

Trade Compliance Flash: Biden Administration Modifies Investment Prohibitions Targeting Chinese Military-Industrial Complex Companies

International Alert

06.11.2021

On June 3, 2021, President Biden issued an executive order titled, *Addressing the Threat from Securities Investments That Finance Certain Companies of the People's Republic of China* (E.O. 14032), which resets and rebrands the U.S. sanctions program aimed at combatting the People's Republic of China's (PRC) military-industrial complex and Military-Civil Fusion strategy by prohibiting U.S. person purchases or sales of publicly traded securities of companies identified on the newly created Non-SDN Chinese Military-Industrial Complex Companies List (NS-CMIC List). E.O. 14032 replaces virtually all the substantive and procedural aspects of Executive Order 13959 of November 12, 2020, *Addressing the Threat from Securities Investments That Finance Communist Chinese Military Companies* (E.O. 13959), entirely revokes the subsequent modifications made to E.O. 13959 through Executive Order 13974 (E.O. 13974),¹ and establishes a far more traditional Office of Foreign Assets Control (OFAC)-administered sanctions program tailored to the stated policy goals.

E.O. 14032, along with several newly issued OFAC Frequently Asked Questions (FAQs), seeks to eliminate some of the more puzzling aspects of E.O. 13959, in part by resolving several ambiguities that had vexed the global financial community since the program's introduction in November 2020. Notably, the U.S. Department of Defense (DoD) will no longer play a primary role in identifying companies that will be subject to prohibitions on U.S. person investments under this program. Moreover, numerous entities that were previously subject to prohibitions under E.O. 13959 because they were identified by the DoD as Communist Chinese Military Companies (CCMCs) pursuant to Section 1237 of the FY 1999 National Defense Authorization Act (FY99 NDAA) are not included on the new NS-CMIC List. Likewise, because the scope of E.O. 14032 targets companies operating in the defense and related materiel sector and the surveillance technology sector of the economy of the PRC, a number of new companies will be subject to investment prohibitions for the first time, with the prospect for significant expansion of the NS-CMIC List in the future.

E.O. 14032 Removes Department of Defense Authority Over Company Listings and Creates the NS-CMIC List

In addition to providing the Secretary of the Treasury the authority to list companies that met the criteria of a CCMC, E.O. 13959 relied principally upon listings made by the Secretary of Defense pursuant to Section 1237 of the FY99 NDAA, as amended. That DoD listing process for CCMCs under the FY99 NDAA, which was never intended to carry with it the prohibitions on U.S. person investments in publicly traded securities set forth in E.O. 13959, proved to be a sub-optimal mechanism to administer this program and achieve U.S. policy goals. Recent court challenges to DoD's CCMC listings exposed a lack of process and supporting evidence, in at least some instances, and exposed the problems in granting DoD the authority to identify companies that would be subject to the prohibitions of E.O. 13959.²

Section 1 of E.O. 14032 removes all references to the DoD-led FY99 NDAA listing process. Using a more traditional approach to identifying sanctions targets, E.O. 14032 provides the Secretary of the Treasury (*i.e.*, OFAC) the authority to target companies operating in specific industry sectors, in this case the "defense and related materiel sector or the surveillance technology sector of the economy of the PRC." Moreover, while authorizing a consultative role for the Secretary of Defense and the Secretary of State, E.O. 14032 establishes the Secretary of Treasury, and by extension OFAC, as the key decisionmaker in identifying companies subject to prohibitions under this program.

Companies subject to prohibitions under E.O. 13959, as amended will appear on a newly published NS-CMIC List on OFAC's

website. The NS-CMIC list replaces the NS-CCMC List in its entirety. The NS-CCMC List has been deleted from OFAC's website. [OFAC FAQ #899](#).

With respect to potential future additions to the NS-CMIC List, OFAC has indicated that it:



[e]xpects to use its discretion to target, in particular, persons whose operations include or support, or have included or supported, (1) surveillance of persons by Chinese technology companies that occurs outside of the PRC; or (2) the development, marketing, sale, or export of Chinese surveillance technology that is, was, or can be used for surveillance of religious or ethnic minorities or to otherwise facilitate repression or serious human rights abuse.

[OFAC FAQ #900](#).

That focus seems more well-aligned with U.S. policy seeking to counteract and increase pressure on the PRC government and companies that profit from perceived human rights abuses and forced labor practices perpetrated against the Uyghurs and other ethnic minorities in Xinjiang Province. It also opens the possibility of significant future expansion of the NS-CMIC List within these parameters.

Overall, the initial group of 59 companies included on the NS-CMIC List, which are also identified in the Annex to E.O. 14032, expands the overall number of persons subject to prohibitions under E.O. 13959, as amended. Notably, however, numerous companies that were part of the now defunct NS-CCMC List were not migrated to the new NS-CMIC-List and will not be subject to prohibitions under E.O. 13959, as amended. Among those companies that are no longer subject to the prohibitions of E.O. 13959, as amended, are all companies listed by DoD in so-called "Tranche 5," released during the final days of the Trump administration in January 2021. The full list of companies previously listed by DoD, but **not** included on the NS-CMIC List is as follows:

- Advanced Micro-Fabrication Equipment Inc. (AMEC)
- Beijing Zhongguancun Development Investment Center
- China Construction Technology Co. Ltd. (CCTC)
- China International Engineering Consulting Corp. (CIECC)
- China National Aviation Holding Co. Ltd. (CNAH)
- China National Chemical Corporation (ChemChina)
- China National Chemical Engineering Group Co., Ltd. (CNCEC)
- China Three Gorges Corporation Limited
- Commercial Aircraft Corporation of China, Ltd. (COMAC)
- Dawning Information Industry Co (Sugon)
- Global Tone Communication Technology Co. Ltd. (GTCOM)

- GOWIN Semiconductor Corp
- Grand China Air Co. Ltd. (GCAC)
- Luokung Technology Corp. (LKCO)
- Sinochem Group Co Ltd
- Xiaomi Corporation

Timing and Divestiture Considerations

In terms of timing, E.O. 14032 also resets the clock on prohibitions imposed under E.O. 13959, as amended, which will be implemented as follows:

- With respect to persons listed in the Annex of E.O. 14032, the prohibition on purchasing and selling any publicly traded securities or derivatives of such securities goes into effect at 12:01 a.m. Eastern Daylight Time on August 2, 2021.
- For those not listed in the Annex (*i.e.*, those added to the NS-CMIC List by OFAC at a later date), the prohibitions go into effect at 12:01 a.m. Eastern Daylight Time on the date that is 60 days after the date of the person's listing.

E.O. 14032 also creates wind-down periods during which the purchase or sale of publicly traded securities that would otherwise be prohibited are authorized "solely to [a]ffect the divestment, in whole or in part, of such securities by a United States person." The deadlines for undertaking these divestment transactions are:

- 12:01 a.m. Eastern Daylight Time on June 3, 2022, with respect to any person listed in the Annex of E.O. 14032; or
- With respect to persons not listed in the Annex (*i.e.*, those added to the NS-CMIC List by OFAC at a later date), 12:01 a.m. Eastern Daylight Time on the date that is 365 days after the date of the person's listing.

Scope of Permissible Activities with Companies on the NS-CMIC List

With the issuance of E.O. 14032, and in line with the comprehensive program reset that this executive order represents, OFAC has taken the opportunity to set the record straight with respect to the scope of prohibitions faced by companies included on the NS-CMIC List. Despite OFAC's prior efforts to clarify the scope of E.O. 13959 and prohibitions applicable to U.S. persons, significant ambiguity and confusion persisted regarding core aspects of the program. Much of the newly issued OFAC guidance, specifically, OFAC FAQs 898-905, attempts to draw distinctions between the prohibitions imposed on U.S. persons by E.O. 13959, as amended, and traditional blocking sanctions administered by OFAC.

- First, OFAC guidance highlights that the prohibitions under E.O. 13959, as amended apply only to companies specifically listed in the NS-CMIC List, meaning that the subsidiaries of companies on this list are *not* subject to these sanctions under OFAC's 50 Percent Rule. [OFAC FAQ #857](#).
- Second, U.S. persons are not prohibited from providing investment advisory, investment management, or similar services to a non-U.S. person, in connection with the non-U.S. person's purchase or sale of a covered security, provided that the underlying purchase or sale would not otherwise violate E.O. 13959, as amended. For example, OFAC notes a U.S. investment adviser for a non-U.S. fund "is not prohibited from advising on, authorizing, directing, or approving purchases or sales of covered securities by the non-U.S. investment fund, provided that the underlying purchase or sale would not otherwise violate E.O. 13959, as amended (*e.g.*, neither the purchase nor sale of the covered security is for the ultimate benefit of a U.S. person, the purchase or sale is not a willful attempt to evade the prohibitions of E.O. 13959, as amended, etc.)." [OFAC FAQ #902](#).
- Third, OFAC guidance notes that U.S. persons are not prohibited from being involved in, or otherwise facilitating, purchases or

sales of securities issued by CMICs on behalf of their non-U.S. employer, "provided that such activity is in the ordinary course of their employment and the underlying purchase or sale would not otherwise violate E.O. 13959, as amended." [OFAC FAQ #903](#).

- Fourth, OFAC states that U.S. market makers and other market intermediaries are permitted to facilitate **divestment**-related activities from publicly traded securities of CMICs. [OFAC FAQ #904](#) and [FAQ #865](#).
- Finally, OFAC explicitly states that transactions and activities, such as buying goods and services that do not involve purchases or sales of publicly traded securities and derivatives issued by CMICs are not prohibited by E.O. 13959, as amended. [OFAC FAQ #905](#).

Key Takeaways and Compliance Considerations

Most importantly, as a practical matter, E.O. 14032 creates a new OFAC sanctions program which, although it resembles the earlier program established by E.O. 13959, differs in several key ways:

- The listing process has broken free of the inherent limitations imposed by the odd mix of responsibilities and authorities underlying E.O. 13959, which was awkwardly tied to statutory defense authorization criteria that were not created with sanctions in mind and relied on DoD to make listing decisions, even though it had little expertise or experience in administering such a process.
- The new sanctions program is now entirely controlled by the U.S. Department of the Treasury, which has substantial experience in making such listings, including experience in identifying with precision the entities being placed on the lists it administers (*e.g.*, the NS-CMIC List).
- E.O. 14032 has new listing criteria that are more traditional and more well-defined than those included in E.O. 13959, which should allow U.S. investors and potential Chinese targets of these prohibitions to better gauge and manage U.S. sanctions risk.
- OFAC has clarified that the NS-CMIC List is now "the List," meaning that the 50 Percent Rule does not apply and the unconventional concept of "close matches" has been eliminated.
- A significant number of companies previously included on the now defunct NS-CCMC List have been left off the new NS-CMIC List (presumably because they did not meet the new listing criteria, or Treasury determined that there were other policy-related considerations that warranted excluding them) and a number of new companies were identified and listed for the first time under this program.

As a result of these changes, U.S. companies (particularly U.S. investors and financial institutions) that conduct business in China, even those which have already undertaken a compliance analysis in connection with E.O. 13959, should conduct a new review to ensure compliance with the comprehensive changes implemented by E.O. 14032. This new analysis should be guided by several factors:

- Because the new NS-CMIC List represents a substantial change from the prior NS-CCMC List, U.S. person investors, particularly U.S. financial institutions, should carefully review their portfolios to determine whether any of their holdings are affected. Some U.S. persons will no doubt find that divestment is no longer necessary, while others will identify new, previously unanticipated divestment issues, or will confirm that divestment remains necessary. Even outside the investment community, all U.S. persons conducting substantial business with China should consider conducting a compliance review to determine (i) whether such business involves companies on the NS-CMIC List, and, if it does, (ii) what conduct could be subject to updated prohibitions concerning the purchase or sale of publicly traded securities, as set forth in E.O. 14032. This review must occur quickly in light of the impending effective date of August 2, 2021.
- While any initial review should occur quickly to ensure compliance with the most time-sensitive aspects of E.O. 13959, as amended, the wind-down period and divestment window (should divestment become necessary) is much longer (*i.e.*, 365 days), allowing investors and other companies affected by these new restrictions a reasonable time to comply.

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¹In related guidance accompanying E.O. 14032, OFAC states that going forward, it will refer to E.O. 13959, as amended by E.O. 14032, as "E.O. 13959, as amended."

²See *Xiaomi Corp. v. U.S. Dept. of Defense*, No. 21-280 (D.D.C. 2021); *Luokung Tech. Corp., et al. v. U.S. Dept. of Defense, et al.*, No. 2021-0583 (D.D.C. 2021).

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