

## **TRUMP ADMINISTRATION RESTRICTS INVESTMENTS IN COMPANIES LINKED TO CHINESE MILITARY**

To Our Clients and Friends:

On November 12, 2020, President Trump issued Executive Order (“E.O.”) 13959 restricting the ability of U.S. persons to invest in securities of certain “Communist Chinese military companies.”<sup>[1]</sup> This E.O. alleges that under China’s national strategy of “Military-Civil Fusion,” China “exploits United States investors” to finance the development of its military, intelligence, and security capabilities. While the E.O. is only the latest in a flurry of actions by the Trump administration directed against Beijing, it is the first measure to focus on securities—including investments in securities of dozens of prominent Chinese companies, as well as mutual funds and index funds that hold such companies’ shares. Under the E.O., U.S. persons—including individual and institutional investors, stock exchanges, fund managers, investment advisers, broker-dealers, and insurance companies—will be prohibited from purchasing for value publicly traded securities of certain Chinese companies starting in early January 2021 and, absent a change in policy by the incoming Biden administration, will be incentivized to engage in divestment transactions through November 11, 2021.

The E.O. currently applies to 31 ostensibly civil companies that the United States alleges have ties to the Chinese military. The names of those companies appear on two lists published by the U.S. Department of Defense in June 2020 and August 2020, and reproduced below. The U.S. Department of the Treasury has yet to publish guidance indicating whether the E.O. extends to those companies’ subsidiaries; however, a plain-language reading of the E.O. suggests that it may only apply to subsidiaries (if any) that the U.S. Secretary of the Treasury identifies by name. Among the targeted entities are substantial enterprises such as China Mobile Communications and Hikvision, many of which have shares traded on mainland Chinese, Hong Kong, or U.S. stock exchanges. Additionally, several of the targeted companies were added earlier this year to the U.S. Department of Commerce’s Entity List and are therefore already subject to stringent restrictions on access to U.S.-origin goods, software, and technologies. In that sense, the new E.O. marks an expansion of U.S. pressure on Beijing from targeting suppliers of certain large Chinese firms to constricting their sources of financing, albeit in a relatively narrow manner. According to a leading China-focused research organization, of the 31 companies identified to date, only 13 are publicly traded components of the MSCI China Index and only Hikvision has substantial foreign ownership.<sup>[2]</sup>

Effective January 11, 2021—sixty days after the E.O. was issued—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 any Communist Chinese military company.” “Transaction” is defined to mean the purchase for value of any publicly traded security and the prohibition applies to shares in such companies, as well as shares held indirectly through popular

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investment vehicles such as exchange traded funds. The E.O. also permits U.S. persons, until November 11, 2021—one year after the E.O. was issued—to engage in otherwise prohibited transactions in order to divest their existing holdings in any of the named Communist Chinese military companies. Although the E.O.’s narrow definition of prohibited transactions does not appear to require U.S. persons to divest holdings in these companies, the prospect of securities becoming illiquid after November 11, 2021 may lead many U.S. investors to divest their holdings during this time.

In this regard the surgical and staggered imposition of restrictions under the E.O. reflects prior approaches the United States used with Venezuela and Russia and is likely animated by similar concerns. When the United States acted to limit the Maduro regime’s access to finance starting in 2017, it, *inter alia*, restricted transactions associated with certain Venezuela bonds. But, in order to limit the collateral consequences on innocent parties that held significant numbers of those bonds, the United States allowed the limited divestment of those bonds. In the Russia context, following the Crimea incursion in 2014, the United States imposed sanctions on some of the largest enterprises in the Russian financial and energy sectors. However, due to the exposure of U.S. and allied interests to those enterprises, the United States similarly stopped short of imposing blocking sanctions on any of the targeted entities. As with the new China E.O., Russian “sectoral” sanctions prohibit U.S. persons from engaging in only certain types of financial transactions with identified firms. And, importantly, absent some other prohibition, the earlier Russian sectoral sanctions and the new China E.O. permit U.S. persons to continue engaging in all other lawful dealings with listed entities.

The new E.O. is the latest in a series of U.S. measures calculated to address perceived threats to U.S. national security posed by China’s policy of “Military-Civil Fusion.”<sup>[3]</sup> Like the U.S. Department of Commerce’s expansion of the Military End User Rule, the new Huawei-specific Direct Product Rule, and the recent spate of Entity List designations, as well as the U.S. Government’s procurement ban on certain technologies from several Chinese companies (including two companies that are subject to the new E.O.), this latest action is designed to curtail American support for Chinese companies that allegedly support the Chinese military. The E.O. also complements outreach by the U.S. State Department in August 2020 urging colleges and universities to divest from Chinese holdings more generally,<sup>[4]</sup> and President Trump’s Working Group on Financial Markets, which has developed guidance that would require companies to provide American regulators with access to audit work papers to remain listed on U.S. exchanges, access that China had historically refused.<sup>[5]</sup> White House officials are reportedly prioritizing further action against Beijing during President Trump’s final weeks in office.

While the E.O.’s prohibition will take effect shortly before President-elect Biden is sworn in, the apparent wind-down period for U.S. persons to divest their holdings in the listed Communist Chinese military companies extends nearly a year into the next president’s term. As such, in our assessment, the key date for this new policy is not only January 11, 2021, when the prohibition takes effect, but also nine days later when the new administration assumes power. Because the E.O. is not mandated by statute or any other requirement, once in office President Biden could engage with the E.O. as he sees fit: he could revoke the E.O. outright, narrow its reach through published guidance and the exercise of enforcement discretion, decline to target additional Chinese companies, or allow the E.O. to lapse on November 12, 2021 when the President is required by the International Emergency Economic Powers Act to renew the national emergency determination that allowed for the E.O.

However, even for a Biden administration that will be intent on changing the tone of U.S. foreign policy—including through closer coordination with traditional allies—rescinding or eliminating these and other restrictions on Beijing without receiving any concessions in return could spark bipartisan pushback in the U.S. Congress and potentially in the electorate. Moreover, even if President Biden were to narrow or revoke the new E.O., the measure may nevertheless serve its intended purpose of making U.S. persons (including U.S. financial institutions) less willing to hold securities or other financial instruments of, or do other business with, companies that have been linked to the Chinese military, intelligence, or security services. Furthermore, in light of China’s increasingly robust regulatory responses to U.S. unilateral measures—seen in the Hong Kong national security law, Beijing’s new export control law, and its continued threat of establishing an “unreliable” suppliers list for companies that choose to comply with U.S. regulations and cease certain sales to Chinese companies—we expect that China will also respond to this E.O. How China chooses to react will either reduce tensions between Beijing and Washington or continue to exacerbate the situation by potentially imposing costs on entities that choose to comply with this new measure.

\* \* \*

As of November 12, 2020, the 31 Communist Chinese military companies to which the prohibition will apply are as follows:

1. Aviation Industry Corporation of China (AVIC)
2. China Aerospace Science and Technology Corporation (CASC)
3. China Aerospace Science and Industry Corporation (CASIC)
4. China Electronics Technology Group Corporation (CETC)
5. China South Industries Group Corporation (CSGC)
6. China Shipbuilding Industry Corporation (CSIC)
7. China State Shipbuilding Corporation (CSSC)
8. China North Industries Group Corporation (Norinco Group)
9. Hangzhou Hikvision Digital Technology Co., Ltd. (Hikvision)
10. Huawei
11. Inspur Group
12. Aero Engine Corporation of China
13. China Railway Construction Corporation (CRCC)

14. CRRC Corp.
15. Panda Electronics Group
16. Dawning Information Industry Co (Sugon)
17. China Mobile Communications Group
18. China General Nuclear Power Corp.
19. China National Nuclear Corp.
20. China Telecommunications Corp.
21. China Communications Construction Company (CCCC)
22. China Academy of Launch Vehicle Technology (CALT)
23. China Spacesat
24. China United Network Communications Group Co Ltd
25. China Electronics Corporation (CEC)
26. China National Chemical Engineering Group Co., Ltd. (CNCEC)
27. China National Chemical Corporation (ChemChina)
28. Sinochem Group Co Ltd
29. China State Construction Group Co., Ltd.
30. China Three Gorges Corporation Limited
31. China Nuclear Engineering & Construction Corporation (CNECC)

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[1] Exec. Order No. 13959, 85 Fed. Reg. 73185 (Nov. 12, 2020), <https://www.govinfo.gov/content/pkg/FR-2020-11-17/pdf/2020-25459.pdf>.

[2] *Another Trump Attack on Chinese Stocks*, Gavekal Dragonomics (Nov. 13, 2020), <https://research.gavekal.com/article/another-trump-attack-chinese-stocks>.

[3] The Military-Civil Fusion policy is described in China’s national strategic plan “Made in China 2025,” which was announced by Premier Li Keqiang and his cabinet in May 2015.

[4] Kevin Cirilli & Shelly Banjo, *U.S. Warns Colleges to Divest China Stocks on Delisting Risk*, Bloomberg Quint (Aug. 19, 2020), <https://www.bloombergquint.com/business/state-department-urges-colleges-to-divest-from-chinese-companies>.

[5] Press Release, *President's Working Group on Financial Markets Releases Report and Recommendations on Protecting Investors from Significant Risks from Chinese Companies*, U.S. Dep't of Treasury (Aug. 6, 2020), <https://home.treasury.gov/news/press-releases/sm1086>.



*The following Gibson Dunn lawyers assisted in preparing this client update: Judith Alison Lee, Adam Smith, Jose Fernandez, Chris Timura, Stephanie Connor, R.L. Pratt and Scott Toussaint.*

*Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding the above developments. Please contact the Gibson Dunn lawyer with whom you usually work, the authors, or any of the following leaders and members of the firm's International Trade practice group:*

**United States:**

*Judith Alison Lee – Co-Chair, International Trade Practice, Washington, D.C. (+1 202-887-3591, [jalee@gibsondunn.com](mailto:jalee@gibsondunn.com))*

*Ronald Kirk – Co-Chair, International Trade Practice, Dallas (+1 214-698-3295, [rkirk@gibsondunn.com](mailto:rkirk@gibsondunn.com))*

*Jose W. Fernandez – New York (+1 212-351-2376, [jfernandez@gibsondunn.com](mailto:jfernandez@gibsondunn.com))*

*Marcellus A. McRae – Los Angeles (+1 213-229-7675, [mmcrae@gibsondunn.com](mailto:mmcrae@gibsondunn.com))*

*Adam M. Smith – Washington, D.C. (+1 202-887-3547, [asmith@gibsondunn.com](mailto:asmith@gibsondunn.com))*

*Stephanie L. Connor – Washington, D.C. (+1 202-955-8586, [sconnor@gibsondunn.com](mailto:sconnor@gibsondunn.com))*

*Christopher T. Timura – Washington, D.C. (+1 202-887-3690, [ctimura@gibsondunn.com](mailto:ctimura@gibsondunn.com))*

*Ben K. Belair – Washington, D.C. (+1 202-887-3743, [bbelair@gibsondunn.com](mailto:bbelair@gibsondunn.com))*

*Courtney M. Brown – Washington, D.C. (+1 202-955-8685, [cmbrown@gibsondunn.com](mailto:cmbrown@gibsondunn.com))*

*Laura R. Cole – Washington, D.C. (+1 202-887-3787, [lcole@gibsondunn.com](mailto:lcole@gibsondunn.com))*

*Jesse Melman – New York (+1 212-351-2683, [jmelman@gibsondunn.com](mailto:jmelman@gibsondunn.com))*

*R.L. Pratt – Washington, D.C. (+1 202-887-3785, [rpratt@gibsondunn.com](mailto:rpratt@gibsondunn.com))*

*Samantha Sewall – Washington, D.C. (+1 202-887-3509, [ssewall@gibsondunn.com](mailto:ssewall@gibsondunn.com))*

*Audi K. Syarief – Washington, D.C. (+1 202-955-8266, [asyarief@gibsondunn.com](mailto:asyarief@gibsondunn.com))*

*Scott R. Toussaint – Washington, D.C. (+1 202-887-3588, [stoussaint@gibsondunn.com](mailto:stoussaint@gibsondunn.com))*

*Shuo (Josh) Zhang – Washington, D.C. (+1 202-955-8270, [szhang@gibsondunn.com](mailto:szhang@gibsondunn.com))*

**Asia and Europe:**

*Fang Xue – Beijing (+86 10 6502 8687, [fxue@gibsondunn.com](mailto:fxue@gibsondunn.com))*

*Qi Yue – Beijing – (+86 10 6502 8534, [qyue@gibsondunn.com](mailto:qyue@gibsondunn.com))*

*Joerg Bartz – Singapore – (+65 6507 3635, [jbartz@gibsondunn.com](mailto:jbartz@gibsondunn.com))*

*Peter Alexiadis – Brussels (+32 2 554 72 00, [palexiadis@gibsondunn.com](mailto:palexiadis@gibsondunn.com))*

*Attila Borsos – Brussels (+32 2 554 72 10, [aborsos@gibsondunn.com](mailto:aborsos@gibsondunn.com))*

*Nicolas Autet – Paris (+33 1 56 43 13 00, [nautet@gibsondunn.com](mailto:nautet@gibsondunn.com))*

# GIBSON DUNN

*Susy Bullock – London (+44 (0)20 7071 4283, sbullock@gibsondunn.com)*  
*Patrick Doris – London (+44 (0)207 071 4276, pdoris@gibsondunn.com)*  
*Sacha Harber-Kelly – London (+44 20 7071 4205, sharber-kelly@gibsondunn.com)*  
*Penny Madden – London (+44 (0)20 7071 4226, pmadden@gibsondunn.com)*  
*Steve Melrose – London (+44 (0)20 7071 4219, smelrose@gibsondunn.com)*  
*Matt Aleksic – London (+44 (0)20 7071 4042, maleksic@gibsondunn.com)*  
*Benno Schwarz – Munich (+49 89 189 33 110, bschwarz@gibsondunn.com)*  
*Michael Walther – Munich (+49 89 189 33-180, mwalther@gibsondunn.com)*  
*Richard W. Roeder – Munich (+49 89 189 33-160, rroeder@gibsondunn.com)*

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