of the 2020 Draft is also similar to this.

[20] Articles 13 and 15 of the 2019 Draft and Article 12 of the 2020 Draft.

[21] Article 13 of the 2019 Draft and Article 13 of the 2020 Draft.

[22] Article 9 of the 2019 Draft.

[23] Article 10 of the 2019 Draft.

[24] Article 9 of the 2020 Draft.

[25] *Ibid.*

[26] *See* Catalog of Import and Export Licenses Administration of Dual-use Items and Technologies promulgated by MOFCOM and China Customs on December 31, 2005 and last amended on December 31, 2019; Arms Export Administration List promulgated by former SASTIND and PLA Armaments on November 1, 2002; and Nuclear Export Administration List promulgated by former SASTIND on June 28, 2001 and amended by China Atomic Energy Authority, MOFCOM, MFA and China Customs on June 27, 2018.

[27] *See* Article 25 of the 2017 Draft, Article 17 of the 2019 Draft and Article 15 of the 2020 Draft.

[28] *See* Joint Comments by 11 Industrial Associations of U.S. and Japan (Jan. 26, 2010), available at: [cistec.or.jp/english/export/china\\_law/200210-english.pdf](http://cistec.or.jp/english/export/china_law/200210-english.pdf).

[29] *See* Article 18 of the 2019 Draft and Article 16 of the 2020 Draft.

[30] *See* Article 29 of the 2017 Draft, Article 20 of the 2019 Draft and Article 18 of the 2020 Draft.

[31] *See* MOFCOM, *MOFCOM: China to Establish the “Unreliable Entity List” Regime* (May 31, 2019), <http://www.mofcom.gov.cn/article/i/jyjl/e/201905/20190502868927.shtml>.

[32] See Gibson, Dunn & Crutcher LLP, *Citing a National Emergency, the Trump Administration Moves to Secure U.S. Information and Communications Technology and Service Infrastructure* (May 20, 2019), <https://www.gibsondunn.com/citing-national-emergency-trump-administration-moves-to-secure-us-information-and-communications-technology-service-infrastructure/>; On August 21, 2019, the Trump Administration increased its Entity List designation of Huawei affiliates to over 100 entities.

[33] On a press conference of MOFCOM on August 22, 2019, a MOFCOM spokesman responded that the “unreliable entity list” was “going through internal procedures and would be released recently.” A spokesman from MFA repeated the same on October 8, 2019, following the U.S.’s blacklisting an additional 28 Chinese entities on October 7, 2019.

[34] See MOFCOM, *MOFCOM: China to Establish the “Unreliable Entity List” Regime* (May 31, 2019), <http://www.mofcom.gov.cn/article/i/jyj/e/201905/20190502868927.shtml>.

[35] *Id.*

[36] See *FAQs – Entity List FAQs*, available at [https://www.bis.doc.gov/index.php/2011-09-12-20-18-59/export-and-reexport-faqs/cat/33-entity-list-faqs#faq\\_105](https://www.bis.doc.gov/index.php/2011-09-12-20-18-59/export-and-reexport-faqs/cat/33-entity-list-faqs#faq_105).

[37] See *Reasons to Introduce the “Unreliable Entities List” Regime? MOFCOM’s Response* (June 4, 2019), <http://coi.mofcom.gov.cn/article/y/gnxw/201906/20190602869699.shtml>.

[38] See *Addition of Certain Entities to the Entity List* (Oct. 9, 2019), <https://www.federalregister.gov/documents/2019/10/09/2019-22210/addition-of-certain-entities-to-the-entity-list>.

[39] See *FAQs – Entity List FAQs*, available at [https://www.bis.doc.gov/index.php/2011-09-12-20-18-59/export-and-reexport-faqs/cat/33-entity-list-faqs#faq\\_104](https://www.bis.doc.gov/index.php/2011-09-12-20-18-59/export-and-reexport-faqs/cat/33-entity-list-faqs#faq_104) and [https://www.bis.doc.gov/index.php/2011-09-12-20-18-59/export-and-reexport-faqs/cat/33-entity-list-faqs#faq\\_118](https://www.bis.doc.gov/index.php/2011-09-12-20-18-59/export-and-reexport-faqs/cat/33-entity-list-faqs#faq_118).

[40] See Sina Finance, *Authorities: MOFCOM’s Interpretation of China’s “Unreliable Entity List” Regime* (June 2, 2019), <https://cj.sina.com.cn/articles/view/1704819467/659d7b0b01900ux8q>.

[41] It is also noteworthy that pursuant to Article 20 of the 2019 Draft, simplified export measures (if previously granted to the exporter) will no longer be applicable to transactions with those on the controlled list. This is no longer the case in the 2020 Draft.

[42] See Chapter 5 of the 2019 Draft and Chapter 4 of the 2020 Draft.

[43] *Id.*

[44] Nikolas Kessels, BDI, *China's Export Control, Statement regarding the Second Draft of China's National Export Control* (Jan. 23, 2020), <https://bdi.eu/artikel/news/peking-legt-neuen-vorschlag-fuer-exportkontrollgesetz-vor/> (in German).

[45] *Id.* See also Art. 1 (5) 1. Council Decision (CFSP) 2019/1560 of September 16, 2019 amending Common Position 2008/944/CFSP defining common rules governing control of exports of military technology and equipment. Based on this decision by the European Council, EU member states need to submit information on their exports of military technology and equipment for transparency purposes.

[46] For example, the Regulations on Control of Arms Export (2002), the Regulations on Control of Nuclear Export (2006), the Administrative Regulations on Monitored Chemicals (2011), the Regulations on Control of Nuclear Dual-Use Items and Related Technologies Export (2007), the Regulations on Control of Missiles and Missile-related Items and Technologies Export (2002), and the Regulations on Control of Biological Dual-Use Items and Related Equipment and Technologies Export (2002).

[47] See Article 14 of the Implementation Regulations of Customs on Administrative Penalties (2004).

[48] See Article 15 of the Implementation Regulations of Customs on Administrative Penalties (2004).

[49] Paragraphs (4) and (5) of Article 15 of the Implementation Regulations of Customs on Administrative Penalties (2004) also provide for fines to be imposed where violations would compromise “China’s tax collection” or “foreign exchange or export tax rebate administration.” Such fines might be higher than those set forth above but these paragraphs are rarely cited by China Customs in administrative penalty cases relating to export control of dual-use items, arms, nuclear, monitored chemicals or likewise.

[50] See the *Case of Yuhong Peng's Smuggling General Goods* available [here](#), (2009) Xia Xing Chu Zi No. 25, where Yuhong Peng assisted a few clients in exporting 1,631,031 kilograms of flour without a valid export license by intentionally and falsely declaring flour as non-controlled goods. Flour was subject to China’s export quota restrictions. Yuhong Peng was found guilty for smuggling general goods and was sentenced to an imprisonment of 10.5 years and fined RMB 1,112,443.77 (approximately US\$ 156,980.71 at the prevailing exchange rate).

[51] See *First Trial Criminal Judgement of Huizhou Haihang Industrial Co., Ltd. and Huizhou Jiangfeng Industrial Development Co., Ltd.* available [here](#), (2016) Yue 13 Xing Chu No. 11, where Huizhou Haihang Industrial Co., Ltd., Huizhou Jiangfeng Industrial Development Co., Ltd., their respective key persons in charge and a few other individuals exported 689.086 tons of rare earth metals without a valid export license by intentionally and falsely declaring rare earth as non-controlled goods. Huanyong Xu, the manager of Huizhou Haihang Industrial Co., Ltd. was sentenced to an imprisonment of 13 years.

[52] See Article 34 of the 2020 Draft.

[53] See Article 37 of the 2020 Draft.

[54] Article 36 of the 2017 Draft; *see also* Article 14 of the 2019 Draft.

[55] See Leian Kae Naduma, *Business Times*, *China Releases Draft Export Control Law, The Country's First* (Jan. 17, 2020), <https://www.btimesonline.com/articles/125133/20200117/china-releases-draft-export-control-law-countrys-first.htm>.

[56] Finbarr Bermingham, *South China Morning Post*, *Trade war clues sought in China's 'ambiguous' new export control law* (Dec. 31, 2019), <https://www.scmp.com/economy/china-economy/article/3044112/trade-war-clues-sought-chinas-ambiguous-new-export-control>.

[57] See Statement by 11 U.S. and Japanese industrial associations, *Joint Comments by Industrial Associations of the United States and Japan on China's Revised Draft Export Control Law* (Jan. 26, 2020), [https://www.cistec.or.jp/english/export/china\\_law/200210-english.pdf](https://www.cistec.or.jp/english/export/china_law/200210-english.pdf) and Statement by 14 European and Japanese industrial associations, *Joint Comments by Industrial Associations of Europe and Japan on China's Revised Draft Export Control Law* (Jan. 21, 2020), [https://www.cistec.or.jp/service/china\\_law/20200123-english.pdf](https://www.cistec.or.jp/service/china_law/20200123-english.pdf).

[58] Article 9 of the 2017 Draft.

[59] See Article 30 of the 2019 Draft and Article 28 of the 2020 Draft. Such measures include “entering into the place of business ... for inspection,” “viewing and copying ... relevant agreements, accounting books, business correspondence ...” and “seizing and detaining relevant items.”

[60] See Article 31 of the 2019 Draft and Article 29 of the 2020 Draft.

[61] See Benjamin Wilhelm, *World Politics Review*, *Why America's Global Campaign Against Huawei Is Failing* (Jan. 29, 2020), <https://www.worldpoliticsreview.com/trend-lines/28503/why-europe-is-resisting-trump-s-campaign-against-huawei-china>.

[62] Limited exceptions apply in terms of military and dual-use goods.

[63] *Id.*

[64] See Carisa Nietzsche/Sam Dorshimer, *The Hill*, *America and Europe will lose to China in transatlantic trade war* (Jan. 31, 2020), <https://thehill.com/opinion/international/480942-america-and-europe-will-lose-to-china-in-transatlantic-trade-war>.

[65] *Id.*

[66] See Greg Knowler, *Journal of Commerce*, *Europe faces \$11 billion hit from US-China 'phase one' deal: study* (Mar. 27, 2020), [https://www.joc.com/regulation-policy/europe-faces-11-billion-hit-us-china-%E2%80%98phase-one%E2%80%99-deal-study\\_20200327.html](https://www.joc.com/regulation-policy/europe-faces-11-billion-hit-us-china-%E2%80%98phase-one%E2%80%99-deal-study_20200327.html).



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