
CHINA'S UNRELIABLE ENTITY LIST AND THE INFRINGEMENT OF THE CONTRACTUAL SPIRIT: WHAT DOES THE LAW SAY?

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On 31 May 2019 the Ministry of Commerce of China (MOFCOM) announced the creation of an Unreliable Entity List designed for foreign companies and individuals (UEL).

Initial hints at what draft criteria would place a company on this list were few. However, it was widely reported that it would affect businesses who "... deviate from the contractual spirit". Of course, the suggestion that this could become a criterion for foreign companies trading in China raised quite a few eyebrows.

The other criteria that were rumoured in 2019 seemed intuitive and consistent. They'd list companies if they would "threaten China's national security" or "fail to comply with the principles of the market economy". In contrast, references to "contractual spirit" seemed out of place within MOFCOM's apparent logic. Chinese and foreign companies are free to negotiate the rules of their commercial transactions, in compliance with the trade law international practice. The contractual freedom is essentially recognised in China by, among others, article 464 of the new civil code and by China's ratification of the United Nations Convention on Contracts for the International Sale of Goods (CISG).

As a result, any possible deviation and inconsistency from the "contractual spirit" should be assessed by the parties themselves and not by a government body. However, in the UEL that MOFCOM published

in its Order no. 4 of 2020, in September last year, the criteria for being listed were reduced to two:

- (1) endangering national sovereignty, security or development interests of China;
- (2) suspending normal transactions with an enterprise, other organisation, or individual of China or applying discriminatory measures against an enterprise, other organization, or individual of China, which violates normal market transaction principles and causes serious damage to the legitimate rights and interests of the enterprise, other organization, or individual of China.

What might this mean in practice? Imagine the following example: A Chinese manufacturer supplies products on a regular basis to a European purchaser. If a batch of goods is defective and the European company might suspend its payment, according to a provision agreed upon by the parties.

Now imagine that the Chinese company – acknowledging that its counterparty failed to pay the due price for its goods – sends a report to the PRC's relevant central departments that constitute the 'working mechanism' which decides whether to put the buyer on the UEL. This could effectively stop the European company from doing business in China. What happens next?

What if the working mechanism is not told of the fact that the buyer was sent defective goods? What safety net ensures that parties receive a fair hearing before they're put on the UEL? In fact, MOFCOM's order provides that the working mechanism shall decide to investigate each report or "suggestion" it receives. During this process the foreign business "may state or defend its case" (article 6). Furthermore, once a foreign entity is placed on the list it will be given a "time limit" – effectively a grace period – "to rectify its actions" (article 9).

Nevertheless, the question remains: which "normal market transaction principles" are foreign entities expected to follow? As a rule of thumb, we can assume they should abide by certain international frameworks for trade and business. But the world of international trade and relations can be anarchic and rules may conflict. Will MOFCOM or the working mechanism in such instances be the final arbiters of what is "accepted" or will it be the international community?

This is a minor point of vagueness that is somewhat disharmonious with an otherwise reasonably consistent and clear order from MOFCOM. A simple clarification may grant more security and stability to both Chinese and international trading partners.

Lastly, ponder also that what parties could do, within the context of their contractual freedom, is agree to a specific clause designed to prevent a foreign party from being reported to MOFCOM over any breach of their agreement. Instead, the parties could establish a mutual and internal process to overcome possible setbacks.



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