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PERSPECTIVES

Engaging With Chinese Companies: Managing ‘Proxy Sanctions’ Risk

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INTRODUCTION

We are entering a year of acute political risk for international trade, with a high likelihood that the Trump administration will hit China with punitive tariffs and increased export controls. Against the backdrop of trade tariffs, China also presents a challenge for international companies from a direct sanctions perspective. The sanctions environment will – we believe – get more challenging even if eventually some form of rebalancing is achieved with the United States.

While heavily sanctioned countries such as Russia and Iran present clear 'no go' cases for business and legal teams, the complex nature of US sanctions against China, coupled with the country's global trade exposure, can lead to finely balanced judgement calls and unintended hazards. Getting reliable information on the structure, ownership and activities of Chinese companies is not straightforward. In this article we will discuss the 'proxy sanction' risk as well as the direct China sanctions risk.

The tempo of punitive measures against China will certainly increase over 2025. Under the departing Biden administration earlier this month the US issued more sanctions against two relatively 'mainstream' Chinese companies with strong ties to global markets – Tencent and CATL, the world's largest battery maker. The recent shutdown of TikTok in the US was a striking example of how what appears to be a non-strategic / military entity can be linked to national security. While Trump has postponed the ban as a bargaining chip for tariffs, in other areas he will push China harder. China has levied its own sanctions – perhaps most significantly the ban on rare earth processing technology in 2023 and outright export bans on critical minerals such as gallium, germanium, and antimony in 2024. It has targeted some US companies directly – with sanctions (and theoretical fines) on Lockheed Martin and Raytheon Technologies, which were added to a register of "unreliable entities" that had sold arms to Taiwan.

THE SANCTIONS LANDSCAPE

As it stands, there are broad swathes of sanctions against China and Chinese entities:

General economic sanctions related to the ongoing US-China trade war are likely to intensify – incoming President Trump has accused China of unfair trading and business practices in his first term and has advocated a "tough" stance on China.

Russia-related sanctions – Since the 2022 Russia-Ukraine invasion, the US, the EU, and other Western countries have introduced several sanctions covering Chinese individuals and entities involved in supporting Russian military or strategic industrial sectors.

'Humanitarian' / Human rights-related sanctions – most notably, US sanctions imposed in relation to human rights abuses against ethnic minority groups residing in the Xinjiang Uyghur Autonomous Region. The 2021 US Uyghur Forced Labor Prevention Act establishes that "all goods produced entirely or in part in Xinjiang are implicated in forced labor and bans their import unless importers can demonstrate otherwise." The US has also imposed sanctions on the Xinjiang Production and Construction Corps ('XPCC') – a Chinese paramilitary organisation and state-owned enterprise – for human rights abuses. These sanctions are particularly hazardous for companies that do not have clear oversight of their supply chains and local counterparties. The new US Secretary of State Marco Rubio has been particularly hawkish on pushing for greater human rights-related sanctions against China.

Sanctions against organised crime, mainly in relation to drugs and money laundering, but also in relation to cyberattacks. These pertain to criminal enterprises as well as malicious actors, such as Integrity Tech, a Chinese cybersecurity company that was reported to have links to the Chinese Ministry of State Security and was involved in computer intrusion incidents against US entities and individuals. Integrity Tech was sanctioned in January 2025.

These sanctions are in addition to **blacklists that the US government** uses to target (mainly) Chinese companies and individuals, ranging from those involved in the military-industrial complex (the Chinese Military Companies List) to bans on equipment being used the US federal government. A notable example is China's Huawei, which was first blacklisted by the US in 2019 for national security risks, as well as its opaque

ownership structure. While the blacklists tend to be more relevant for US government buyers and certain high-tech sectors, they are often a precursor to more stringent sanctions and blocking orders (and a listing can easily impact the ability of the targeted company to do business or raise capital).

PROXY RISK FOR SANCTIONS

Aside from the direct impact of sanctions, there is the possibility for investors of proxy risk from the third-party relationships that a Chinese company may have with other sanctioned countries and entities. We are seeing a particular focus on Chinese companies that may – for example – trade with Russia or Iran via energy supplies or indeed have representative offices in those countries. The risk here is that the counterparty may fall under US sanctions as those trading relationships become more apparent. Or the sector in which the company operates – such as sensitive semiconductor technology – may become subject to more punitive sanctions as the geopolitical temperature of Sino-US relations fluctuates.

The risk of civil and criminal penalties for investors is high. In August 2024, the US Office of Foreign Assets Control (OFAC) fined Haas Automation, Inc. USD 2.5 million for apparent violations of US export controls and sanctions laws, including shipments of computer parts to banned parties in Russia and China. Many other firms have been hit with fines, ranging from well-known firms such as Microsoft to regional electronics exporters.

In late 2024, the Chinese telecoms company ZTE Corp. agreed to pay civil and criminal fines in the US totaling USD 1.2 billion for shipping telecommunications equipment to Iran and North Korea, the largest penalty ever imposed in a US export control case.

Some smaller examples include the Dalian Xinpenghai Electromechanical Equipment Co. Ltd., which was sanctioned by the US in early January 2025 for supplying more than USD 24 million worth of machine tools and other goods to the Russian-based firms. The Shandong Huaguang Optoelectronics Co Ltd. is on Specially Designated Nationals (SDN) list of individuals and entities blocked by OFAC for supplying laser diodes to Russia-based entities.

Internationally, a number of China-linked Singapore and Dubai-listed companies have now been placed on the US sanctions list for facilitating Russian oil and liquid natural gas (LNG). Other regions have also been hit. On 15 January 2025, OFAC published an update to the US SDN List naming, among others, three Malaysia-registered companies for their involvement in enabling Russian efforts to evade US sanctions.

Conversely, it is worth noting that Chinese companies have in some cases actively avoided purchasing Russian products. Chinese state oil refiners such as CNOOC, PetroChina, Sinochem, and Sinopec have been highly cautious in buying Russian oil cargo. Nonetheless CNOOC has been – as of January 7, 2025 – placed on the list of companies aiding the Chinese military. We saw a similar approach taken by Chinese state-owned companies and banks in regard to Iranian sanctions. China is highly sensitive to its ability to do business globally (particularly within the dollar system).

One of the key factors to check in any counterparty relationship is whether the Chinese entity has a local presence / trading business in a sanctioned third country or does business with a sanctioned country or ships goods to it.

Finally, there is an emerging risk area of Chinese companies being involved in asymmetric attacks on Western interests. This recently has been brought into focus by the alleged involvement of a Chinese cargo ship – the Yi Peng3 – in severing subsea communications cables between Germany and Finland, and Lithuania and Sweden.

IDENTIFYING AND MITIGATING SANCTIONS RISK

One of the key challenges in assessing Chinese counterparty risk is ensuring that you are dealing with right company. Accessing Chinese corporate databases outside China is difficult without a Chinese phone number or ID. Similarly named companies proliferate, and having the correct ideograms for the

precise counterparty is essential. The operating environment is highly opaque.

A good example is China Aerospace Science and Technology Corporation (also known as CASC), a state-owned aerospace company. Its Chinese name is 中国航天科技集团有限公司. CASC is designated on the US Chinese Military-Industrial Complex list.

CASIC's Chinese name is similar to another central state-owned aerospace company, China Aerospace Science and Industry Corporation (also known as CASIC). Its Chinese name is 中国航天科工集团有限公司. Again, while both have similarities in terms of names and ownership, they are two distinct entities. Both are sanctioned, whereas the Hong Kong-listed China Aerospace International Holdings Limited (also known as CASIL or 中国航天国际控股有限公司) is an investment holding company, 38.37% held by CASC and not sanctioned by the US.

As noted above, the telecoms giant Huawei has been targeted by the US since 2019 through various export controls and blacklists on national security grounds. While some of the company's subsidiaries (such as Huawei Technologies Huawei Investment and Holding Co.) are on the restricted Chinese military list, other subsidiaries, and investments such as its digital unit (Huawei Digital Power Technologies Co. Ltd.), and its investment arm, Hubble, are not sanctioned by the US. This of course could conceivably change over the lifetime of the Trump administration.

CONCLUSION

What are the best ways of mitigating these risks? Maintaining a live risk register of commercial partners is key. Companies change ownership, their trading patterns vary, and trade compliance rules shift as the US and other governments set policy. Information on the ownership and activities of Chinese companies is available, just not easily accessible. We recommend below further steps that compliance and legal teams should consider:

- Make sure you have the exact ideograms for your counterparty,
- Check SDN (frozen assets), import / export restrictions, and relevant blacklists,
- Pay attention to 'inherited' sanctions risk – the fact that 50%-plus ownership by a sanctioned entity normally means that the subsidiary itself is considered under sanctions. Even a sub-50% ownership can attract reputational and regulatory scrutiny (not least from financial institutions).
- Determine whether your partner has any trading / representative presence in sanctioned third countries or ships s to sanctioned countries,
- Look carefully for evidence of JV announcements, trade partnerships and Memorandums of Understanding (MoUs) with potentially problematic third parties.

Investors will have no control over the direction and pace of sanctions and export control policies over the coming years, but careful analysis of counterparties and the use of experts can reduce and mitigate trade compliance risks.

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