



POLICY ALERT /// September 24, 2020

China Announces “Provisions on the Unreliable Entity List”

Summary

On September 19, China’s Ministry of Commerce (MOFCOM) released an administrative order – the “Provisions on the Unreliable Entity List” (“the UEL”) – that provides initial procedures for the designation of persons, companies, or organizations that act contrary to China’s interests, as well as laying out possible sanctions.¹ While China has not yet targeted any persons or companies under this authority, non-Chinese firms operating in China or with Chinese counterparties should monitor developments regarding implementation of the new order to better understand their potential exposure.

- **The UEL targets non-Chinese “entities,” which include any “enterprise, other organization, or individual of a foreign country,” that broadly acts contrary to China’s national interests.** The UEL establishes a mechanism to investigate whether a foreign entity has endangered China’s sovereignty, security, and development, or otherwise interfered with normal economic relations with Chinese entities. During the investigation phase, a foreign entity may provide evidence disputing that its behavior fits that criteria. If the investigation finds against the foreign entity, China can apply a variety of punitive measures, including: bans on import/export activities, investment, entry into or residence in China; a monetary fine; and “other necessary measures.”
- **The UEL is a direct response to increasing tensions in the U.S.-China relationship.** China first announced the UEL in May 2019 at the height of the trade dispute, though Beijing did not then offer any details on how it would operate.² Since that time, the United States has taken a number of actions to push back on Chinese behavior it considers unacceptable, including: revoking Hong Kong’s “special status” in light of Beijing’s crackdown on the city’s pro-autonomy demonstrations; designating high-ranking officials for human rights abuses in Xinjiang; and Executive Orders targeting the popular Chinese mobile applications TikTok and WeChat.³ The UEL further delineates China’s framework for employing economic coercion.
- **Companies with a presence or business activity in China should closely follow China’s implementation of the UEL.** MOFCOM has wide latitude to further define the provisions of the UEL, including the criteria for listing/delisting. Companies should closely follow how Beijing handles investigations and who it ultimately lists. Companies should also prepare for handling potential conflict-of-law situations. Companies with operations in China who comply with U.S. sanctions or export controls on Chinese entities would likely fit the criteria for listing, as China views these measures as an infringement of its sovereignty.



Understanding the Provisions of the UEL

The UEL provides for a multistage process for determining whether a foreign entity should be listed, formally listing it, and then potentially removing it.

- **Investigations.** According to the order establishing the UEL, an office for an inter-departmental working mechanism will be established at the Ministry of Commerce. The staff of this working mechanism will organize and implement the UEL. It will decide, based on information obtained by the Chinese government, whether to investigate the actions taken by a foreign entity. During the investigation phase, the mechanism is empowered to ask questions and consult relevant documentation. At this stage, a targeted foreign entity may argue that its alleged activities do not fit the criteria for listing.
- **Criteria for investigation and listing.** The prospective behavior that may lead to being added to the UEL is structured broadly and is not necessarily bound to activities that take place within China. The behavior includes:
 - “Endangering national sovereignty, security or development interests of China”;
 - “Suspending normal transactions with an enterprise, other organization, or individual of China or applying discriminatory measures against an enterprise, other organization, or individual of China.”

The range of conduct within those definitions could include actions taken as a result of U.S. sanctions (e.g., suspending a contract with a Chinese counterparty that had been designated). In the recent past, China has imposed countersanctions on U.S. legislators who had sponsored legislation to impose sanctions on Chinese government officials and entities.⁴ Beijing could also target entities that engage in activities that do not follow China’s interpretation of its sovereign rights. The working mechanism for the UEL will also use specified criteria to determine whether to add a foreign entity. The working mechanism will consider the degree of damage to “legitimate rights and interests” of Chinese companies and individuals, and whether the foreign entity is acting in accordance with generally accepted international trade practice.⁵

In developing this framework, China may begin to resolve at least some of the ambiguity around the methods it uses to apply economic coercion to foreign individuals or firms. In previous instances when it has threatened economic retaliation, it often did not specify what specific acts it would undertake. For example, when China previously targeted international airlines for listing Taiwan as a separate country on their flight routes, it was not explicit about the range of punishments those airlines would face for non-compliance.⁶ Similar lack of clarity attached to Beijing’s threats to sanction U.S. defense firm Lockheed Martin following that company’s arms sales to Taiwan. The Chinese government did not



articulate what the sanctions consisted of or how they would be applied.⁷ It could now do so more formally with the UEL.

- **The nature of the sanctions to be imposed.** Any announcement of an addition to the UEL will be public and contain a warning of the consequences of dealing with an entity on the UEL. China may take a broad range of actions, including but not limited to restrictions on a foreign entity's ability to engage in trade with or investment in China. A foreign entity's personnel may also see their ability to travel or reside in China restricted. MOFCOM may also impose fines on foreign entities or adopt "other necessary measures." As currently written, the order does not envision freezing of assets in the same way that U.S. sanctions require.⁸

Once the working mechanism decides to add a foreign entity to the UEL, it may specify a time limit for the foreign entity to "rectify its actions" before pursuing specific restrictive measures. The working mechanism also establishes a licensing procedure for Chinese entities who need to engage in transactions with a foreign entity on the UEL. Foreign entities on the UEL may also formally apply for removal. The working mechanism will decide whether to remove a foreign entity from the UEL if it both rectifies its actions within the specified time limit and "takes measures to eliminate the consequences of actions" though the exact nature of those requirements remains to be determined.

Implications for the Private Sector

Companies with a presence in China should understand the establishment of the provisions for the UEL represent Beijing's efforts to provide a framework for its use of sanctions. The Chinese government has taken this step to further formalize its response to U.S. economic pressure.

- **A high degree of uncertainty exists around how China will implement the UEL.** The order establishing the operations of the UEL does not offer specific guidance or definitions for many of its provisions. The broad language of several of the order's articles means the Chinese government will maintain substantial flexibility in implementation and enforcement. According to press reports, some Chinese leaders are hesitant to impose costs on U.S. companies, particularly in the last weeks before the U.S. presidential election.⁹ Until China starts to formally launch investigations and list foreign entities, it will be difficult to determine what conduct Beijing considers egregious enough to warrant the UEL's restrictive measures.
- **The UEL may lead to conflict-of-law issues for companies operating in China that are also subject to U.S. jurisdiction.** China has long-considered compliance with U.S. sanctions and export controls to be a violation of its sovereignty. It may use the UEL, and its threat of loss of access to the Chinese market, to dissuade firms from compliance with U.S. measures, or to punish those that choose to follow U.S. law.



Endnotes

¹ Ministry of Commerce, People's Republic of China, "MOFCOM Order No. 4 of 2020 on Provisions on the Unreliable Entity List," (September 19, 2020), available at <http://english.mofcom.gov.cn/article/policyrelease/questions/202009/20200903002580.shtml>.

² "What We Know About China's 'Unreliable Entities' Blacklist," Bloomberg (June 4, 2019), available at <https://www.bloomberg.com/news/articles/2019-06-04/understanding-china-s-unreliable-entities-blacklist-quicktake?sref=Pw1Mp35R>.

³ For more background on these actions, see K2 Intelligence-Financial Integrity Network, "U.S. Takes Additional Economic Steps Against China," (August 13, 2020), available at https://www.finintegrity.com/uploads/8/7/8/0/87802750/2020.08.12_-_china_policy_alert_update_-_final.pdf.

⁴ Chun Han Wong, "China Threatens to Sanction Lockheed Martin Over Taiwan Arms Deal," *Wall Street Journal* (July 14, 2020), available at <https://www.wsj.com/articles/china-to-sanction-lockheed-martin-over-taiwan-arms-deal-11594727908>.

⁵ Article 7 of the order addresses these issues: "The working mechanism shall, according to the results of the investigation and by taking into overall consideration the following factors, make a decision on whether to include the relevant foreign entity in the Unreliable Entity List, and make an announcement of the decision: (1) the degree of danger to national sovereignty, security or development interests of China; (2) the degree of damage to the legitimate rights and interests of enterprises, other organizations, or individuals of China; (3) whether being in compliance with internationally accepted economic and trade rules; (4) other factors that shall be considered." Ministry of Commerce, People's Republic of China, "MOFCOM Order No. 4 of 2020 on Provisions on the Unreliable Entity List," (September 19, 2020), available at <http://english.mofcom.gov.cn/article/policyrelease/questions/202009/20200903002580.shtml>

⁶ Sui-Lee Wee, "Giving In to China, U.S. Airlines Drop Taiwan (in Name at Least)," *New York Times* (July 25, 2018), available at <https://www.nytimes.com/2018/07/25/business/taiwan-american-airlines-china.html>.

⁷ At the time, most observers assumed China meant to block Lockheed Martin from selling to Chinese, which it could not have done under U.S. law. Chun Han Wong, "China Threatens to Sanction Lockheed Martin Over Taiwan Arms Deal," *Wall Street Journal* (July 14, 2020), available at <https://www.wsj.com/articles/china-to-sanction-lockheed-martin-over-taiwan-arms-deal-11594727908>.

⁸ In some ways, the UEL raises comparisons to both the Office of Foreign Assets Control's Specially Designated Nationals and Blocked Persons List and Sectoral Sanctions Identification List, and the Department of Commerce's Entity List. Like the SDN and SSI lists, China's UEL can lead to the blocking of specific transactions, including equity investment in China. Similar to the Entity List, the UEL can block imports/exports to/from China, though, as conceived by this order, it is much broader than how Commerce's Entity List restricts exports. Exact comparisons to U.S. economic measures will only become more precise as China begins to add entities to the list.

⁹ Lingling Wei, "Chinese Leaders Split Over Releasing Blacklist of U.S. Companies," *Wall Street Journal*, (September 21, 2020), available at https://www.wsj.com/articles/chinese-leaders-split-over-releasing-blacklist-of-u-s-companies-11600708688?mod=hp_lead_pos6.