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China Lays Legal Basis for Unreliable Entity List Enforcement

The Ministry of Commerce of the People's Republic of China issued "Provisions on the Unreliable Entity List" (UEL), a Decree which has come into effect immediately.¹ While the concept of UEL was introduced on 31 May 2019 and is yet to be published, the issuance of the Decree suggests that remarkable progress has been made in terms of enforcement readiness.

The Decree is built on China's Foreign Trade Law and National Security Law, which takes foreign trade relations and national security as their subjects. The legislative purpose is stated in Article 1 of the Decree, "for the purpose of safeguarding national sovereignty, security and development interests, maintaining fair and free international economic and trade order, protecting the legitimate rights and interests of enterprises, other organisations, and individuals of China."

As analysed in a previous article², the UEL is a quasi-sanction programme which fills a gap in the instruments at China's disposal. UEL will enable the establishment of a sovereign sanction regime by China.

The UEL – once implemented – will target two kinds of behaviours committed by foreign entities:

1. Actions that harm China's "national sovereignty, security or development interests." This clause may be underpinned by the National Security Law;
2. Behaviours that interrupt "normal transactions with an enterprise, other organisation, or individual of

China or applying discriminatory measures against an enterprise, other organisation, or individual of China, which violates normal market transaction principles and causes serious damage to the legitimate rights and interests of the enterprise, other organisation, or individual of China."

The second point reiterates the spirit of the Foreign Trade Law but has more implications countering the current stop-supplying trends of foreign entities in fear of potential US extraterritorial enforcement.

As for how to assess the aforementioned behaviours so that a decision can be made regarding whether or not to add an entity to the UEL, Article 7 stipulates that the assessment shall be guided by the following principles:

1. The danger posed by the behaviour to the "national sovereignty, security or development interests of China;"
2. The damage caused by the behaviour to "the legitimate rights and interests of enterprises, other organisations, or individuals of China;"

¹ <http://www.mofcom.gov.cn/article/b/fwzl/202009/20200903002593.shtml>
<http://english.mofcom.gov.cn/article/policyrelease/questions/202009/20200903002580.shtml>

² <https://www.linkedin.com/pulse/unreliable-entity-list-its-nature-johnny-xie/>

These aforementioned clauses are reminiscent of the trade remedies that are regulated by the Foreign Trade Law. For example, in anti-dumping cases, the authorities need to identify the dumping behaviour, the damage to domestic industry, and the cause and effect relation between the two facts. The methodology can help foster objective criteria and transparent procedures aiming to prevent authorities from making decisions based on unproved charges, allegations, or pure political reasons. Similar to trade remedies, the Decree grants foreign entities the right to appeal for removal from the UEL and to defend themselves during the investigation period.

3. **Whether or not the behaviour is in compliance with “internationally accepted economic and trade rules.”** The Decree does not define what constitutes “internationally accepted” economic and trade rules. Empirical evidence shows that China recognises and enforces UN sanctions but its stand on sanctions imposed by the European Union and United States has not been defined. For instance, in the event that a foreign entity ceases to supply Chinese customers owing to US export control or sanction regulations, would that move be interpreted as compliance with internationally accepted economic and trade rules even if it is to the detriment of Chinese interests?
4. **“Other factors that shall be considered.”** Such a clause is typically included in Chinese legislations as it allows for a broad interpretation by authorities. The most significant part from a trade compliance point of view is the detailed penalties introduced by the Decree, which was absent when the UEL concept was first announced.

Article 10 of the Decree enumerates six categories of penalties that can be imposed on the foreign entities listed on UEL.

1. **“[R]estricting or prohibiting the foreign entity from engaging in China-related import or export activities.”** As we know, the US export control regime exercises controls over the export of items of US origin while US sanction programmes generally prohibit US persons from rendering services to sanction targets. Here, “China-related” does not specify whether it is related to the items of Chinese origin or the persons of Chinese nationality, or both of them. Or anything with Chinese elements, for example, conducting a transaction in Chinese currency or even the language. Another area of ambiguity is the “import or export activities.” Does it mean the traditional trade in goods

only or to include trade in service and deemed import & export as well?

Moreover, while the restriction and prohibition are directed towards foreign entities, are there any requirements for Chinese entities to help ensure the policy effect? That is, to put an obligation on Chinese entities not to engage the foreign entities for any economic activities like the SDN list’s effect on US persons?

At the end of Article 10, it states that “[t]he measures provided for in the preceding paragraph shall be implemented according to law by the relevant departments in light of their respective duties and functions, and other units and individuals shall cooperate in the implementation.” This implies that legislators have foreseen the challenges and difficulties in interagency communication and cooperation.

Exceptions to UEL are mentioned in Article 12. “Where, under special circumstances, it is necessary indeed for an enterprise, other organisation, or individual of China to conduct transactions with the foreign entity that is restricted or prohibited from engaging in China-related import or export activities, an application shall be submitted to the Office of the working mechanism, then the transactions with the foreign entity in question may be conducted upon approval.” It is clear that exceptions are based on a case by case application and approval mechanism rather than a standard license and licensing mechanism.

2. **“[R]estricting or prohibiting the foreign entity from investing in China.”** Control over investment is relatively easier than control over import and export activities because China has an existing foreign investment review system to leverage. However, the Decree still needs to clarify whether the restriction and prohibition are against future investment only or will affect existing investment of the foreign entity as well. That is, to ban a business and force it to exit the Chinese market completely.
3. **“[R]estricting or prohibiting the foreign entity’s relevant personnel or means of transportation from entering into China;”**
4. **“[R]estricting or revoking the relevant personnel’s work permit, status of stay or residence in China.”** Clauses 3 and 4 can be enforced easily because the Police, Customs, and Diplomacy already have effective controls in these areas.

5. “[I]mposing a fine of the corresponding amount according to the severity of the circumstances;” The calculation and determination of the amount of a fine can be a technical issue and demands elaboration. Depending on how to view and measure the damage, the range between the lower end and the higher end can be very broad.
6. “[O]ther necessary measures.” Again, a typical catch-all clause.

In summary, the Decree has set a legal basis for UEL enforcement, formulated an interagency working mechanism, defined assessment criteria and procedures and materialised the penalties. Economic operators are advised to get acquainted with the new regulations, conduct risk assessment and take compliance measures accordingly.

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JOHNNY XIE

Managing Director
Export Controls & Sanctions
johnny.xie@fticonsulting.com
+86 21 2315 1019