

How Multinationals Can Withstand U.S.-China Trade Conflict

MARCH 16, 2022

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The growing economic and political tension between the U.S. and China has placed multinationals with operations in China in a tenuous position—comply with U.S. laws, sanctions or other orders, and in return, suffer economic backlash, or worse, from the Chinese government or consumers.

For decades, the U.S. has sought to promote democratic values through implementation of laws and regulations related to trade and investments with extraterritorial applicability, including prohibitions against transactions with certain individuals and entities, restrictions regarding dispositions of certain goods, and prohibitions against specific conduct, such as bribery.

Stating the obvious, multinational companies subject to U.S. jurisdiction have faced severe consequences for failing to comply with these U.S. laws and regulations.

Recently, the U.S. increased its focus on Chinese interests deemed incompatible with democratic values, instituting numerous new laws, amendments and sanctions intended to persuade change. China's response to this recent activity has been prolific, though not of the nature the U.S. had hoped.

Rather than acceding to the U.S., China has responded with its own legal strategy, including creating a legal and regulatory framework that penalizes entities conducting business within its borders that seek to comply with these U.S. laws and sanctions.

Acknowledging that the U.S. and China are critical regions for multinational companies, and compliance with the laws and regulations of both would be ideal, the currently conflicting legal regimes make that ideal virtually impossible.

Accordingly, multinationals operating within China are faced with this dilemma—comply with U.S. laws and regulations and suffer the consequences from the Chinese government, or comply with Chinese law and regulations and suffer the consequences from the U.S. government.

For multinational companies, compliance decisions in this environment require careful consideration of multiple factors, including weighing the numerous competing risks involved.

China Response—the Legal Regime

In recent months, China has taken several steps seemingly targeted at discouraging compliance with U.S. and other foreign laws.

These steps include enacting (1) the Provisions on the Unreliable Entity List; (2) the Measures on Obstructing the Unjustified Application of Foreign Laws and Measures; (3) the Anti-Foreign Sanctions Law; and (3) the Data Security Law and Personal Information Protection Law.

In addition, China issued new multi-agency anti-corruption guidelines that allow for the blacklisting of foreign entity violators.

Beyond these legislative acts, Chinese agencies, media and celebrities participated in a series of negative campaigns targeted at multinationals adhering to U.S. sanctions laws—such as Swedish clothing company Hennes & Mauritz AB, or H&M; U.S. chipmaker Intel Corp.; and U.S. retail warehouse entity Sam’s Club, owned by Walmart Inc.

The most recent negative publicity came directly from the Chinese government as China’s anti-corruption enforcement agency, the Central Commission for Discipline Inspection, added fuel to the growing disincentives fire. A December 2021 article on the CCDI website stated that the alleged removal of products from Xinjiang province by Sam’s Club “reveals stupidity and short-sightedness, and will surely have its own bad consequences.”

The Specifics

In 2020, the Chinese Ministry of Commerce issued the Unreliable Entity List, under which punitive measures may be imposed against foreign entities, organizations or individuals for conduct judged to endanger China’s sovereignty, national security, or development interests, or that apply discriminatory measures against Chinese enterprises, organizations, or individuals.

In January 2021, the Ministry of Commerce issued the Measures on Obstructing the Unjustified Application of Foreign Laws and Measures, which allow the Chinese government to create prohibition orders to block the extraterritorial effect of unilaterally imposed foreign laws, measures or sanctions directed at conduct in third countries that are deemed to be to the detriment of Chinese interests.

Prohibition orders relate only to third-country restrictions. As such, they will not affect restrictions on business activities directly between the sanctioning country—such as the U.S.—and the sanctioned country—China. However, China-based subsidiaries of U.S. companies seeking to comply with U.S. sanctions against third countries will be subject to potential punishment.

On July 10, 2021, China next enacted the Anti-Foreign Sanctions Law, elevating its countersanction regime from regulation to the level of law. The Anti-Foreign Sanctions Law serves as a means of deflecting and discouraging the growing use of sanctions and other laws or enforcement actions by foreign governments believed to be against Chinese interests.

Put succinctly, the statute prohibits individuals and companies from complying with foreign laws China perceives to be discriminatory restrictive measures against China’s national interests, requiring these same individuals and entities to cooperate and implement Chinese countermeasures.

The Anti-Foreign Sanctions Law creates a mechanism through which individuals and organizations—including foreign-invested entities, and affiliated individuals and entities—can be added to a countermeasure list and subjected to certain retaliatory measures for interfering with the internal affairs of China in ways that are deemed “in violation of international law and basic principles of international relations.”

In the brief period since its enactment, China has already utilized the Anti-Foreign Sanctions Law to countersanction U.S. individuals and organizations.

Following the U.S. Department of the Treasury's July 16, 2021, addition of seven Chinese officials to the Specially Designated Nationals list, pursuant to the Hong Kong Autonomy Act of 2020 China sanctioned seven U.S. individuals, including former Secretary of Commerce Wilbur Ross, Human Rights Watch's China director Sophie Richardson, U.S.-China Economic and Security Review Commission Chair Carolyn Bartholomew, and Jonathan Stivers, former staff director of the Congressional-Executive Commission on China.

In December 2021, as a follow-on to March 2021 sanctions against Chinese officials related to the treatment of Uyghurs in Xinjiang province announced by the U.S., Britain, Canada and the European Union, the U.S. took expanded action against the humanitarian concerns, including the U.S. Senate's passage of the revised Uyghur Forced Labor Prevention Act and the U.S. Treasury's addition of several Chinese companies and private individuals to the Chinese Military-Industrial Complex Companies list.[1]

During this same period, on Sept. 1 and Nov. 1, 2021, the Data Security Law and the Personal Information Protection Law came into effect. The purported purpose of the data laws is to prevent harm to China's national security, public interest or the lawful rights and interests of Chinese citizens or organizations.

The practical application of these laws, however, creates disincentives for entities and individuals to comply with U.S. and other foreign laws. In general, the data laws apply extraterritorially to data processing and security, placing restrictions and requirements on the cross-border transfer of certain types of company data and personal information located within China. Violations of these restrictions or requirements can result in civil, administrative and even criminal punishments.

The disincentive to comply with U.S. and other foreign laws is most evident in the requirements for entities and individuals to inform Chinese government agencies prior to the production of any data to foreign governments in relation to any foreign investigation or enforcement action, and possibly even in some civil litigation discovery. To the extent production is allowed, those same entities and individuals are required to utilize Chinese government procedures for the act of production.

And, finally, amid implementation of the data laws, on Sept. 8, 2021, a consortium of Chinese governmental entities—the Central Commission for Discipline Inspection, National Supervision Commission, CPC Central United Front Work Department, CPC Central Political and Legal Affairs Commission, Supreme People's Court, and Supreme People's Procuratorate—announced that it had jointly issued the anti-corruption guidelines, an internal policy statement related to anti-corruption enforcement.

Although the official policy statement is an internal document and therefore not available to the public, the public joint announcement made clear the multi-agency anti-corruption guidelines related to an increased emphasis, and cooperative approach among Chinese government entities, on the investigation of bribery—both bribe-receivers and bribe-givers.

Historically, Chinese bribery investigations have focused on bribe-receivers—in other words, China's own officials. The focus on bribe-givers suggests the common theme surrounding recent Chinese regulatory actions—a heightened interest in punishing outsiders.

Unique Risks Following Issuance of the Guidelines

Presently, it is unclear whether U.S. or foreign entities will ultimately be the target of this increased focus on anti-corruption and related cooperation among Chinese government agencies; however, the heightened risk of potential blacklisting for violators, carbon-copy prosecutions and stricter approaches to confiscation as a result of the multi-agency anti-corruption guidelines do appear targeted toward foreign enterprises.

Blacklisting

Per the anti-corruption guidelines, the Chinese government will explore implementation of a blacklist system for companies and individuals found to have paid bribes in China. While it is unclear how this blacklist system will be implemented, multiple avenues appear to already exist, such as the Unreliable Entity List or the social credit system, as well as the existing ability to revoke business licenses.

Once blacklisted, a company or an individual will face significant challenges in conducting business in or with China. The risk of blacklisting is not limited to violations arising from bribes to public officials, but can arise from commercial bribery, currently prohibited by China's Anti-Unfair Competition Law.

The guidelines do not specify a materiality threshold related to the seriousness of the wrongdoing, although the CCDI has stated that it has prepared detailed provisions regarding the blacklisting system. Whether, or when, these thresholds may become public is unknown.

Carbon-Copy Prosecutions

While not widely publicized, China has utilized carbon-copy prosecutions—or administrative investigations—in response to public settlements with non-Chinese authorities involving conduct in China for several years.

The increased risk of carbon copy prosecutions is not simply theoretical and should not be ignored in an environment of significantly increased anti-foreign enforcement activities combined with the risk of additional investigations by separate agencies for the same conduct.

As previously highlighted, the data laws provide the Chinese government with an additional arrow in its quiver—the ability to investigate and find liability for complying with foreign subpoenas seeking China-based data. The application of the data laws serves as a double-edged sword.

Whether a company elects to notify the Chinese government in advance of producing China-based data in a foreign enforcement action, as required by the newly enacted data laws, or whether a company elects to violate the data laws and willfully produce data without prior notification, the company may face some Chinese government response. In either circumstance, the current environment suggests a carbon-copy prosecution is likely to be initiated.

Stricter and Broader Approach

The new multi-agency anti-corruption guidelines represent a more aggressive approach by the Chinese government in terms of targeting those who pay bribes, as opposed to China's historical focus on the recipients of bribes—Chinese officials—and in terms of increasing penalties for those involved in bribes.

With respect to enhanced penalties, any property or other benefit gained by bribes will be subject to potential confiscation, while any access to government officials or qualifications, such as licenses to operate in China, will be subject to potential revocation or cancellation.

Additionally, it will be harder to obtain credit for mitigating circumstances. Currently, credit or mitigation is usually applied if the bribe-payer actively cooperates with the investigation or self-reports wrongdoing.

The multi-agency anti-corruption guidelines, however, emphasize the need to manage the acute risks of bribery before the conduct occurs. In other words, simply cooperating after the failure to manage the risk without putting in controls to prevent the bribes in the first place is unlikely to present a case for mitigating circumstances.

While these enhanced restrictions do appear more in line with enforcement actions under the Foreign Corrupt Practices Act, they can also be interpreted as measures that are consistent with China's interest in penalizing outsiders.

China's Multifaceted Response—Public Backlash

Public relations challenges are an ever-present risk for multinational companies operating in China. Some may remember the crisis faced by European grocer Carrefour in the months leading up to the 2008 Olympics, or the nationwide campaign against Japanese businesses in 2005.

Recently, multinationals adhering to U.S. sanctions and foreign laws have been targeted by Chinese agencies, media and celebrities in print, television and social media in a series of negative campaigns. The targets of these negative campaigns have included some very prominent names, including Nike Inc., H&M, Intel and Sam's Club.

Shortly after the U.S., Britain, Canada, and the EU announced sanctions against Chinese officials related to the treatment of Uyghurs in Xinjiang province in March 2021, numerous fashion brands, including Nike and H&M, were trending in Chinese social media with netizens calling for widespread boycotts. When allegations were raised that Intel requested its suppliers to avoid products from Xinjiang, a similar backlash was sparked.

During the 2021 holiday season, there was a significant amount of coverage related to stories of netizens destroying Christmas decorations in Beijing.

More recently, in mid-January, the CCDI published a scathing article accusing U.S. retail giant Walmart and its Sam's Club chain of "stupidity and shorted-sightedness" after social media users alleged that Sam's Club had removed Xinjiang-sourced products from its stores and website. The article appeared to be directed at placing pressure on the company, as it discussed the amount of money the company has made in China, suggesting that it should take a stance on the issue.

The Sam's Club series of events may be the most telling with respect to the Chinese government's efforts to discourage compliance with foreign laws. Typically, informal political position statements or calls for public action from the Chinese government come through publications such as the Global Times or news agencies such as Xinhua News Agency.

A statement from the CCDI is unique and of concern because the CCDI is the party's enforcement arm for misconduct by party members. This means that a statement on the CCDI website is intended for the party and government officials, yet that intent appears distorted here.

While China did spend 2020 and 2021 establishing a countersanctions regime, utilizing those tools would likely also have punished Chinese economic interests. Using the CCDI website as a tool in this context appears to have been motivated by a desire to avoid this unwanted result.

Takeaways

China's recent flurry of activity has created a relatively comprehensive legal framework for administering retaliatory sanctions, penalizing conduct deemed detrimental to China's interests, and locking companies completely out of its market and products.

Historically, China has been willing to initiate retaliatory investigations against both foreign and local entities—and as of now, retaliatory sanctions have only been used against current or former U.S. government officials or nongovernmental organization personnel in response to U.S. sanctions.

However, the recent trend toward Chinese nationalistic protection suggests future retaliation efforts in the form of investigations, sanctions and negative public relations strategies may be targeted against foreign entities operating within its borders. These strategies will most likely be carefully designed to limit damage to China's own economy and interests.

The risk of retaliatory investigations presents particular concern due to China's uniquely challenging compliance environment. Within China, no specific trigger or allegation is necessarily required for Chinese authorities with tax, unfair competition, data security or anti-monopoly oversight to inquire into compliance with Chinese law or to initiate a review.

Further enhancing the risk is the commonality of investigating authorities to expand investigations, to transfer cases or evidence to other authorities, or to conduct joint investigations.

Multinational companies at risk of being caught in the crosshairs of the U.S.-China dispute should be proactive, taking steps to prepare for potential investigations. If China administrative agencies come, they will move quickly. Historically, even so-called friendly raids provided only a few hours' notice to the target entity. Thus, at a minimum, companies will be well-served by preparing for potential investigations, putting a contingency plan and a triage team in place, and moving forward any planned business or compliance audits.

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