

US investment and export restrictions on Chinese military companies



Jeffrey Richardson, Thomas Appleman and Zhiguo Du review the recent developments relating to President Trump's Executive Order 13959 and its impact on investors in covered securities and exporters of regulated items to China.

During his last few months in office, President Trump issued Executive Order 13959 ('CCMC-EO') prohibiting ownership by US persons of covered securities in designated Communist Chinese military companies ('Chinese military companies'). US persons are now restricted from investing in covered securities of designated Chinese military companies, while exporters must perform expanded due diligence when exporting regulated items to designated Chinese military companies.

Original CCMC-EO issued 12 November 2020

On 12 November 2020, Trump declared a national emergency issuing the CCMC-EO¹ pursuant to authority granted under the National Defense Authorization Act for Fiscal Year 1999, as amended ('1999 NDAA'), the International Emergency Economic Powers Act ('IEEPA'), and the National Emergencies Act. The CCMC-EO prohibits US persons² from investing in publicly-traded securities of any person³ designated by the Secretary of Defense or the Treasury Secretary as a Chinese military company. The CCMC-EO initially applied to the 31 Chinese companies listed in its Annex. The listed Chinese military companies include well-known technology, aerospace, shipbuilding, and construction companies such as China Mobile Communications Group, China Telecommunications Corp., Huawei, Hangzhou Hikvision Digital Technology, Aviation Industry Corporation of China, China Shipbuilding

Industry Corporation, and China Railway Construction Corporation. As noted below, the list of Chinese military companies designated under the CCMC-EO now encompasses more than 44 entities.

The CCMC-EO prohibits 'transactions' covering any purchase for value in 'publicly-traded securities' and 'securities that are derivative of, or designed to provide investment exposure to such securities' of listed

THE LIST OF CHINESE MILITARY COMPANIES DESIGNATED UNDER EXECUTIVE ORDER 13959 NOW ENCOMPASSES MORE THAN 44 ENTITIES.

Chinese military companies ('CCMC-securities'). Although not defined in the CCMC-EO, derivative and other CCMC-securities for this purpose may include, for example:

1. investments in mutual funds;
2. exchange-traded funds; and
3. other investment vehicles, which directly or indirectly, are invested in the listed Chinese military companies.

Under the CCMC-EO, the Treasury Secretary may promulgate rules and regulations, exercising the powers under IEEPA to carry out the purposes of the CCMC-EO. The CCMC-EO contemplates that future regulations, orders, directives, and licences will be issued pursuant to the CCMC-EO to exempt otherwise prohibited transactions from the CCMC-EO.



For the designated Chinese military companies, the transaction prohibition became effective at 9:30 a.m. EST on 11 January 2021, and the CCMC-EO requires US persons divest any CCMC-securities held on 11 January 2021 by no later than 11 November 2021. While for Chinese military companies designated in accordance with the CCMC-EO after 11 January 2021, the transaction prohibition becomes effective 60 days after the designation and the CCMC-securities must be divested within 365 days of the date of the designation. Violations of the CCMC-EO include any prohibited transaction by any US person, or within the United States, to evade or avoid, having the purpose of evading or avoiding, or that violates or attempts to violate, and any conspiracy formed to violate, any of the prohibitions of the CCMC-EO.

The CCMC-EO defines a Chinese military company as any individual or entity that:

1. the Secretary of Defense lists as a Chinese military company operating directly or indirectly in the United

States pursuant to Section 1237 of the 1999 NDAA as amended ('Section 1237');

2. the Secretary of Defense, in consultation with the Treasury Secretary, determines and lists as a Chinese military company pursuant to Section 1237; or
3. the Treasury Secretary publicly lists as meeting the criteria of Section 1237 for designation as a Chinese military company.

These future designations may further include subsidiaries of the currently designated Chinese military companies. Once listed, an entity continues to be a Chinese military company for purposes of the CCMC-EO until removal from the list by the Secretary of Defense or Treasury Secretary.

OFAC's FAQs interpret the CCMC-EO

Between 28 December 2020 and 27 January 2021, the US Department of the Treasury's Office of Foreign Assets Control ('OFAC') issued 15 frequently asked questions ('FAQs'),⁴ interpreting the CCMC-EO and clarifying OFAC's enforcement

interpretation of certain provisions of the CCMC-EO.

The FAQs address CCMC-EO concerns such as the following:

1. application of the CCMC-EO to Chinese military company subsidiaries;
2. name discrepancies between the identified Chinese military companies and the issuers of the CCMC-securities;
3. definition of ‘publicly-traded securities,’ scope of ‘financial instruments,’ and requirements for divestment of CCMC-securities;
4. the ability of market participants to facilitate divestment of CCMC-securities, as well as;
5. permitted transactions under new General License 1A.

For the detailed summary of the FAQs, see Appendix – Summary of OFAC FAQs – CCMC-EO appended to this article.

Expansion of the definition of ‘Chinese military company’

On 1 January 2021, the 2021 National Defense Authorization Act (‘2021 NDAA’)⁵ was enacted into law significantly expanding the definition of Chinese military company to include Chinese entities that are identified as ‘military-civil fusion contributors’. As revised, the broad definition of Chinese military company will now include any business entity:

- 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 People’s Liberation Army or any other organisation 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.⁶

In addition, the 2021 NDAA defines ‘military-civil fusion

contributors’ as entities within the following seven broadly defined industry categories:

- Entities knowingly receiving assistance from the Chinese government or the Chinese Communist Party through science and technology efforts initiated under the Chinese military industrial planning apparatus.
- Entities affiliated with the Chinese Ministry of Industry and Information Technology, including research partnerships and projects.
- Entities receiving assistance, operational direction, or policy guidance from the State Administration for Science, Technology and Industry for National Defense.
- Any entities or subsidiaries defined as a ‘defense enterprise’ by the State Council of the People’s Republic of China.
- Entities residing in or affiliated with a military-civil fusion enterprise zone or receiving assistance from the Chinese government through such enterprise zone.
- Entities awarded with receipt of military production licences by the Chinese government, such as a: weapons and equipment research and production unit classified qualification permit; weapons and equipment research and production certificate; weapons and equipment quality management system certificate; or equipment manufacturing unit qualification.
- Entities that advertise on national, provincial, and non-governmental military equipment procurement platforms in the People’s Republic of China.

In addition to the above categories, ‘military-civil fusion contributors’ may also include any other entities the Secretary of Defense determines are appropriate.

As to impact, the 2021 NDAA broadens the definition under which the Department of Defense (‘DoD’) may list Chinese military companies,

as well as requires the DoD to update the list of Chinese military companies by 15 April 2021 and annually thereafter until 31 December 2030.

Amendment of the CCMC-EO

On 13 January 2021, Trump issued Executive Order 13974 (‘Amended CCMC-EO’),⁷ amending certain sections of the CCMC-EO. Sections 1(b) and (c) of the CCMC-EO provide US persons 365 days from the entity’s designation to divest CCMC-securities.

The Amended CCMC-EO provides that the divestment obligations with respect to a designated entity depend on the date the entity is designated as a Chinese military company, and clarifies that US persons must divest any CCMC-securities (1) by 11 November 2021 if the Chinese military company was listed with the 31 original CCMC-EO designated entities, or (2) 365 days after the date that the entity is designated as a Chinese military company.

The Amended CCMC-EO further (1) clarifies that possession of any CCMC-securities by a US person is prohibited after the end of the applicable divestment period, and (2) revises the definition of ‘transactions’ to include any ‘sale’ of CCMC-securities to clarify that sales of CCMC-securities after the end of the divestment period would violate the Amended CCMC-EO (further see Appendix – FAQ 873).

The current list of ‘Chinese military companies’

The CCMC-EO initially applied to 31 Chinese military companies named in the Annex to the CCMC-EO as previously listed by the Secretary of Defense. On 8 January 2021, OFAC published an updated version of its Non-SDN Communist Chinese Military Companies List (‘Non-SDN CCMC List’).⁸ The updated Non-SDN CCMC List includes the initial list of 31 Chinese military companies, and the four additional entities⁹ designated by DoD on 3 December 2020. Also, the Non-SDN CCMC List provides additional identifying

information such as also-known-as references, summary of issuer names that exactly or closely match the names of identified entities, and equity tickers. Finally, on 14 January 2021, DoD designated nine additional entities in the aviation, technology, and semiconductor industries as Chinese military companies.¹⁰

As of February 2021, 44 Chinese entities are designated as Chinese military companies. In addition, the updated Non-SDN CCMC List includes subsidiaries of the 44 designated Chinese military

ONCE LISTED, AN ENTITY CONTINUES TO BE A CHINESE MILITARY COMPANY FOR PURPOSES OF EXECUTIVE ORDER 13959 UNTIL REMOVAL FROM THE LIST BY THE SECRETARY OF DEFENSE OR TREASURY SECRETARY.

companies, with names closely matching those designated entities. So, the total number of Chinese entities subject to the Amended CCMC-EO now exceeds 44 when including [subsidiary] entities with names closely matching the designated entities. Under the Amended CCMC-EO, the transaction prohibition effective date for the initial 31 entities remains 11 January 2021, with the divestment period ending on 11 November 2021. For entities subsequently designated as Chinese military companies, the transaction prohibition remains effective for 60 days after the designation with the divestment period extending for 365 days after such a designation.

Impact on exporters

The Chinese military companies list now affects both investors of the CCMC-securities and exporters. As background, on 23 December 2020, the US Department of Commerce Bureau of Industry

LINKS AND NOTES

- ¹ Available here: <https://public-inspection.federalregister.gov/2020-25459.pdf>
- ² 'US persons' covered by the CCMC-EO include 'any United States citizen, permanent resident alien, entity organized under the laws of the United States or any jurisdiction within the United States (including foreign branches), or any person in the United States.' Id.
- ³ 'Person' means an individual or entity in the CCMC-EO. 'Securities' for purposes of the CCMC-EO are defined to include any 'security' as defined in the Securities Exchange Act of 1934. Also included as 'securities' are 'currency, notes, bills of exchange and banker's acceptances with maturities not exceeding 9 months.' Id.
- ⁴ Available here: <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/topic/5671>
- ⁵ Available here: www.congress.gov/116/bills/hr6395/BILLS-116hr6395enr.pdf; the revisions discussed in this article are in Sec. 1260 H. (pp. 578-79).
- ⁶ Id.
- ⁷ Available here: www.govinfo.gov/content/pkg/FR-2021-01-19/pdf/2021-01228.pdf
- ⁸ Available here: www.treasury.gov/ofac/downloads/ccmc/ns-ccmc_list.pdf
- ⁹ Available here: <https://media.defense.gov/2020/Dec/03/2002545864/-1/-1/1/TRANCHE-4-QUALIFYING-ENTITIES.PDF>
- ¹⁰ Available here: <https://media.defense.gov/2021/Jan/14/2002565154/-1/-1/0/DOD-RELEASES-LIST-OF-ADDITIONAL-COMPANIES-IN-ACCORDANCE-WITH-SECTION-1237-OF-FY99-NDAA.PDF>
- ¹¹ Available here: <https://www.govinfo.gov/content/pkg/FR-2020-12-23/pdf/2020-28052.pdf>
- ¹² Since the CCMC-EO does not impact Russia and Venezuela, this article does not review the restrictions as applicable to Russia and Venezuela under EAR §744.21 Restrictions on certain 'military end-use' or 'military end-user' in the People's Republic of China, Russia, or Venezuela.
- ¹³ Available here: www.whitehouse.gov/briefing-room/presidential-actions/2021/01/20/regulatory-freeze-pending-review/
- ¹⁴ Available here: https://home.treasury.gov/system/files/126/chinese_military_gl2_1.pdf
- ¹⁵ Available here: https://home.treasury.gov/system/files/126/ccmc_gl1a_01272021_1.pdf

and Security ('BIS') issued a list of designated military end-users ('MEU List')¹¹ under §744.21 ('MEU Rule') of the Export Administration Regulations ('EAR') restricting the export, reexport, or transfer (in-country) of regulated items listed in §744.21 Supplement No. 2 ('MEU Items') to 'military end-users' in China.¹²

This MEU List includes a 'first tranche' of over 100 designated military end-users from China and Russia. Most of the Chinese entities on the MEU List are in the aerospace industry, including seven subordinate institutions of Aviation Industry Corporation of China and eight subordinate institutions of Aero-Engine

Company of China. The MEU Items include many commercial items listed in Supplement No. 2 arranged by export control classification numbers from each of the Commerce Control List categories (1)-(9). The MEU Items generally are not otherwise controlled for export, reexport, or transfer (in-country) to China, so exporters should develop internal compliance tools to flag the need to perform due diligence prior to the shipment of MEU Items to China.

The MEU List, however, is not an exhaustive list of all 'military end-users' subject to the MEU Rule. Accordingly, the MEU Rule requires comprehensive due diligence by parties participating in the export, reexport, or transfer (in-country) to determine whether a Chinese recipient is a 'military end-user' subject to the MEU Rule. For due diligence, parties should first confirm if the item under analysis is (1) subject to the EAR, and (2) a listed MEU Item. If yes, then the exporter should review to confirm whether the MEU Item recipient is on the MEU List. If the recipient is on the MEU List, then a licence is required. If the recipient is not on the MEU List, then technical due diligence must be performed to apply the definitions of 'military end-user' and 'military end-use' under the MEU Rule to confirm whether a licence is required.

As to further due diligence guidance, BIS notes that exporters should closely scrutinise Chinese military companies designated by DoD

that are not currently on the MEU List. For compliance, DoD-designated Chinese military companies raise a red flag requiring additional due diligence as to whether a licence is required prior to the export, reexport, or transfer of MEU Items to such DoD-designated entities. Therefore, in addition to the investors of the Chinese military company securities, exporters must also be mindful of the recent developments in Chinese military company designations.

In sum, on 20 January 2021, the Biden administration issued a Regulatory Freeze¹³ requiring US departments and agencies ensure President Biden appointees or designees have the opportunity to review and approve any new or pending rule. Since the Biden administration came to office, the only action pertaining to the CCMC-EO has been the issuance of two new OFAC FAQs. Therefore, the CCMC-EO will continue to cause ambiguity and uncertainty requiring US investors and exporters conduct greater due diligence, while focusing attention on the interaction between US departments and agencies co-responsible for designating Chinese military companies.

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APPENDIX – SUMMARY OF OFAC FAQs – CCMC-EO

FAQ NO.	PUBLICATION DATE	ISSUES	SUMMARY OF OFAC'S GUIDANCE
857:	28 December 2020	Publicly-traded securities of subsidiaries of Chinese military companies.	OFAC intends to publicly list the subsidiaries that (1) issue publicly-traded securities, and (2) are 50% or more owned or determined to be controlled by one or more Chinese military companies. The CCMC-EO applies to Chinese military companies publicly listed by the Department of Treasury pursuant to CCMC-EO section (4)(a)(iii).
858	28 December 2020	In some cases, names of Chinese military companies identified by the US Department of Defense ('DoD') may not match the actual names of issuers.	The CCMC-EO applies to publicly-traded securities (or any publicly-traded securities that are derivative of, or are designed to provide investment exposure to, such securities) of an entity with a name that exactly or closely matches the name of an entity identified as a Chinese military company. OFAC published the Chinese military companies list on its website, which includes the names of entities identified in or pursuant to the CCMC-EO and additional identifying information of such entities.
859	28 December 2020	Definition of 'publicly-traded securities.'	OFAC clarifies that 'publicly-traded securities' include securities (as defined in section 4(d) of the CCMC-EO) denominated in any currency that trade in any jurisdiction on a securities exchange or through the method of trading that is commonly referred to as 'over-the-counter.'
860	28 December 2020	Scope of 'financial instruments.'	The financial instruments covered by the CCMC-EO include, but are not limited to, derivatives (e.g., futures, options, swaps), warrants, American depositary receipts ('ADRs'), global depositary receipts ('GDRs'), exchange-traded funds ('ETFs'), index funds, and mutual funds, to the extent such instruments also meet the definition of 'security' as defined in section 4(d) of the CCMC-EO.
861	28 December 2020	Prohibition of investments in US or foreign funds holding securities of Chinese military companies.	The CCMC-EO applies to investments by US persons in US and foreign funds, such as ETFs or other mutual funds that hold publicly-traded securities of Chinese military companies or their derivatives.
862	4 January 2021	Whether divestment of holdings in securities of Chinese military companies by 11 January 2021 is required.	US persons, including US funds and related market intermediaries and participants, are not required to divest their holdings in publicly-traded securities (and derivatives) of the Chinese military companies identified in the Annex to the CCMC-EO by 11 January 2021. According to the CCMC-EO, US persons will have until 11:59 p.m. EST on 11 November 2021 to divest prohibited securities that were held as of 9:30 a.m. EST on 11 January 2021. If additional business entities are designated as Chinese military companies, then divestiture must occur within 365 days of the date of designation.
863	6 January 2021	Whether US persons are permitted to serve as a custodian, offer for sale, serve as a transfer agent, and trade in CCMC-securities.	OFAC clarifies that the following services by US persons are permissible (as long as they are not provided to US persons in connection with prohibited transactions): clearing, execution, settlement, custody, transfer agency, back-end services, as well as other such support services.

FAQ NO.	PUBLICATION DATE	ISSUES	SUMMARY OF OFAC'S GUIDANCE
864	6 January 2021	Subsidiaries with names that 'exactly or closely match' the names of identified Chinese Military Companies.	The prohibitions under the CCMC-EO apply to subsidiaries of listed Chinese military companies with a name that exactly or closely matches the name of a Chinese military company identified in the CCMC-EO. In this guidance, OFAC specifically identified seven entities having names that 'closely match' the names of covered Chinese military companies. On 8 January 2021, OFAC issued General License No. 1 to address the implementation issue relating to the 'closely match' requirement. The General License No. 1 has been replaced in its entirety by General License No. 1A in FAQ 878, which is summarised below.
865	6 January 2021	Whether market intermediaries and other participants can facilitate divestment of CCMC-securities.	OFAC permits market intermediaries and other participants to engage in ancillary or intermediary activities that are necessary to effect divestiture during the relevant wind-down periods or that are otherwise not prohibited under the CCMC-EO. OFAC also permits transactions by US persons involving investment funds that are seeking to divest during the relevant wind-down periods to ensure compliance with the CCMC-EO.
871	14 January 2021	Compliance obligations of securities exchanges operated by US persons.	General License 2 ¹⁴ permits all transactions and activities by securities exchanges operated by US persons related to securities of the Chinese military companies identified by OFAC after 12:01 a.m. eastern standard time, 14 January 2021 through the applicable 365-day divestment period.
872	14 January 2021	US person divestment of CCMC-securities.	US person must divest any Chinese military company securities that they hold by the end of the 365-day wind-down period and after the end of the wind-down period, US person will be prohibited from holding or trading in Chinese military company securities.
873	14 January 2021	Definition of 'transaction.'	The definition of 'transaction' is expanded to include any sale of a covered publicly-traded security.
874	14 January 2021	Activities permitted to divest holdings of CCMC-securities.	Transactions (including purchases for value and sales) entered into on or before the end of the applicable 365-day divestment period, solely to divest, in whole or in part, from Chinese military companies securities, is permitted. OFAC also refers to FAQ 865 regarding the permissibility of market intermediaries and other participants engaging in ancillary or intermediary activities that are necessary to effectuate divestiture during relevant wind-down periods.
878	27 January 2021	Permitted transactions under new General License 1A.	Effective 27 January 2021, General License No. 1, dated 8 January 2021, is replaced and superseded in its entirety by General License No. 1A ('GL 1A'). ¹⁵ US persons may, subject to the conditions in the general licence, engage in transactions otherwise prohibited by the CCMC-EO involving CCMC-securities of entities whose names closely match, but do not exactly match, the name of a Chinese military company. But GL 1A does not authorise transactions in CCMC-securities identified on OFAC's Non-SDN Communist Chinese Military Companies List or otherwise identified by the DoD pursuant to the CCMC-EO.
879	27 January 2021	Whether GL 1A authorises transactions with entities identified as subsidiaries of a Chinese military company.	GL 1A does not authorise any transactions involving CCMC-securities of entities listed on OFAC's Non-SDN Communist Chinese Military Companies List (NS-CCMC List) as a subsidiary of a business entity already determined to be a Chinese military company.