

President Trump Issues Executive Order Prohibiting Transactions Involving Publicly Traded Securities of “Communist Chinese Military Companies”

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International Trade Controls, Public Policy

On Thursday, November 12, 2020, President Trump signed an [Executive Order](#) (the “Order”) that, beginning on January 11, 2021, will prohibit U.S. persons from transacting in the publicly traded securities of 31 companies that the Department of Defense has identified as “Communist Chinese military companies.” The requirement for the Department of Defense to create a list of companies was directed by Congress pursuant to Section 1237 of the National Defense Authorization Act (“NDAA”) for Fiscal Year 1999. The Order, entitled “Addressing the Threat from Securities Investments that Finance Communist Chinese Military Companies,” follows months of U.S. government scrutiny and regulatory action with respect to the activity of Chinese companies. It may also represent one in a series of last-minute actions taken on China by the Trump Administration as it nears the end of its term.

Finding that China “is increasingly exploiting United States capital to resource and to enable the development and modernization of its military, intelligence, and other security apparatuses, which continues to allow the PRC to directly threaten the United States homeland and United States forces overseas, including by developing and deploying weapons of mass destruction, advanced conventional weapons, and malicious cyber-enabled actions against the United States and its people,” the Order declares a national emergency with respect to the threat posed by China’s “military-industrial complex” under the authorities granted in the International Emergency Economic Powers Act (“IEEPA”), the National Emergencies Act, and Section 301 of Title 3 of the United States Code.

Under the Order, U.S. persons will have through November 11, 2021, to divest securities in these companies. Furthermore, the Order authorizes the Secretaries of Defense and/or Treasury to designate additional parties as Communist Chinese military companies subject to the same prohibitions (also accompanied by a one-year divestment period), and delegates authority to the Secretary of the Treasury, in consultation with other agencies, to enforce the Order, including by promulgating implementing rules and regulations.

Principal Elements of the Executive Order

Prohibited Conduct

Pursuant to the Order, beginning at 9:30 AM Eastern Standard Time on January 11, 2021, U.S. persons are prohibited from engaging in “any transaction in publicly traded securities, or any securities that are derivative of, or are designed to provide investment exposure to such securities,” of the “Communist Chinese military companies” on two existing lists of Chinese

companies incorporated by reference in the Order. Moreover, the same restriction applies beginning 60 days after the designation of any additional Communist Chinese military companies pursuant to the Order.

The Order defines “United States person” as “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.” The Order defines “security” by reference to Section 3(a)(10) of the Securities Exchange Act of 1934, but then adds to this definition “currency or any note, draft, bill of exchange, or banker’s acceptance which has a maturity at the time of issuance of not exceeding 9 months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.” The latter portion of the definition appears to refer to debt instruments collectively known as commercial paper.

Importantly, the prohibitions in Section 1(a) of the Order do not apply unless the security also is “publicly traded,” and the Order includes no definition for this concept. The Order also includes no obvious geographic limitation for where covered securities are publicly traded, so absent contrary guidance from the U.S. Department of the Treasury, even transactions by U.S. persons involving affected securities traded on non-U.S. exchanges would appear to be prohibited. Nevertheless, by focusing on “publicly traded” securities, the Order appears to make clear that certain securities transactions involving the affected companies—such as joint venture investments—are not prohibited.

Affected Securities

For the initial round of prohibitions slated to go into effect on January 11, 2021, the Order relies on a list of “Communist Chinese military companies” promulgated by the Department of Defense pursuant to a mandate in Section 1237 of the Fiscal Year 1999 NDAA (as amended). The Act required the Department of Defense to create a list of “those persons operating directly or indirectly in the United States or any of its territories and possessions that are Communist Chinese military companies,” with such persons defined to include parties listed in one of two Defense Intelligence Agency reports from the 1990s, and any other person that “is owned or controlled by, or affiliated with, the People’s Liberation Army,” and “is engaged in providing commercial services, manufacturing, producing, or exporting.”

Although the mandate to promulgate a list of Communist Chinese military companies is more than 20 years old, the Department of Defense issued the first names, in response to Congressional interest, in [June](#) and [August 2020](#). A total of 31 companies have now been formally identified by the Department of Defense as “Communist Chinese military companies.” These companies include, for example, China Mobile Communications Group and China Telecommunications Corp., both of whose shares are traded on U.S. exchanges.¹

The Order also contemplates future additional designations by the Secretaries of Defense and/or Treasury. Sections 4(a)(ii) and (iii) of the Order define “Communist Chinese military company” to include:

- any person that the Secretary of Defense, in consultation with the Secretary of the Treasury, designates in the future pursuant to the authority” of the Order; or

¹ See *Chinese Companies Listed on Major U.S. Stock Exchanges*, U.S.-China Economic and Security Review Commission, Oct. 2, 2020, https://www.uscc.gov/sites/default/files/2020-10/Chinese_Companies_on_US_Stock_Exchanges_10-2020.pdf.

- any person that the Secretary of the Treasury separately determines “is owned or controlled by the People’s Liberation Army” and “is engaged in providing commercial services, manufacturing, producing, or exporting” or is a “subsidiary of a person already determined to be a Communist Chinese military company.”

Certain Divestitures Authorized

Notwithstanding these prohibitions on the specified transactions, Section 1(b) of the Order authorizes on or before November 11, 2021, “purchases for value or sales . . . solely to divest, in whole or in part” securities in companies designated under Section 4(a)(i) of the Order. With respect to future designations that may be made under Section 4(a)(ii) or (iii) of the Order, Section 1(c) of the Order authorizes, for one year from the date on which a person is determined to be a Communist Chinese military company, “purchases for value or sales . . . solely to divest, in whole or in part, from securities that any United States person held” on the date that the applicable prohibition takes effect.

Interpretive Questions

The Order leaves several open questions about the scope of its prohibitions, which may be addressed in near-term guidance and/or implementing regulations. Potential questions include, among others:

- What it means for a security to be “publicly traded.” As noted, there is no clear geographic limitation in the Order that requires the securities to be traded on U.S. exchanges. Even in the United States, however, the term “publicly traded” could include securities registered with the Securities and Exchange Commission (“SEC”) and listed on national securities exchanges, registered securities not listed on national exchanges, or even securities not registered with the SEC pursuant to regulatory exemptions.
- Whether the securities of unlisted subsidiaries of designated companies are affected by the Order. Although property-blocking and sectoral economic sanctions administered by the Treasury Department’s Office of Foreign Assets Control apply not only to specifically designated persons, but also to persons owned 50% or more, individually or in the aggregate, with other persons whose property is blocked or who are subject to the same sectoral sanctions, it does not appear that principle will govern here. Section 4(a)(iii) of the Order, which empowers the Secretary of the Treasury to list “subsidiar[ies] of a person already determined to be a Communist Chinese military company,” would presumably be unnecessary if subsidiaries were already included in the Order’s prohibitions.
- What transactions are included as authorized divestment activity under Sections 1(b) and (c) of the Order. In addition to authorizing “sales . . . solely to divest” from affected securities, the Order also authorizes “purchases for value . . . solely to divest” from such securities. What purchases may be included in this time-limited divestiture authorization (such as purchase transactions necessary to unwind short positions), and the range of activities by third-parties that are authorized to facilitate them, appear to remain open questions.

Because the Department of the Treasury (in consultation with other officials) is authorized to promulgate rules and regulations and otherwise carry out the Order, it is possible regulations to implement the Order and/or interpretative guidance or frequently asked questions will be issued that address these and other questions in the weeks ahead.

Looking Ahead

The Order follows increasing expressions of concern from lawmakers and the Trump Administration about the convergence of civilian and military activities in China. For example, legislation recently [proposed](#) by Senator Marco Rubio of Florida seeks to prohibit certain Chinese firms from accessing U.S. capital markets, and the Trump Administration has adopted a number of related measures, such as the May 15, 2019 [Executive Order on Securing the Information and Communications Technology and Services Supply Chain](#), and the April 2020 [expansion of export controls restrictions](#) for Chinese, Russian, and Venezuelan military end uses and end users in the Export Administration Regulations. Similarly, the Secretary of Defense has the authority to add Chinese telecommunications companies to the list of companies that the U.S. government or its contractors may not obtain or use telecommunications equipment or services from under Section 889 of the John S. McCain NDAA for Fiscal Year 2019. It is possible that the telecommunications companies included on the Department of Defense's Section 1237 list may be considered by the Defense Secretary for addition to the Section 889 restrictions.

In the final weeks of the Trump Administration, it is possible that additional actions—such as designation of additional parties pursuant to the Order, or designation of additional Chinese parties on the Entity List maintained by the Commerce Department's Bureau of Industry and Security—could be taken to further restrict Chinese companies' access to U.S. investment capital or commodities, software, and technology subject to U.S. export control jurisdiction. It remains to be seen whether the incoming Biden Administration—which likewise has expressed concern about China on a range of issues, including trade and national security—will maintain or modify the Order, which could be repealed without Congressional involvement.

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We will continue to monitor developments in this area, and we are well positioned to assist clients in understanding how these developments may affect their business operations.

If you have any questions concerning the material discussed in this client alert, please contact the following Covington attorneys and advisors:

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