

# Chinese Ministry of Commerce places two companies on its Unreliable Entity List for the first time

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On February 16, the Ministry of Commerce of the People's Republic of China announced its first ever use of the Unreliable Entity List, designating Lockheed Martin Corporation and Raytheon Missiles & Defense. This client update gives an overview of China's Unreliable Entity List framework and a comparison with other economic measures which are part of the toolkit that China has developed to counter perceived threats by foreign governments and private actors to its national security and interests.

## Introduction

On February 16, 2023, the PRC Ministry of Commerce (MOFCOM) announced that it is placing Lockheed Martin Corporation (Lockheed Martin) and Raytheon Missiles & Defense (Raytheon) on the Unreliable Entity List (UEL). This is the first time that any company has been placed on the UEL since its introduction in May 2019. The practical significance of this action is likely to be limited, as both Lockheed Martin and Raytheon are generally precluded from doing business in China by the longstanding U.S. prohibition on exports of defense articles and services to that country, and both companies have previously been the target of Chinese government sanctions or export control actions in the past.

This client update provides an overview of the UEL regime, the differences between the UEL and the list regime under PRC Export Control Law, as well as the list of targets of the PRC Anti-Foreign Sanctions Law (AFSL), and how MOFCOM's February 16 announcement compares to past announcements made by the PRC Ministry of Foreign Affairs (MOFA).

## Regulatory framework and history of the UEL

The UEL regime is part of the toolkit that China has been developing, through the use of economic measures, to counter the perceived damage to PRC national interests caused by the actions of foreign countries and private parties. When this concept was first introduced in May 2019, the Chinese government made no designation and announced no regulatory framework for the UEL. It was reportedly designed to mirror the U.S. government's investigation into certain Chinese technology firms and their designations on the entity list maintained by the U.S. Department of Commerce.

In September 2020, the MOFCOM announced the "Provisions on Unreliable Entity List" (Provisions), providing for the establishment of a working mechanism involving various central government authorities to administrate the UEL. The Provisions allow the PRC authorities to investigate actions taken by relevant foreign entities based on their own identification of situations requiring investigation or upon "suggestions or reports by relevant parties".

The Provisions contain a non-exhaustive list of factors for determining whether to add a foreign entity on the UEL. This includes the degree of danger to China's national sovereignty, security or the development interests of China; the degree of damage to the legitimate rights and interests of Chinese entities; and whether the listed entity actions comply with internationally accepted economic and trade rules.

Under the UEL framework, foreign entities on the list may be restricted or prohibited from engaging in China-related import or export activities or investing in China.<sup>1</sup> Relevant personnel or transportation vehicles of foreign entities may be restricted or prohibited from entering into China. The relevant personnel's work permits, status of stay or residence in China may be restricted or revoked. A fine may also be imposed, depending on the seriousness of the case.

Since the promulgation of the UEL Provisions, no entity had been listed until February 16, 2023.

## The UEL as compared with other list-based regimes

The UEL is not the only list-based regime promulgated in recent years by the Chinese government to protect its national security interests. It is not to be confused with (i) the targets of counter measures imposed pursuant to the 2021 PRC AFSL; and (ii) the list regime under the 2020 PRC Export Control Law (ECL).

### The AFSL

On June 10, 2021, the AFSL was enacted by the Standing Committee of the PRC National People's Congress (NPCSC) with immediate effect. The AFSL sets out the legal framework under which the relevant departments of the PRC State Council may implement counter measures to curb the effects of perceived "discriminatory restrictive" measures imposed by foreign governments against Chinese nationals and organizations "in breach of international law and principles of international relations" to interfere with China's internal affairs (Foreign Restrictive Measures). The AFSL also sets out individuals' and organizations' obligations to comply with the Chinese government's counter measures, and provides for liability of individuals and organizations for failure to comply with or cooperating in the implementation of Foreign Restrictive Measures.

The AFSL provides the legal grounds for the Chinese authorities to impose "list-based" Counter Measures (Counter Measures List) on designated individuals and organizations (DIOs) that in the Chinese government's view, directly or indirectly, participated in the formulation, decision and implementation of the Foreign Restrictive Measures.

Counter measures may also be extended to apply to additional targets beyond the DIOs, including:

1. spouses and immediate family members of individual DIOs;
2. senior management and *de facto* controllers of DIOs that are organizations;
3. organizations in which any individual DIO holds senior management positions; and
4. organizations which are *de facto* controlled by any DIO, or in which any DIO participates in their establishment and/or operations.

With regards to the potential consequences for appearing on the Counter Measures List, the Chinese government's measures include denial of entry into the territory of the People's Republic of China, seizing and/or freezing property in China and prohibition or restriction of persons in China from conducting business with DIOs. There is also a catch-all provision that authorizes other restrictive counter measures as necessary. With the exception of the asset-freezing measures provided for by the AFSL, which represents the first time such measures were explicitly authorized by a national anti-boycott legislation, the consequences for breaching the AFSL and UEL list regimes appear similar.

Since the enactment of the AFSL, the MOFA has made numerous announcements of sanctions against foreign individuals and organizations, citing authority vested to it by the AFSL.<sup>2</sup>

## The PRC Export Control Law

The ECL, a national legislation passed by the NPCSC in October 2020, came into effect on December 1, 2020. It streamlines and consolidates previously fragmented regulations by setting out the control and licensing framework for controlling and monitoring exports of military, dual-use, and other goods, technology and services in accordance with its national interests. It creates an export control entity list regime (“Entity List”) imposing export restrictions on named individuals and entities, and further centralizes the enforcement powers.

The departments responsible for export control under the State Council and the Central Military Commission are vested with power to enforce the ECL, including through inspection of venues, seizures of controlled items, interviews and information enquiries, impositions of shipping suspensions, orders for the return of exported controlled items and reviews of bank accounts. The term “controlled items” is broadly defined and covers not only dual-use, military and nuclear items, but also “other goods, technologies, services and items relating to the maintenance of national security and interests, and performance of anti-proliferation and other international obligations” (collectively, Controlled Items).

Under the ECL, both end users and importers of Controlled Items could potentially be placed on the Entity List if they:

- breach export control regulations regarding “end users” or “end uses”;
- endanger China’s national security and interests; or
- apply Controlled Items to terrorist activities.

For end users and importers on China’s Entity List, the Chinese government may impose measures to prohibit or restrict their deals relating to the relevant Controlled Items and suspend the export of such Controlled Items to the listed entities. However, where the end users or importers have taken measures such that the circumstances causing them to be listed no longer prevail, they may apply for a removal from the Entity List.

As such, the PRC ECL’s Entity List mechanism is distinct from the UEL regime, although both are designed for protecting or advancing national interests through economic measures. Given the focus of both regimes on national security and interests, it is possible to have companies ending up on both lists.

## The latest MOFCOM announcement

The MOFCOM order on February 16, 2023 announced the following measures against Lockheed Martin and Raytheon:

1. Prohibition of any import and export business involving China;
2. New investment ban within Chinese border;
3. Border entry ban for their senior management;
4. Refusal and/cancellation of permit for their senior management to work in, travel through or reside in China;
5. Imposition of a fine in the amount of two times the arms trade sales to Taiwan, which shall be paid within 15 days of the announcement, failing which additional fines may be imposed.

While we have previously seen measures similar to items 1-4 above against individuals and companies subject to Chinese sanctions announced by MOFA, the fifth measure is a novel one. It remains to be seen how the penalty will be enforced in reality for targets without assets in China.

In the past, MOFA had made sanctions announcements against foreign defense companies:

- in July 2020 against Lockheed Martin;
- in October 2020 against Lockheed Martin, Boeing Defense, Space & Security (Boeing Defense) and Raytheon;
- in February 2022 as countermeasures against Lockheed Martin and Raytheon in accordance with the AFSL (for the first time as the AFSL wasn't available in 2020); and
- in September 2022 against CEOs of Raytheon and Boeing Defense.

In each of these prior instances, the MOFA announced the measures at its spokesperson's regular press conference just days after a Taiwan arms sale that involved the sanctioned defense companies was reported in the U.S. There were no specific measures announced by the MOFA spokesperson other than naming the companies as targets of Chinese sanctions. It is unclear whether these UEL listings, like prior sanctions actions, will have a significant practical impact, especially as U.S. defense contractors' ability to do business in China is already highly restricted under U.S. law, and none appear to have had a meaningful presence in China. However, the legal framework that the Chinese government is developing for sanctions and other restrictive measures could potentially be used for more impactful actions in the future.

## Conclusion

As noted above, the February 16 announcement by MOFCOM marks the unprecedented use of the UEL regime by the PRC authorities. Several issues still remain unclear, such as whether and how the fines against Lockheed Martin and Raytheon will be implemented in practice; the interplay between the various regimes given their inherent similarities; whether the PRC government will increasingly be adding new entities to the UEL in future; and the true extent of the practical ramifications of an entity being added to the UEL.

***If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.***

**Paul D. Marquardt**

+1 202 962 7156

paul.marquardt@davispolk.com

**Martin Rogers**

+852 2533 3307

martin.rogers@davispolk.com

**Joshua Friedman**

+852 2533 3393

joshua.friedman@davispolk.com

**Will Schisa**

+1 202 962 7129

will.schisa@davispolk.com

**Yuan Zheng**

+852 2533 1007

yuan.zheng@davispolk.com

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- <sup>1</sup> In our view, given the traditional jurisdictional reach of MOFCOM, “China” for purposes of the Unreliable Entity List would exclude Hong Kong SAR, Macau SAR and Taiwan.
- <sup>2</sup> The MOFA had been announcing imposition of sanctions (without specifying the measures) against foreign individuals and organizations even before the enactment of the AFSL.