



ACC SOUTHERN CALIFORNIA IN HOUSE COUNSEL CONFERENCE

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Caught in a Web: Companies and Investors Grapple with US China Tensions and ESG



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Agenda

- Introduction
- Update on the White House/Congress and China in 2024
- Anti-China Legislation & Congressional Investigations
- Avoiding Traps for Investors Dealing With China Today
- Looking Around Corners and Risk Mitigation
- Questions and Answers
- Conclusion

Update on the White House/Congress and China in 2024

■ Evan Chuck

U.S. – China – 2023 Highlight

■ November 15, 2023 – Summit – Biden and Xi

- Competition – De-risking vs. de-coupling; responsible management
- Military – Resumed high level military to military communication
- AI – Need to address advanced AI systems use, deployment, and safety
- Taiwan – U.S. commitment to freedom of navigation and overflight, adherence to international law, maintaining peace and stability in the South China Sea and East China Sea, and the complete denuclearization of Korean peninsula.
 - U.S. called for restraint in use of China military in Taiwan strait, criticized PRC's unfair trade policies, non-market economic practices, and punitive actions against U.S. firms.

Biden Administration in Context– 2024 – The Main Issues

**(1) Russia and
Ukraine War**

**(2) China and
East Asia (North
Korea and
Taiwan)**

**Presidential
Election**

**(3) Israel, Gaza
and the Wider
Middle East**

**(4) The
Technology
Race**

Biden and China – 2024 – Areas of Focus

(1) International Trade – Tariffs

- Biden Administration is debating the future of Trump-era tariffs on \$300b of Chinese goods.
- Currently is finalizing review of the existing tariffs – expected in coming weeks.
- Biden Administration considering raising tariffs on electric vehicles and critical minerals and lowering tariffs on certain Chinese consumer products not deemed strategically important.

(2) Domestic Manufacturing – Buy American

- As a result of a March 2022 Biden Administration rule, starting October 25, 2022, federal agencies were required to increase the domestic content requirement for products purchased by federal agencies to 60%.
- As of January 1, 2024, that requirement increased to 65% and will increase to 75% in 2029.

(3) Export Controls on Targeted End Users/Uses and Sensitive Technology

- Since 2022, Biden has expanded controls over a wider range of U.S. advanced computing chips and semiconductor manufacturing equipment (SME) destined for China or U.S. arms embargoed countries, as well as U.S. items destined for advanced integrated circuit (IC) manufacturing, SME manufacturing, or supercomputing end uses in these countries.
- These actions are in addition to restrictions on all transfers to targeted Chinese entities, and on Chinese

(4) Restrictions on Outbound Investment

- In August 2023, the Biden Administration issued an executive order establishing a new Outbound Investment Program to prohibit U.S. investment in China, focusing on sectors relevant to military, intelligence, surveillance, and cyber security.

2024 Political Landscape

- 2024 Presidential Election year – limited time in Congress to pass standalone bills
- Few legislative vehicles available
 - Government funding – key deadlines on Jan. 19 and Feb. 2
 - Border Security
 - National Security Supplemental– Israel, Ukraine, Taiwan
 - National Defense Authorization Act
- Bipartisan focus – hard on China stance – Republicans and Democrats will want to showcase their party’s progress on China policy ahead of the November elections.
- There are hundreds of anti-China bills in 118th Congress alone. The number of bills related to China has skyrocketed over the last few years.

Areas of Congressional Focus on China

(1) Public Safety

- Members seek to investigate China's role in the flow of fentanyl into the U.S., its role in the COVID-19 pandemic, and mechanisms to decouple the pharmaceutical supply chain.
 - *Key Bills: HR 5448 Countering CCP Fentanyl Trafficking Act*

(2) Trade – Tariffs and Sanctions

- Several members, including the co-chairs of the Select Committee on the CCP, recommend the U.S. revoke Permanent Normal Trade Relations (PNTR) status, mainly to support American domestic manufacturing. Other recommendations call to increase tariffs on Chinese products.
 - *Key Bills: S. 906 Ending Normal Trade Relations with China Act of 2023*
S. 125 China Trade Relations Act of 2023
S.591 - South China Sea and East China Sea Sanctions Act of 2023
HR 2571 Reshoring American Manufacturing Act of 2023

(3) Strategic Competition – Domestic Manufacturing

- To increase U.S. capabilities in the strategic competition with China, members aim to increase domestic U.S. manufacturing and onshoring of key industries, including AI technology development and EV battery production.
 - *Key Bills: H.R.4683 Closing Loopholes for the Overseas Use and Development of Artificial Intelligence Act*

Areas of Congressional Focus on China

(4) Educational Exchange

- Last year brought several Congressional reports focused on China's state-sponsored influence and technology transfers at U.S. colleges and universities.
- Congressional proposals seek to limit access to research, expand U.S. Government oversight of partnerships with Chinese research institutions, and increase enforcement efforts.
 - *Key Bills: H.R. 5933 Defending Education Transparency and Ending Rogue Regimes Engaging in Nefarious Transactions DETERRENT Act*

(5) Inbound/Outbound Investment

- Congress is focusing on outbound investment and export control legislation to complement and go beyond Biden's EO. Members focus on financial transactions, sensitive technologies, and other key industries.
- Members also seek to decrease Chinese investment in American entities for national security concerns.
 - *Key Bills: H.R.4577 Protecting U.S. Farmland and Sensitive Sites From Foreign Adversaries Act*
H.R.499 - SAFE from PRC Investments Act

(6) Military Defense

- Congress has displayed desire to support Taiwan militarily and financially in the event of a Chinese invasion.
- Congress is also monitoring Chinese involvement in the Russia- Ukraine War, restricting U.S. information flows to companies connected to the People's Liberation Army, and tracking Chinese military action in the South China Sea.
 - *Key Bills: HR 554 Taiwan Conflict Deterrence Act of 2023*
S 686 Restricting the Emergence of Security Threats that Risk Information and Communications Technology

Act

U.S.-China Legislation to Watch

Outbound Investment Transparency Act	Preventing Adversaries from Developing Critical Capabilities Act	China Competition Bill 2.0
<ul style="list-style-type: none"> • <u>Sponsors</u>: Sens. Cornyn (R-TX), Casey (D-PA) • <u>Committee(s)</u>: Senate Finance Committee • <u>Summary</u>: Would require U.S. companies to notify the Treasury Department of investments in sensitive sectors in “countries of concern,” including in semiconductors, artificial intelligence, quantum technology and supercomputing • <u>Status</u>: Passed by a 92-6 vote in the Senate version of the FY24 NDAA– removed from final version 	<ul style="list-style-type: none"> • <u>Sponsors</u>: Reps. McCaul (R-TX), Meeks (D-NY) • <u>Committee(s)</u>: House Foreign Affairs Committee • <u>Summary</u>: Would bar U.S. investment in foreign entities of concern that could pose a threat to national security, such as work on semiconductors, artificial intelligence, quantum technology and supercomputing • <u>Status</u>: Removed from FY24 NDAA, McCaul noted his intention to work with House Financial Services Chairman Patrick McHenry (R-NC) to introduce a standalone outbound investment bill in 2024 	<ul style="list-style-type: none"> • <u>Sponsors</u>: Sen. Schumer (D-NY) • <u>Committee(s)</u>: Senate Finance Committee, Senate Armed Services Committee, Senate Foreign Relations Committee, among others • <u>Summary</u>: Would limit flow of advanced tech to China through export control laws and sanctions; curb US investment in China; invest in domestic industries; align allies against Chinese government; deter China from conflict with Taiwan through military alignment with allies • <u>Status</u>: Schumer aims to work with Sens. Young (R-IN) and Cornyn (R-TX). Bill could act as a legislative vehicle for the Casey-Cornyn or McCaul-Meeks and other standalone bills

House Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party

- Co-Chaired by China hawks Reps. Mike Gallagher (R-WI) and Raja Krishnamoorthi (D-IL)
- Dec. 12 Bipartisan Committee Report—Reset, Prevent, Build: A Strategy to Win America's Economic Competition with the Chinese Communist Party
 - 150 Policy Recommendations under three pillars
 - **Pillar I:** Reset the Terms of Our Economic Relationship with the PRC
 - **Pillar II:** Stem the Flow of U.S. Capital and Technology Fueling the PRC's Military Modernization and Human Rights Abuses
 - **Pillar III:** Invest in Technological Leadership and Build Collective Economic Resilience in Concert with Allies
 - Report acts as a blueprint of potential legislation for China policy in 2024
 - Lawmakers have already introduced bills based on this report
- Congressional Investigations – targeting and analyzing U.S. private sector relationships with China and Chinese companies

Congressional Investigations Related to China

■ Main Congressional Investigative Bodies

- House Select Committee on the Strategic Competition Between the U.S. and the Chinese Communist Party
- House and Senate Intelligence Committees
- Congressional-Executive Commission on China (CECC)

■ Topics of Concern:

- Threats to national security from U.S. investments in China, including university endowments
 - May 2023: House Select Committee initiated an investigation into retail companies Nike, Adidas, Shein, and Temu for alleged use of Uyghur forced labor in their supply chains.
 - July 2023: House Select Committee sent letters to four U.S. venture capital firms concerning investments in Chinese AI and semiconductor companies that the committee alleged “directly contributed” to China’s human rights abuses, military modernization, and efforts to supplant U.S. technological leadership.
 - August 2023: House Select Committee announced an investigation of BlackRock and MSCI for allegedly facilitating capital flows to PLA contractors, human rights abusers, and companies tied to the PRC surveillance state.
 - November 2023: CECC sent letters to Costco and ADI raising concerns about the sale of Hikvision and Dahua products.
- Military preparedness, supply chain risks, and dependence on Chinese products
- Threats to cybersecurity, privacy, human rights, and intellectual property
- PRC influence on U.S. universities, threats to research security, and conflicts of interest

- **Takeaway:** The political dimensions of congressional investigations raise potential legal, financial, and reputational issues for U.S. companies, universities, private equity sponsors, and strategic investors with operations in or other exposure to China.

Changes in the Chinese Legal Environment: Avoiding Traps for Investors and Companies Dealing With China Today

- Evan Chuck
- Juge Gregg

Areas of High Risk

- **Investments in businesses that rely on Chinese manufacturing.**
 - Start With Corporate ESG policies – watch out for the “S” (Social) and use of forced labor.
 - US Uyghur Forced Labor Prevention Act – any import *in whole or in part* into the U.S. is deemed to contain illicit forced labor unless an importer can prove by clear and convincing evidence that it does not. (Proving a negative is hard to do).
 - Extraordinary diligence and operational burdens.
 - Some businesses cannot sufficiently “de-risk” China.
 - Increased enforcement can cripple the business.
 - Subject to reputational harm by third parties and NGOs (e.g., Sheffield Hallam U).
 - Proliferation of similar Uyghur forced labor laws (Germany/EU/Canada).
 - Third party lawsuits against companies/investors engaged in alleged forced labor.
 - Scrutiny by U.S. Congress, such as the House Select Committee on the CCP;
 - **Multinational risk mitigation can trigger China retaliatory sanctions (e.g., Antiforeign Sanctions Law, Unreliable Entity list designations, retaliatory PRC export controls)**
 - **Data needed for the business can be restricted or highly regulated due to vague Chinese data security/national security laws (e.g., China’s Revised Counterespionage Law, State Secrets Law); other sensitive political issues (e.g., Taiwan).**
 - **China operations subject to ad hoc investigations, raids, detentions and exit bans.**



PRC Enforcement Actions in 2023

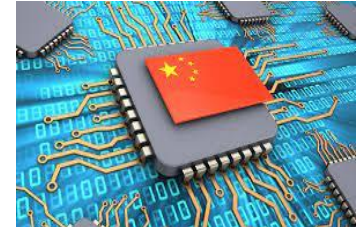
- **Micron Technology (March 31, 2023):** Proactive cybersecurity review and subsequent product ban in China.
- **Mintz Group (March 20, 2023):** Five Chinese nationals arrested and office closed.
 - Raid proceeded by an exit ban on one employee, a Singaporean national, in January 2023.
 - In July 2023, China imposed roughly \$1.5 million in financial penalties for unapproved “foreign-related statistical investigations” across 37 projects from March 2019 – July 2022 without proper approval.
- **Astellas Pharma (March 2023):** Authorities detained an employee for “spying.”
 - In October 2023, China formally arrested the executive, a Japanese national, for alleged espionage.
- **Bain & Company (April 2023):** Authorities questioned employees at Shanghai office .
- **Capvision (May 2023):** Authorities questioned employees at Shanghai office for alleged state secret theft.
- **Nomura Holdings (September 2023):** Published reports that PRC authorities barred a senior banker overseeing the firm's investment banking operations from leaving mainland China.
- **Kroll (September 2023):** Published reports that PRC authorities barred a senior executive from leaving mainland China.
- **Kharon (December 2023):** Public statements by PRC authorities that China had frozen assets held in China by the U.S. company, which identifies sanctions and compliance risks for organizations, and two executives over work related to Xinjiang.



Areas of High Risk

Investments in businesses that rely on or involve Chinese technology.

- Existing or prospective investments could be subject to scrutiny from finalization of proposed outbound investment rules announced by the Biden Administration in 2023. (particularly AI, quantum computing, advanced manufacturing (e.g. semiconductor)).
- Changing export control laws and practices in the US, EU, UK and elsewhere can severely impact data intensive business models that incorporate transfers of non-China technology into China for further development.
- There is also growing concern about transfer of US data and IP theft related to Chinese parties in the US, EU, UK.
- Scrutiny by U.S. Congress, such as the House Select Committee on the CCP (e.g., Tik-Tok, Schein)**
- Multinational risk mitigation can trigger China retaliatory sanctions (e.g., Antiforeign Sanctions Law, Unreliable Entity list designations, retaliatory PRC export controls)**
- Data needed for the business can be restricted or highly regulated due to vague Chinese data security/national security laws (e.g., manufacturing data).**
- Data needed for the business can be restricted or highly regulated due to vague Chinese data security/national security laws (e.g., China's Revised Counterespionage Law, State Secrets Law); other sensitive political issues (e.g., Taiwan).**
- China operations subject to ad hoc investigations, raids, detentions and exit bans.**



Areas of High Risk

- **Investments in businesses that have Chinese ownership/control in the US/EU/UK.**
 - Existing or prospective businesses, particularly those who have Chinese or Chinese Communist Party (“CCP”) members in board or executive positions with affiliates/subsidiaries in the US, EU, UK could face conflicts between corporate law duties and obligations under applicable laws and PRC law obligations as well as obligations required by the CCP (e.g., auto supply chain).
 - Changing export control laws and practices in the US, EU, UK and elsewhere can severely impact data intensive business models that incorporate transfers of non-China technology into China for further development.
 - There is also growing concern about transfer of US data and IP theft related to Chinese parties in the US, EU, UK.
- **Investments in business that rely on cross-border financing and capital transfers.**
 - Businesses that could be susceptible to US/EU/UK sanctions or Chinese retaliatory sanctions (e.g., AFSL, Unreliable Entity List) can face very difficult banking conditions in China. Even the threat of being sanctioned can paralyze a company’s financial operations.



Looking Around Corners and Risk Mitigation

- Evan Chuck
- Juge Gregg

Risk Mitigation

- **For some investors, China is a market that is too big to ignore or exit.**
 - The De-coupling vs. De-risking Paradox
 - Tariff engineering?
 - Corporate strategies to reduce market share in exchange for regulatory certainty.
 - Hedging strategy.
 - Watch for PRC corporate and labor/employment traps (approvals and delays).
 - Analyze the impact of changing export control laws in all relevant jurisdictions.
New licensing requirements may be on the horizon.
 - Increase diligence screening to account for concerns for export controls, sanctions, and IP theft.
 - Anticipate government scrutiny and prepare proactive and reactive government affairs strategy. Don't let your China government affairs strategy atrophy.
 - Consider a tabletop exercise ("Ukraine 2.0").
 - Evaluate banking relationships and corporate/tax efficiency structuring options in light of retaliatory sanctions risk.



Looking around corners

- **How well do you know your supply chain? And where does it lead?**
 - Concerns raised today are limited to direct investors in China
 - Knowing only first tier suppliers is not enough
 - Claims of supply chain complexity will not insulate you

- **Do you have the right contracting in place with your supply chain**
 - Ownership and shipping issues
 - Liability allocation
 - Information disclosure requirements

Looking around corners

■ What claims are you making that may prove problematic?

- E.g., Starbucks – “100% ethical sourcing” lawsuit
- Have you thought through how you will respond to the tough questions? Or what the tough questions even are?

■ Growing expectations regarding supply chain due diligence

- Requirements in EU, California and other jurisdictions

■ Environmental issues, not just forced labor

- Requirements for due diligence for forestry issues (legality, deforestation-free requirements)
- Increasing need to understand carbon in your supply chain
- Responsibility for PFAS and other ingredients
- Some issues where env’t and human rights overlap (e.g., soy, fisheries, forest products)

Incident response planning

- **Do you know who the POCs and STLs on particular issues are? Or how you will quickly designate them?**
 - Important to ensure that consistent decisions are being made
 - Communication governance (internal and external)
 - Knowledge management (e.g., who should be receiving the considered legal advice)

- **Do you have mechanisms to centralize/manage legal advice from various parts of the company (and ensure consistency)**
 - Are those mechanisms going to work real-time for rapidly evolving scenarios?

- **Do the front-line employees have playbooks for initial responses**
 - Think through, in advance, how to ensure that the first responses don't make matters worse (e.g., inspections, seizures, press inquires, etc.)

- **Do you know who you will call?**
 - What is your team of outside advisors (legal, crisis communication, public policy, etc.)

Questions & Answers

