

PSSI PERSPECTIVES — 40

STUCK IN THE MIDDLE KINGDOM

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EXECUTIVE SUMMARY

In April and May 2026, China took two landmark legal actions that fundamentally alter the risk calculus for foreign companies operating in China. First, the State Council issued two sweeping decrees expanding China's countersanctions toolkit from a largely declaratory framework into an operational enforcement regime. Second, China's Ministry of Commerce activated its "Blocking Rules" for the first time in five years, issuing a prohibition order declaring that U.S. sanctions on five Chinese oil refineries "shall not be recognized, enforced, or complied with" on Chinese soil.

Taken together, these measures place foreign companies in an irresolvable legal conflict. Compliance with U.S. and EU law, including sanctions obligations, forced labor due diligence, and supply chain investigations, now constitutes a potential offense under Chinese law, exposing companies to litigation, asset seizure, and market exclusion in China. The personal stakes are equally serious: China's new decrees authorize exit bans on foreign executives, meaning the individuals responsible for compliance decisions may find themselves unable to leave the country.

These developments represent a major and deliberate strategic shift. China is constructing a parallel legal order designed to erode the effectiveness of Western sanctions by making compliance with them prohibitively costly.

This Perspective argues that Western governments have an obligation to respond, such as by protecting companies penalized for obeying home-country law, by coordinating a joint U.S.-EU legal and diplomatic response, and by establishing clear reciprocity mechanisms for exit ban cases.

STUCK IN THE MIDDLE KINGDOM

In what is likely a historical first, a major power has legally ordered foreign companies to break their own home country's laws, on pain of being sued and losing their local assets. Within just a few weeks of each other, China has taken two landmark legal actions which fundamentally alter the operating environment for foreign companies in China.

TWO NEW DECREES

Firstly, in April 2026, China's State Council issued two new decrees to expand and strengthen their countersanctions toolkit - Decree No. 834 (Regulations on Industrial and Supply Chain Security) and Decree No. 835 (Regulations on Countering Foreign Improper Extraterritorial Jurisdiction). Alarming, these decrees demonstrate a major shift in China's enforcement approach, from being largely declaratory and ad hoc to increasingly operational. They also signal a new, global ambition for China's legislative reach, as the decrees affirm China's right to extraterritorial jurisdiction over any activity with an "appropriate connection" (适当联系) with China (Decree No. 835, Art. 4).

Foreign companies face an expanded array of countermeasures, including asset freezes, trade prohibitions, investment restrictions, data-transfer restrictions, visa suspensions, and fines (Decree No. 835, Art. 8). Foreign companies are also prohibited from conducting supply-chain-related "investigations and other information collection activities" within China "in violation of Chinese laws, administrative regulations, departmental rules, and relevant state provisions" (Decree No. 834, Art. 13). Moreover, what qualifies as information collection activities is perilously vague. The Chinese government will also establish a "Malicious Entity List" (恶意实体清单) of foreign entities which "promote or participate in implementing" an iden-

tified foreign measure, exposing them to the same punishments (Decree No. 835, Art. 8).

The decrees also cover the activity of Chinese companies, allowing the Chinese Ministry of Justice to prohibit Chinese persons from complying with foreign measures, and authorizing penalties for violations of such prohibitions (Decree No. 835, Art. 13). Worse still, any Chinese persons harmed by another party's compliance with foreign measures can sue for damages in Chinese courts (Decree No. 835, Art. 13).

China's new decrees place foreign companies in an impossible legal position. Laws like the U.S. Uyghur Forced Labor Prevention Act and the EU's Corporate Sustainability Due Diligence Directive legally require supply chain investigations. Under China's new framework, conducting that same due diligence is now grounds for investigation, liability, and potential asset seizure. There appears to be no path that satisfies both.

THE BLOCKING RULES

The second major development in recent weeks solidifies this legal conundrum. On May 2, 2026, China's Ministry of Commerce (MOFCOM) issued a prohibition order under its Blocking Rules - the first time China has used them since they were introduced five years ago. Triggered by U.S. Treasury sanctions on five Chinese refineries for importing Iranian oil, MOFCOM declared that these sanctions "shall not be recognized, enforced or complied with," and that any companies, or banks, must not participate in such sanctions.

Affected Chinese companies may now sue any company or financial institution for complying with such sanctions, and seek compensation for economic losses (Blocking Rules, Art. 9). The defendants can theoretically be headquartered anywhere in the world, so long as the "harm" occurred in China - allowing Chinese courts to assert jurisdiction over foreign entities.

Just as with the two decrees, these Blocking Rules create an impossible position for international companies to navigate. A European bank deciding whether to process a payment for a sanctioned Chinese refinery must now choose between two sets of legal consequences. Violating U.S. sanctions, such as those imposed on the five refineries, carries the risk of major civil penalties, criminal fines, imprisonment, asset forfeiture, the loss of business licenses, or exclusion from the U.S. financial system. If complying with U.S. sanctions causes any losses to the Chinese counterparty, they may seek damages in court, with any resulting judgment enforced against its Chinese assets, subsidiaries, or joint ventures. The Chinese government may also apply other elements of its anti-sanctions framework, and add the company to its Unreliable Entity List or apply measures to restrict or cut off access to the Chinese market.

The difficulty for foreign companies is that the conduct most likely to draw Chinese regulators' attention is precisely the conduct that U.S., UK, and EU regimes increasingly require: complying with OFAC sanctions, halting imports under the Uyghur Forced Labor Prevention Act, and conducting human-rights supply chain due diligence under EU directives. In short, obeying the law of your home country is now grounds to be sued in China.

The threat does not stop at legal liability. China's two new decrees also authorize exit bans on foreign executives, significantly raising the stakes from legal risk to personal risk. Accordingly, individuals who make the decision to wind down China operations, cut a supply relationship, or comply with home-country sanctions, may suddenly find themselves trapped and unable to leave the country. This is part of a worrying larger trend, as exit bans are increasingly common in Chinese laws and regulations.

For example, a 2018 amendment to the Supervision Law allows exit bans to be placed on anyone connected to an investigation, even if they are not a suspect. These restrictions were on full display a few years ago, when Richard O'Halloran, an Irish businessman, flew to Shanghai to resolve a commercial issue which traced its origins from before O'Halloran had joined the company. As he attempted to board his flight home, he was detained by Chinese authorities. Despite never being charged with any crime or accused of wrongdoing, he was barred from leaving the country and subjected to endless hours of questioning and pressure to sign documents falsely incriminating him. After nearly three years of “quiet diplomacy” by the Irish government, a commercial agreement was reached, and the Shanghai court lifted his exit ban. The case of Richard O'Halloran -- having lost 20 kilos, suffered extreme stress, isolation, multiple seizures, and his heart stopping requiring emergency resuscitation, and tormented by PTSD following the ordeal -- was designed to send a clear message: the foreign nationals responsible for a company's compliance decisions face personal consequences for making them.

A WINDOW INTO CHINA'S AMBITIONS

To understand what China is doing strategically, it helps to ask a simple question: Why now? The Blocking Rules sat unused for five years, with the legal architecture having been under construction since 2020. Beijing clearly had the tools earlier, but it chose not to use them. That restraint was itself strategic, reflecting the calculation that Chinese banks and firms with significant U.S. dollar exposure had more to lose from a direct legal confrontation than from quiet workarounds. What changed is that Beijing has now decided the moment of activation is worth the cost.

For decades, the United States has wielded sanctions as a primary instrument of foreign policy, and that power rests on a specific structural foundation: global dollar dominance. Because the vast majority of global trade is settled in dollars, and because dollar transactions route through the U.S. financial system, the U.S. can effectively conscript the entire global banking network into its sanctions regime. In effect, it means comply with OFAC, or lose access to dollars, and therefore to global commerce. For decades, it sought to wield this power to undermine state sponsors of terror or militarily belligerent nations around the world - particularly Iran, North Korea, and Russia.

China cannot replicate that power. The renminbi remains a marginal share of global trade settlement, and Chinese financial institutions are deeply embedded in the dollar system. Beijing's direct intervention in manipulating its currency, and a handful of other such measures, further discourage trust in the renminbi. As it turns out, replication may not be the goal. The more achievable ambition, and the one these regulations are designed to advance, is a quiet erosion.

Specifically, if Beijing can demonstrate that complying with U.S. sanctions carries real legal and financial costs in China, it raises the price of enforcement for every multinational operating in both jurisdictions. Banks, insurers, and trading companies will face growing pressure to find workarounds, seek exemptions, or quietly avoid sanctioned entities rather than comply. Over time, that friction accumulates.

What makes China's approach historically novel is its location - inside the global trading system rather than outside it. Russia's response to Western sanctions was largely to decouple: exit dollar clearing, build alternative payment channels, accept isolation and find pathways to evade the sanctions through neighboring connector countries. China's response is the opposite: stay deeply integrated, but use that integration as leverage. Every multinational with Chinese assets, every bank with Chinese operations, every insurer with Chinese counterparties becomes an involuntary pressure point. The more embedded foreign companies are in China, the more effective the threat. The trap only works because the door was once so wide open.

This is also a message directed well beyond Washington. Beijing has explicitly framed these measures as a model for other countries, particularly in the Global South, to resist what it characterizes as Western economic and financial coercion. Whether or not that framing gains traction, the signal is clear: China is positioning itself as the architect of an alternative legal order in which U.S. extraterritorial jurisdiction is not accepted as a fact of global commerce, but contested, countered, and ultimately delegitimized. That project will not succeed or fail on the basis of five oil refineries in Shandong, but it has now, unmistakably, begun.

POLICY RECOMMENDATIONS

The Need for Government Responsibility - If obeying the laws of your own country place you in the crosshairs of being sued abroad, then governments that require compliance with their laws have an obligation to protect the companies caught in the crossfire. States can not simply leave their companies stranded when they are penalized for their legal compliance. Concretely this could mean safe harbor provisions, legal defense funds, or diplomatic commitments to raise cases where companies are penalized for home-country compliance.

Increased Transatlantic Coordination - This is also an opportunity to strengthen U.S.-EU relations and coordinate a response. While China's Blocking Rules and new decrees ostensibly seem to target U.S. extraterritorial measures, particularly the OFAC sanctions imposed on the five Chinese refineries, their wording and scope allow for targeting any foreign state or actor. As the EU has, in recent years, dramatically ramped up its economic statecraft measures - with numerous sanctions packages on Russia and heavy import duties on goods like electric cars coming from China - these Chinese measures risk undermining Europe's present efforts. The U.S. and EU need an immediate coordinated response, such as issuing a joint statement of legal position, rather than leaving companies to navigate two Western regimes plus a Chinese counter-regime individually. This absence of transatlantic coordination is itself a vulnerability Beijing is certainly seeking to exploit.

Reciprocate in Kind - Western governments should also look at establishing explicit reciprocity policies: if China places an exit ban on a national for compliance-related decisions, the response should be automatic and proportional, such as visa restrictions, asset scrutiny, or market access consequences for Chinese companies or state-linked entities. The Richard O'Halloran case referenced above clearly demonstrates that quiet diplomacy alone is insufficient.

CONCLUSION

Looking at the two new decrees and the Blocking Rules taken together, these developments mark a fundamental shift in the risks of doing business in China. Beijing has constructed a legal architecture specifically designed to make compliance with Western law an offense on Chinese soil. China is constructing a parallel legal order designed to erode the effectiveness of Western sanctions by making compliance with them prohibitively costly. Foreign companies now face an impossible choice, as they are pressured to ignore their own national laws under threat of litigation, asset seizure, and potential market exclusion. The executives responsible for making these decisions may not even be free to leave the country while making it.

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