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China's Export Control Law 2020 - 10 steps for European companies to take

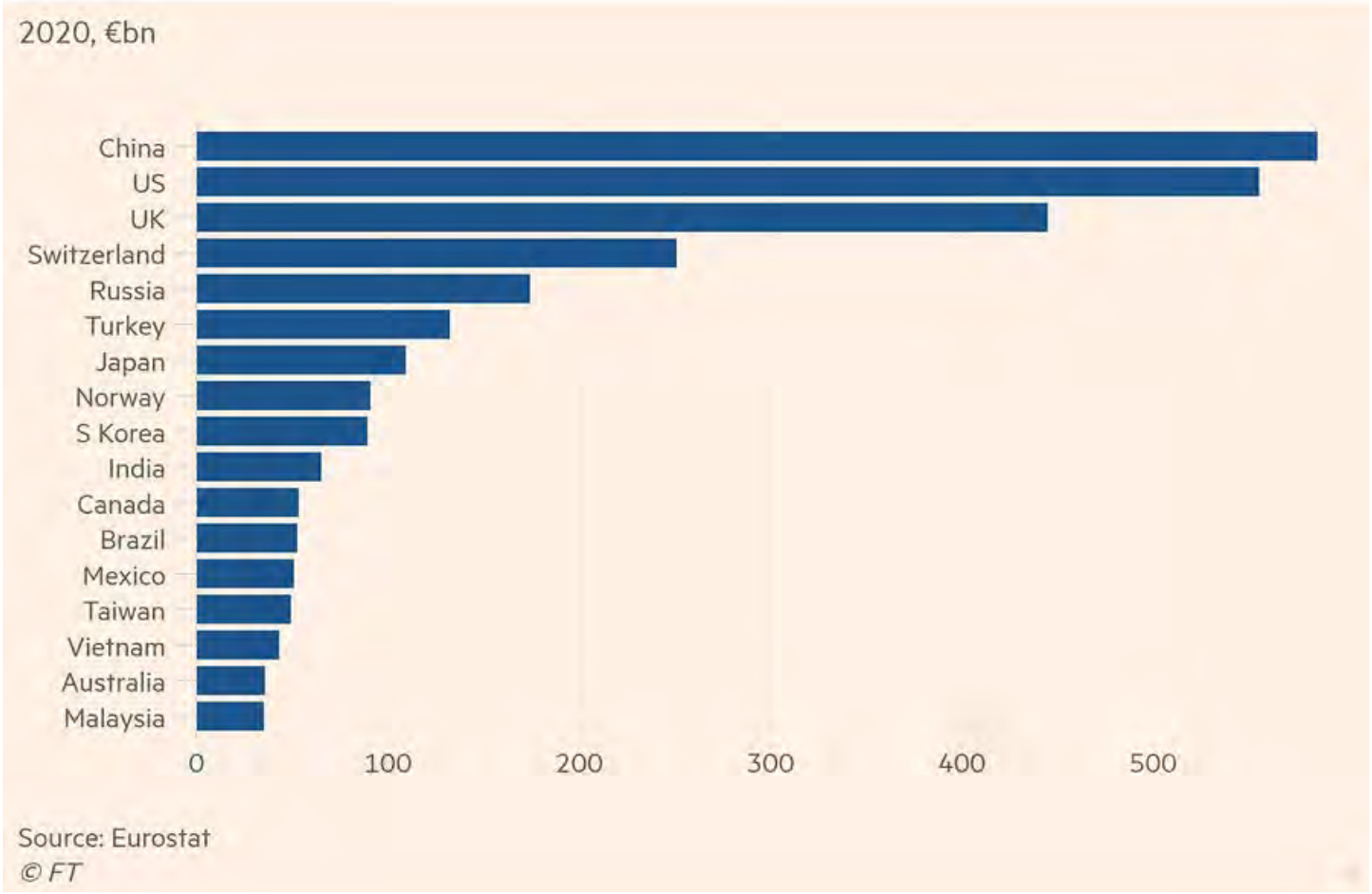
As a strategy to address the concerns of protecting its national security and interests, China promulgated on 17 October 2020 its new Export Control Law with various export control mechanisms, including a process for imposing reciprocal measures against instances that China views as an abuse of export control measures by foreign governments. It entered into force on 1 December 2020.

As this new legislation is very relevant for European companies (1), we identified 10 steps to take in order to avoid fines and blacklisting (2).

1 - The Chinese Export Control Law is relevant for European companies

1.1. In 2020, China overtook the U.S. as EU's biggest trading partner.

Where trade with most of Europe's major partners dipped due to the Covid-19 pandemic, trade between China and the EU was worth 586 billion EUR last year, compared with 554 billion EUR worth of imports and exports from the U.S..



China was the only major global economy to see growth in 2020, with a strong demand for European cars and luxury goods (+ 5.6 % in imports overall). Meanwhile, China's exports to Europe benefited from strong demand for medical equipment and electronics (+ 2.2 % in exports overall).

China is the largest exporter, and the third largest importer in the world (2019).

The five-year strategy adopted by the EU on China in 2016 mapped out the European Union's relationship with China. It promotes reciprocity, a level playing field and fair competition across all areas of co-operation. It also includes a trade agenda with a strong focus on improving market access opportunities, deals with overcapacity and calls on China to engage with ambition at multilateral level.

China is now the third largest partner of EU exports of goods (10.5 %) (2020) and the largest partner for EU import of goods (22.4 %) (2020). Among EU Member States, the Netherlands are the largest importer of goods from China (2020), while Germany is the largest exporter of goods to China (2020).

China's sophisticated supply chain has enabled it to become a high-tech export giant, with computers, power devices, broadcasting technology, telephones, and transport equipment dominating Chinese exports.

1.2. There are different drivers for this new export control legislation.

The developments in China's export control regime have increasingly been driven by various new initiatives and challenges, such as the Made in China 2025 policy, cybersecurity concerns and the U.S.-China trade war. Chinese government policymakers determined that the lack of a comprehensive export control law made it difficult to protect China's national security and interests, especially against the backdrop of U.S. sanctions imposed in recent years on major Chinese technology companies, such as Huawei, Tencent, and ByteDance.

The emergence of China's Export Control Law is significant because it represents the first effort of its kind to launch a unified and comprehensive export control regime. The new law is a strategic pivot for the country as it matures in its view of its own national security and its place in the world as a competitive producer of sensitive goods.

For decades China operated without a comprehensive export control law, relying instead on various administrative regulations to regulate export activities involving sensitive items, including nuclear items, biological items, chemicals, missiles, and military products.

China's export control legislation was relatively fragmented, the overall coordination mechanism of export control work was not perfect, the scope of controlled items and control measures were not completely equal and balanced with other countries, and they were no longer suitable for the requirements of the development of the times [1].

China however joined the Zangger Committee [2] and the Nuclear Suppliers Group (NSG) [3] and has formally applied for the membership in the Missile Technology Control regime (MTCR) [4] and keeps contact and exchanges with the Wassenaar Arrangement [5] and the Australia Group [6] through several rounds of dialogues and consultations.

1.3. Extraterritoriality and a significant shift in China's export control landscape.

Companies engaging in international trade must pay close attention to this significant shift in China's export control landscape. Many aspects of implementation and enforcement of the law are yet to come. The heart of the entire system - the Control List - has not yet been released. Guidance on how the export control authorities will monitor end users and end uses, and the creation of the monitoring list, are all areas on which the legislation remains unclear.

As there will be severe penalty provisions for violation of the law, multinational companies should take compliance control measures as soon as possible so as to avoid serious consequences of penalties or sanctions by the law.

Apart from China based export operators and deemed exporters, European importers, end-users and re-exporters, as well as third-party service providers, should be very attentive to the developments in Chinese export control legislation. The extra-territorial effect of the new legislation is demonstrated through different provisions, some of them directed against States.

Importers, end-users and re-exporters

The law reaches out to end-users and importers outside of China who are receiving or importing controlled items from Chinese business partners, and submits them to obligations related to the use of such products. Companies may be mentioned on the restricted list of entities with whom Chinese exporters may not anymore do business.

The law includes into its scope European importers who are re-exporting goods received from Chinese counterparts.

Third-party providers

The new law governs any person, who provides any agency, shipping, delivery customs clearance, third-party e-commerce trading platform, financial and other services for any export operator. In circumstances where such parties know about a Chinese export operator's engagement in export control violations, they will be subject to penalties as well [7]. European and other foreign entities are likely to fall into that category.

Penalties include fines between 100.000 to 500.000 RMB (if the illegal turnover is between 0 and 100,000 RMB), or a fine between 3 and 5 times the value of the illegal turnover (in case this is more than 100.000 RMB), a warning, an order to stop the violation and the confiscation of any illegal income.

Foreign entities endangering Chinese national security and interests

The law also expressly states that any organization and individual from outside of China who is violating this law, is endangering the national security and national interests of the PRC, and is hindering the performance of non-proliferation and other international obligations, shall be subject to investigation and legal liability in accordance with the law [8].

It seems that all these three conditions must be met in order for this provision to be invoked.

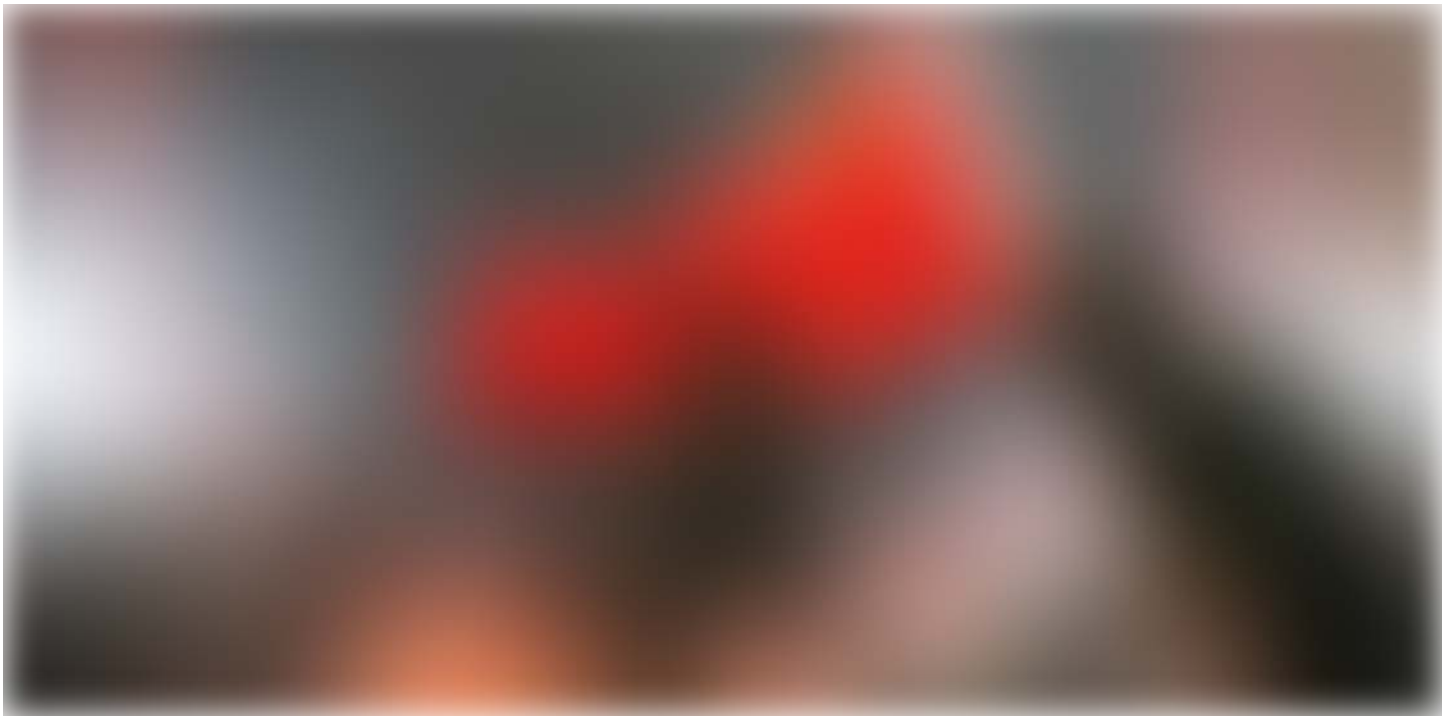
It is not entirely clear which provisions by the law are being referred to by the first condition. The vague wording seems to target all provisions of the new law. On the other side, general principles of criminal law require that there should be specific prohibitions in the law before someone can be penalized.

The second condition for incurring legal liabilities has nothing to do with export control of Controlled Items or foreign importers or end-users. It imposes liabilities on all persons and entities in a foreign territory who are "endangering the national security or interest of China". This requirement is problematic as foreign companies or individuals cannot completely ensure avoidance of such

liability risk. It is difficult to judge what activities may endanger national security or interest of China from the perspectives of foreign companies or individuals.

National security refers to the state's power to govern, sovereignty, unity and territorial integrity, the welfare of the people, sustainable economic and social development and other major national interests, and the ability to ensure a continued state of security [9]. Thus, national security includes broad macro issues such as political, sovereign, economic, social and other major interests of China. It remains difficult for foreign companies or individuals to determine such macro and relativity issues.

The third condition, indicating hinderance in performing non-proliferation and other international obligations, is ambiguous as well. Are the "international obligations" those of the Chinese government, or those of another State or entity?



States abusing export control measures

Reciprocal measures may be taken by the Chinese authorities against a country or region which abuses export control measures to endanger China's national security and national interests [10]. The scope and implementation by China of this new retaliation provision remain unclear at this moment of time.

Countermeasures may be taken in the following directions: (1) imposing equivalent export control restrictions on the relevant countries and regions; (2) imposing equivalent export control restrictions on specific entities from relevant countries and regions; (3) denying the applicability in China of the export control requirements of relevant countries and regions.

These rules are separate from those released on 9 January 2021 by MOFCOM. The 16 articles long Rules on Counteracting Unjustified Extra-Territorial Application of Foreign Laws and Other Measures

[11] are aimed at safeguarding China's national sovereignty, security and development interests, and protecting the legitimate rights and interests of Chinese citizens, legal persons and other organizations. This "blocking law" applies to situations where the extra-territorial application of non-Chinese laws and other measures are determined to violate international law and basic principles of international relations, and unjustifiably prohibit or restrict Chinese persons from engaging in normal economic, trade and related activities. If a person complies with foreign laws and measures prohibited by a MOFCOM prohibition order, the affected Chinese persons may file a civil lawsuit in the Chinese courts and seek compensation, absent the granting of an exemption to the complying entity.

2 – Ten steps European companies should take

Step 1. Create awareness

It is important for companies operating in China to note that there may now be China-specific controls to respect for certain types of goods, technologies and services.

Companies should design training programs and provide such training to their employees. A good training program should provide job-specific knowledge and communicate the responsibility of each employee dealing with Chinese business.

The 2020 Export Control Law regulates the export of certain items which include civil-and-military "dual-use"items, military items, nuclear items, and other goods, technology, and services identified as necessary to safeguarding China's national security and interests, and fulfilling international obligations such as non-proliferation of nuclear, chemical, and biological weapons. Controlled Items also include technology pertaining to controlled commodities, components and software.

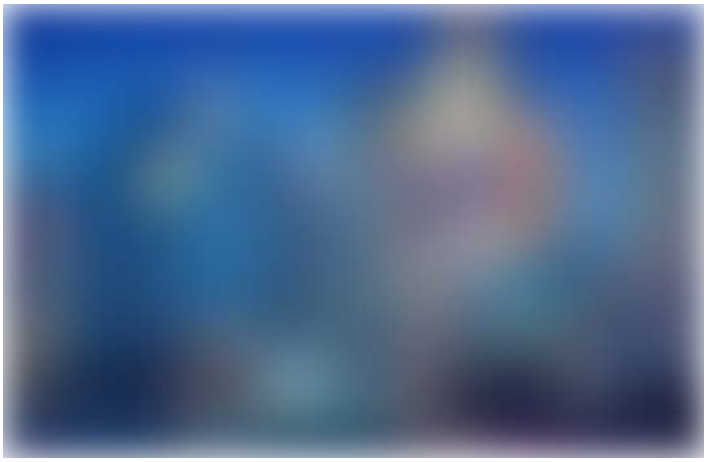
The new law not only regulates direct export activities, but also control deemed export, re-export and special export activities, including:

- transferring of controlled items from the territory of China to overseas;
- citizens, legal entities and unincorporated entities of China (should covering wholly or jointly owned China subsidiaries invested by foreign entities) providing controlled items to foreign entities and individuals (the EC Law is silent on whether such activities need to be performed within or outside of the territory of China);
- the transit, transshipment, transportation or re-export of controlled items; and

- the export of controlled items, from bonded areas, export processing zones and other special customs supervision areas, and export supervision warehouses, bonded logistics centres and other bonded supervision places, to overseas.

European companies are directly concerned by the new export control legislation in two cases. In the first case, their Chinese subsidiaries are operating exports. In the second case, they are themselves importers and/or end users of controlled items or service providers for export transactions, including agency, freight forwarding, delivery, customs declaration, third-party e-commerce transaction platform and financial service providers.

Step 2. Implement an Internal Compliance Program



Any non-Chinese business dealing with China should establish an internal trade compliance program to comply with China's new export control regulations. Companies should ensure that they have reviewed the consequences of these regulations on their business activities and implement the relevant policies and procedures to ensure compliance.

Companies should utilize tools and services to constantly screen their goods, services and technologies coming from China, as well as their business partners, suppliers, customers, agents, end users and other business counterparts (Chinese or non-Chinese) in order to make sure that such entities or persons are not subject to any trade sanction or restriction in China.

Controlled items

The Export Control Law applies to the export of the following items:

- dual-use items: items that have both civil and military uses or contribute to the enhancement of military potential, especially those goods, technology and services that can be used to design, develop, produce or use weapons of mass destruction and vehicles of their transportation;
- military products: equipment, special production facilities and other related goods, technologies and services used for military purposes;
- nuclear: nuclear materials, nuclear equipment, non-nuclear materials used in reactors, and related technologies and services;
- other goods, technologies, services and items related to safeguarding national security and interests, fulfilling international obligations such as non-proliferation; and
- technical materials and data related to the above mentioned items [12].

The new law is controlling items in two ways: a permanent and a temporary control list.

Export Control Lists

Export control authorities have been granted legal power to make or revise the export control lists for controlled items in accordance with the Export Control Law, other relevant laws and regulations, and export control policies [13].

In the now unified export control system, the said list, directories, or catalogues may be adjusted from time to time pursuant to Export Control Law and other relevant administrative regulations. In that case, authorities will work to establish and adjust the control lists, and promptly publish such lists in accordance with export control policies.

The law itself does not specify the sources, contents, possible exceptions and other details of the controlled items.

It is yet unclear whether the authorities will integrate the current export control lists as-is or promulgate new lists.

On 22 October 2020, following the promulgation of the Export Control Law, the Ministry of Commerce indicated that it would actively promote the formulation of supporting regulations of the Export Control Law to ensure the effective implementation of the various systems established thereby, and at the same time, will further improve and release in due course the Control List.

It is reasonable to expect that the Control List will encompass the substance of the recently updated Catalogue of Export-Prohibited and Export-Restricted Technologies of China.

In the nuclear, biological and chemical fields, the relevant lists currently cover virtually all of the materials and technologies included in the control lists of the Zangger Committee, the NSG and the OPCW [14].

In the missile field, the scope of the Chinese list is generally the same as the Technical Annex of the MTCR.

Controlled dual-use items are listed in The Catalogue of Dual-use Items and Technologies Subject to Import and Export License Administration. It is updated annually.

An adjusted Catalogue of Dual-use Items and Technologies Subject to the Administration of Import and Export Licenses has been released by MOFCOM and the General Administration of Customs on 31 December 2020 and came into force on 1 January 2021, repealing the previous catalogue from 2019. The Catalogue has 135 pages and is divided into one section for import licenses and one section for export licenses. The export control list mentions inter alia dual-use biological products and related equipment and technologies, missiles and related items and technologies, precursor chemicals and special items and technologies for civil use (such as cutter suction dredgers or bucket dredgers). Services are currently not mentioned in the Catalogue.

Example: Encryption List

Import List

1. Encrypted phones
2. Encrypted fax machines
3. Cipher machines (including cipher cards)
4. Encryption VPN devices

Export List

Hardware, software and technology related to:

1. Security chips
2. Cipher machine (cipher card)
3. Encrypted VPN devices
4. Key management products
5. Special purpose cryptographic devices
6. Quantum cryptographic devices
7. Cryptanalytic devices
8. Items specifically designed to develop or produce these items
9. Items specifically designed to measure, test, evaluate and examine these items

But the Catalogue of Technologies Prohibited or Restricted from Export of the PRC is as well relevant. By the latest amendment on 28 August 2020, have been added to the list e.g. space material production technology unmanned aerial vehicle technology, laser technology, cryptographic and AI interactive interface technologies.

Current control lists share some common problems when it comes to listing highly sensible items, such as vague descriptions of listed controlled items or lack of clear technical standards for the control.

The existing definition may not be sufficient for companies to identify controlled items in their daily operations. Are foreign-made items containing components of China-origin controlled items? If yes, what is the threshold for the proportion, and what is the standard for calculation? Should public information developed in China, such as certain open source code, be regarded as controlled items? Should technologies and other items developed by Chinese nationals outside China be considered as controlled items?

Temporarily Controlled Items

The law allows the authorities to designate any goods, technologies or services outside the Export ControlLists as temporarily controlled items for up to two years.

Before expiration of any temporary control period, an evaluation will be carried out and the authorities will decide whether to cease, extend or change the temporary control based on the result of evaluation. This "temporary export controls" mechanism is providing the Chinese government with maximum flexibility to quickly impose restrictions, on a strategic basis, as warranted.

The temporary control regime may bring uncertainties to overseas companies who have or will develop trade relations with entities or persons in China regardless of any relevant jurisdiction or nationality of that entity or person. At the same time, it could be challenging to predict the impact of the Export Control Law on any existing or future trade relations considering the difficulties in anticipating risks of being caught by the temporary control regime.

Catch-all

The Export Control Law also requires exporters to apply for licenses prior to dealing with the export of certain goods, technology, and services, if the exporter "knows or should have known," or is notified by the Export Control Authorities, that export of the items may: (i) endanger China's national security and interests; (ii) be used for designing, developing, manufacturing, or utilizing weapons of mass destruction or the vehicles to transport the same; or (iii) be used for the purpose of terrorism.

If an exporter is uncertain about whether the goods, technology, or services to be exported are considered ControlledItems under the Export Control Law, it should inquire the competent Export Control Authority.

These two rules extensively expand the Export Control Law's application. In addition to the ControlledItems that are clearly listed on the Control List, exporters and their European business partners will be well-advised to closely follow the Export Control Authorities' ad hoc announcements on Controlled Items that are subject to temporary export restrictions. Furthermore, companies should develop adequate expertise to enable them to identify items that are "known or should have been known"to be Controlled Items, but are otherwise not listed on the ControlList or subject to temporary export regulations.

A key in determining whether an export license is needed from the Authorities is finding out if any good, service or technology that companies intend to export falls under any existing Export Control Lists or the category of Temporarily Controlled Items published by the Authorities. Companies should be familiar with the structures and contents of the Export Control Lists and Temporarily Controlled Items published by the Authorities, and to determine whether or not any authorization is required to

export from China. Companies should closely monitor the Export Control Lists, Blacklists and other sanction lists published and updated by the Chinese authorities.

A company should foresee relevant risks when accepting an order, and at the export and sale stage of the controlled item, and establish a customer risk and warning screening system. If necessary, it may address an inquiry or submit an application to the national export control authority in advance so as to effectively reduce compliance risks.

Step 3. Prepare to be part of complete License Application documentation

European companies should be aware of that their Chinese business partners, in order to export any ControlledItem on an Export Control List or any Temporarily Controlled Items, must apply to the authorities for a license. The same is for goods subject to the catch-all clause [15].

When assessing exporters' applications for export license, Chinese authorities will take into account the following factors [16]:

1. national security and national interests;
2. international obligations and commitments;
3. type of export;
4. sensitivity of the items;
5. destination country or region of the export;
6. end-users and end use;
7. credit record of the export operator; and
8. other factors provided in laws and administrative regulations.

While "credit record" is a newly added factor, compared to the 2017 Draft Law, the metrics for evaluating an entity's credit record have not been communicated until now.

China's social credit system ("SCS") establishes a system by which the Chinese government collects information and rates companies across a wide range of areas (e.g., tax, environment) and then can reward or sanction companies based on that information and rating. SCS notably functions as an information-sharing system among government agencies, which means that non-compliance in one area, such as bribery and corruption, will be more quickly reported, publicized, and shared with other government agencies, and, in many cases, with the public [17].

The "joint-sanctions" approach can lead to, among other things, higher inspection rates, targeted audits, and difficulties obtaining unrelated administrative approvals, as government agencies view the company as less trustworthy and therefore less willing to grant permits, licenses, or other

administrative approvals. The SCS score also serves as a reference point when obtaining loans in China and in foreign exchange activities (including getting money out of China). In extreme cases, a violation can lead to a company's debarment from public procurement in China and can impact the SCS score of the individual serving as the company's named representative in China.

A company's SCS score is also impacted by the SCS scores of its business partners. The additional transparency and access to presumptively accurate government-provided information about potential business partners may help with due diligence efforts. On the other hand, companies may need to invest compliance bandwidth into regularly monitoring and assessing the scores of its business partners in China, and consider ways to mitigate the risk that a partner's conduct — even unrelated to the company — could impact a company's SCS score.

The SCS scores of key individuals, such as a company's legal representative or high-ranking management personnel, may also affect a company's SCS score.

Previously made references to "development interest" and "supply on the market" have been removed in the final text.

Types of licenses are not formally mentioned in the Export Control Law. It however mentions the grant of facilitation measures such as a general license if an export operator establishes an internal compliance system for export control compliance and if the system works well [18]. Specific measures will be provided by licensing authorities. Individual licenses therefore seem to constitute standard practice.

Earlier drafts gave the agency 45 business days to review and approve/deny a license application, with the option for an extension of 15 business days under "special circumstances." That clause was completely removed. Implementing regulations, which are typically issued after a law is enacted, may address such deadlines in the future.

Step 4. Prepare for investigations

Chinese exporters are expected by their authorities to evaluate their business partners. This does not only include European importers, but also all third-party partners like cargo carriers, customs brokers, sales agents, R&D partners, financial service providers, e-commerce transaction platforms etc. The objective for the Chinese entity is to know if their business partners have engaged in any export or import violations or are in any way restricted or sanctioned.

Especially for overseas partners, the Chinese ICP Guidelines [19] instruct to regularly investigate and update the situation of partners. The investigation should include business and other related licenses, board members, shareholders and actual controlling structure.

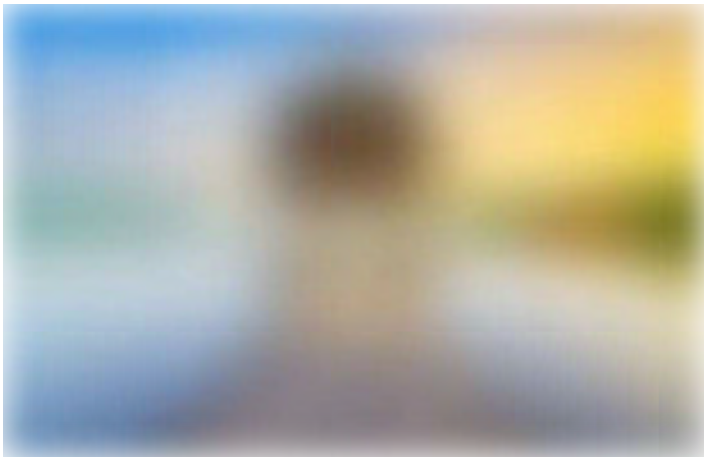
European customers should anticipate that their Chinese suppliers must enquire with them about the end-use of the products and ask them to sign end-use statements. All end-users will be verified by setting up an automatic order screening system and by purchasing related databases.

The review work will start before signing the contract. Chinese companies will carry out inspections on items, end-users, end-uses and transportation routes. Specific review issues will include whether the controlled items, agents and end-users are related to terrorism, or included in a Chinese blacklist or a UN sanctions lists. Further due diligence will be required with regard to abnormal behaviours seen in the customer's attitude.

The contract proposed by the Chinese exporter will now include specific export control compliance related clauses. Only after the he has obtained the export license will he be allowed to perform the relevant obligations of the export contract. During the performance of the contract, he will be required to screen again the relevant information of the parties involved in the transaction, and confirm whether the previous reviews were complete.

There is a requirement of strengthen end-user and end-use management, by strictly evaluating and verifying end-users and end-uses of the controlled items. False end-user and end-use information must be identified. Questions that European end-users should expect include potential re-exports to other countries and relevant foreign employees among staff dealing with controlled goods.

Step 5. Review contractual clauses



Some of your standard contractual provisions to be reviewed include those related to compliance, as well as to representations and warranties.

Compliance clause. For those companies whose business could be significantly influenced by ECL, it is necessary to revisit and make necessary amendments to the compliance clauses in their existing transactional documents. For certain overseas companies, their compliance clauses are usually tailored to fit for specific compliance requirements of the jurisdiction where they or their parent companies are located. Since the compliance requirements may differ from jurisdiction to jurisdiction, the compliance clauses designed for one jurisdiction may not be sufficient to fulfil the requirements set out by Export Control Law. As such, companies should consider drafting tailor-made compliance clauses to fulfil the

requirements under all applicable laws for a specific transaction and follow its internal risk assessment policies.

Certain exemptions should allow for non- compliance or conditional compliance with relevant jurisdictions' boycott requirements, despite of which are relatively stringent to apply.

Representations and warranties clauses. To mitigate any deal-killing risks, one party should consider at an early stage requiring the counterpart to insert certain clauses to mitigate the risk, such as representations and warranties clauses, undertakings and covenants that are made by the restricted entity stating that by carrying out the export or import transaction and entering into the transactional documents it has not and will not violate any applicable export control regulations or sanction rules in all the relevant jurisdictions.

Termination and force majeure clauses. Termination clause and force majeure clause should be carefully drafted to include situations where ECL is not complied with.

Before entering into a contract, European companies should consider that the implementation of the Export Control Law may result in potential conflicts between this law and the export control laws or anti-boycott regulations of the relevant jurisdictions that may be applicable to the transaction and the parties concerned.

Some countries and regions' export control laws have long-arm jurisdiction and can apply extraterritorially to persons abroad. Complying with the Export Control Law could lead to potential breach of laws from other jurisdictions and vice versa. For instance, complying with the Export Control Law may result in the breach of U.S. Anti-Boycott Regulations for certain companies.

The question will also be if the European Union will update the EU anti-boycott regulation EC/2271/96 [20], established in 1996 as a result of the US sanctions regarding amongst others Cuba, in order to protect European businesses against the far reaching extraterritorial application of non-EU legislations.

Anyway, European often need to navigate through narrow streets to avoid violating sanctions law and anti-boycott law. If a risk of violation of some law will occur by necessity, parties will need to balance carefully the potential consequences of violating a respective country's legal regime. It is advised to consider these issues in documenting contractual relationships to ensure that your contracts reflect the agreed-upon balance of such considerations.

Step 6. Conduct due diligence on your Chinese operations

If you have subsidiaries in China, these must carefully examine whether their export items are listed as Controlled Items and if their export and other operations are subject to the Export Control Law. The subsidiary is also to establish internal screening and due diligence mechanism for importers and end users.

Businesses will also now need to screen for entity designations under China's various regulations, such as the Provisions on Unreliable Entity List and the Export Control Law. There should be effective due diligence procedures in place to identify whether the company's counterparts are Chinese or non-Chinese, and whether they are subject to specific trade restrictions, such as being listed on the monitoring list under the Export Control Law or the Unreliable Entity List[21]. Changes to these lists should be closely followed.

The implementation of an internal compliance program is formally recommended, even if not legally required. Such an ICP [22] is a condition to be able to benefit from facilitation measures such as a general license. It is however not the only one, as the exporter operator's system has, as well, to work well [23]. And even if both conditions are met, there is no absolute right to benefit from those measures. It is up to the authorities to grant the measures (meaning that it has the veto right) and to define what these measures are.

While the Internal Compliance System facilitates license management, it also constitutes the policy to ensure compliance with the Export Control Law, for example to identify items that are on the ControlList or designated as under temporary export restrictions, or to implement the catch-all clause. The concept is the same as in the U.S. or the EU. The Internal Compliance Program is not an obligation for exporters, but demonstrates compliance internally and vis-à-vis authorities, and provides easier license management.

This similarity in the approach is confirmed when reading the Guiding Opinions on Establishing the Internal Compliance Mechanism for Export Control by Exporters of Dual-use Items (2021 Guiding Opinions [24]) issued on 28 April 2021 by China's Ministry of Commerce (MOFCOM). Attached to those are new Dual-Use Item Export Control Internal Compliance Guidelines (ECC Guidelines [25]), including 37 pages of detailed recommendations for internal policies and procedures to prevent, detect, and remediate violations of China's Export Control Law. Both documents are not compulsory, but reflect the authorities' expectations with regard to effective compliance programs, like in the U.S. or the EU. They also apply to scientific research institutes.

The Chinese Guidelines are putting forward higher and more detailed requirements for enterprise compliance than the current law on dual-use items. The internal compliance management system of corresponding enterprises should meet the requirements of the Chinese Guidelines to the maximum extent.

Principles. The establishment of an internal compliance mechanism for export control should follow the following principles:

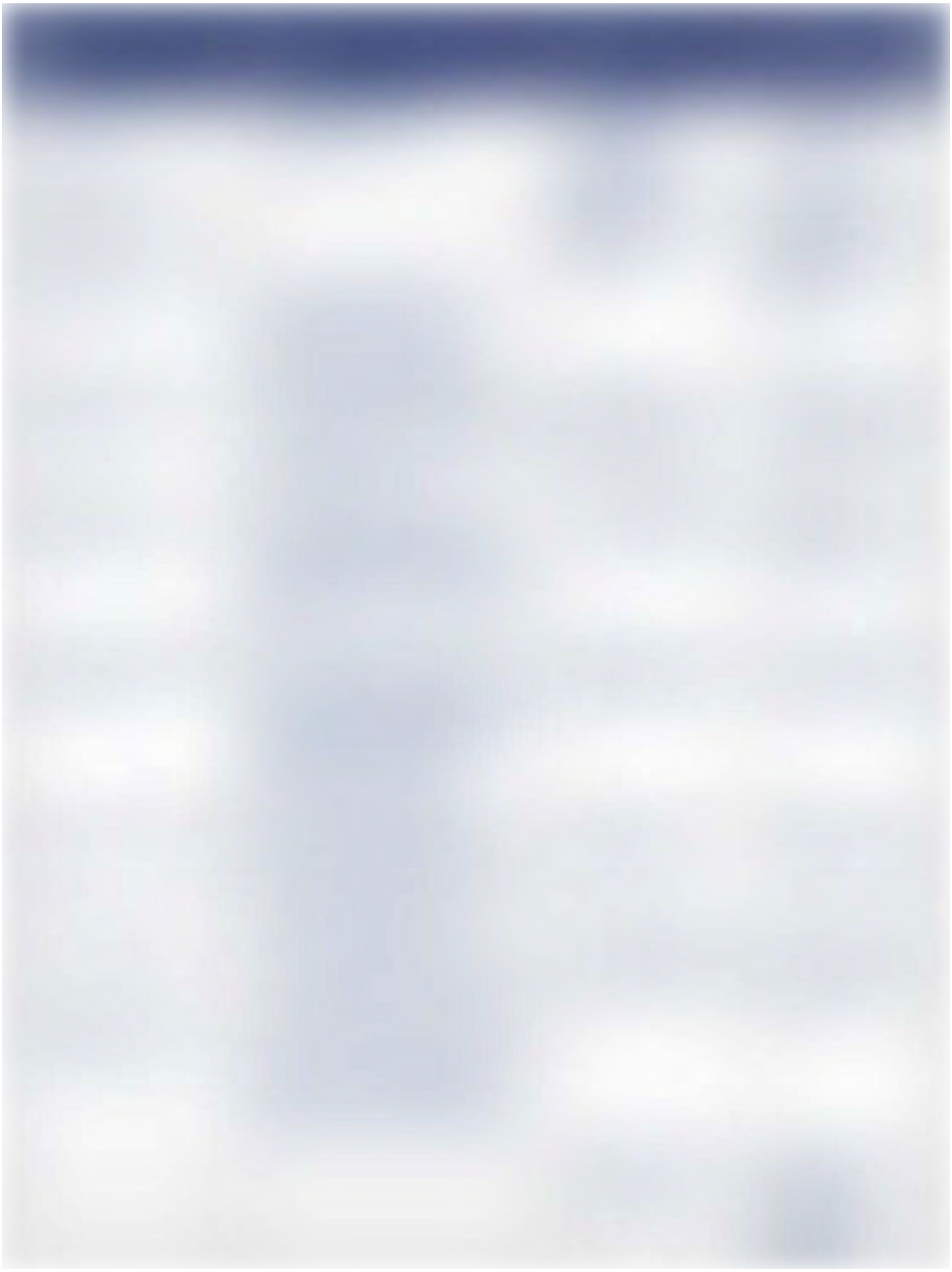
The principle of legality. Export operators should take strict enforcement of relevant national export control laws and regulations as the fundamental principle of establishing an internal compliance

mechanism for export control, and fully understand the importance of legal compliance operations. The relevant actions of the operators must comply with the provisions of export control laws and regulations. If there are violations of laws and regulations, the operators will bear corresponding legal responsibilities.

The principle of independence. The internal compliance mechanism is an important part of the management system of export operators and exists independently in the management system. Through the process control and system guarantee of the internal compliance mechanism, export operators regulate and self-supervise their own business behaviours. The internal compliance mechanism can exercise one-vote veto power for violations of national export control laws and regulations.

The principle of effectiveness. Combining the actual operating conditions, export operators establish an effective internal compliance mechanism for export control, to achieve high-level attention, full participation, full control, regular evaluation, and continuous improvement of the operating system, so as to give full play to the internal compliance mechanism for export business activities. The role of supervision and control.

Basic Elements. The 2021 Guiding Opinions and ECC Guidelines list nine essential elements of an export control compliance system. They do not differ fundamentally from guidelines issued by authorities in the U.S. and the EU.



EU [26]. Luxembourg [27]

Highlights. The 2021 Guiding Opinions, which replace previous ones issued in 2007, are highlighting certain elements.

Independence of the organizational structure. The compliance organization should reflect the principle of independence, and authorize a dedicated person to issue a ban on any objectionable export-related behavior or seek the opinions of the competent government department. It should be avoided that only a single person is responsible for reviewing and judging whether certain complex transactions are in compliance.

Keep data files. Contacts by telephone fax, e-mail and other methods must be recorded as appropriate.

Comprehensive risk assessment. This constitutes a newly added element. It requires exporters, while considering their organizational scale, industries and modes of operation, to conduct a comprehensive assessment of the export control risks that they may face, identify the business links that are prone to non-compliance risks and match the compliance resources and contents of examination based on the risk level. This mainly includes information on the items under operation, customers, technology and R&D, export countries/regions, internal operations, third party partners, and risk prevention measures. The risk assessment may result in the issuance or update of the internal compliance mechanism and relevant organizational management system for export control that are suitable for their own characteristics.

Compliance audit. Also new is the compliance audit that can be conducted by a dedicated person within the company, or an external third-party agency. The audit should analyse whether the review process has been followed during the transactions, whether the organization is running smoothly, whether the investigation of suspicious matters is effective, and whether there are areas for improvement in compliance matters. Exporters shall regularly audit the reasonableness, feasibility and effectiveness of their internal compliance mechanism.

Emergency measures. Exporters shall encourage their employees to improve their risk awareness, set up internal reporting channels and investigation procedures for suspicious matters, and require their employees to, upon discovery of any suspicious order, customer or activity, promptly report to the internal compliance mechanism for export control so that the latter may carry out an investigation and make a final decision. Where the exporters find that they fail to apply for an export license for exported items, or that the end user or end use is changed or the end user or end use is inconsistent with the contract, they shall take emergency remedial measures and report to the governmental departments in a timely manner.

Step 7. Manage the end-use and re-export of products imported from China

End-use

End-use (how will the product ultimately be used) and end-user (who will ultimately use the product) management as foreseen by the Export Control Law is built on 4 pillars.

1. Exports operators, who must submit to the Chinese authorities documents that certify end users and end use of the controlled items [28] and report to the authorities when they become aware of any possible change of the end-users or end-use [29];
2. End-users of controlled items, who shall undertake not to alter the end use of the controlled items or assign them to any third party without the authorities' approval [30];
3. The national or local government agencies in the place where end-use or end-users are located, to issue the related documents certifying end users and end use of the controlled items [31];
4. The Chinese authorities, who have to establish a risk management system for end-users and end-uses of controlled items, evaluate and review end-users and end-uses of controlled items, and implement a strict management of end-users and end-uses [32].

The law does not provide the timing of when the end-users and end-uses certification must be provided, but is seems clear that this has to be made when asking for the export license.

European importers and end users need to ensure that the Controlled Items received from China under an export license will meet the end-use and end-use requirements and restrictions, as exposed to the Chinese business partners. Any re-exportation must only take place after this operation has received the authorizations foreseen by the Export Control Law.

The Export Control Law requires that any deviation from the original end users and/or end uses of exported Controlled Items be promptly reported to the authorities. Therefore, there should be a post-transaction monitoring system that reasonably traces the end-user and end-use status of exported Controlled Items. Any anomaly should be timely escalated for the company to make necessary disclosure to the authorities.

Re-export

The Export Control Law provides that the transit, transhipment and through shipment, and re-export of any Controlled Items, as well as the export of Controlled Items from special customs supervision areas such as bonded areas, export processing zones and other areas specially regulated by the customs, and from regulated bonded places such as regulated export warehouses and bonded logistics centres, shall all be governed by the Export Control Law.

There is no clear and precise definition of the wording of "re-exporter". Generally speaking, a re-export takes place when an imported product is then exported by the original importer to a

subsequent importer. As such, any person who re-exports controlled items is equally required to obtain a Chinese export license.

The "de minimis rule", which was proposed in previous review drafts, has not been included in the final text. It dealt with an export of uncontrolled products with certain proportion of controlled items. In previous versions, the definitions of re-export and re-exporters set out a detailed percentage threshold for controlled items.

This may imply that the re-export of foreign-made products containing China-made controlled contents is not subject to ECL regime. However, it could also mean that there is room left for future administrative regulations to set a threshold. Future administrative regulations may further clarify the scope of re-export and, in particular, the "de minimis standard". It is therefore important to be wary of the uncertainties and risks based on the above mentioned rule.

If, for example, a Chinese company A exports controlled items (e.g. dual-use products) to a Luxembourg company B, after which a U.S. company C imports the said controlled items from the Luxembourg, there are requirements for the Chinese company A (acting as the original exporter of the controlled items), and the Luxembourg company B (acting as the re-exporter of the controlled items) to comply with rules of the Export Control Law in particular in obtaining the license for exporting (and re-exporting) controlled items.

The first draft of the Export Control Law included a rule on re-exporting "a controlled item or a foreign product that contains a certain percentage of value of China's controlled items" from a country outside of China to a third country. The second draft has deleted this provision, but added the term "re-export" to the provision regulating other situations where export controls may apply, such as trans-shipments. This rule may be reintroduced in future regulations.

It also remains unclear whether the wording of "re-export" means "re-export from China of items exported to China" (as it is part of a list speaking of transhipment and through shipment) or "re-export from countries other than China of items previously exported from China".

Blacklist

An important part of the authorities' risk management system will be the restricted (or control) list of importers and end-users that violate the requirements regarding the management of end-users and end-uses, may endanger national security or national interests, or use controlled items for terrorist purposes [33].

This black-list is a required tool to be used by Chinese export operators. They are prohibited to enter into any transactions with any importer or end-user that is included in the restricted list. If there is however a true need to enter into the transaction, the export operator can submit an application to the Chinese authorities [34].

Listed importers and end-users may however lodge an application to the Chinese authorities for removing them from the restricted list. This may be the case if any of the circumstances at the origin of the listing (violation of the requirements regarding the end-users and end-uses management; endangering national security or interests; or using controlled items for terrorist purposes) are eliminated upon implementation of relevant measures. The de-listing is, however, a discretion only. Authorities are deciding based on the actual situation [35].

Vis-à-vis listed importers and end-users the Chinese authorities may take all necessary measures. These include prohibiting or restricting the deals relating to controlled items, ordering suspension of export of the controlled items, and withholding export licensing facilitation measures (like global licenses).

The exact relationship with the Unreliable Entity List, introduced by the Ministry of Commerce of the PRC on 19 September 2020, is still unclear. The reasons for being included in that first blacklist are not the same. While the relevant provisions also emphasize on endangering national sovereignty, security or development interests of China, the second criteria have a clear focus on anti-boycott. They mention discriminatory measures, which violate normal market transaction principles and cause serious damage to the legitimate rights and interests of Chinese entities, as reasons for being included in the Unreliable Entity List. Because of the reference of national interests in both lists, it is however not excluded that one entity could appear on all of those.

The system implemented by the 2020 Law also relies on the cooperation of export operators. These have to report to the authorities any change in the end-users of the initially demonstrated end-use of the controlled items at stake.

Step 8 – Be aware of deemed exports.

Chinese Export Control Law has introduced the concept of “deemed export”. It widely catches and regulates any citizen, legal person or unincorporated organisation of the PRC who provides controlled items to a foreign organisation or individual, thus catching all non-cross-border exporting activities, no matter what form they take and where the importer is located.

Please note that the new law does not clearly define what constitutes the “provision” of controlled items.

A deemed export may therefore be the employment in China of foreign employees to perform work related to controlled technology.

If, for example, an Employee A (Chinese nationality) and employee B (German nationality) both work in companies located in China, Employee A may be deemed as an exporter under ECL if he or she transfers a controlled item (e.g. restricted technology) to employee B in the course of business (e.g. via electronic form). This is true regardless of the actual place where the importer (employee B) is located and the form of such transfer. In this case, employee A will be required to obtain a license for exporting such technology to Employee B.

This poses the question also of cross-border technology transfer. For R&D involving foreigners in China, the corresponding export license may be a pre-condition for the relevant foreigners to obtain a work permit in China.

There are currently no general license, license exceptions or exemption mechanisms for technology export regulation, so as to facilitate frequent and routine cross-border technology exchanges, for example for basic research.

A deemed export may as well be publishing and distributing information on controlled technology at trade shows.

With the promulgation of Export Control Law, even the sale of a company or business (for example a Chinese company's subsidiary in a EU country) associated with controlled items to a foreign purchaser, regardless whether the sale takes place domestically or in a foreign country, could be caught by "export" under the Export Control Law, and therefore triggers the seller/exporter's obligation to obtain an export license before proceeding with the sale.

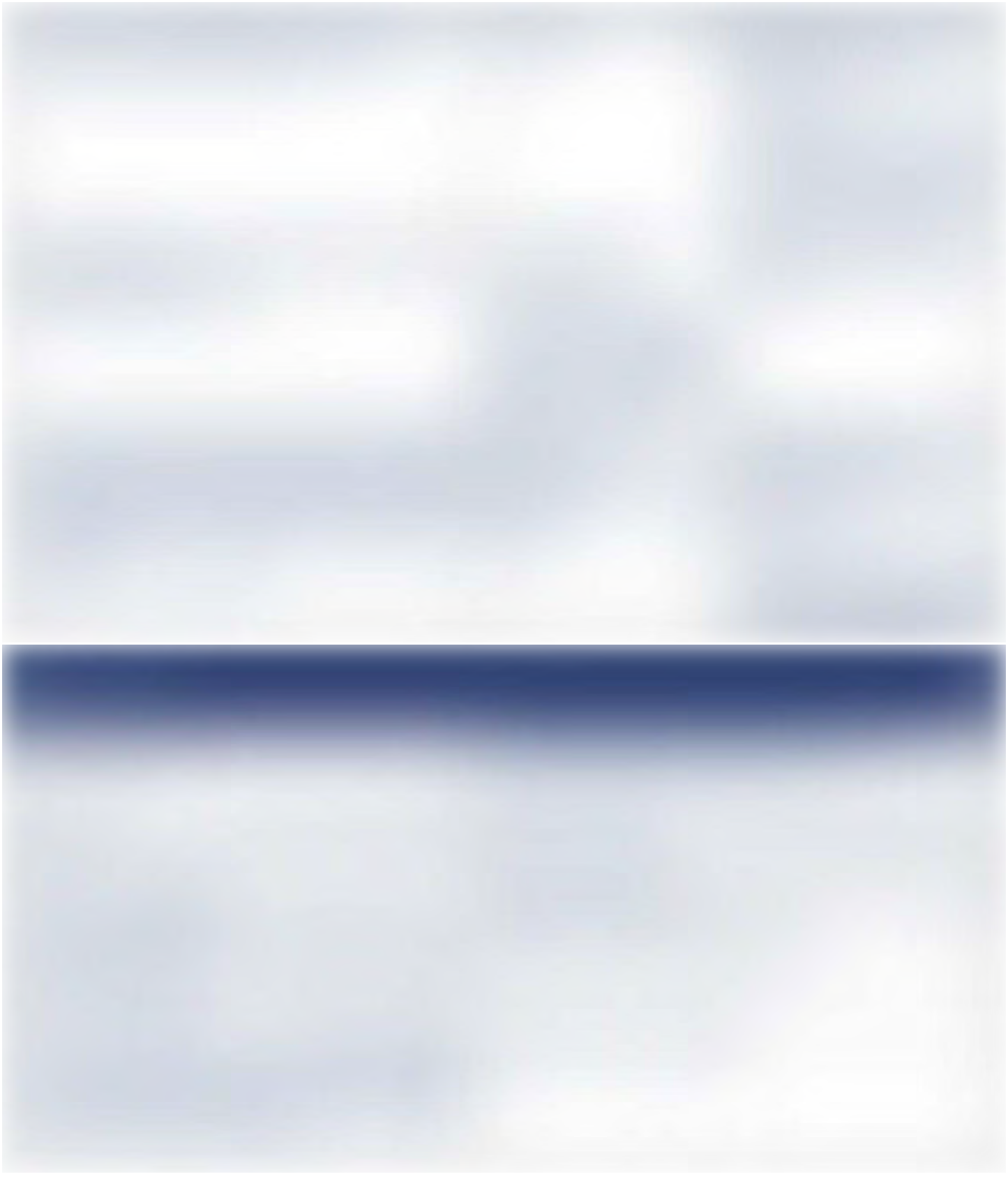
Step 9. Take into consideration China's national security

Foreign or overseas companies need to be cautious about the issue of national security of China. Overseas companies need to watch out for the touchy or sensitive political issues relevant to China's power to govern, sovereignty, unity and territorial integrity, the welfare of people, sustainable economic and social development [36].

A negative public comment or publication or label on the product may trigger such sensitive issues and may be deemed as detrimental to China's national security, with a consequence of entry into the blacklist, and/or even administrative or criminal penalties.

Step 10. Avoid penalties

The Export Control Law adopts a more stringent penalty system compared with the previous administrative regulations. It subjects any person or entity violating the Export ControlLaw to administrative penalties and criminal penalties, including but not limited to warning, confiscation of products, fines, cancellation of an export license and imprisonment.



Summary:

Notes:
[1] “Notes on the “Export Control Law of the People’s Republic of China (Draft)”, at the 15th meeting of the Standing Committee of the 13th National People’s Congress on December 23, 2019, by Minister of Commerce Zhong Shan
[2] http://zanggercommittee.org/
[3] https://nuclearsuppliersgroup.org/en/
[4] https://mtcr.info/
[5] https://www.wassenaar.org/
[6] https://www.dfat.gov.au/publications/minisite/theaustraliagroupnet/site/en/index.html
[7] Export Control Law, article 36
[8] Export Control Law, article 44
[9] National Security Law of the People’s Republic of China, Article 2, downloaded under the link https://www.chinalawtranslate.com/en/2015nsl/
[10] Export Control Law, article 48
[11]http://english.mofcom.gov.cn/article/policyrelease/questions/202101/20210103029708.shtml
[12] Export Control Law, article 2
[13] Export Control Law, article 9
[14] https://www.opcw.org/chemical-weapons-convention
[15] Export Control Law, article 12
[16] Export Control Law, article 13
[17] More information on the SCS under https://www.europeanchamber.com.cn/en/publications-corporate-social-credit-system
[18] Export Control Law, article 14
[19] available in Chinese language under http://images.mofcom.gov.cn/aqygzj/202104/20210428182950304.pdf
[20] Council Regulation (EC) No 2271/96 of 22 November 1996 protecting against the effects of the extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom, consolidated version under http://data.europa.eu/eli/reg/1996/2271/2018-08-07
[21] MOFCOM Order No 4 of 2020 on provisions on the Unreliable Entity List, http://english.mofcom.gov.cn/article/policyrelease/questions/202009/20200903002580.shtml
[22] See RespectUs series of 27 blog articles on Internal Compliance Programs under

https://www.respectus.space/blog/categories/icp-series
[23] Export Control Law, article 14
[24] available in Chinese language under
http://www.mofcom.gov.cn/article/b/c/202104/20210403056267.shtml
[25] available in Chinese language under
http://images.mofcom.gov.cn/aqygzj/202104/20210428182950304.pdf
[26] Commission Recommendation (EU) 2019/1318 of 30 July 2019 on internal compliance programmes for dual-use trade controls under Council Regulation (EC) No 428/2009, OJ L 205 of 5 August 2019, p. 15, available under https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019H1318&rid=8
[27] Internal Compliance Program (ICP), Guidelines for Luxembourg exporters, Ministry of Economy, Feb 2020, available under https://guichet.public.lu/dam-assets/catalogue-pdf/oceit/programme-interne-conformite/oceit-icp-brochure-en.pdf
[28] Export Control Law, article 15
[29] Export Control Law, article 16
[30] Export Control Law, article 16
[31] Export Control Law, article 15
[32] Export Control Law, article 17
[33] Export Control Law, article 18
[34] Export Control Law, article 18, par. 3
[35] Export Control Law, article 18, par. 4
[36] National Security Law of the People's Republic of China, passed on 1 July 2015 at the 15th meeting of the Standing Committee of the 12th National People's Congress, article 2