

US Responds to Developments in Hong Kong With Sanctions, US Export Control Amendments

07 / 16 / 20

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In the wake of China's new national security law for Hong Kong that went into effect on June 30, 2020, the Trump administration has taken several steps to significantly pare back Hong Kong's preferential status under U.S. trade law and policy, and to target persons determined to "threaten the peace, security, stability, or autonomy of Hong Kong," among other activities. These developments followed President Donald Trump's [May 29, 2020, announcement](#) that his administration would begin the process of revoking the special treatment afforded to Hong Kong by the United States in response to China's "pattern of misconduct." The president announced at the same time that the U.S. government would potentially sanction Chinese persons and governmental officials determined to be "eroding Hong Kong's autonomy" under the "one country, two systems" framework memorialized in the Sino-British Joint Declaration of 1984 and Hong Kong Basic Law.

In late June and early July 2020, the U.S. Department of Commerce's Bureau of Industry and Security (BIS) implemented several changes to long-standing policies to bring Hong Kong on par with mainland China with respect to U.S. export controls, including the suspension of several notable license exceptions. While the goal of these changes, as indicated by Commerce Secretary Wilbur Ross, is in large part to avoid the potential diversion of sensitive U.S. technology from Hong Kong to the Chinese People's Liberation Army or Ministry of State Security, their practical effect is the imposition of new administrative burdens on exports, re-exports and transfers (in-country) to Hong Kong.

Additionally, on July 14, 2020, President Trump signed into law the Hong Kong Autonomy Act (HKAA), which passed in the House of Representatives and the Senate with broad bipartisan support. The HKAA creates a framework for imposing sanctions on foreign persons that materially contribute to or facilitate China's failure to meet its obligations under the Sino-British Joint Declaration and Hong Kong Basic Law. In signing the HKAA, the president [issued a statement](#) registering his disagreement with provisions of the HKAA that "could limit [his] discretion under Article II of the Constitution to conduct the Nation's foreign affairs," and that the administration would treat such provisions as merely "advisory and non-binding." President Trump also simultaneously issued an executive order declaring a national emergency with respect to the threat posed by China's efforts to undermine Hong Kong's autonomy, formally suspending or eliminating any differential treatment of Hong Kong under U.S. law, and authorizing sanctions on persons determined to be engaged in a broad array of anti-democratic or repressive activity.

As discussed further below, the HKAA contemplates that any sanctions imposed under the HKAA will generally be preceded by publicly available reports that signal the persons that will be subject to the sanctions, as well as the underlying rationale. Nevertheless, the president has several alternative authorities at his disposal through which he could also target the type of conduct described in his May 29 announcement, such as the Global Magnitsky Human Rights Accountability Act, the Hong Kong Human Rights and Democracy Act, and the executive order. We can therefore not discount the possibility of the United States imposing sanctions or otherwise taking action relating to Hong Kong sooner than envisioned by the HKAA, and potentially without forewarning.

Finally, it is important to note that these developments are part of a broader effort by the U.S. government to increase economic and geopolitical pressure on China. Tensions between the U.S. and China reached new levels last week when the Trump administration imposed sanctions on senior Chinese officials over human rights abuses against the largely Muslim Uighur minority — with China responding this week by imposing

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sanctions on certain U.S. officials, including Sens. Marco Rubio and Ted Cruz. As sanctions continue to ratchet up pressure on both countries, a resolution in the near term seems increasingly out of reach.

The Hong Kong Autonomy Act

Reports on Foreign Persons Involved in the Erosion of Hong Kong's Autonomy

The HKAA requires no later than 90 days after enactment that the secretary of state, in consultation with the secretary of the treasury, submit to Congress a report that identifies any foreign person (individual or entity) that is “materially contributing, has materially contributed to, or attempts to materially contribute to the failure of the Government of China to meet its obligations” under the Sino-British Joint Declaration or Hong Kong Basic Law (the Foreign Person Report). For purposes of the HKAA, a foreign person materially contributes to such conduct if the foreign person took action that “resulted in the inability of the people of Hong Kong (A) to enjoy freedom of assembly, speech, press, or independent rule of law; or (B) to participate in democratic outcomes” or “otherwise took action that reduces the high degree of autonomy of Hong Kong.”

Between 30 and 60 days after submitting the Foreign Person Report, the secretary of the treasury, in consultation with the secretary of state, must submit a separate report to Congress that identifies any foreign financial institution that knowingly conducts a “significant transaction” with a foreign person identified on the Foreign Person Report (the FFI Report, and, together with the Foreign Person Report, the Reports). The HKAA does not define what constitutes a “significant transaction” for purposes of the FFI Report. In certain other sanctions programs where the term is used in the context of so-called secondary sanctions, the U.S. Department of the Treasury’s Office of Foreign Assets Control (OFAC) has set out guidance regarding how it will assess whether a transaction is “significant.” OFAC generally identifies certain factors it will consider in its review of significance, including, among others, the size, number, frequency and nature of the transaction(s); whether the transaction(s) are part of a pattern of conduct; and the impact of the transaction(s) on statutory objectives. Nevertheless, OFAC reserves for itself broad discretion by indicating it will evaluate the totality of the facts and circumstances and by including a catch-all that allows for the inclusion of any factors that the secretary of the treasury deems relevant on a case-by-case basis.

The Reports must be delivered to Congress in unclassified form and made available to the public, and must include the rationale justifying the inclusion of each identified person or institution. However, the secretaries of the treasury and state may expand

on this rationale in a classified annex and may exclude information from the Reports for purposes of protecting intelligence interests or law enforcement activities. The HKAA also permits the president to exclude persons from the Reports under certain circumstances, provided the president notifies Congress of the reason for the removal.

Imposition of Sanctions

While the HKAA requires the president to impose sanctions on the foreign persons and foreign financial institutions identified in the Reports, it provides the president some discretion with respect to the timing of such sanctions. The president may impose blocking sanctions (*i.e.*, an asset freeze and transaction ban) and visa restrictions on the persons identified in the Foreign Person Report at any time within one year of delivery, but these sanctions become mandatory at the one-year mark. With respect to foreign financial institutions included in the FFI Report, the HKAA sets forth a menu of 10 sanctions ranging from prohibitions on the institution acting as a primary dealer of U.S. government debt instruments to full blocking sanctions.¹ The HKAA also permits the president to impose most of the sanctions on an institution’s principal executive officers.

The president has discretion to impose five or more of the sanctions at any point during the one-year period following delivery of the FFI Report, after which the requirement to impose at least five of the sanctions becomes mandatory. The HKAA requires the president to impose all of the remaining sanctions no later than two years after delivery of the FFI Report.

The HKAA requires the Reports to be updated in an “ongoing manner.”

Limitations on the President's Ability To Lift Sanctions Imposed Under the HKAA

Section 8 of the HKAA sets out a process for the president to waive or terminate the application of sanctions imposed on certain persons. However, similar to the framework established

¹ The 10 sanctions set forth in the HKAA are: (1) the prohibition on loans by U.S. financial institutions to the identified institution; (2) a bar on the identified institution from serving as a primary dealer in U.S. government debt instruments; (3) a bar on the identified institution from serving as an agent of the U.S. government or as a repository of U.S. government funds; (4) the prohibition of foreign exchange transactions involving the identified institution; (5) the prohibition of any transfers of credit or payments involving the identified institution; (6) the prohibition of all transactions involving the property of the identified institution; (7) restrictions on exports, re-exports and transfers (in-country) to the identified institution of commodities, software and technology subject to U.S. jurisdiction; (8) a ban on U.S.-person investment in the equity or debt of the identified institution; (9) the exclusion from the United States of the sanctioned institution’s non-U.S. officers, principals or shareholders, subject to certain exceptions; and (10) the imposition of any of the first eight sanctions on the identified institution’s principal executive officers.

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under the Countering America's Adversaries Through Sanctions Act,² the HKAA subjects to congressional review the president's decision to waive or terminate the application of sanctions imposed on persons and financial institutions targeted under the HKAA. Congress may issue a joint resolution disapproving of the president's actions under these waiver and termination provisions, which would prevent the waiver, termination or removal from taking effect.

Section 8 was at the heart of the statement President Trump issued concurrent with signing the HKAA into law. On the matter of waiver and termination, the statement asserted that limitations imposed by Section 8 would be treated by the Trump administration "as advisory and non-binding."

The Executive Order

As noted above, the executive order formally suspends or eliminates any preferential or differential treatment afforded to Hong Kong under U.S. law and policy, and it directs the heads of agencies to implement any changes necessary to give effect to the July 14, 2020, executive order within 15 days of its issuance.

Beyond this significant policy shift, and unlike the process contemplated in the HKAA, the executive order immediately authorizes the imposition of sanctions on any foreign person (individual or entity) that either the secretary of state or the secretary of the treasury determines is or has been involved, directly or indirectly, in the development, adoption, implementation or execution of China's new national security law for Hong Kong. The executive order similarly authorizes sanctions for any person, or for a leader or official of any entity, determined "to be responsible for or complicit in, or to have engaged in, directly or indirectly":

1. "actions or policies that undermine democratic processes or institutions in Hong Kong";
2. "actions or policies that threaten the peace, security, stability, or autonomy of Hong Kong";
3. "censorship or other activities with respect to Hong Kong that prohibit, limit, or penalize the exercise of freedom of expression or assembly by citizens of Hong Kong, or that limit access to free and independent print, online or broadcast media"; or
4. "the extrajudicial rendition, arbitrary detention, or torture of any person in Hong Kong or other gross violations of internationally recognized human rights or serious human rights abuse in Hong Kong."

In the final section of the executive order, the president reserves the right to revisit the determinations made and actions taken under the executive order, should any "changes in China's actions ensure that Hong Kong is sufficiently autonomous to justify differential treatment in relation to [mainland China] under United States law."

The executive order was not accompanied by any immediate designations, meaning no person has yet been blocked under it and added to OFAC's list of Specially Designated Nationals and Blocked Persons. It therefore remains to be seen how and when the secretaries of state and the treasury may decide to implement the relevant sanctions. Nonetheless, the sanctions regime established through the executive order is, on its own, likely to elicit a strong and potentially in-kind response from China.

Rollback of Hong Kong's Preferential Status Under US Export Controls

The U.S. Department of Commerce has in recent weeks implemented several changes to long-standing policies and regulations governing exports, re-exports and transfers of items subject to the Export Administration Regulations (EAR) to Hong Kong so as to treat such activities the same as for mainland China. These changes were reaffirmed in the executive order and mean not only the loss of Hong Kong's preferential status as compared to mainland China under the EAR but also the imposition of additional administrative requirements for export activities related to Hong Kong that were not previously required. The Commerce Department has indicated that "further actions to eliminate differential treatment are also being evaluated," and has urged Beijing to "reverse course" and fulfill the promises it has made.

On June 29, 2020, the secretary of commerce announced the suspension of all Commerce Department regulations that afford preferential treatment to Hong Kong under the EAR, including the availability of certain export license exceptions. Following the secretary's announcement, the BIS formally suspended all such license exceptions, effective June 30, 2020. These actions affected several notable provisions under the EAR, including the generally more favorable case-by-case licensing policy for export activities involving Hong Kong as opposed to mainland China and certain license exceptions previously available to Hong Kong under EAR Part 740 (though license exceptions that are available to mainland China remain available for Hong Kong). Exports to Hong Kong must now also comply with certain special requirements applicable to exports to mainland China, including the requirement that exports of over \$50,000 that require a license be

² See our [August 4, 2017](#), and [November 9, 2017](#), client alerts for a discussion of the Countering America's Adversaries Through Sanctions Act.

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accompanied by a “PRC End-User Statement” and the prohibition on exports, re-exports or transfers (in-country) of certain “military end-use” or “military end-user” items under EAR Part 744.

Shipments of items that were on dock for loading, on lighter, laden aboard an exporting or transferring carrier, or en route aboard a carrier to a port of export or re-export on June 30, 2020, subject to actual orders, may be processed pursuant to the pre-existing license exceptions. Deemed exports and re-exports to Hong Kong may similarly continue under these exceptions until August 28, 2020, after which time they will be subject to applicable licensing requirements.

In addition to the Commerce Department’s actions, the State Department announced that it will cease exports of U.S.-origin defense equipment to Hong Kong and take steps to impose on Hong Kong the same restrictions on exports of U.S. defense and dual-use technologies that are currently applicable to mainland China.

Going Forward

Global financial institutions and multinational companies with significant business or operations in Hong Kong should review their potential exposure as a result of the HKAA, the executive order and recent changes under U.S. export control laws, and assess whether these developments may warrant modifications to existing practices or closer monitoring of certain business relationships.

With the pace of developments in recent weeks and the escalation playing out between the United States and China, we do not believe the executive order and the HKAA signal the end of the road for legislative and executive branch action regarding Hong Kong. Rather, we believe there is significant risk of continued efforts by the United States to impose political and economic pressure on China — and the likelihood of future responses by China. As with most aspects of the U.S.-China relationship, given the stakes, it will be imperative for U.S. and non-U.S. companies active in Asia to keep a watchful eye on Hong Kong and any further political, economic and legal developments in the weeks and months ahead.

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