Navigating the Complex Relationship Between the U.S. and China

▶ Tatman Savio, registered foreign lawyer and partner at Akin Gump, and Clete Willems, partner at Akin Gump, discuss the current state of U.S.-China relations, what will (and won't) be different under the Biden administration, and how businesses and investors in the region should proceed going forward.

CCBJ: It's hard to imagine a more confounding situation than what companies and investors – not to mention their lawyers – are facing when it comes to the contentious relationship between the United States and China. Give us your high-level view of the situation as the Trump administration ends and the Biden team grapples with a troubled situation.

Clete Willems: It certainly has been a very contentious situation, as well as a disruptive and confusing time for many companies and investors, given the significant number of actions the Trump administration took with regard to China over the last several years. Even during the last 10 days of the Trump administration, there were five or six very significant actions, ranging from sanctions on Hong Kong to a withhold release order (WRO) that is going to make it much more difficult to import cotton or products made from cotton from the Xinjiang region, based on the view that they're made from forced labor. We've also seen other companies classified as Communist Chinese Military Companies (CCMC), which means U.S. investment into them is prohibited. There's a lot going on, and it's been very difficult for people to understand how these actions affect them and how they all relate to one another.

As we're transitioning from one administration to the next, I believe there will be a similar policy trajectory. This is obvious from what the Biden folks have said in their confirmation hearings. Additionally, if you look at the actions that President Biden is taking, he's signing a huge number of executive orders and regulatory actions, largely overturning many of the policies of the Trump administration. But notably absent are any efforts to overturn Trump administration actions toward China. What that signals is that you are going to have a high-level continuation of those policies. The Biden administration will likely have a much more predictable, thorough process, but I don't believe the trajectory of the policy itself is going to change in a significant way. This is an issue that really has bipartisan agreement.

One last point to consider, of course, is how China views this – what does China want to do? I think it's clear that China would like to reduce the temperature a bit. They have revamped their trade team, and they're talking about potentially engaging in some form of negotiations with the Biden team. But it's going to take quite some time. I sense that the Biden team will proceed slowly and cautiously, try to get a handle on the situation and coordinate with other countries before they actually negotiate with China. They may open up some dialogue, just to show that it's important to talk to each other, but I don't expect substantive negotiations in the near future.

With tensions high and optimism hard to come by, how do you counsel clients who need to make potentially costly business decisions in the face of the chaos that has enveloped the world's most important geopolitical relationship?

Tatman Savio: It can be a minefield for companies that are doing business in China, but even so, there are a multitude of opportunities in the Chinese market, as well as

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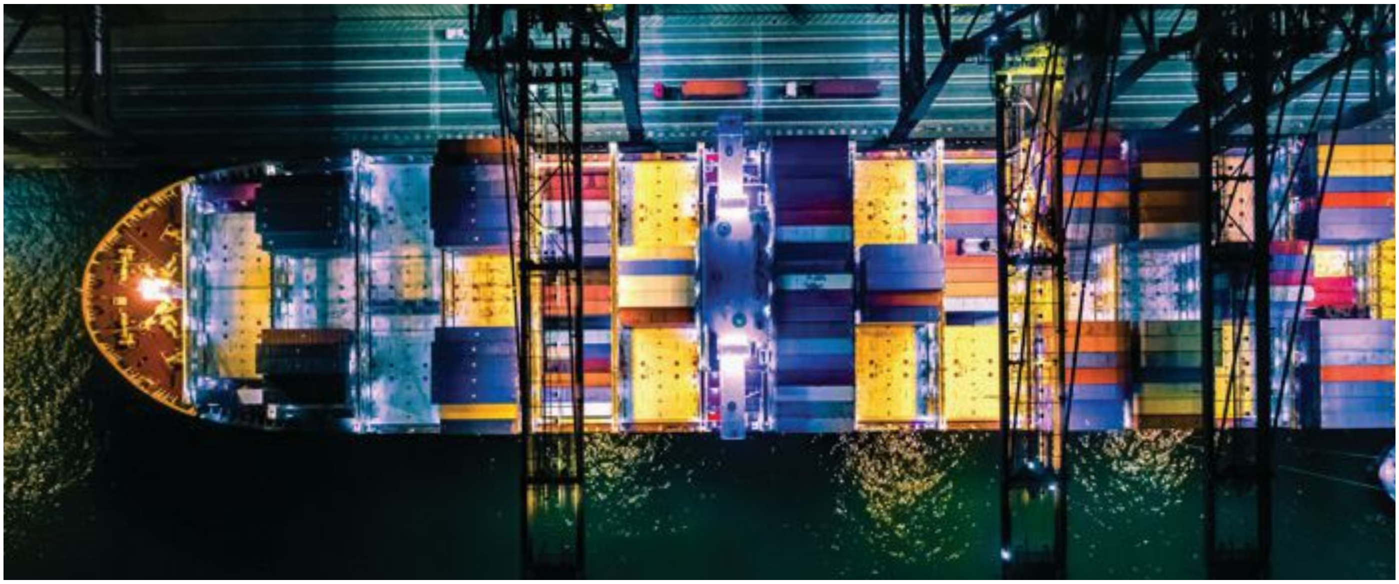
entrenched business relationships between U.S. companies and Chinese companies that remain important. There has been a flurry of activity, as Clete described, related to actions targeting Chinese companies, and we've seen the U.S. export control rules and sanctions rules leveraged against Chinese companies in ways that we've never seen before. The rapidity and frequency of those actions can be dizzying for U.S. as well as non-U.S. companies that are doing business in that market.

It's important for companies to understand the overall policy landscape, so that they can piece together the U.S. government's actions against China within a broader framework. The actions stem from very particular policy positions by the U.S. government. Those include concerns about China's stated policy of "Military-Civil Fusion," and the ways in which China has focused on breaking down barriers between its civilian and defense sectors to advance its military. The Military-Civil Fusion policy has generated scrutiny from the U.S. government because there is concern that items that are being sent to China by U.S. companies are not being used for civil purposes but are instead being passed along to the Chinese military.

Another Chinese policy about which the U.S. government has expressed concerns is "Made in China 2025." This is China's strategic plan to become a leader in high-technology manufacturing, including in the fields of artificial



intelligence, telecommunications, robotics, and other areas, by the year 2025. Here again, you see U.S. actions targeting the technology sector of China based on concerns about the way China is trying to promote domestic champions in these high-tech areas.

As Clete mentioned, the U.S. government also has concerns about alleged human rights abuses in Xinjiang Province, and you see the response to that playing out in Entity List and sanctions designations that target companies that are engaged in business there. And the last area I'll note is the South China Seas, and the U.S. government's focus on companies that it views as supporting the Chinese government's activities and buildup there.

Of course, in addition to understanding the policy rationale underpinning U.S. government enforcement actions, it's critical for clients to understand the actions themselves and, specifically, what they mean from a legal perspective and the related requirements under U.S. sanctions and export controls laws. In that regard, sanctions restrictions generally apply to the activities of U.S. persons, whereas export control restrictions apply to exports and reexports of items that are subject to U.S. export control jurisdiction, so the consequences of particular enforcement measures can vary significantly.

Related to this, we've seen the U.S. government increasingly use denied and restricted party lists to penalize Chinese companies and advance foreign policy and national security objectives. These lists are not created equal, and they can lead to vastly different legal consequences and obligations. For example, the Treasury Department's SDN List functions as a sanctions blacklist, and U.S. persons are generally prohibited from engaging in transactions with companies on that list. This is more expansive than the Commerce Department's Entity List, which generally prohibits exports and re-exports of items subject to U.S. export control jurisdiction to listed companies without a license. And the Entity List itself is broader than the Commerce Department's more recent Military End User List, which creates export license requirements for a more narrow subset of items subject to U.S. jurisdiction. Then you have the recently created CCMC list, where U.S. persons are prohibited from investing in securities of designated companies. I'm just scratching the surface with these examples, but as you can tell, there are a tremendous number of measures for companies to sort through when doing business in China.

Willems: I've heard from so many clients who are trying to understand the differences between all of these different actions, and the implications of each of them. First of all, many of them are just confused by what's going on; but secondly, when they do find out what's going on, in many cases it actually becomes very disruptive for them. So I do think that optimism is hard to come by for many of these companies, especially those with deep roots in Asia. However, just to put a slightly different spin on it, I will note that for some companies, where there is a disruption there also is also an opportunity. You have a large number of U.S. companies saying, "OK, I see where this policy is going, now how do I find a way to take advantage of that?" If the U.S. is concerned about supply chains with China, for instance, and your supply chain is with Japan, or with another region that is considered to be more of a trusted partner of the United States right now, there may be opportunities there.

> **Investment and other business opportunities in China can be significant, but companies must look at them in the proper context and be equipped to understand and manage the risk.**
> – TATMAN SAVIO

Despite the rhetoric, a new administration brings a certain amount of optimism, but not everyone expects smooth sailing. For example, former U.S. Ambassador to China, Terry Branstad, recently told Bloomberg Television, "I don't see a likelihood of a big change in the policy with the change of administrations." Do you agree? What do you expect from a new administration?

Willems: I touched on this a bit already, but yes, I do agree with what Ambassador Branstad said. On a general level, there is strong bipartisan support for a tough policy on China that encompasses both the human rights issues and the issues around economic practices and foreign policy. That said, there are some areas where I believe there will be differences between the Trump administration and the Biden administration. One of the things that will be different is that trade is not going to be such a front-page issue, where you're seeing new headlines and actions taken day in and day out. President Biden has talked about wanting to focus on domestic issues first. The United States faces several crises right now, from the coronavirus to the economy, and Biden has talked about wanting to make those areas his emphasis.

When it comes to China, you're not going to have this situation anymore where the president wakes up in the morning thinking about the trade deficit. That's not who Joe Biden is. On China, Joe Biden wakes up thinking about broader foreign policy, not economic policy, and that has always been the way he's approached these kinds of international issues. So you're going to see more discussion about what's going on in Hong Kong, maybe more discussion about the South China Sea, or Xinjiang, or Taiwan, and less about export controls and tariffs.

Similarly, you're not going to see policy by tweet anymore. You're not going to see rapid shifts from one day to the next. It's going to be a much more thorough interagency decision-making process. Then, once a decision is made, that decision will likely stick. You're going to see a much more multilateral approach, and one of the things that President Biden has spoken at length about is trying to work with partners and allies of the United States that have similar concerns with China's policies. You're going to see an attempt to pursue these issues through a multilateral framework, including the World Trade Organization. The last thing I will mention is that even if there is still a significant amount of tension between the United States and China, you are going to see an effort to have more dialogue, and to find other areas where we can cooperate. For instance, there's been a great deal of discussion about cooperation with respect to climate, as people look for ways that the U.S. and China can work together to tackle that issue.

Savio: I've seen a fair amount of optimism among U.S. and non-U.S. companies with the change in Administration for the reasons that Clete mentioned. People do not expect smooth sailing altogether, but they do expect calmer waters. The optimism is rooted in part in the opportunity for everyone to catch their breath a bit, to have a reset with this new administration. As I said before, the pace of the enforcement actions under Trump was dizzying, and companies have had to expend significant resources and brainpower trying to get their arms around everything that occurred. So people are looking forward to a pause, and Biden has indicated that there will be a pause and an examination of certain policies. People are also looking forward to a more regular order process – a return to the predictability of the policy-making process and the way the U.S. government makes and announces policy changes and legal actions.

The Trump administration sanctioned more than 200 Chinese entities, municipal governments, and universities since 2019, catching some companies in the crossfire. "There is an escalation of tit-for-tat," said Alex Capri, a research fellow at the Asia-based Hinrich Foundation. "From a corporate governance perspective, multinational companies and individuals will find themselves increasingly whipsawed." Tell us how investors and companies can navigate such an environment without taking on undue risk.

Savio: Go in with eyes wide open, with a recognition that there are risks, of course, but knowing that there are ways to manage and mitigate them. That goes back to being informed and having an understanding of the policies that are leading to these trade restrictions, and then also understanding the ways in which these different measures overlap, intersect or, in some cases, are completely different from one another

There are many different U.S. agencies involved in administering laws that impact the relationship with China and the activities of U.S. companies in China. I've already mentioned the Department of Commerce, which administers the export control rules and the Entity List and the Department of Treasury, which administers the sanctions laws, including the SDN List and the CCMC List. The Department of Defense and the State Department also play role in export control and sanctions issues.

It's really important for companies to understand who their business partners are, and to be equipped to comply with varying restrictions that may exist on those business partners. It's critical to do a screening and diligence of your transaction to evaluate whether your counterparty is subject to U.S. trade restrictions and to analyze whether it might become so in the future. Once you've gone through that screening process, if you determine that your counterparty, or someone involved in your transaction, is on one of these restricted party lists, it's crucial to understand what that means for you and your company. As I noted earlier, jurisdiction applies in different ways, and the restrictions can be quite broad – amounting to a blacklist and a prohibition on doing business with the company at all – or they can be quite nuanced and particular. Not all of these lists are created equal, and not all of the restrictions and jurisdictional bases are the same. For this reason, the fact that a counterparty is on a particular list can have a tremendous impact on a transaction or no impact at all.

Beijing issued new rules on foreign sanctions meant to protect local firms from "unjustified" overseas enforcement actions by allowing Chinese citizens or companies to sue for compensation in Chinese courts. Observers differ on how serious this action is. "The new rules are more than anything a signaling mechanism to both Chinese companies and U.S. companies in China. We now have a legal ability to counteract the long arm jurisdiction of U.S. domestic law," said one analyst of Chinese politics and economics. What, if any, lasting impact will such "signaling" moves have?

Savio: This is an interesting and important development on the China side. The actions coming out of the U.S. have been fast and furious, but the reactions on the China side have been more subdued in recent months. On January 9, there was an issuance of blocking measures by China's Ministry of Commerce, which has been interpreted as China's response to the recent proliferation of U.S. sanctions and the export control restrictions. The important thing to note about these blocking measures at the outset is that it remains to be seen how the Chinese government will enforce them. These blocking measures are not completely uncommon or unusual, and the European Union and Canada and other jurisdictions have similarly worded blocking measures that target extraterritorial laws that are deemed contrary to international law and impact the activities of their companies.

As an initial matter, the China blocking measures are targeted at understanding the ways in which Chinese companies are being impacted by extraterritorial laws. The rules impose an obligation on Chinese companies to report foreign laws and measures that restrict or prohibit them from engaging in certain economic activities. The Chinese government will take the input from these companies and potentially issue blocking measures that will create a prohibition on complying with certain extraterritorial laws. Now, it remains to be seen which laws could be captured within that blocking order. On its face, the China blocking measures could be read to only cover secondary sanctions laws, which are, from the U.S. perspective, laws that don't require any U.S. nexus for the U.S. government to assert jurisdiction and take enforcement action.

There's a significant amount of discussion and commentary as to what might come down from the Chinese side. I believe it will depend in part on the Biden administration's articulation of its policy toward China, and how it may or may not adjust the temperature with respect to U.S.-China relations. China, meanwhile, will be obtaining reports from its companies as to the precise impact that they're experiencing as a result of extraterritorial laws, and it will make decisions accordingly.

If you could give one piece of advice to skittish investors and businesses focused on the region, what would it be?

Willems: Realistically, investors and businesses need to realize that the tension in this relationship is here for the foreseeable future, and they're going to have to proceed with eyes wide open, and really make sure that they are accounting for these risks and protecting against them, so that any damage that occurs can be mitigated. But you need to be realistic and realize that this is the world we're going to be in for a while, and the smart move is to be prepared, and to take action in advance to be able to mitigate any consequences from that tension.

The second point, which I hear from companies and from investors, is that this disruption can also create opportunity. You have many things changing in the region, and you need to try to understand the trends, predict the trends, and take advantage of them.

Savio: From my perspective as a trade lawyer advising on the application of U.S. law in Asia, I think that companies and investors need practical tools to navigate investment opportunities and business transactions in China, the upside of which can be huge if companies look at them in the proper context and are equipped to understand and manage the risk. Obviously, there is a great deal at stake for both the U.S. and China in terms of the trajectory of the relationship. When pursuing business opportunities, it's important to navigate the parameters effectively. This can be done by being informed, having good advisors, ensuring that you have a good process for identifying and analyzing potential risks, and undertaking measures – whether via contractual safeguards, compliance reviews, or other mechanisms – to ensure you don't run afoul of ever-changing U.S. legal requirements. ■

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