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Introduction to the TianTong Law Firm – Cleary Gottlieb China Initiative

This is the fourth client briefing in a series prepared by leading Chinese law firm TianTong Law Firm and international law firm Cleary Gottlieb Steen & Hamilton LLP following developments relevant to Chinese companies doing business in the United States and U.S. companies working in China. The initiative aims to comprehensively follow developments with perspectives from leading lawyers in the United States and China, providing timely and integrated advice to our respective clients. Cleary Gottlieb litigators based in New York and Washington, D.C. have partnered with TianTong lawyers based in Beijing in this joint initiative.

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U.S. Regulatory Challenges for Chinese Companies: The COSCO Case Study

Chinese companies and their affiliates may face significant consequences from the imposition of U.S. sanctions, even where no conduct within U.S. jurisdiction has occurred.

Following President Donald Trump's announcement on May 8, 2018 of U.S. withdrawal from the Joint Comprehensive Plan of Action (the "Iran Nuclear Deal"), the U.S. administration has announced a "maximum pressure" campaign centered around the strengthening of economic sanctions against Iran. As Iran's largest trading partner and the largest importer of Iranian crude oil in recent years, China—and Chinese companies—have increasingly become an area of focus by U.S. sanctions authorities. What types of activities—whether within or outside U.S. jurisdiction—might subject Chinese companies to the risk of being prosecuted or sanctioned under the United States' Iran sanctions program? What are the consequences of being sanctioned? We explore these issues in the case study below about the U.S. sanctions imposed against two subsidiaries of China's largest shipping company.

Background

In January 2016, China's two largest, state-owned shipping companies—China Ocean Shipping (Group) Company and China Shipping (Group) Company—merged to form China COSCO Shipping Corporation Limited ("COSCO Shipping"), one of the largest shipping companies in the world. By 2018, COSCO Shipping had more than 1,000 ships, 12% of the container shipping market, and $40 billion in annual revenue.

On May 8, 2018, the United States withdrew from the Iran Nuclear Deal, reviving a number of U.S. sanctions against Iran that had been waived under the agreement. Among other activities, the restored sanctions applied to the purchase or transportation of oil from Iran after November 4, 2018, though the United States initially granted six-month waivers from the restored sanctions to China—the world's largest importer of Iranian oil—as well as to India, South Korea, Japan, Italy,

Greece, Taiwan, and Turkey. On April 22, 2019, while the United States and China were engaged in trade negotiations, the United States announced that it would not renew any of the Iran sanctions waivers, allowing them to expire on May 1, 2019. China continued to import oil from Iran.

Relevant Legal Issues

U.S. sanctions against Iran consist of an expansive web of overlapping executive orders, statutes, and regulations administered primarily by the U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") and the U.S. Department of State. At a high level, the United States administers two types of sanctions against Iran—so-called "primary" and "secondary" sanctions.

Primary Sanctions. Under U.S. primary sanctions, U.S. persons and non-U.S. persons acting within U.S. jurisdiction are effectively prohibited from dealing with persons located, organized, or resident in Iran, among other restrictions.[1] U.S. authorities view jurisdiction expansively. Non-U.S. companies are subject to U.S. jurisdiction to the extent that they act within the United States, which includes acting through U.S.-incorporated entities, or engaging in transactions involving U.S. goods, persons or entities. In particular, recent U.S. enforcement actions against Chinese companies have asserted jurisdiction based on the companies' export or re-export of U.S.-origin goods, technology, or components, as well as payments made in U.S. dollars (including FX transactions involving U.S. dollars), as almost all such transactions are routed through "correspondent" bank accounts in the United States and "cleared" through the U.S. financial system.

Iran and North Korea have been areas of enforcement focus by U.S. authorities in recent years, particularly with respect to Chinese companies. Companies that violate U.S. sanctions laws may face substantial civil and criminal fines, and their individual employees may face fines as well as imprisonment. Notably, in addition to bringing civil and criminal actions against foreign companies and their employees, the United States can also bring civil "forfeiture" actions against foreign property that is alleged to be related or traceable to certain violations of U.S. law. When enforcing judgments against such foreign property, the United States may pursue funds in U.S. correspondent banks that facilitate dollar clearing for the foreign bank holding the contested assets. That foreign bank may then seek to debit the amount from the account holder alleged to have violated U.S. law.

Secondary Sanctions. In addition to primary sanctions, the United States also maintains secondary sanctions aimed at deterring targeted dealings relating to Iran outside U.S. jurisdiction. Secondary sanctions do not technically involve a violation of U.S. law; they are a political threat that foreign persons dealing with Iran outside U.S. jurisdiction may face consequences, including themselves becoming targets of primary sanctions or, for foreign financial institutions, losing the ability to maintain and use correspondent accounts in the United States, which are required to conduct transactions in U.S. dollars.

[1] As used here, "persons" includes both individuals and entities. "U.S. person" is a defined term that includes all U.S. citizens, permanent residents ("green card" holders), and legal entities, wherever located, and non-U.S. persons when they are located in the United States. Restrictions on Iranian-origin services include services performed outside Iran by a citizen, national or permanent resident of Iran who is ordinarily resident in Iran, or an entity organized under the laws of Iran or any jurisdiction within Iran, with certain enumerated exceptions.

Among the most severe consequences for a company is being added to OFAC's Specially Designated Nationals and Blocked Persons List (the "SDN List"). As a result of being added to the list, or "designated," any property of the designated company that comes within the United States or control of a U.S. person is blocked. Moreover, all persons within U.S. jurisdiction—including all U.S. banks—are prohibited from dealing with the designated company. The consequences of the designation may also flow down to a company's subsidiaries—any entity that is 50% or more owned by one or more sanctioned persons, whether directly or indirectly, is automatically also sanctioned, regardless of whether that entity appears on the SDN List.

Remedies & Responses. Persons who seek to engage in a transaction that would otherwise be prohibited—including dealing with a sanctioned person within U.S. jurisdiction—can apply for a "specific license" from OFAC. After reviewing and evaluating an application on a case-by-case basis, OFAC may issue a specific license permitting the applicant to engage in the otherwise prohibited transaction. Although there is no required format for specific license applications, OFAC will generally take into account the relevant facts and parties, as well as whether the requested transaction is consistent with the sanctions policy or national interest of the United States. In addition to specific licenses, OFAC may from time to time publish licenses of general application, or "general licenses," permitting particular types of transactions that otherwise would be prohibited, obviating the need for individuals to apply for a specific license.

Companies that become designated may seek to be removed from the SDN List and, indeed, OFAC maintains that it removes hundreds of individuals and entities from the SDN List every year. U.S. authorities frequently stress that the ultimate goal of U.S. sanctions "is not to punish, but to bring about a positive change in behavior." Designated persons or entities may submit a request for removal, detailing any evidence that there is insufficient basis for the designation, changes relating to the basis for the designation, positive changes in behavior, or proposed remedial steps.

The COSCO Sanctions

Following U.S. withdrawal from the Iran Nuclear Deal, secondary sanctions against Iran were re-imposed as of November 5, 2018, including, most notably for purposes of this case study, secondary sanctions for the purchase of Iranian oil.

On September 25, 2019, the U.S. Department of State announced that two COSCO companies—COSCO Shipping Tanker (Dalian) Seaman & Ship Management Co. Ltd., and the company that controlled it, COSCO Shipping Tanker (Dalian) Co., Ltd.—were being sanctioned and accordingly added to the SDN List.[2] Notably, the sanctioned COSCO entities were not alleged to have engaged in any actions within U.S. jurisdiction; the press statement announcing the designations did not suggest that the entities had imported Iranian oil to U.S. persons, transacted in U.S. dollars, or otherwise engaged in any sanctioned activity involving U.S. persons or services. Rather, the two COSCO entities were designated under secondary sanctions "for knowingly engaging in a significant transaction for the transport of oil from Iran."

Together, the two designated COSCO entities operated only about 40 of COSCO's more than 1,000 ships and, as discussed above, the sanctions applied only to the designated entities and their

[2] The United States also imposed sanctions against China Concord Petroleum Co., Kunlun Holding Co., Kunlun Shipping Co., Pegasus 88, and five individual executives.

direct or indirect subsidiaries through at least 50% ownership. U.S. and non-U.S. persons were thus prohibited from dealing with those entities within U.S. jurisdiction under primary sanctions. COSCO Shipping, however, was not sanctioned, and OFAC explicitly stated this. Nevertheless, there was confusion within the global shipping industry as to which particular ships were covered, and oil traders became wary of booking any COSCO tankers. As a consequence, oil shipping rates spiked dramatically, rising from about $25,000 per day in mid-September to more than $300,000 per day in mid-October.

Apparently to mitigate this confusion, OFAC issued a general license on October 24, 2019 that permitted "all transactions and activities . . . ordinarily incident and necessary to the maintenance or wind down of transactions involving, directly or indirectly, Cosco Shipping Tanker (Dalian) Co., Ltd., or any entity owned, directly or indirectly, 50 percent or more by Cosco Shipping Tanker (Dalian) Co., Ltd." On December 19, 2019, OFAC issued an additional general license permitting the same activity through February 4, 2020. Finally, after months of reported negotiations and cooperation with U.S. authorities, OFAC removed COSCO Shipping Tanker (Dalian) Co., Ltd. from the SDN List on January 31, 2020. The other designated COSCO entity, COSCO Shipping Tanker (Dalian) Seaman & Ship Management Co. Ltd., remains on the SDN List today.

Key Takeaways

The combination of the U.S. government's increasing reliance on economic sanctions as a foreign policy tool and recent strains in the China-U.S. relationship mean that Chinese companies should stay abreast of the reach and consequences of U.S. sanctions. A certain amount of sanctions risk may be outside the control of companies operating in certain sectors or regions, but there are ways to mitigate the risk of U.S sanctions.

- **China and Iran.** As China is Iran's largest trading partner, Chinese companies face a particularly high risk of being targeted by secondary sanctions. Although U.S. authorities are afforded wide discretion in the imposition of secondary sanctions and may consider a number of factors, dealings resulting in significant revenue for the Government of Iran and dealings involving high-profile Chinese companies or companies with ties to the Chinese government may be especially likely to draw the attention of U.S. authorities.

- **Scope of U.S. sanctions.** As discussed above, U.S. authorities take a broad view of jurisdiction. Indirect acts within U.S. jurisdiction, including the participation of U.S. persons, use of U.S. services or goods (including U.S.-origin technology or components), or U.S. dollar payments can be enough to subject a company—or its customers and suppliers—to U.S. jurisdiction. Such acts could also subject certain assets held by a company in foreign banks to U.S. civil forfeiture actions. Companies should assess the jurisdictional footprint of their business activities and consider jurisdictional consequences when they engage with new business partners or create new funds or subsidiaries. Additionally, even when acting outside U.S. jurisdiction, companies should take note of the potential imposition of U.S. secondary sanctions for certain targeted activities.

- **Collateral impacts.** In addition to enforcement actions, violating sanctions laws could result in severe reputational consequences worldwide and cause other businesses to be unwilling to deal with a company. In particular, violations could impact a company's

banking relationships and financing activities, harming its ability to transact business. Sanctions provisions in financing agreements are often broader than the requirements under U.S. sanctions, and even immaterial violations of sanctions laws may result in default events or other consequences under certain agreements.

- **Sanctions compliance programs.** U.S. authorities in past enforcement cases have considered whether a company has implemented a sanctions compliance program or engaged with outside counsel for sanctions compliance as factors weighing in favor of reducing the level of penalties for sanctions violations. Conversely, a company's lack of a sanctions compliance program may be an aggravating factor under OFAC's Economic Sanctions Enforcement Guidelines. As U.S. sanctions continue to expand and evolve, sanctions counsel can help companies craft robust, risk-based compliance programs and provide insight on unwritten and up-to-date industry practice. Such compliance programs are particularly relevant to companies with significant exposure to U.S. persons, goods, or services or that process transactions in U.S. dollars.

- **Plan ahead.** The imposition of sanctions can cause immediate disruption without a clear resolution of uncertainties for weeks or longer. Sanctions can change rapidly, and conversely, unintended consequences can go unaddressed for weeks or months. Companies should consider sanctions risks to their supply chains and counterparties when preparing risk assessments and contingency plans.

    - **Due diligence on customers and suppliers.** OFAC has recommended that companies conduct due diligence, including through the use of questionnaires and certifications, to identify customers and suppliers who do business in or with Iran or persons subject to U.S. sanctions. Companies may consider imposing restrictions and/or heightened due diligence requirements on sales to customers or the use of certain products or services from suppliers considered to present a high sanctions risk.

    - **Due diligence for M&A.** Due diligence during mergers and acquisitions should be integrated with a company's compliance functions to support effective risk assessments. Appropriate due diligence entails identifying sanctions risks, escalating risks to senior levels, addressing risks before closing transactions, and incorporating identified risks into overall risk assessments (including through post-transaction testing and auditing).

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Chinese Responses to U.S. Economic Sanctions

Once impacted by sanctions measures, the remedies available to Chinese companies under U.S. law are limited, and if they face U.S. investigations or criminal charges related to economic sanctions, Chinese companies should deal with them carefully. As further discussed below, Chinese companies may consider taking appropriate "defensive measures" to deal with U.S. economic sanctions and related U.S. government actions.

The Chinese government, however, can take certain "offensive measures" in response to U.S. sanctions. For example, as described in detail below, it can enact the "Unreliable Entities List" and take action against the listed companies. However, before issuing detailed implementation rules of such a list, the Chinese government must carefully consider implementing the list in the Chinese legal system, the power of its law enforcement authorities, and the remedies available to the listed entities under Chinese law to ensure that the "Unreliable Entities List" is based on China's "Rule of Law" system and is not perceived as a diplomatic retaliatory measure against other countries.

"Defensive Measures" of Chinese Companies

Chinese companies can take several "defensive measures" to protect against U.S. economic sanctions. First, before conducting business transactions with companies from sensitive jurisdictions, Chinese companies should engage American lawyers to be advised about the potential risks of U.S. economic sanctions. For example, one Chinese company and a foreign company signed a "Large Equipment Supply Contract" for a petrochemical project in a Middle Eastern country. However, as the general contractor of the project, the foreign company encountered U.S. economic sanctions pressure and was unable to fulfill its obligations under the Contract in time. Under these circumstances, the foreign company proposed that, if the Chinese company could find another Chinese company to take over the project as the general contractor, it promised to help the new Chinese general contractor obtain payment from the Middle Eastern owner. Fortunately, this was a feasible and cost-effective dispute resolution method for the parties, but such arrangements are not always possible. Chinese companies should therefore consult with American lawyers specialized in trade regulatory practice in advance of entering business arrangements that may carry economic sanctions risks.

Second, under rare circumstances, Chinese companies may apply for sanctions exemptions (known as "specific" and "general" licenses) from the U.S. government. As illustrated in this case study, COSCO Shipping Tanker (Dalian) Co., Ltd. was successfully removed from the SDN List after negotiating with the U.S. government. This indicates that the U.S. economic sanctions system provides certain remedies and recourse mechanisms for companies impacted by U.S. economic sanctions. However, it is possible that COSCO Shipping Tanker (Dalian) Co., Ltd. succeeded in obtaining a sanctions exemption because of its parent company's strength and leading position in the global shipping industry. The economic sanctions against COSCO Shipping Tanker (Dalian) Co., Ltd. resulted in huge impacts on international shipping prices and affected the interests of many countries, which may have led the U.S. government to reconsider its decision to impose the

sanctions. In practice, most Chinese companies should not expect to successfully negotiate an exemption from U.S. sanctions after they are implemented.

Third, Chinese companies should also consider the possibility of investigations and criminal charges by the U.S. Department of Justice for alleged violations of U.S. sanctions laws or related anti-money laundering laws. Both Chinese companies as well as their executives may face civil or criminal legal risks from such investigations and charges. When responding to U.S. government investigations or criminal proceedings, Chinese companies need to engage American lawyers. However, many Chinese companies prefer to hire a Chinese legal team to act as "lead counsel" of the project and ask this Chinese legal team to engage a reliable U.S. legal team on behalf of its Chinese clients. The Chinese and U.S. legal teams then work together to develop an appropriate strategy for responding to the U.S. investigations or criminal charges. In developing this strategy, the Chinese and U.S. lawyers must consider several issues, including (1) the professional ethics rules facing American lawyers (e.g., whether they may be required to disclose certain information to the U.S. government); (2) how and to what extent American lawyers should access the Chinese company's information (e.g., whether project documents should be sent abroad); and (3) the cooperation model between the Chinese and U.S. legal teams (e.g., Chinese lawyers may be responsible for fact-finding, and American lawyers may be responsible for communicating with the U.S. judicial authorities and interpreting U.S. law). "American-style" investigation and evidence collection methods can be ineffective at obtaining productive cooperation from Chinese companies, and therefore cooperation between American and Chinese lawyers is essential. For example, when American lawyers send questions to Chinese companies and express their willingness to fly to China to interview the Chinese companies' executives, Chinese lawyers often propose a more pragmatic "fact finding - evidence collection" working approach. As such, the Chinese legal team must not only address the interests and concerns of its Chinese clients, but also help the American legal team complete its evidence collection work, which may require careful coordination by the Chinese lawyers.

"Offensive Measures" of the Chinese Government

As Chinese companies face a relatively passive and defensive situation when facing U.S. economic sanctions, the Chinese government has been called on to take affirmative "offensive measures" (i.e. "countering measures") such as publishing the "Unreliable Entity List." On May 31, 2019, the Ministry of Commerce of the People's Republic of China announced that China will establish a "Unreliable Entities List" in accordance with the "Foreign Trade Law of the People's Republic of China," the "Anti-monopoly Law of the People's Republic of China," the "National Security Law of the People's Republic of China," and other relevant laws and regulations. If published, this "Unreliable Entities List" would identify foreign corporations, organizations, and individuals that (1) impose blockades, stoppages of supplies, or other discriminatory measures on Chinese entities for non-commercial purposes; (2) cause substantial damages to Chinese companies or related industries; and (3) trigger a threat or potential threat to China's national security. The Chinese government would then take necessary measures against the entities on the list. Since May 31, 2019, the spokesperson for the Ministry of Commerce of China has repeatedly expressed that China is processing the relevant procedures for the establishment of the "Unreliable Entity List."

The following table shows the "Unreliable Entity List" plan proposed by the Chinese government:

Chinese "Unreliable Entity List"	
Governing Authority	The Ministry of Commerce of the People's Republic of China
Triggering Criteria	The Chinese government would mainly consider the following four elements: (1) whether the entities have imposed blockades, stoppages of supplies, or other discriminatory measures on Chinese entities; (2) whether such conduct is motivated by non-commercial purposes, which violate the market rules and spirit of contract; (3) whether such conduct cause substantial damages to Chinese companies or related industries; and (4) whether such conduct triggers a threat or potential threat to China's national security. Entities that satisfy the above conditions would be named in the "Unreliable Entity List."
Legal Consequence	There are currently no specific regulations. However, the spokesperson for the Ministry of Commerce stated that the Chinese government would take necessary legal and administrative measures against those entities on the list. In addition, being included on the "Unreliable Entity List" itself can be perceived as a warning, which is equivalent to informing Chinese and foreign companies that the such entities lack the ability to guarantee the stability of supply chains.
Adjustment Procedure	There are currently no specific regulations. However, the spokesperson for the Ministry of Commerce stated that there would be an investigation procedure before including companies on the "Unreliable Entities List" and such entities would have a right to defend themselves. The Chinese government would also make corresponding changes to the list to add or remove entities according to the relevant standards.

In light of the plan outlined above, Chinese and foreign companies should note the following key "takeaway" points regarding the "Unreliable Entities List":

1) The list is a counter-measure taken by the Chinese government to safeguard international trading principles and the multilateral trading system, to oppose unilateralism and trade protectionism, and to safeguard China's national security, public interests, and the legitimate rights of Chinese companies.

2) As for the legal consequences, while protecting the legitimate rights and interests of foreign investment companies and improving the foreign investment environment in China, the Chinese government would adopt certain measures against entities that are regarded as unreliable. The possible measures may include the establishment of licensing requirements, listing entities as "negative credit companies" according to the China social credit reference system, and imposing restrictions on the listed entities' affiliated companies. Listed entities may also face legal liability for any unlawful conduct.

3) As to remedies, the Chinese government will conduct necessary factual investigations, give the listed entities the ability to defend themselves, and make periodic adjustments to the list. Even after being listed as an unreliable entity, the entity may be entitled to submit an application to be removed from the list. In order to learn the specific control measures and remedies, it is necessary for companies to pay close attention to the follow-up measures and policies of the Ministry of Commerce and relevant authorities in China.

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This client briefing is the result of a collaboration between TianTong Law Firm (http://www.tiantonglaw.com) and Cleary Gottlieb Steen & Hamilton LLP (www.clearygottlieb.com) to monitor and address legal developments that may be of interest to our clients in China, the United States, and around the world.

TianTong Law Firm is a leading Chinese law firm solely dedicated in complex civil and commercial dispute resolution. The firm has consistently been recognized by Chambers and Partners and Asian Legal Business as a leading firm in dispute resolution. Headquartered in Beijing, TianTong has established six branches across the country. In the past decade, TianTong has been keeping one of the highest winning rates among all Chinese firms before the Supreme People's Court. TianTong advises on all types of commercial disputes, e.g., litigation, arbitration, contentious bankruptcy and enforcement proceedings with its most impressive achievements in banking and finance, construction and engineering, corporate and M&A disputes. In addition, TianTong has extensive experience in representing clients in domestic and international arbitration cases, and is specialized in advising clients on recognition and enforcement of foreign arbitral awards in China.

Cleary Gottlieb is a leading international law firm with 16 offices in the U.S., Latin America, Europe, and Asia. The firm is consistently ranked as one of the leading international firms for government investigations, white collar criminal defense, litigation, and a variety of related fields. The team includes nine former federal prosecutors, including two recent Acting U.S. Attorneys for the Southern District of New York; several former senior officials of the U.S. Securities and Exchange Commission, including its most recent Chief Litigation Counsel of the Enforcement Division; and several former senior officials from the Federal Trade Commission and the Department of Justice's Antitrust Division, including its most recent Deputy Assistant Attorney

General for Litigation and Assistant Chief of the International Section. Cleary Gottlieb is routinely instructed with respect to many of the highest-profile cross-border matters in the financial services, technology, anti-corruption, antitrust and competition, and related fields.

For more information, please contact:

TianTong Law Firm
Yard 3 Nanwanzi, Nanheyan Avenue
Dongcheng District, Beijing
100006, PRC
+86 10 51669666
ttchinainitiative.list@tiantonglaw.com

CLEARY GOTTLIEB STEEN & HAMILTON LLP
One Liberty Plaza
New York, New York 10006
+1.212.225.2000

2112 Pennsylvania Avenue NW
Washington, D.C. 20037
+1.202.974.1500
cgshchinainitiative@cgsh.com