

Executive Order Prohibits U.S. Investment in “Communist Chinese Military Companies”

Key Notes:

- Executive Order 13959 bans U.S. persons from transacting in publicly traded securities or derivatives or similar securities of any publicly traded Chinese companies designated by the U.S. Department of Defense as enabling Chinese military aims.
- It also authorizes the Secretary of the Treasury to identify subsidiaries of the named companies, which will be subject to the same restrictions.
- Ban takes effect on January 11, 2021.

On November 12, President Donald Trump signed Executive Order (E.O.) 13959, “Addressing the Threat from Securities Investments That Finance Communist Chinese Military Companies,” which prohibits U.S. persons (companies and individuals) from investing in certain Chinese firms found to be enabling the Chinese military. This is the latest effort to pressure China over what the Trump administration describes as abusive business practices in the United States. Specifically, the E.O. bans U.S. persons from transacting in securities of any of the [31 Chinese companies](#) previously listed by the U.S. Department of Defense (DoD) pursuant to Section 1237 of the [National Defense Authorization Act for Fiscal Year 1999](#) (NDAA) as enabling China’s “Military-Civil Fusion development strategy” and the modernization goals of the People’s Liberation Army. The DoD and the U.S. Department of the Treasury may add additional Chinese companies, and the Treasury Department may add subsidiaries to the list of banned investments. While the E.O.’s ban becomes effective on January 11, 2021. However, the scope of the ban remains to be clarified by the U.S. government.

IEEPA Sanctions Authorized by Section 1237 of the NDAA

Section 1237(a) of the NDAA authorizes the president to impose sanctions under the International Emergency Economic Powers Act (IEEPA) in the case of any commercial activity in the United States by a person who is on the list published under Section 1237(b). Notably, the NDAA authorizes the president to impose IEEPA sanctions “without regard to” IEEPA’s requirement that the president first declare a national emergency, as is usually the case under the IEEPA. A broad range of sanctions may be applied under IEEPA, including requiring U.S. persons to block all property of a sanctioned person (as is required for all persons on the Specially Designated Nationals (SDN) List). The investment ban directed under E.O. 13959 is not the most severe of available sanctions.

Section 1237(b) requires that the DoD “make a determination of those persons operating directly or indirectly in the United States or any of its territories and possessions that are Communist Chinese military companies and shall publish a list of those persons in the Federal Register.”

Prohibitions

E.O. 13959 expressly targets civilian Chinese companies that are “key to the development of the PRC’s military, intelligence and other security apparatuses” and raise capital by selling public securities to U.S. investors. Pursuant to the order, the following transactions by any U.S. person are prohibited:

- On January 11, 2021, 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.
- Sixty days after a person is determined to be a Communist Chinese military company, any transaction in publicly traded securities, or any securities that are derivative of or are designed to provide investment exposure to such securities, of that person.

The E.O. also prohibits any transaction that “evades or avoids, has the purpose of evading or avoiding, causes a violation of, or attempts to violate the prohibitions” of the order.

Notably, the E.O. defines “Communist Chinese military company” to include not only companies currently on or later added to the DoD list, but also companies that the Secretary of the Treasury publicly lists as meeting the criteria in Section 1237(b)(4)(B) of the NDAA or as a subsidiary of a person already determined to be a Communist Chinese military company. Based on a plain reading of E.O. 13959 and this provision in particular, it appears that E.O. 13959’s prohibitions do not apply to subsidiaries of Communist Chinese military companies unless they are listed publicly by the Treasury Department or DoD. Nevertheless, this is an issue to watch closely as the government implements this order.

Exceptions

The E.O. provides two limited exceptions for the following transactions:

- On or before 11:59 p.m. Eastern Standard Time on November 11, 2021, any U.S. persons may engage in purchases for value or sales, solely to divest, in whole or in part, from securities held in a Communist Chinese military company as of 9:30 a.m. Eastern Standard Time on January 11, 2021.
- On or after 60 days from the Communist Chinese military company determination, for 365 days, U.S. persons may engage in purchases for value or sales of securities solely to divest, in whole or in part, from securities held in the Communist Chinese military company.

Thus, as to the 31 companies currently designated on the DoD list, U.S. persons will have until November 11, 2021 to engage in otherwise prohibited purchases and sales transactions in the Chinese military company securities for purposes of divestment only. After the initial 60-day period following any future determination, U.S. persons will have 365 days to engage in otherwise prohibited purchases and sales of Chinese military company securities in order to divest.

Open Questions on Scope

Many open questions on its scope and impact on U.S. persons remain to be answered by OFAC and the DoD. For example, the DoD list includes the name “Huawei” but does not clarify what specific legal entities are subject to the prohibitions. Additionally, the types of securities the E.O. refers to, directly or indirectly, are also not defined. Finally, it is not clear whether the prohibition will cover only transactions where a U.S. person is the principal (buyer or seller) or also transactions where a U.S. person processes the transaction in some capacity.

Potential Impact on U.S. and Non-U.S. Persons

Investment Compliance and Disclosures

- *U.S. persons should reassess their investments’ risk profiles and consider divestment on or before November 11, 2021.* Although the E.O. provides a period to divest, it does not specifically require divestment. However, since Section 1237 authorizes the president to impose further sanctions on Communist Chinese military companies, investors should consider the impact that potential sanctions, particularly blocking sanctions, would have on their investments.
- *U.S. persons should scrutinize investments going forward to ensure that they do not engage in prohibited investment in Communist Chinese military companies.* Prohibited investments may include mutual funds and other bundled investment vehicles, as noted below.
- *Indirect investments and mutual funds may fall within the scope of “derivative” or “designed to provide investment exposure” and U.S. persons should proceed with caution.* Although guidance on this topic has not yet been issued, a concurrent [statement](#) issued by

National Security Advisor Robert O'Brien implied that the E.O. also is intended to cover "passive institutional investment vehicles such as mutual funds and retirement plans."

- *Companies that trade in securities of designated Communist Chinese military companies, including mutual funds, should consider whether disclosures are required if selling to U.S. persons.*
- *Non-U.S. persons should be mindful that assisting a U.S. person in prohibited transactions in covered securities and investments may be considered to "cause" a U.S. person to violate E.O. 13959, which may itself be a violation under the E.O.*

Risk of Further Sanctions

- U.S. persons should be vigilant for forthcoming guidance on the scope of the DoD list. To date, OFAC's 50% rule, which applies certain sanctions to not only listed entities but all property and interests in property 50% owned by one or more certain sanctioned entities, is not currently applicable to the Communist Chinese military companies. This may change. Also, as noted above, the Treasury Department may list subsidiaries of the Communist Chinese military companies that will be subject to the E.O. 13959 restrictions.
- There is some indication that Congress will pressure the DoD to continue to update this list and impose additional restrictions on the companies on this list. Neither the NDAA nor IEEPA require that the president impose sanctions on the DoD list entities. Nevertheless, the risk of future action may have a commercial impact on transactions that involve these entities, even if the commercial transactions are currently permissible.

Implications for Federal Contractors

As noted, the DoD list identifies Chinese companies in the United States that the U.S. government deems to support Chinese military operations. Based on existing rules addressing the U.S. government supply chain, companies should assess whether the DoD list triggers any existing prohibitions on doing business with companies owned or controlled by the Chinese military or a foreign government. Some of these rules include the Federal Acquisition Regulation and Section 514 of the Consolidated Appropriations Act for FY 2018.

FOR MORE INFORMATION

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