

Trump Administration Bars U.S. Investments in Certain Chinese Companies Linked to Chinese Military

by Lawrence Ward, Justin T. Huff, Dave Townsend, and T. Augustine Lo

On November 12, 2020, President Trump issued Executive Order 13959¹ (“the Order”) that will shortly bar any U.S. person from “any transaction in publicly traded securities, or any securities that are derivative of, or are designed to provide investment exposure to such securities” of any “Communist Chinese military company” (as that term is defined in the order). The effective date of this new rule will be January 11, 2021 (“Effective Date”). U.S. persons who hold such securities in such a company as of the Effective Date will have an express “safe harbor” under Section 1(b) of the Order until midnight, November 11, 2021, to divest themselves of such securities.

The Order invokes and relies on the International Emergency Economic Powers Act (“IEEPA”), 50 U.S.C. §1701 et seq., the main statute upon which the Office of Foreign Assets Control (“OFAC”) typically relies in imposition of its economic sanctions. OFAC distributed the Order publicly via email on November 13. When published in the Federal Register, the Order included an Annex² that lists 31 PRC companies that initially come within its scope.

The Order is linked to and dependent on certain lists of “Communist Chinese military companies” that Congress has mandated be issued by the DoD. There has been strong and consistent bipartisan support in Congress for some two decades requiring that DoD to compile and publish these lists of PRC companies as the basis for such Executive action, and Congress will therefore likely continue to insist on this DoD activity for the foreseeable future.

The Basis of the Order

The Order rests upon several “findings” by President Trump to justify the declaration of a national emergency under the Executive powers granted by IEEPA:

- The People’s Republic of China (“PRC”) exploits U.S. capital markets to enable certain PRC companies to develop and modernize the People’s Liberation Army (“PLA”) and the intelligence and other security capabilities of the PRC;

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- Such development and modernization of the PLA and other PRC intelligence and security forces endangers both the U.S. homeland and U.S. military forces stationed overseas, including weapons programs and malicious cyber attacks against the United States;
- The PRC has a “military-civil fusion” strategy under which the PRC government compels PRC companies that are “ostensibly private and civilian” to provide direct support to aid the PRC’s military, intelligence and security services; and
- PRC companies that list securities in the U.S. can secure funding from U.S. capital markets to underwrite such corporate activities in aid of such “military-civil fusion.”

A “Communist Chinese military company” and Other Key Definitions

Under the Order, a “*Communist Chinese military company*” is one that has been identified by the U.S. DoD under §1237 of the Strom Thurmond National Defense Authorization Act of 1999 (“1999 NDAA”), P.L. 105-261, as amended, or §1222 of Ronald W. Reagan National Defense Authorization Act of 2005 (“2005 NDAA”), P.L. 108-375, or is a publicly listed subsidiary of such a company named by DoD. Under §1237 in the 1999 NDAA, Congress had required DoD to list in the Federal Register any PRC companies linked to the PLA that were found to be operating within the United States, and Congress had directed DoD to consult with the Department of Justice, the Federal Bureau of Investigation and other elements of the U.S. intelligence community to develop such a list. However, for various reasons, DoD declined to make public such a list until a bipartisan group of U.S. Senators and Members of the House of Representatives pressed again in 2019 for DoD to comply with this NDAA requirement. The DoD finally released an initial list of 20 such PRC companies linked to the PLA in June 2020 and then added a second shorter list of 11 more PLA-related companies in August 2020. The public DoD lists of PLA-related companies should now be updated at least annually.

It is instructive to look at §1237(b)(4)’s own internal definition of the phrase “*Communist Chinese military company*,” which states that such an entity is either:

- any person identified in Defense Intelligence Agency publication VP-1920-271-90, dated September 1990, PC-1921-57-95, dated October 1995, or any update of those publications for the purposes of this section; or
- any other person that:
 - is owned or controlled by the People’s Liberation Army; and
 - is engaged in providing commercial services, manufacturing, producing or exporting.

§1237 also defines the term “*People’s Liberation Army*” as the PRC’s land, naval and air military services, the police and the intelligence services or any member of those forces.

Under the Order, the term “*transaction*” is defined to be “the purchase for value of any publicly traded security,” and the term “*United States person*” is defined to include any U.S. citizen or permanent resident alien, any person in the United States, or any entity incorporated in the United States (including foreign branches) but excluding any foreign subsidiary of a U.S. company. Given that a “transaction” is defined by the Order only to include a “purchase for value,” one could argue that a divestment by a U.S. person through a sale transaction that occurs after midnight, November 11, 2021, would fall

outside the scope of the Order and not be prohibited.

Furthermore, under the Order, the term “*security*” is as defined under U.S. securities laws in 15 U.S.C. § 78c(a)(10), which includes:

any note, stock, treasury stock, security future, security-based swap, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a ‘security’; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing.

Unusually, the Order goes on to add to its “*security*” definition further language that is not contained in the above statutory definition, namely “currency or any note, draft, bill of exchange, or banker’s acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.” Since the Order means to affect only a PRC company’s “publicly listed security,” it is unclear what the U.S. Government would consider a “publicly listed” “currency” of such a PRC company, but it is possible, in time, OFAC may issue further guidance to assist the financial industry in its application of the Order.

§1237 and IEEPA

Beyond these key definitions, §1237 of the 1999 NDAA also expressly authorizes the President to rely on such a published DoD list of “*Communist Chinese military companies*” to apply the broad economic sanctions powers of IEEPA to limit or bar particular kinds of business activity within the United States of any such listed PRC company. Interestingly, the Order does not apply the full force of IEEPA against such PRC companies that have been identified by DoD but, instead, only bars their access to U.S. stock exchanges for public listings to raise capital for their corporate operations and expansion and to bar U.S. persons from buying the securities of such PRC companies.

Because the Order does invoke IEEPA and authorizes the Secretary of the Treasury, in consultation with the Secretary of Defense, the Director of National Intelligence and other Executive Branch officials, to enforce the Order, it is not surprising that, once the White House had released the text of the Order, OFAC was the agency chosen to send out an announcement of the Order along with its full text and links to the June and August 2020 lists released by DoD. Because of OFAC’s role in implementation of the Order, it is quite likely that the 31 listed PRC companies will now be picked up by most, if not all, of the commercial compliance software tools used for sanctions list checking by many banks and companies. Some of these PRC companies were already notorious and “flagged” because, for example, they were already on the Entity List maintained by the Bureau of

Industry and Security (“BIS”) (e.g., Huawei and Hikvision), but others on DoD list have not been previously subject to any such U.S. trade sanctions.

Business Judgment Required

American banks, companies and even universities may now have to begin making some consequential business judgments on their on-going commercial or other relationships with each of these 31 listed PRC companies. If a DoD-listed company was already subject to heavy U.S. sanctions, such as being named to the BIS Entity List with a broad “subject to the EAR” export license requirement and an indication that BIS would apply a “presumption of denial” to a U.S. person’s export license application, the Order will likely have only a marginal effect because most U.S. organizations would have already cut most if not all of their business ties to a company on the Entity List. As of the date of this article, 13 of the 31 PRC companies listed in the Order’s Annex are already subject to some form of U.S. sanctions.

However, the more difficult and nuanced question will be posed by a PRC company named to DoD list that has no other U.S. sanctions history, and, as of the date of this article, 18 of the 31 PRC companies shown in the Annex of the Order do not appear to be subject to any such U.S. sanctions measures. Should a U.S. organization such as a company or a university continue to do normal business with such a listed entity if the U.S. organization has nothing to do with any listed securities transactions but, by the nature of the definitions in §1237, that DoD-listed PRC company is said to be “owned or controlled” by the PLA? Does such information add materially to the U.S. organization’s “knowledge” about the listed PRC entity in case there is any kind of export control violation involving that listed entity? Is there any material risk of reputational damage to the U.S. organization for dealing with a PRC company “owned or controlled” by the PLA, especially if the nature of bilateral relations between the United States and the PRC were to become even further strained or if there might even be some actual physical conflict? Is the commercial or other gain or benefit for the U.S. organization likely to outweigh these sorts of business or reputational risks if the U.S. organization continues to do business or to have significant relations with such a DoD-listed PRC company?

These and other similar questions are now likely to be prudent for the management of U.S. organizations as they look over the 31 PRC companies that have thus far been named by DoD under §1237 and that have now been targeted by the Administration through the issuance of the Order. Such questions will also be pertinent to any other PRC companies that the DoD may add to its §1237 list in the future, as Congress is likely to expect DoD to do.

The Current §1237 List

As noted above, through November 2020, DoD has named the following 31 PRC companies as satisfying the criteria of a “Communist Chinese military company” under §1237, and so the Order, by its terms, will apply to any of these 31 listed companies and any subsidiaries thereof:

Aero Engine Corporation of China
Aviation Industry Corporation of China (AVIC)
China Academy of Launch Vehicle Technology (CALT)
China Aerospace Science and Industry Corporation (CASIC)
China Aerospace Science and Technology Corporation (CASC)
China Communications Construction Company (CCCC)
China Electronics Corporation (CEC)
China Electronics Technology Group Corporation (CEPC)
China General Nuclear Power Corporation
China Mobile Communications Group
China National Chemical Corporation (ChemChina)
China National Chemical Engineering Group Co., Ltd. (CNCEC)
China National Nuclear Corporation
China North Industries Group Corporation (Norinco Group)
China Nuclear Engineering & Construction Corporation (CNECC)
China Railway Construction Corporation (CRCC)
China South Industries Group Corporation (CSGC)
China Shipbuilding Industry Corporation (CSIC)
China Spacesat
China State Construction Group Co., Ltd.
China State Shipbuilding Corporation (CSSC)
China Telecommunications Corporation
China Three Gorges Corporation Limited
China United Network Communications Group Co. Ltd.
CRRC Corporation
Dawning Information Industry Co. (Sugon)
Hangzhou Hikvision Digital Technology Co., Ltd. (Hikvision)
Huawei
Inspur Group
Panda Electronics Group
Sinochem Group Co. Ltd.

It is difficult to predict when DoD might add more PRC companies to this list. In the future, if and when more such companies are added beyond the ones shown in the Annex to the Order, then a U.S. person would have a 60-day grace period in which to divest such holdings.

The strong bipartisan pressure in both houses of Congress presumably led DoD to release its first list of Communist Chinese military companies in June 2020. Such broad-based political demand for this list to be kept current (at least on an annual basis) probably means that this DoD list may now become something of a fixture in the realm of trade compliance for most U.S. organizations vis-à-vis the PRC. Moreover, with this modest step in applying this limited form of U.S. sanctions against 31 large and well-known PRC companies, the U.S. Government may have created a precedent for yet more barriers to be erected through such economic sanctions that will affect economic and trade relations and perhaps other elements of the complex bilateral relationship

between the United States and the PRC.

¹ 85 Fed. Reg. 73185 (Nov. 12, 2020).

² *Id.*, at 73189.