US-China Trade and Enforcement Issues: What's Next?

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As the United States changes administration, there is significant interest in how the country's relationship with China may evolve with respect to trade, national security and government enforcement. Although some modifications in tone and approach under the Biden administration are possible, fundamental changes in these areas appear unlikely.

CFIUS

One of the areas where tensions between China and the U.S. have had a noticeable impact is the work of the Committee on Foreign Investment in the United States (CFIUS) on China-related corporate transactions. This interagency committee, which reviews the national security implications of foreign investments in U.S. companies or operations, has increasingly subjected proposed China-related investments and transactions to heavy scrutiny. This is in response to rising concerns in Washington, D.C. that China may be using M&A and other investments to gain access to sensitive U.S. technology. CFIUS' focus on China began at the end of the Obama administration and intensified considerably under the Trump administration. This caused Chinese direct investment in the U.S. to fall by approximately 89% compared to 2016, according to the U.S.-China Investment Project. More broadly, two-way foreign direct investment flows between the U.S. and China were around $19 billion in 2019, significantly below 2016's record $60 billion.

How much will change in the scrutiny of China-related corporate transactions under the Biden administration remains to be seen. CFIUS may take a slightly more nuanced view of each proposed investment's potential threat to national security, with reduced focus on less sensitive sectors (*e.g.*, commodity products, services or basic manufacturing) that were largely scrutinized based on broader U.S.-China tensions rather than specific national security implications. However, heightened scrutiny will likely continue in areas that involve advanced technology, sensitive personal data and the public sector (*e.g.*, semiconductors, artificial intelligence or machine learning, pharmaceuticals and government contracts) because of the widespread and broadly bipartisan view that loss of the U.S.' comparative advantage would seriously undermine U.S. national security.

The Trump administration also issued a number of executive orders directed at China, including, most recently, "Addressing the Threat From Securities Investments That Finance Communist Chinese Military Companies." Effective January 11, 2021, the executive order prohibits U.S. persons from purchasing securities of certain "Communist Chinese military companies," including 31 companies previously identified by the U.S. Department of Defense. It remains to be seen whether this and other similar executive orders will remain in force under the Biden administration.

Export Controls, Sanctions and Tariffs on China

Over the first few years of the Trump administration, the U.S. put in place significant tariffs against Chinese imports, and China responded with retaliatory tariffs of its own. This cycle of tariffs halted only with the signing of the Phase One Trade Agreement between the U.S. and China in January 2020. Under the agreement, China committed to making structural changes in the areas of intellectual property protection and enforcement, technology transfer, agriculture, financial services and currency. China also committed to increasing its imports of goods and services from the U.S. by at least $200 billion in 2020 and 2021.

Some news reports have suggested that China may seek to renegotiate the Phase One Agreement with the Biden administration. It is unlikely, however, that the administration will agree to changes that weaken China's commitments. Although President Biden has been critical of the tariffs that the Trump administration put in place against China, his administration would likely only remove or reduce the tariffs in return for additional concessions from the Chinese government in areas that have long been a source of tensions, including, for example, the use of industrial subsidies, overcapacity in certain sectors like steel and aluminum, cyber intrusions, and the role of Chinese state-owned enterprises in the economy. The United States has been highly critical of China's policies and practices in these areas because of the unfair advantages they provide to Chinese companies and the adverse effects they have on U.S. companies. The Biden administration would likely seek commitments from China to eliminate and prohibit subsidies that harm U.S. companies, reduce production capacity in key industries, cease engaging in cyber intrusions in the commercial sphere, and ensure that state-owned enterprises act on the basis of commercial considerations and not receive any unfair advantages.

In the area of export controls and sanctions, the Biden administration may take more robust actions when it comes to human rights issues. In addition, the Biden administration may make even more extensive use of withhold release orders to ban imports of products alleged to have been made with forced labor.

DOJ Enforcement

We have previously analyzed the U.S. Department of Justice's (DOJ) China Initiative, launched in November 2018, that promised to dedicate additional government resources to investigating and prosecuting offenses such as trade secret theft and economic espionage involving China. In November 2020, the DOJ announced that it had charged three additional China-related economic espionage cases in the past year, bringing the total number to five since the initiative was first announced. In the past two years, the DOJ has charged more than 10 cases in which trade secret theft had some alleged nexus to China.

In addition, a number of academic and scientific researchers have been charged in the past two years with false statement, fraud, tax or other offenses relating to their nondisclosure or false statements concerning their relationships with the Chinese government. Many of these cases have related to the defendants' involvement with the Thousand Talents Plan, a program by which China, through grants and other inducements, recruits scientists and researchers to work on research projects backed by the Chinese government. (See our April 2, 2020, client alert, "DOJ's 'China Initiative' Uses Scheme-to-Defraud Charges for Nondisclosure of Ties to China.") More prosecutions are likely in the pipeline; according to FBI Director Christopher Wray, his agency opens a new China-related counterintelligence case every 10 hours.

Although the Biden administration may rebrand the China Initiative in response to criticisms that its country-centric focus encourages unfair scrutiny of Chinese or Chinese American individuals, a full-scale retrenchment seems unlikely in the face of the near consensus in the U.S. intelligence and law enforcement communities that the underlying national security threat from China is real. We also can expect the DOJ under the Biden administration to remain aggressive in using the legal tools at its disposal to obtain evidence from individuals and entities subject to U.S. jurisdiction in aid of its China-related investigations and prosecutions.

PCAOB Inspection and China Securities Law

The Biden administration will nominate a new chairperson to replace Jay Clayton, who stepped down as chairman of the Securities and Exchange Commission (SEC) at the end of 2020. Despite the change in leadership, in light of the continuing political and economic tensions between the U.S. and China, SEC scrutiny of U.S.-listed Chinese issuers will likely remain high.

In order for their securities to be listed on a U.S. securities exchange, registrants — whether located in the U.S. or abroad — must comply with registration and reporting provisions that include annually filing with the SEC financial statements audited by an independent auditor registered with the Public Company Accounting Oversight Board (PCAOB). China's state security laws, including those governing the protection of state secrets and national security, have been invoked in recent years to limit the ability of the PCAOB to oversee audit firms in mainland China and Hong Kong.

On December 18, 2020, President Trump signed into law a bill that allows the SEC to ban a foreign issuer's securities from trading on U.S. securities exchanges if the PCAOB is unable to inspect the issuer's accounting firm for three consecutive years. (See our December 3, 2020, client alert, "Holding Foreign Companies Accountable Act Poised To Be Signed Into Law.") The push for more transparency into U.S.-listed China-based issuers is likely to continue unbated during the Biden administration given the strong bipartisan support for such measures. (See "Hong Kong's Exchange Improves Its Allure for Chinese Issuers.")

Adding to the complexity of the securities environment overall is the more active role that the China Securities Regulatory Commission (CSRC) has begun to play in cross-border investigations in enforcing Article 177 of the Securities Law of the People's Republic of China. Effective March 1, 2020, the newly revised law provides that, without the prior approval of the relevant Chinese authority, no entity or individual in China may transmit outside China any documents or materials relating to securities business activities overseas, including to the SEC. An April 2020 statement by the SEC warned investors of the risks of investing in emerging markets and noted that "in China, there are significant legal and other obstacles to obtaining information needed for investigations or litigation." It remains to be seen how the SEC under the Biden administration will work with the CSRC to obtain the information and evidence it needs to investigate U.S.-listed China-based issuers.

With the Biden administration, we expect to see several changes with respect to national security measures, sanctions and export controls, as well as enforcement practices. However, these changes are unlikely to alter the current trajectory of the U.S.-China relationship, as the administration will face continued bipartisan pressure to take strong action when it comes to China.