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Brief Analysis on the “Unreliable Entity List”

By David Pan | Ivy Hong | Shana Sha

On 31 May 2019, the Ministry of Commerce (“MOFCOM”) of the People’s Republic of China (the “PRC”) ¹ announced that the Chinese government will introduce an “Unreliable Entity List” (the “UEL”), in response to the threat of unilateralism and trade protectionism to China’s national security, public interests and legitimate rights and interests of Chinese enterprises. The UEL will include foreign enterprises, organizations or individuals that violate market rules, deviate from the spirit of the contract, engage in boycott or cut off supplies to Chinese enterprises for non-commercial purposes and cause serious damages to Chinese enterprises. The detailed measures of the UEL will be released by MOFCOM soon.

MOFCOM officials commented that the government would consider “four factors” in determining whether a subject (foreign entity or individual) will be blacklisted, ² including:

- (1) Whether the subject’s actions are taken for non-commercial purposes and against market rules and the spirit of the contract (Subjective Purpose);

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- (2) Whether the subject has taken specific “discriminatory measures” against Chinese entities, such as boycotting or cutting off supplies (Objective Actions);
- (3) Whether the subject’s actions have caused material damage to Chinese enterprises and related industries (Actual Damage);
- (4) Whether the subject’s actions constitute a threat or potential threat to China’s national security (Potential Damage).

1. Background of the introduction of UEL

1.1 Macroeconomic global environment

In recent years, some foreign countries have abused the concept of national security, measures of export control, and means of long-arm jurisdiction to cope with the continuous expansion of China's foreign trade. Such abuses have not only caused serious harms to the division of labor in global industrial chain, supply chain and value chain, but also China’s national interests. ³

Meanwhile, China's legal system still has shortcomings in dealing with foreign trade relations and unilateralism. Therefore, it is necessary to strengthen the construction of PRC laws to improve China's ability to safeguard its own trade interests and stabilize foreign trade relations. ⁴

1.2 US-China Trade War

The continuous trade friction between China and the US since March 2018 is the direct cause of China introducing the UEL.

On 10 May 2019, the US announced that it would raise tariffs on \$200bn of Chinese goods from 10% to 25%;⁵ China responded by declaring that it would take necessary countermeasures if the US tariffs took effect. ⁶

On 16 May 2019, Bureau of the Industry and Security (“BIS”) amended the *Export Administration Regulations* (“EAR”) and designated Huawei Technologies Co., Ltd. (“Huawei”) and 68 affiliated Huawei entities to the Entity List. ⁷ According to the BIS, they designated Huawei due to the US government’s belief “that Huawei has been involved in activities contrary to the national security or foreign policy interests of the United States.” ⁸ For all of the entities included in the Entity List, BIS impose a license requirement for the export, re-export, or transfer of all items “subject to the EAR.” The BIS is likely to refuse the license if the sale or transfer would jeopardize US national security or foreign policy interests.

On 2 June 2019, MOFCOM released a *White Paper on China’s Stance on US-China Economic and Trade Consultations*,⁹ which stated that the recent announcement by the US of raising tariffs on China

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is not conducive to solving bilateral economic and trade issues. China is strongly opposed to the US action and has no choice but to respond and safeguard its legitimate rights and interests.

1.3 Reference to Foreign Experience

With respect to unilateral and multilateral sanctions, the US has introduced anti-boycott regulations in *The Export Administration Act* and the *Tax Reform Act of 1976* in the 1970s. In 2018, the anti-boycott regulations were reintegrated into the *Anti-boycott Act of 2018*, which is managed by BIS as part of the *Export Control Reform Act of 2018*.¹⁰

Anti-Boycott Act of 2018 listed six categories of boycotts against which the BIS has the power to impose fines of up to \$1 million or criminal penalties of up to 20 years in prison, or civil penalties such as export bans, license revocation and fines.¹¹

In contrast, China has not formally promulgated a systematic and fundamental law on export control.

2. Legal Basis

According to the MOFCOM, the UEL system was made in line with China’s *Foreign Trade Law*, *Anti-Monopoly Law*, and *National Security Law*.¹² In addition, the *Constitution*, the *Foreign Investment Law*, and other related laws emphasize on safeguarding national security and ensuring the normal operation of the market economy system, that foreign enterprises must comply with Chinese laws and regulations. In the future, when the *Export Control Law* comes into force, it will also provide a legal basis for the UEL.

2.1 Foreign Trade Law

The *Foreign Trade Law* includes general provisions¹³ and authorization provisions,¹⁴ but both are relatively in principle. According to Article 7 of the *Foreign Trade Law*, in the event that any country or region adopts prohibitive, restrictive or other similar measures that are discriminatory in nature against the PRC in trade, the PRC may, in light of the actual conditions, take countermeasures against the country or region accordingly.

This indicates that when Chinese enterprises are subject to discriminatory treatment in international trade in a certain country or region, China has the right to take corresponding measures against the enterprises in that country or region.

2.2 Anti-Monopoly Law

According to Article 17 of the *Anti-Monopoly Law*, undertakings holding dominant market positions are prohibited from doing the following by abusing their dominant market positions: refusing to enter

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into transactions with their trading counterparts without justifiable reasons; or applying differential prices and other transaction terms among their trading counterparts who are on an equal footing without justifiable reasons.

Whether domestic laws or administrative orders could constitute "justifiable reasons" and thus become a defense for foreign entities in violating *Anti-Monopoly Law*? At present, it is unclear whether a foreign entity can be considered to have "justifiable reasons" when it is forced to carry out discriminatory measures such as refusal and restriction of transactions by abiding their domestic laws or administrative order. However, if the above situation could constitute an exemption to the *Anti-Monopoly Law*, it will go against what the UEL originally intended for - if the conducts of the foreign entity have met the abovementioned four factors of the UEL, but will be excluded because of the above defense, then it will be meaningless to set up the UEL.

2.3 National Security Law

According to Articles 19 and 59 of the *National Security Law*, the state shall maintain its economic order and security for important industries and crucial fields related to lifeline of the national economy; the state shall also establish the rules and supervision mechanism to conduct national security review on matters and activities that affect or may affect national security.

To some extent, the above provisions reflect that if foreign individuals or entities conduct trade business in the important industry and key fields in China, they should abide by China's laws and regulations. Otherwise, it is likely to be deemed as a threat to China's national security and thus be added to the UEL.

2.4 The Constitution and Foreign Investment Law

Both the *Constitution* and the *Foreign Investment Law* emphasize the maintenance and protection of China's economic order.

According to Article 15 of the *Constitution*, the state forbids any entity or individual from interfering with the social and economic order; Article 18 further stipulates that all foreign enterprises and other foreign economic organizations, as well as Sino-foreign joint ventures located in China, shall abide by the PRC laws.

Similar to the provisions of the *National Security Law*, Article 35 of the *Foreign Investment Law* stipulates that the state shall establish a safety review system to conduct safety review of any foreign investment that affects or may affect national security.

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2.5 The Export Control Law (Draft)

The *Export Control Law* (Draft) clarifies the principle of reciprocity, that is, if any country (region) adopts discriminatory export control measures against China, China may take retaliatory measures against that country (region). Meanwhile, according to Article 29 of the *Export Control Law* (Draft), the authorities in charge of export control may maintain a control list of foreign importers and end-users that violate the end-user and end-use commitment, potentially endanger national security and development interests, and may be used for terrorist purposes. The competent authority may also take necessary control measures on domestic exporters and their related transactions, such as prohibiting or cancelling their export license.

Although the *Export Control Law* has not been formally implemented, it can also provide legal foundations for the UEL to some extent after it takes effect.

3. Influence on Chinese and foreign enterprises

Although the detailed measures has not yet been released by the MOFCOM, we can still take reference from the legal practice of the *Anti-Monopoly Law*, the *Export Control Law* (Draft) and the US EAR.

The legal liability stipulated in the *Anti-Monopoly Law* is mainly reflected in penalty of fines. The legal liability stipulated in the *Export Control Law* (Draft) is more extensive, including fines, marked in credit information system, and revocation of export privileges and license. Since the UEL targets foreign entities, if a foreign entity sets up a branch in China, China can impose fines on the branches of the foreign entity, included them into the credit information system and disqualify their export privileges in accordance with the principle of territorial jurisdiction.

After the establishment of the UEL, foreign entities or multinational companies involved in China trade activities may face an awkward dilemma - if the administrative order issued by foreign country goes contrary to Chinese laws and regulations, and foreign entities act in accordance with its domestic administrative order, they would possibly be included in the UEL in China.

For instance, FedEx recently diverted two packages from Japan, addressed to Huawei China, to the US without authorization of Huawei. China's Ministry of Foreign Affairs responded at the press conference on July 26¹⁵ that the statement by FedEx apologizing it was a “mistake” to transfer Huawei parcels to the US was not consistent with the facts. Meanwhile, investigations by Chinese authorities have also found that FedEx is suspected of holding over 100 inbound Huawei parcels. Based on the findings, FedEx is likely to face punishment with a series of violations in China, including being added to the UEL.

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¹ A spokesman for MOFCOM answered questions on China's plan to establish the Unreliable Entity List, <http://www.mofcom.gov.cn/xwfbh/20190531.shtml>, last visited on July 11, 2019.

² Interpretation from MOFCOM: Why is the Unreliable Entity List introduced? <http://coi.mofcom.gov.cn/article/y/gnxw/201906/20190602869699.shtml>, last visited on July 11, 2019.

³ See above.

⁴ Who the "Unreliable Entity List" is for – Interview with Fan Cui, Research Director of China Society for World Trade Organization Studies, People website, <http://finance.people.com.cn/n1/2019/0603/c1004-31116232.html>, last visited on July 11, 2019.

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⁶ A spokesman for MOFCOM made a statement on the proposed tariff upgrade by the US side, <http://www.mofcom.gov.cn/article/ae/ag/201905/20190502861184.shtml>, last visited on July 11, 2019.

⁷ Addition of Entities to the Entity List, <https://www.federalregister.gov/documents/2019/05/21/2019-10616/addition-of-entities-to-the-entity-list>, last visited on July 11, 2019.

⁸ Department of Commerce Announces the Addition of Huawei Technologies Co. Ltd. to the Entity List, <https://www.commerce.gov/news/press-releases/2019/05/department-commerce-announces-addition-huawei-technologies-co-ltd>, last visited on July 11, 2019.

⁹ MOFCOM released a white paper on China's stance on US-China economic and trade consultations, http://paper.people.com.cn/rmrb/html/2019-06/03/nw.D110000renmrb_20190603_3-01.htm, last visited on July 11, 2019.

¹⁰ Kevin J. Wolf, Thomas J. McCarthy, Steven C. Emme, Andrew R. Schlossberg, *The Export Control Reform Act and Possible New Controls on Emerging and Foundational Technologies*, <https://www.akingump.com/en/news-insights/the-export-control-reform-act-of-2018-and-possible-new-controls.html>, last visited on July 11, 2019.

¹¹ U.S. Code Title 50. WAR AND NATIONAL DEFENSE Chapter 58. EXPORT CONTROL REFORM Subchapter II. ANTI-BOYCOTT ACT OF 2018 Section 4843. Enforcement, <https://www.law.cornell.edu/uscode/text/50/4843>, last visited on July 15, 2019.

¹² A spokesman for MOFCOM answered questions on China's plan to establish the Unreliable Entity List, <http://www.mofcom.gov.cn/xwfbh/20190531.shtml>, last visited on July 11, 2019.

¹³ See Article 1 of the Foreign Trade Law.

¹⁴ See Article 7 of the Foreign Trade Law.

¹⁵ Foreign Ministry spokesperson Chunying Hua held a press conference on July 26, 2019, https://www.fmprc.gov.cn/web/fyrbt_673021/jzhsl_673025/t1683669.shtml, last visited on August 5, 2019.