China’s new export control regime is on its way

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China’s export control regime consists of scattered pieces of legislation, some of which were last updated nearly a decade ago. In June 2017, China’s Ministry of Commerce released a draft Export Control Law for public consultation. Its contents follow from current legislation and enforcement practice, while also introducing major changes to the existing regime. If enacted, it will be the first comprehensive export control law in China. We recommend that companies active in China closely follow the relevant legislative and enforcement developments to understand how the new regime might affect their operations, both in China and elsewhere.

With developments in science and technology, China has been playing an increasingly important role in international trade as a major exporter of high-tech products. In this respect, China has recognised a growing need to update the current export control legislation and strengthen enforcement practice. In June 2017, China’s Ministry of Commerce (MOFCOM) released a draft Export Control Law (Draft ECL) for public consultation.

The current regime

The current legislation regulating China’s export control consists of a patchwork of laws (for example, China’s Foreign Trade Law, Customs Law and Criminal Law), administrative rules and regulations (for example, regulations on the export of certain controlled items), and international treaties. Controlled items covered by current legislation mainly include dual-use, military, and nuclear items. These include not only tangible goods such as equipment and materials, but also intangible goods such as technology and services. Export relates to not only transactions in the business context, but also export outside China for other purposes, such as technology assistance and cooperation in the R&D context.

Hong Kong, Taiwan and Macau are considered extraterritorial jurisdictions under China’s export control regime. The transfer of goods from mainland China to these locations is considered an export, and therefore must comply with China’s export control legislation.

MOFCOM, under the supervision of the State Council and the Central Military Commission, administers the export control regime in China. MOFCOM’s subordinate division, the Bureau of Industry, Security and Import and Export Control, is responsible for reviewing and granting export licences, generating and amending lists of controlled items, and conducting investigations and enforcing the law. Often, a Chinese exporter is subject to the joint supervision of MOFCOM and other regulators, depending on the specific item to be exported and the category and industry to which it belongs. The customs authority checks all required filings and approvals before the controlled goods or service can leave mainland China.

The export of military items is exclusive to state-authorised trading companies, while dual-use items may be exported by any (qualified) business operators. To export dual-use items, business operators are required to obtain administrative approvals. The filing procedure to get these approvals is generally lengthy, and the requirements are substantive, including properly screening foreign buyers, monitoring end-use compliance, and promptly notifying authorities of any end-use change or irregularity.

Major changes introduced by the Draft Export Control Law

The Draft ECL contains elements of the current legislation and practice in China’s export control regime, and also introduces some changes. The major changes are set out below.

<u>Expanding the definition of export</u>: the Draft ECL clarifies the definition of export to include transfers to places outside mainland China, as well as transfers from Chinese parties to non-Chinese parties within mainland China. This includes, for example, transfers to Hong Kong citizens and foreign individuals and companies (known as deemed transfers). In addition, as one of the most important changes introduced by the Draft ECL, similar to the US regime, China’s export control regime is likely to expand the extra-territorial scope by recognising a form of “re-export”. According to the Draft ECL, a foreign-manufactured item that contains China-origin controlled content exceeding a certain threshold – irrespective of export origination and destination – will be subject to the export control restrictions. The threshold is not specified in the current draft.

<u>Redesigning the controlled items list</u>: the various controlled items lists attached to the scattered pieces of current legislation will likely be merged into two lists as appendices to the new export control law; that is, the dual-use items list and the military items list. The Draft ECL does not set out the specific items in these lists. Besides the change of form, it is unclear whether and to what extent the new lists of controlled items will differ from – and likely more extensive than – the current ones. The Draft ECL does not cover the export of nuclear items, which will be regulated separately.

<u>Strengthening investigation and enforcement powers</u>: an important rationale of proposing the Draft ECL is to further empower Chinese authorities. The Draft ECL grants the relevant Chinese authorities (for example, MOFCOM and its local bureaus) new investigative powers to enforce the export controls, including but not limited to the right to enter and check an operator’s business premises, seal and seize relevant items, and freeze bank accounts.

<u>Allowing flexibility for additional export control</u>: in an emergency situation, as a measure to protect national security and state interests, Chinese authorities may impose temporary restrictions on specific items that are not on any of the controlled items lists. This is similar to the catch-all provision in the EU regime, where the competent authority may designate dual-use items that are not in any official controlled items list for ad hoc controls. According to the Draft ECL, the temporary restrictions will usually last no longer than two years and will be subject to the approval of the State Council or the Central Military Commission.

<u>Raising administrative penalties</u>: the Draft ECL explicitly prohibits

any violation or circumvention of export controls. The Draft ECL introduces harsher fines than before, with non-compliant exporters being exposed to fines of up to ten times the illegal turnover. Any illegal gains will be confiscated. In addition, individuals involved may be charged with individual liabilities; for example, a fine up to RMB 300,000 (approximately EUR 38,000). Besides the possible fines, the non-compliant entity will likely receive a negative record in the company register system, which is maintained by Chinese regulators. This record is open and accessible to the public for an unspecified period, as outlined in the Draft ECL. This may cause reputational damage to the non-compliant business operators and impede the administrative procedures for export of controlled items in the future.

Final remarks

The Draft ECL, in line with current legislation, reiterates that business operators are encouraged to establish internal policies and procedures to ensure compliant business practice. In this respect, the Draft ECL will not drastically change the existing export control regime, but it delivers a clear message that business operators must continue to ensure compliance and, in particular, be aware of the regulatory risks related to any non-compliant export of controlled items.

There is no specific timeline indicating when the new export control law will be final and promulgated. We will track legislative developments and report on any progress.