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# Hughes Hubbard & Reed

## Economic Sanctions Against China: U.S. Economic Sanctions Targeting the Chinese Economy – TikTok Falls Under Sanctions Against China (3/3)

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This article on the adoption of U.S. economic sanctions and export controls against the Chinese tech giant TikTok closes our three-part overview of economic sanctions against China. As a reminder, parts 1 (Hong Kong) and 2 (Huawei) are available on our website.

Against a backdrop of growing diplomatic tension between Washington and Beijing over technological, economic and geopolitical issues, one star in China's digital economy is now under scrutiny from the U.S. executive branch. Suspicions of espionage and use of the data collected for Beijing's benefit underscore the U.S. government's recent actions against TikTok, a social media network that has now more than a billion users worldwide.

### **U.S. mistrust of TikTok against a backdrop of rising tensions between Beijing and Washington**

Use of the TikTok application had been growing significantly in recent months, with increased use stemming in part from the Black Lives Matter movement denouncing racism and police violence, and had been enjoying growing success in the United States, where it now has more than 100 million users.<sup>1</sup>

This rapid adoption by U.S. citizens worried U.S. authorities, largely due to the suspected risks of U.S. citizens' personal data being collected by Chinese intelligence services via the application. These fears are based on Article 7 of the China Internet Security Law adopted in June 2017, which states that "*any organization or citizen shall, in accordance with the law, support, assist and cooperate with national intelligence work and keep secret any national intelligence work of which they have knowledge.*" While these allegations of espionage have not been substantiated

by publicly available evidence and have always been denied by TikTok and its parent company, ByteDance, Tik Tok has been subject to increased scrutiny by U.S. authorities since 2019.

Specifically, in February 2019, as a result of legal action undertaken by the Federal Trade Commission (“FTC”), TikTok entered into a \$5.7 million settlement agreement with the U.S. authorities for illegally collecting data from users under 13 years of age without their parents’ consent. This was allegedly in violation of the Children Online Privacy Protection Act, which requires parental authorization prior to any collection of personal data.<sup>2</sup>

Subsequently, being aware of the risks linked to the potential use of the data collected by Chinese intelligence services, the U.S. military banned its members from downloading TikTok on government issued phones.<sup>3</sup> Other elements within the U.S. government have taken similar measures, with the U.S. Senate, for example, passing the *No TikTok on Government Devices Act*, which would ban TikTok from phones provided by U.S. agencies if it becomes law.<sup>4</sup>

In July 2020, with memories of Russian interference in the last presidential election still vivid, Democratic candidate Joe Biden’s campaign team also decided to ban the application from staffers’ business and personal phones following the suspicions of espionage surrounding TikTok.<sup>5</sup>

At the same time, the Committee for Foreign Investment in the United States (“CFIUS”), the U.S. agency responsible for ensuring that foreign investments do not harm the security and strategic interests of the United States, launched an investigation into TikTok’s prior acquisition of the Musical.ly application (which was ultimately integrated into TikTok) by ByteDance in 2017 for \$800 million. This investigation was launched at the request of several senators concerned the application is a threat to national security.<sup>6</sup>

In this context, in July 2020, U.S. Secretary of State Mike Pompeo and President Donald Trump threatened to exclude TikTok from the U.S. market.<sup>7</sup>

### **The effects of tightening the U.S. vise on TikTok, another jewel in China’s digital technology crown**

The Trump administration carried out these threats on August 6, 2020, with the publication of two Executive Orders (“E.O.”) prohibiting any U.S. person or person subject to U.S. jurisdiction from engaging in transactions with TikTok’s parent company ByteDance.

Under the orders, the U.S. Department of Commerce had 45 days from the signing of the orders to specify the scope of the prohibited transactions. In a press release dated September 18,<sup>8</sup> the Department of Commerce announced that the restrictive measures would take effect in two stages, on September 20 and November 12, 2020. These measures are mainly prohibitions on U.S. persons from providing certain services to the application

The Department of Commerce ordered that the following transactions be prohibited with TikTok as of September 20, 2020:

- the provision of services to distribute or maintain this application, its codes and updates through an online mobile application store.

However, the Department of Commerce later extended these deadlines to September 27, 2020, to allow ByteDance’s divestment negotiations with Oracle to continue.<sup>9</sup>

Further, the Department of Commerce ordered that the following transactions be prohibited from November 12, 2020 with TikTok:

- the provision of Internet hosting services, distribution network services, or Internet transit or peering services - directly concluded or arranged - enabling the operation or optimization of this application;
- the use of the application codes, functions or services in the operation of software or services developed and/or accessible within the United States.

However, the enforcement of these measures has been delayed by U.S. courts. In a legal suit brought by ByteDance, the U.S. judge granted the plaintiff's request for temporary injunctive relief prohibiting the Trump administration from enforcing the E.O.s on the grounds that, among other things, there is a significant risk that the E.O.s violate the U.S. Constitution's right to freedom of speech.<sup>10</sup> The Trump administration has appealed both injunctions.

The U.S. Executive adopted these two E.O.s because of the potential risks that the Chinese application poses to U.S. national security. According to the E.O.s, TikTok "*automatically capture vast swaths of information from [their] users. This data collection threatens to allow the Chinese Communist Party access to Americans' personal and proprietary information.*" In addition, the TikTok E.O. adds that the app could be used to "*track the locations of Federal employees and contractors, build dossiers of personal information for blackmail, and conduct corporate espionage.*"<sup>11</sup> The E.O.s also justify the measures taken on the grounds that the application have already been subject to similar restrictions by other countries such as India or Australia because of the risks they pose to the users' data protection.

Through these means, the Trump administration would therefore *de jure* exclude TikTok from the U.S. market. If the E.O.s are permitted to become effective, this application would no longer be available in U.S. app stores, including those of Google and Apple.

In any event, in this context, it is vital for companies with commercial relationships with this entity to evaluate their commercial relationship in order to determine the potential impact of this designation on their activity if the E.O.s become effective.

While the August 6, 2020 E.O.s had been based on the International Emergency Economic Powers Act (the statutory authority for most U.S. sanctions programs), on August 14, 2020, President Trump signed another E.O. on the basis of Section 721 of the 1950 Defense Production Act (the statutory authority for CFIUS) to order the divestment of ByteDance's 2017 acquisition of Musical.ly.<sup>12</sup> This E.O. requires ByteDance to dispose of TikTok's U.S. assets for national security reasons within 90 days (i.e. November 12, 2020) under conditions set out by CFIUS (excluding the 30-day extension decided by CFIUS).<sup>13</sup>

### **A contrasting Chinese response in the context of the sale of ByteDance's U.S. activities**

In this context, the CEO of TikTok, Kevin Meyer, who was appointed at the beginning of June 2020, decided to resign, as it would be impossible for him to carry out his duties if the E.O. becomes effective.<sup>14</sup> At the end of August 2020, TikTok decided to mount a legal challenge to the E.O.<sup>15</sup>

The Chinese authorities, through diplomatic spokesman Wang Wengbin, denounced "*political manipulation and repression*" following the unprecedented measures taken against the TikTok application in the United States.<sup>16</sup>

These measures initially prompted TikTok's parent company, ByteDance, to enter into discussions to sell its U.S. operations to a U.S. company. However, in response to this E.O., China has strengthened its export controls rules for the first time since 2008, in particular to include "*personalized information recommendation services based on data analysis*" whose algorithms allow, after analyzing user behavior, to provide personalized content, thereby submitting the acquisition of this technology to the approval by the Chinese authorities.<sup>17</sup> These new controls effectively target TikTok's underlying core algorithm. In the current climate of open economic tension with

Washington, it seems unlikely that Beijing will give its approval to ByteDance to sell the technology behind TikTok. ByteDance therefore finds itself trapped between the U.S. hammer forcing it to sell its activities on U.S. territory (or risk shutting it down completely with no compensation under the August 6, 2020 E.O.), and the Chinese anvil, which would only approve the sale of an empty shell, there being little chance of Beijing granting the authorizations required for the transfer of technology.

In these tense circumstances, while the sale to a joint Microsoft-Walmart ticket had been the leading favorite, now a "*privileged technological partnership*" with another standard-bearer in Silicon Valley, Oracle, whose CEO is an active supporter of President Trump, appears to be favored.<sup>18</sup> However, in an article published in the Chinese state-run daily newspaper, the China Daily on September 23,<sup>19</sup> this potential arrangement was vigorously questioned in the following terms: "*China has no reason to give the go-ahead to such an agreement which is dirty and unjust and is based on intimidation and extortion.*" The newspaper argues that if the United States were to succeed in reaching such an agreement with ByteDance, it will merely be the first in a long series of takeovers and pressure by other foreign companies. This new development leads us to reconsider any potential improvement in Sino-American commercial discussions or dialogue.

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<sup>1</sup> [https://www.lemonde.fr/pixels/article/2020/06/15/black-lives-matter-en-boucle-sur-tiktok\\_6042945\\_4408996.html](https://www.lemonde.fr/pixels/article/2020/06/15/black-lives-matter-en-boucle-sur-tiktok_6042945_4408996.html).

<sup>2</sup> <https://www.ftc.gov/news-events/press-releases/2019/02/video-social-networking-app-musically-agrees-settle-ftc>.

<sup>3</sup> <https://www.reuters.com/article/us-usa-tiktok-navy/u-s-navy-bans-tiktok-from-government-issued-mobile-devices-idUSKBN1YO2HU>.

<sup>4</sup> <https://www.congress.gov/bill/116th-congress/senate-bill/3455>.

<sup>5</sup> <https://edition.cnn.com/2020/07/28/politics/biden-campaign-tiktok/index.html>.

<sup>6</sup> <https://www.reuters.com/article/us-usa-congress-tiktok/senators-call-for-intelligence-probe-into-chinese-owned-app-tiktok-idUSKBN1X32J3>.

<sup>7</sup> <https://edition.cnn.com/2020/07/07/tech/us-tiktok-ban/index.html>.

<sup>8</sup> <https://www.commerce.gov/news/press-releases/2020/09/commerce-department-prohibits-wechat-and-tiktok-transactions-protect>.

<sup>9</sup> <https://www.commerce.gov/news/press-releases/2020/09/statement-delayed-prohibitions-related-tiktok>.

<sup>10</sup> <https://www.wsj.com/articles/tiktok-makes-its-case-for-last-minute-relieve-from-u-s-download-ban-11601225594>; <https://www.nytimes.com/2020/09/27/technology/tiktok-ban-ruling-app.html>.

<sup>11</sup> <https://www.federalregister.gov/documents/2020/08/11/2020-17699/addressing-the-threat-posed-by-tiktok-and-taking-additional-steps-to-address-the-national-emergency>.

<sup>12</sup> <https://home.treasury.gov/system/files/136/EO-on-TikTok-8-14-20.pdf>.

<sup>13</sup> As such, CFIUS has the opportunity to oppose an a posteriori sale even if the sale was not subject to a priori CFIUS authorization.

<sup>14</sup> <https://www.ft.com/content/c35fc9fb-6466-43f0-8ad6-ddf6c1cc7d79>.

<sup>15</sup> <https://newsroom.tiktok.com/fr-fr/tiktok-files-lawsuit>.

<sup>16</sup> <https://www.lefigaro.fr/flash-eco/pekin-crie-a-la-repression-apres-les-mesures-de-trump-contre-tiktok-et-wechat-20200807>.

<sup>17</sup> <https://www.ft.com/content/a8480c0d-7cce-4f10-88ec-6b8294e71ec4>.

<sup>18</sup> <https://www.lesechos.fr/tech-medias/hightech/oracle-choisi-pour-reprendre-les-activites-americaines-de-tiktok-1242041>.

<sup>19</sup> <https://global.chinadaily.com.cn/a/202009/23/WS5f6a2445a31024ad0ba7b1c9.html>.

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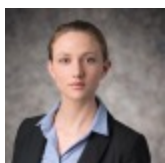
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