

Biden Administration Revises and Expands Restrictions on U.S. Person Investment in Chinese Companies and Releases New List of “Chinese Military Companies” Under 2021 NDAA Section 1260H

by Lawrence Ward, Catherine X. Pan-Giordano, Justin T. Huff, Dave Townsend, and T. Augustine Lo

The Biden Administration last week substantially modified restrictions on U.S. person investments in certain Chinese companies, focusing those new restrictions particularly on entities with ties to the Chinese defense or surveillance technology sectors. President Biden’s new June 3, 2021 Executive Order 14032 (“EO 14032”) expanded earlier executive restrictions in some respects while also eliminating some previous prohibitions targeting certain Chinese companies that were put in place at the end of the Trump Administration. At the same time, the U.S. Treasury Department’s Office of Foreign Assets Control (“OFAC”) created and published a new Non-SDN Chinese Military-Industrial Complex Companies List (“NS-CMIC List”) under EO 14032.

U.S. financial institutions, brokerage firms, exchanges, and investors will now all need to assess whether they hold “publicly traded securities” of any of the 59 named Chinese entities on the new OFAC NS-CMIC List. EO 14032 defines the term “publicly traded securities” by adopting the definition of that term under the Securities Exchange Act of 1934, which also includes a variety of investment vehicles such as calls, swaps, exchange traded funds, index funds, mutual funds, options, privileges related to a foreign currency, and others. Under EO 14032, the same prohibition extends to “any publicly traded securities that are derivative of such securities or are designed to provide investment exposure to such securities.” OFAC notes that “market makers” or intermediaries in securities trading will also be subject to EO 14032. U.S. persons can only buy and sell such “publicly traded securities” of the 59 entities on the initial NS-CMIC List until 12:01 am on August 2, 2021 (U.S. Eastern Time). After that date, U.S. persons will no longer be able to purchase the publicly traded securities of these 59 entities and will only be able to divest such securities until 12:01 am on June 3, 2022 (U.S. Eastern Time). (For any Chinese entity subsequently added to the NS-CMIC List, the prohibition will apply to its publicly traded securities 60 days after such listing, and divestment will be permissible until 365 days after such listing.)

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OFAC's initial NS-CMIC List includes many large and well-known Chinese companies such as China National Offshore Oil Corporation, China Mobile Limited, China Shipbuilding Industry Company Limited, Huawei, and Semiconductor Manufacturing International Corporation ("SMIC"). EO 14032 also authorizes OFAC in its discretion to add more such entities in China's defense or surveillance technology sectors to the NS-CMIC List but does not define exactly what is considered within those industrial sectors. The White House stated that EO 14032 will allow targeting of Chinese companies that undermine U.S. "security or values of the United States and our allies" and the Biden Administration will consider adding companies involved in China's defense, intelligence and other security research and development sectors and also entities that develop or use Chinese surveillance technology in ways that abuse human rights.

Separately, the U.S. Department of Defense ("DoD") also released on June 3, 2021 its own new list of "Chinese Military Companies" as required by Congress in Section 1260H of the National Defense Authorization Act ("NDAA") of 2021 ("Section 1260H").

Background Legislation, Earlier Executive Order & Lawsuits

Beginning more than 20 years ago, Congress directed the DoD to publish a public list of "Communist Chinese Military Companies" ("CCMCs") under Section 1237 of the NDAA of 1999, as amended ("Section 1237"). The criterion set by Congress in Section 1237 was that, to be named as a CCMC, DoD, in conjunction with other elements of the U.S. defense and intelligence community, had to find a company was owned or controlled by the People's Liberation Army ("PLA") or by other parts of China's defense or intelligence establishment, or be owned or controlled by an entity affiliated with the defense industrial base of China. For some two decades, DoD failed to produce such a Section 1237 List. However, finally, between June 2020 and January 2021, under Section 1237, DoD designated a total of 44 such CCMCs in five tranches.

As we had previously reported based on the DoD's issuance of its Section 1237 List, the Trump Administration then issued Executive Order 13959 ("EO 13959") on November 12, 2020 to restrict U.S. persons from investing in any CCMC named by DoD under Section 1237. As Congress had envisioned under Section 1237, DoD took the lead in selecting and designating CCMCs, but the Trump Administration tasked a different agency in a separate Cabinet department, OFAC within the Department of the Treasury, to implement EO 13959's investment restrictions, and that division of roles led to some considerable confusion between those two federal agencies.

For example, there are multiple Chinese companies with publicly traded securities that had close but not exact matches to entity names on DoD's CCMC List, and it was also unclear whether a CCMC designation by DoD would then apply to every subsidiary that is owned or controlled by a named CCMC entity. Given such legal confusion, three Chinese companies chose to challenge their Section 1237 designations in federal court lawsuits before the U.S. District Court for the District of Columbia. Two of those, Xiaomi Corporation and Luokung Technology, obtained a favorable judicial finding in March and

May 2021, respectively, that there were fundamental problems with DoD's Section 1237 designations and the related capital markets restrictions under EO 13959.

Comparison & Contrasts Between EO 13959 and EO 14032

For all practical purposes, President Biden's EO 14032 amends and largely replaces President Trump's EO 13959. EO 14032 retains EO 13959's declaration of a national emergency related to China's "military-civil fusion" strategy and the potential ability of Chinese companies to assist the PLA, but EO 14032 also expands the scope of the declared national emergency to include China's "surveillance technology outside of" China and the use of such technology to suppress human rights, whether inside China or elsewhere in the world. Finally, EO 14032 sought to cure some of the regulatory confusion that had been caused by EO 13959 applying OFAC's financial sanctions against transactions involving publicly traded securities of entities on DoD's Section 1237 List.

Among the differences between these two Trump and Biden Executive Orders are these factors:

Designating Agency: Under EO 14032, OFAC will now itself designate all the entities named to its own NS-CIMC List instead of being bound by DoD's designations in the Section 1237 List as had been required under EO 13959, and, conversely, being an entity named by DoD to its Section 1237 List will now no longer automatically carry any economic consequences for that entity;

Basis for Designation: Under EO 14032, OFAC can apply its capital markets sanctions against any Chinese company in either the defense or surveillance technology sectors of the Chinese economy instead of being limited to Chinese companies that meet the narrower PLA and defense industrial base ownership or control standards required of NDAA Section 1237 under EO 13959;

Clarity on "Publicly Traded Securities": Under EO 14032, OFAC will apply the same commonly understood definition of "publicly traded securities" as the U.S. Securities and Exchange Commission ("SEC") applies under the Securities Exchange Act of 1934, as amended, instead of using a definition of that key term under EO 13959 that appeared to be significantly broader in scope than the SEC's definition;

Affected Chinese Companies: Under EO 14032, it is expressly stated that only those "publicly traded securities" of a company whose name is an exact match with a company name on OFAC's NS-CMIC List will be covered by EO 14032's capital markets sanctions instead of the ambiguity as to such close-but-not-exact name matches to names on DoD's Section 1237 List under EO 13959; and

Clarity on "50% Rule" Concerns Under OFAC Sanction Regimes: Under EO 14032, a company that is 50% or more owned by a named company on the NS-CMIC List will not

automatically be covered by EO 14032 unless and until OFAC expressly adds that entity to the NS-CMIC List, and U.S. persons will then be given a 60-day transition period to adjust their holdings of such “publicly traded securities” of such an affiliate.

Yet Another DoD List

In addition, under Section 1260H of the NDAA of 2021, Congress recently mandated that the President must identify by April 15, 2021 and then annually thereafter all “Chinese military companies” (“CMCs”) operating within the United States that DoD has associated with China’s “military-civil fusion” strategy. Section 1260H provides that, to be so categorized as a CMC, an entity must be either directly or indirectly owned, controlled, or beneficially owned by, or in an official or unofficial capacity acting as an agent of or on behalf of, the PLA or any other organization subordinate to the Central Military Commission of the Chinese Communist Party; or identified as a military-civil fusion contributor to the Chinese defense industrial base and engaged in providing commercial services, manufacturing, producing, or exporting. (In assigning this new list-generating responsibility to DoD, Congress has also kept in place its previous requirement for the Section 1237 List.)

On June 3, DoD released its new list of Section 1260H designations for 47 CMCs (“Section 1260H List”). Upon closer review, 39 of those 47 CMCs are also found on the Annex to President Biden’s EO 14032 (and there is significant overlap with the previous Section 1237 List). Moreover, all eight of the other CMCs named by DoD appear to be corporate affiliates of SMIC, which itself had already been named in the Annex. However, as of this article’s publication date, it is unclear what further consequences may attach to the 47 CMCs being named to the new Section 1260H List. For example, if the Biden Administration wishes to apply EO 14032’s capital markets sanctions to a CMC on DoD’s new Section 1260H List, then OFAC will need to act separately to add that company to its own NS-CIMC List, which differs from the previous methodology under EO 13959 that would have automatically triggered such a consequence as soon as a Chinese company were added to the DoD’s Section 1237 List.

Further Considerations

The Biden Administration has said that its economic, trade and national security policies towards China are undergoing a comprehensive review by newly confirmed senior officials at the U.S. Departments of State, Defense and Commerce, the Office of the U.S. Trade Representative and the National Security Council, among others. Since taking office on January 20, 2021, the Administration has initiated several key shifts in regulatory policy through the Commerce Department’s Bureau of Industry and Security (“BIS”) that affect the exports of U.S.-origin goods, software or technology to various Chinese companies and that will soon also affect the import of Chinese-origin goods, software or technology in “information communications technology services” (“ICTS”).

During their individual confirmation hearings, most of these key Biden Administration nominees told skeptical U.S. Senators that they were all committed to “being tough on China,” including with respect to U.S. equity investments in Chinese companies. In addition, Congress is currently considering a veritable “*tsunami of legislation*” targeting China (to use the recent description of the U.S.-China Business Council), including new measures that could further expand restrictions on U.S. person investment in Chinese companies or otherwise affect U.S.-China business relationships. For example, on June 8, the U.S. Senate voted to approve the Endless Frontiers Act, S. 1260, with strong bipartisan support, 68 – 32. This legislation would expend about \$250 billion and encompasses some 2,400 pages of new legal requirements and restrictions, many of which will affect U.S.-China business relationships. That massive bill is expected to be taken up by the House of Representatives later this year.

It remains to be seen if any of these new laws being debated in Congress will add yet further “lists” to be reviewed. However, these recent regulatory changes by the Biden Administration show that corporate trade compliance personnel will need to work even more closely with their supply chain planning and marketing and sales colleagues to remain current with the multiple government lists of designated entities in China now being produced among the several lead federal agencies, as shown in the summary table below. Moreover, the multiplication of these lists, each with its own nuanced legal consequences, will require more internally coordinated business processes and the adoption and use of automated screening software tools in more companies that will be able to receive real-time updates to these U.S. Government lists and to alert compliance personnel of such changes or additions (or removals) on a timely basis.

U.S. GOVERNMENT LISTS OF CHINESE COMPANIES (JUNE 2021)		
Authorization	Agency	List
Sec. 1237, 1999 NDAA	DoD	Section 1237 List
Sec. 1260H, 2021 NDAA	DoD	Section 1260H List
Appendix A to Part V of Title 31 of the CFR	OFAC	Specially Designated Nationals (SDN) List
EO 14032	OFAC	NS-CIMC List
Supp. No. 4, Part 744, EAR	BIS	Entity List
Supp. No. 1, Part 764, EAR	BIS	Denied Persons List
Supp. No. 6, Part 744,	BIS	Unverified List

EAR		
Supp. No. 7, Part 744, EAR	BIS	Military End User (MEU) List
Sec. 744.22(f)(2), EAR	BIS	Military-Intelligence End User (MIEU) List

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