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China Enacts Regulations on Unreliable Entity List

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On May 31, 2019, China's Ministry of Commerce announced that China would soon establish an "Unreliable Entity List" (the "**List**"). This announcement came two weeks after the U.S. Department of Commerce placed a Chinese tech giant and its affiliates on the U.S. Entity List.¹ Since then, U.S.-China tensions have continued to escalate. The Trump Administration recently moved to address national security concerns related to certain Chinese social media and communications apps in the United States.

On September 19, 2020, China's Ministry of Commerce finally issued the Regulations on Unreliable Entity List (the "**Regulations**"),² which consist of 14 provisions that provide further detail about the administration of the List. The Chinese government has not yet placed any entities or companies on the List.

According to the Chinese Government, the Regulations were promulgated in the name of safeguarding China's interests in "sovereignty, security, and development," maintaining a "fair and free international economic and trade order," and protecting the "lawful rights and interests of Chinese companies, other organizations or individuals."³ Immediately effective upon issuance,⁴ the Regulations set out (i) the standards for placing entities on the List, (ii) the working mechanism for determining the placement on and delisting from the List (the "**Working Mechanism**"), and (iii) the consequences of being placed on the List.

The Standard

Pursuant to the Regulations, China established the List to take "corresponding measures" against any conduct by foreign entities in international economic and trade and other relevant activities that (i) endangers China's national interests of sovereignty, security, and development; (ii) suspends or terminates normal transactions with Chinese companies, other organizations or individuals in violation of normal market transaction principles; or (iii) adopts discriminatory measures against Chinese companies, other organizations, or individuals in serious violation of their lawful rights and interests. ⁵ "Foreign entities" includes "foreign companies, other organizations or individuals."⁶

In determining whether to place a foreign entity on the List, the Regulations provide in Article 7 that the Working Mechanism would consider (i) the degree of harm caused to China's national interests of sovereignty, security, and development; (ii) the degree of infringement caused to the lawful rights and interests of Chinese companies, other organizations, or individuals; (iii) whether the conduct at issue complies with internationally recognized economic and trade rules; and (iv) other factors that should be considered.⁷

While the Regulations have not defined what constitutes a harm to the specified national interests, the Chinese government has recently announced sanctions on certain U.S. entities that may shed

light on this matter. For example, on July 13 and August 10, 2020, China announced sanctions on the U.S. Congressional Executive Commission on China and other U.S. officials for interfering with affairs concerning Xinjiang and Hong Kong respectively. On July 14, 2020, China announced sanctions against a U.S. defense contractor for its involvement in providing missile parts to Taiwan. This move suggests that foreign entities that China considers as interfering in internal affairs related to these sensitive regions may run the risk of being placed on the List. However, at the time of this writing, no foreign companies have been formally included on the List by the Chinese government.

Similarly, there is no definition as to what constitutes harm to the lawful rights and interests of the Chinese entities. According to the Regulations, foreign entities that discriminate against Chinese businesses can be targeted. Notably, the U.S. government has substantially restricted the operations of several of the leading Chinese communications and technology companies. While foreign entities have ceased conducting business with these Chinese companies to comply with U.S. regulations, whether such cessation would be deemed as a discrimination against Chinese companies, thereby causing all U.S. entities in compliance with U.S. sanctions law to be placed on the List (and effectively acting as a so-called “blocking statute,” as some other jurisdictions maintain, as a response to U.S. sanctions),⁸ remains to be seen. China has not yet responded with any reciprocal actions.

The Regulations do provide some indication regarding what constitutes “internationally recognized economic and trade rules” under Article 7. Article 3 states that the Chinese government (i) is committed to an independent and autonomous foreign policy; (ii) is committed to the fundamental principles of mutual respect for sovereignty, non-interference in internal affairs, and equality and mutual benefit in international relations; (iii) is against unilateralism and protectionism; (iv) is committed to safeguarding core national interests; (v) safeguards the multilateral trading system; and (vi) promotes the construction of an open world economy.⁹ These values were previewed in China’s State Council’s report to the Standing Committee of the National People’s Congress in October 2019.¹⁰ Consequently, any conduct that deviates from the aforesaid principles might be considered to run afoul of “internationally recognized economic and trade rules.”

As with other Chinese laws and regulations, Article 7 also contains a catch-all provision, leaving open the door for the Working Mechanism to consider any “other factors that should be considered.” At this point, it is unclear what these other factors could entail.

The Working Mechanism

The Regulations establish a Working Mechanism to administer and implement the List. All relevant departments of the Chinese government will take part in the Working Mechanism.¹¹ The Office of the Working Mechanism is formed within the Ministry of Commerce.¹²

The Working Mechanism may investigate a foreign entity’s conduct based on its own authority or the suggestions and reports of relevant parties; any decision to investigate will be made public.¹³ In terms of investigative measures, the Regulations authorize the Working Mechanism to inquire about and possibly interview relevant parties, review or copy relevant documents and materials, and take such other steps as may be necessary.¹⁴ During an investigation into a foreign entity’s conduct, the foreign entity may make statements and defenses to the Working Mechanism.¹⁵ Under certain circumstances, the Working Mechanism may decide to suspend or terminate the investigation.¹⁶ A suspended investigation may resume if the facts leading to the suspension have materially changed.¹⁷ Based on the standard described in the previous section, the Working Mechanism may decide to place the investigated foreign entity on the List. If so, such placement will be made public.¹⁸

These provisions describe the general framework for the Working Mechanism to carry out its mandate. However, many aspects of the Working Mechanism remain vague. For example, the Regulations have not specified the form of the “suggestions and reports” on which the Working Mechanism could base its decision to launch an investigation. Nor do the Regulations limit the scope

of the “relevant parties” who can submit these suggestions and reports. The Working Mechanism may take any “other necessary methods” to investigate also begs clarification. How can the investigated foreign entities protect their rights and interests? What are the channels to object to the Working Mechanism’s decision? These are just some of the questions that future relevant rules or regulations will need to address.

Key Provisions of the Regulations

If it determines that a foreign entity should be placed on the List, the Working Mechanism may decide to adopt at least one of the following measures against that foreign entity: (i) restrict or prohibit engagement in import and export activities concerning China; (ii) restrict or prohibit investment within the Chinese border; (iii) restrict or prohibit the entry into Chinese territory of relevant personnel or transportation vehicles; (iv) restrict or cancel work permits, or stay or residence qualifications of relevant personnel within the Chinese border; (v) impose a fine of an amount corresponding to the seriousness of the circumstances; and (vi) take any other necessary measures. These measures will be made public.¹⁹

There are several points that are worth noting concerning these measures.

First, it is uncertain, although likely, that the Regulations intend for these measures to extend beyond mainland China to the Hong Kong and Macau Special Administrative Regions. These Regions have some autonomy to devise their own export/import and foreign investment policies, as well as foreign work and residence requirements, potentially allowing foreign entities on the List to engage in activities within these Regions that the Regulations restrict or ban. However, pursuant to Hong Kong and Macau’s Basic Laws, such autonomy is limited insofar as Chinese sovereignty and foreign affairs are not concerned. Otherwise, authority lies within the Chinese Central Government. As the Regulations are to safeguard China’s national interests in sovereignty, security, and development, the Regulations may likely lead to Hong Kong and Macau adopting consistent enabling local legislation.

Second, the Regulations allow for the imposition of certain fines on foreign entities on the List, without specifying any monetary threshold or limits. There could be several ways for determining these thresholds and limits, and it is unclear at present how fines will be calculated or when they would be triggered. For example, an absolute threshold for triggering the fine could be set or the fines could be limited to a certain percentage of foreign entities’ revenues or profits within a certain period or region might be relevant. Either way, any threshold or limit is currently an open question and observers should continue to monitor whether a subsequent rule or regulation will provide further clarity.

Third, these measures do not appear to include the freezing of funds and assets of the foreign entity concerned within China. However, considering that this remedy is a common form of injunctive relief granted by the Chinese judiciary, observers should continue to monitor whether any future rules or regulations in relation to the List could proscribe or expand the use of this remedy.

Fourth, unless specified, Chinese entities may still transact with foreign entities on the List. Under Article 12, the Regulations provide that, for foreign entities that are restricted or prohibited from engaging in import and export activities concerning China, if a Chinese entity nevertheless requires transactions with such foreign entities under special circumstances, such Chinese entity should apply to the Office of the Working Mechanism for permission to transact. Such transactions may proceed only upon approval.²⁰ Accordingly, it appears that any foreign entities on the List that are not restricted or prohibited from engaging in import and export activities related to China but are subject to other measures (e.g., fines, travel restriction, etc.) may still be allowed to transact with Chinese entities, and the Regulations are not clear whether specific approvals are needed for such kind of transactions.

When deciding to place a foreign entity on the List, the Working Mechanism may also grant a grace period for the entity to rectify its misconduct.²¹ During this period, the penal measures will not be enforced.²² If the foreign entity succeeds in correcting its misconduct and takes measures to mitigate the consequences thereof within the prescribed period, the Working Mechanism will remove the entity from the List.²³ Otherwise, the prescribed measures would commence.²⁴

The Working Mechanism may remove a foreign entity from the List.²⁵ Any foreign entity on the List may also apply for such removal, which the Working Mechanism may consider based on specific facts.²⁶ Any delisting decision will be announced to the public, upon which the relevant measures adopted against the foreign entity will cease.²⁷

Key Takeaways

The Regulations do not necessarily mean that China is closing its doors to foreign investment. The Ministry of Commerce published an article providing expert commentary regarding the Regulations concurrently with the issuance of the Regulations.²⁸ The article asserts that the Regulations do not signal any shift in the Chinese government's position of welcoming and protecting foreign investment: "China's commitment to further opening up remains unchanged." The Ministry of Commerce reinforced this position in its press release on September 20, 2020.²⁹ This is also consistent with the recent enactment of the Foreign Investment Law and a series of affiliated rules and regulations, which ensure, *inter alia*, that foreign investments receive national treatment in China.

Nevertheless, non-Chinese entities should pay attention to whether their conduct could violate the guidelines set forth in the Regulations. Now that China has established the regulatory basis on which to roll out the List, the Chinese government is unlikely to further delay utilizing it to protect its interests.

Chinese entities should also be aware of whether their foreign transaction counterparties are being investigated for inclusion or are already included on the List—which would theoretically be publicly available information. While it is not yet entirely clear, it is unlikely that Chinese entities would face no consequences for entering into transactions with foreign entities that are restricted or banned from engaging in import, export, or activities in relation to China without the requisite approvals.

While these Regulations provide the general guidance on and directions for the standards, mechanisms, and implications regarding the operation of the List, many specifics remain ambiguous. Both Chinese and non-Chinese entities should continue to watch for clarity that future List-related actions, rules, and regulations may provide, including in particular China's Export Control Law—which is currently in its final legislative phase before the National People's Congress.



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- ¹ U.S. Bureau of Industry and Security, Department of Commerce, 84 FR 22961, May 21, 2019 (available at <https://www.federalregister.gov/documents/2019/05/21/2019-10616/addition-of-entities-to-the-entity-list>).
 - ² Regulations on Unreliable Entity List (Ministry of Commerce Decree No. 4 [2020]) (《不可靠实体清单规定》, 商务部令2020年第4号), issued and effective September 19, 2020, Ministry of Commerce of the People's Republic of China (available at <http://www.mofcom.gov.cn/article/b/fwzl/202009/20200903002593.shtml>).
 - ³ Regulations, Art. 1.
 - ⁴ Regulations, Art. 14.
 - ⁵ Regulations, Art. 2.
 - ⁶ Regulations, Art. 2.
 - ⁷ Regulations, Art. 7.
 - ⁸ European Council Regulation (EC) No 2271/96 of 22 November 1996 protecting against the effects of the extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom (available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:01996R2271-20140220>).
 - ⁹ Regulations, Art. 3.
 - ¹⁰ National People's Congress of the People's Republic of China, "Report of the State Council on Accelerating the Transformation and Upgrading of Foreign Trade and Promoting the High-quality Development of Trade" ("国务院关于加快外贸转型升级推进贸易高质量发展工作情况的报告"), October 23, 2019, see <http://www.npc.gov.cn/npc/c30834/201910/f51b57602caa4a668fc38383b9e8f985.shtml>).
 - ¹¹ Regulations, Art. 4.
 - ¹² Regulations, Art. 4.
 - ¹³ Regulations, Art. 5.
 - ¹⁴ Regulations, Art. 6 (1).
 - ¹⁵ Regulations, Art. 6 (1).
 - ¹⁶ Regulations, Art. 6 (2).
 - ¹⁷ Regulations, Art. 6 (2).
 - ¹⁸ Regulations, Art. 8.
 - ¹⁹ Regulations, Art. 10.
 - ²⁰ Regulations, Art. 12.
 - ²¹ Regulations, Art. 9.
 - ²² Regulations, Art. 11.
 - ²³ Regulations, Art. 13 (1).
 - ²⁴ Regulations, Art. 11.
 - ²⁵ Regulations, Art. 13 (1).
 - ²⁶ Regulations, Art. 13 (2).
 - ²⁷ Regulations, Art. 13 (3).

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- ²⁸ The Ministry of Commerce of the People's Republic of China, "Essential System Improvement—Authoritative Expert Answers Reporters' Questions on the 'Regulations on Unreliable Entity List'" ("必要的制度完善——权威专家就《不可靠实体清单规定》答记者问"), September 19, 2020 (available at <http://www.mofcom.gov.cn/article/news/202009/20200903002596.shtml>).
- ²⁹ The Ministry of Commerce of the People's Republic of China, "The Head of Department of Treaty and Law of the Ministry of Commerce Answers Reporters' Questions on the 'Regulations on Unreliable Entity List'" ("商务部条约法律司负责人就《不可靠实体清单规定》答记者问"), September 20, 2020 (available at <http://www.mofcom.gov.cn/article/ae/sjjd/202009/20200903002631.shtml>).