

# Implications of Secretary Pompeo's Certification that Hong Kong No Longer Warrants Separate Treatment Under U.S. Law

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International Trade, Public Policy

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On May 27, Secretary of State Michael Pompeo certified to Congress pursuant to the Hong Kong Human Rights and Democracy Act of 2019 that “Hong Kong does not continue to warrant treatment under United States laws in the same manner as U.S. laws were applied to Hong Kong before July 1997.” In a [statement](#), Secretary Pompeo attributed this action to the announced intention of China’s legislature, the National People’s Congress (NPC), to unilaterally impose national security legislation on Hong Kong, adding that this was “only the latest in a series of actions that fundamentally undermine Hong Kong’s autonomy and freedoms and China’s own promises to the Hong Kong people under the Sino-British Joint Declaration, a UN-filed international treaty.”

On May 28, as anticipated by Secretary Pompeo’s statement, the NPC authorized its Standing Committee to draft and adopt the national security legislation and attach it to an annex of Hong Kong’s Basic Law that lists China’s national laws that are to be applied in Hong Kong. The NPC’s decision also authorized China’s national security organs to establish a presence in Hong Kong and stipulated that the “administrative, legislative and judicial organs of the Hong Kong Special Administrative Region shall, in accordance with relevant laws and regulations, effectively prevent, stop, and punish conduct endangering national security.”

Secretary Pompeo’s certification has no immediate impact on the existing relationship between the United States and Hong Kong, but signifies that potentially dramatic changes are now in prospect. Those changes could extend across a number of legal and political spheres, from tariff treatment and export controls to immigration and consular matters. This client alert begins with an overview of the current legal context, describes what may happen next, and then discusses the potential ramifications, including with respect to trade between the United States and Hong Kong, the application of U.S. export controls to Hong Kong, and CFIUS review of investments in the United States by Hong Kong-based entities.

## Legal Framework

The current U.S. relationship with Hong Kong was established under the [United States-Hong Kong Policy Act of 1992 \(“HKPA of 1992”\)](#). This law enshrined the principle that, notwithstanding the transfer of sovereignty over Hong Kong from the United Kingdom to the People’s Republic of China, scheduled to occur in 1997, the United States would continue to

treat Hong Kong as separate from the rest of China in a variety of political, economic, trade, and other spheres, provided that Hong Kong remained “sufficiently autonomous to justify” such treatment. Specifically the HKPA of 1992 provided that following the handover “the laws of the United States shall continue to apply with respect to Hong Kong, on and after July 1, 1997, in the same manner as the laws of the United States were applied with respect to Hong Kong before such date, unless otherwise expressly provided by law or by Executive order...”

In late 2019, in response to the confrontations taking place in Hong Kong between pro-autonomy demonstrators and the police, Congress enacted the [Hong Kong Human Rights and Democracy Act of 2019](#) (“HRDA of 2019”). Among other things, this law amended the HKPA of 1992 to require an annual certification by the Secretary of State “whether Hong Kong continues to warrant treatment under United States law in the same manner as United States laws were applied to Hong Kong before July 1, 1997.” This certification is required to be made not later than March 31 of each year through 2024. Secretary Pompeo’s certification of May 27, 2020 was made pursuant to this requirement.

The HRDA of 2019 does not require immediate suspension of Hong Kong’s special status following certification by the Secretary of State that Hong Kong no longer “continues to warrant” treatment under U.S. law different than that applied to the China, but Congress’s clear expectation was that it would be difficult for the Administration to continue to extend such treatment after publicly pronouncing that such treatment was no longer warranted.

The HRDA of 2019 further required the imposition of U.S. sanctions on foreign persons found by the President to have engaged in extraterritorial rendition, arbitrary detention, torture, or other gross violations of internationally recognized human rights in Hong Kong. The specific sanctions to be imposed on such persons include the blocking of assets of sanctioned individuals to the degree those assets are subject to U.S. jurisdiction, and the denial of entry to the United States to such individuals. The approach of the HRDA of 2019 was premised on the belief that the economic costs to Hong Kong and China of potentially suspending Hong Kong’s special status, coupled with the threat of sanctions targeting individual Chinese officials, would be sufficiently high that China would be motivated to avoid them by continuing to respect the autonomy of Hong Kong.

### **Likely Next Steps**

Press reporting suggests that Secretary Pompeo’s May 27th certification may be followed by full or partial suspension of Hong Kong’s special status under the HKPA of 1992, and also—perhaps most immediately—by the imposition of U.S. sanctions on persons complicit in diminishing Hong Kong’s autonomy, pursuant either to the HRDA of 2019 or other sanctions authorities available to the President.

Under the procedures of the HKPA of 1992, any suspension of Hong Kong’s status—in whole or in part—would be effectuated by means of an Executive order issued by the President. It is difficult to predict how far the Administration may choose to go in suspending the separate treatment of Hong Kong under U.S. law. It is possible that the Administration will judge that it serves U.S. interests to continue to treat Hong Kong differently than China for some purposes, for example in areas that benefit U.S. citizens and business in Hong Kong, and ordinary Hong Kong people. But in other areas, such as national security, the Administration may well want to suspend preferential treatment. Among the areas that could be especially impacted are trade, export controls, and investment in the United States.

## Potential Trade Impacts

Should the Administration decide to suspend Hong Kong's separate treatment from China under U.S. trade laws, the impact likely will be minimal with respect to trade in goods subject to regular customs duties, as the United States does not maintain any preferential free trade agreements ("FTAs") with Hong Kong. As both China and Hong Kong are—in their own right—members of the World Trade Organization ("WTO"), U.S. imports from both economies are generally subject to the same "most favored nation" (or "MFN") tariff rates imposed by the United States.

In addition to these MFN rates, however, the United States also applies special duties to particular products from certain countries. For example, the Trump Administration has imposed Section 301 tariffs at ad valorem rates up to 25 percent against a wide range of Chinese products, which could similarly be applied against products from Hong Kong. Application of such special tariffs could be the most substantial trade-related consequence of any revocation of Hong Kong's separate treatment under U.S. law but, as noted, such a change does not follow automatically from Secretary Pompeo's certification.

In addition to the lack of a bilateral FTA, there is no bilateral investment treaty in place between the United States and Hong Kong, and the revocation of separate treatment under multilateral treaties to which only Hong Kong (and not China) is a member (such as the WTO Government Procurement Agreement) is not expected to have a significant economic effect.

## Potential Export Controls Impacts

On the basis of the HKPA of 1992, the Department of Commerce currently maintains Hong Kong as separate from China for purposes of export licensing and applies to it significantly more lenient licensing policies. Most prominently, Hong Kong is designated under Country Group B and China is designated in Country Group D in [Supplement No. 1 to Part 740](#) of the Export Administration Regulations ("EAR"). Country Group B destinations are eligible for a number of important licensing exceptions in [Part 740](#) to the EAR. Those exceptions either do not apply to Country Group D destinations, such as China, or are otherwise subject to tighter restrictions or reporting requirements. There also are a number of end-user and end-use restrictions that apply specifically to China in [Part 744](#) of the EAR that do not apply to Hong Kong.

If Hong Kong were no longer treated as separate from China, the benefits afforded to Hong Kong currently as an EAR Country Group B destination would expire and the various rules that impose stricter conditions on exports or reexports to China would apply.

Similarly, unlike China, Hong Kong is not considered as a prohibited destination under the International Traffic in Arms Regulations ("ITAR"), 22 C.F.R. Part 120 et seq., administered by the U.S. Department of State. If Hong Kong were no longer treated as separate from China, U.S. defense articles could no longer be licensed for export to Hong Kong absent a special waiver. Further, State Department licenses and approvals to Hong Kong could be revoked, on the basis of the ITAR arms embargo for China, and U.S. company ITAR registrants owned or controlled by Hong Kong entities could lose their registration status and ability to apply for export licenses under the ITAR.

## Potential CFIUS Impact

The certification is not likely to signal a material change in how the Committee on Foreign Investment in the United States ("CFIUS") will approach investment from Hong Kong, but it may have an impact on certain transactions and for certain acquirers. Over the last several years,

CFIUS has generally made less of a distinction between mainland China and Hong Kong-based entities in the context of the "threat" analysis that CFIUS undertakes on the acquirer in each transaction, with the result being that many, if not most, Hong Kong investors have faced a similar level of scrutiny as Chinese investors. Nevertheless, this has been a fact-specific analysis, and certain Hong Kong entities—primarily those with more of an Anglo-American corporate heritage and ownership or with very few business ties in mainland China—have been perceived as being less susceptible to influence from China, and in turn have been more favorably positioned for CFIUS reviews. The CFIUS-related risk arising from Secretary Pompeo's certification is perhaps greatest for these entities, as the certification reflects a concern within the U.S. government that all Hong Kong-based parties may eventually be subject to influence from China.

Additionally, more investments by Hong Kong parties may now be subject to mandatory filings with CFIUS. As discussed in our recent separate [client alert](#), CFIUS has recently published a proposed rule regarding mandatory filing requirements for certain transactions involving U.S. businesses that produce, design, test, manufacture, fabricate, or develop one or more "critical technologies." The proposed rule abandons the requirement that the critical technology be associated with one of 27 designated industries and instead adopts a new test based on whether "U.S. government authorizations would be required to export, re-export, transfer (in country), or retransfer the critical technology or technologies produced, designed, tested, manufactured, fabricated, or developed by the U.S. business to certain transaction parties and foreign persons in the ownership chain." If, as discussed in more detail above, Hong Kong is no longer treated as separate from China under U.S. export control authorities, and this new CFIUS rule goes into effect in a form close to what has been proposed (as we believe it will), Hong Kong investors will be subject to mandatory CFIUS filings more often than they would have been if the distinction between China and Hong Kong in U.S. export control laws had been maintained.

### **Potential Impact of Hong Kong National Security Legislation**

In addition to exacerbating tensions between China and the United States, analysts expect implementation and enforcement of new national security legislation in Hong Kong, as well as China's response to related protest activity, to significantly impact the business environment for foreign companies in Hong Kong, including with regard to the movement of capital and talent. The chief executive of the Hong Kong Monetary Authority [stated](#) this week that the national security legislation will not change the fundamentals of Hong Kong's monetary and financial system, including the free flow of capital, the convertibility of the Hong Kong Dollar, and the Linked Exchange Rate System (peg to the U.S. Dollar). The U.K. foreign secretary [suggested](#) that Britain may offer citizenship to 300,000 Hong Kong residents if China implements the national security law. Data privacy and cybersecurity is one potential area of direct impact for foreign firms operating in Hong Kong, including the possibility of data access requests from the Hong Kong Government or even China's national security agencies, even if these companies have no operations in mainland China.

### **Conclusion**

Following Secretary Pompeo's May 28th certification, the Trump Administration will be politically compelled to take further steps with respect to Hong Kong. Pressure is already being brought to bear by Congress to steer the Administration in that direction. For example, on May 21, Senators Van Hollen (D-MD) and Toomey (R-PA) introduced the Hong Kong Autonomy Act, which would impose sanctions on Chinese and Hong Kong officials involved in suppressing

demonstrations or imposing China's national security law on Hong Kong, and also on banks that engage in significant transactions with officials sanctioned under this legislation.

At the same time, however, the Administration's overriding objective appears to be the preservation to the extent possible of Hong Kong's autonomy. The Administration therefore is likely to look for approaches that are calibrated to persuade Beijing not to move forward with its most recent initiatives relating to Hong Kong, and to promise to restore the status quo should those initiatives not be implemented.

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