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Decoding Fines under the Unreliable Entity List

On February 16, 2023, the Ministry of Commerce of the PRC (“MOFCOM”) announced its decision to designate two American companies, Lockheed Martin Corporation and Raytheon Missiles & Defense as “unreliable entities”¹ and impose heavy fines on them. This marks the first time that companies have been added to the Unreliable Entity List (“UEL”) since the MOFCOM issued the Provisions on the Unreliable Entity List (MOFCOM Order No. 4 of 2020, hereinafter referred to as the “UEL Provisions”) on September 19, 2020.

In this first-time designation, the competent authority determines fines amounting to twice the contract values of the two companies’ relevant arms sales to Taiwan, China. We have previously shared an [article](#) on the nature of the UEL Provisions. In this article, we will examine the possible sanctions under the UEL Provisions and delve into the determination and structuring of fines under the UEL Provisions, which is one of the punitive measures to be slapped against designated entities if a positive conclusion is reached.

A. Possible sanctions under the UEL Provisions

In terms of regulatory measures, Article 10 of the UEL Provisions stipulates that entities on the UEL may be subject to the following sanctions:

1. Restrictions or bans on their engagement in import and export in relation to

¹ ‘Announcement of the Working Mechanism of Unreliable Entities List on the Designation of Lockheed Martin and Raytheon Missile and Defense in the List of Unreliable Entities’, MOFCOM, <http://www.mofcom.gov.cn/article/zwgk/gkzcfb/202302/20230203391289.shtml>.

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- China;
2. Restrictions or bans on their investment in China;
 3. Restrictions or bans on the entry of their relevant persons and means of transportation in China;
 4. Restrictions on or revocation of the work permit, stay or residential qualification of their relevant persons in China;
- 5. A fine of a corresponding amount as appropriate; and/or**
6. Other necessary measures.

In summary, the competent authority is empowered to impose administrative fines and bans on import and export, investment, travel and stay permits, among others. As an immediate measure, fines take effect shortly after the announcement of designation. In this case, the two listed entities are required to pay the fines within 15 days.

B. Factors in determining the amount of a fine

As stated above, the competent authority is empowered to impose a fine of an appropriate amount on foreign entities that are found “**unreliable**”. We understand that the measures stipulated in Article 10 of the UEL Provisions are intended as guidelines, and specific measures would be implemented with the provisions of relevant laws and regulations of the PRC factored in. For example, the two American entities placed on the UEL are fined an amount equivalent to two times the contract value of their respective arms sales to Taiwan, China.

The UEL Provisions does not specify the amount or range of fines, however, it emphasizes that the fine be appropriate and corresponding to the severity of the circumstances. We understand that these two requirements stipulate that the fines are to be levied from two different perspectives.

First, appropriateness is associated with “unreliability”. As the purposes and objectives of the UEL Provisions are to address violations of normal market transaction principles and serious damage caused consequentially to the legitimate rights and interests of enterprises, the interests of Chinese companies should be given due consideration. Further, as to the appropriateness standard, the competent authority may decide on an amount higher than the actual or potential damage suffered by Chinese

companies, for example, several times the damage incurred.

Second, correspondence is concerned with a specific or a series of specific unreliable actions or behaviors. What constitutes unreliable actions may still hinge on what damage is inflicted upon the legitimate interests of Chinese companies. For example, severing commercial ties with Chinese companies without good causes, or refusing to enforce valid contracts under undue influence, could possibly be considered as unreliable action or behavior. Therefore, the amount of a fine must to an extent be correlated to the alleged offensive action or behavior that triggers the designation of unreliability.

C. The amount of a fine

As indicated by the first ever designation, the competent authority levied on the two entities separate fines that are twice the amount of their respective arms sales. But the upper limit of the fine is not explicitly specified in the UEL Provisions. Therefore, it is possible that the administrative fines imposed by Chinese authorities may be capped by other related laws or regulations with higher hierarchy of authority.

Based on our understanding and previous experience, a fine twice as much as the related contract value may be considered moderate in this case. Nevertheless, it would be inappropriate to assume that such ratio would serve as a norm or standard for determining the amount of fines in other future potential scenarios. In instances of more severe unreliability, a higher ratio of a fine to the related contract value may be deemed suitable.

Furthermore, we would like to highlight a recently released notice by the State Council in reference to administrative fines. According to the State Council's notice on the implementation of the Administrative Penalty Law of the PRC, fines set by departmental rules shall not exceed RMB 200,000. If the amount of the fine exceeds such limit, the relevant authority imposing the fine shall be report to the State Council for approval. In this vein, a direct conclusion could be reached that fines imposed in accordance with the UEL Provisions require a joint determination by the competent authority (a working mechanism composed of relevant departments) and approval from a higher-level authority.

D. The overdue fine

As illustrated above, fines are required to be paid within a specified period, which is reflected in the recent designation. It is reasonable to speculate that the two American companies have not paid the fines as on April 18, the MOFCOM [moved further by imposing trade bans](#) on export from China to these two entities. This raises the question – what would happen if an entity fails to pay the fine within the specified period?

Article 72 of the Administrative Penalty Law provides a clear indication: if a fine is not paid by the due date, an additional fine of 3% of the amount of the fine shall be imposed daily, and the total amount of the additional fine shall not exceed the amount of the original fine. Therefore, the answer to the question seems straightforward, an overdue fine will bring further penalties on the designated entities and in a worst-case scenario, the original fine could be doubled if left unpaid.

Conclusion

It is worth noting that there remain certain unresolved issues regarding fines determination under the UEL Provisions due to the very few cases of enforcement by far. However, with the possibility of further investigations into the unreliability of foreign entities in the future, a clearer roadmap for understanding the determination and structuring of fines may be presented. At least for now, it is important for entities (if listed on the UEL) to comply with the specified period for fine payment to avoid incurring additional penalties, as an overdue fine can result in further financial consequences.

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