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U.S.-China Tensions Continue to Escalate: New Executive Order Bans Investment in 31 Chinese Companies

On November 12, President Donald Trump signed an Executive Order on Addressing the Threat from Securities Investments that Finance Communist Chinese Military Companies (the “Executive Order”).¹ The Executive Order states that the People’s Republic of China (“PRC”) is “increasingly exploiting United States capital to resource and to enable the development and modernization of its military, intelligence, and other security apparatuses, which . . . directly threaten[s] the United States homeland and United States forces overseas.” The Executive Order declares a national emergency requiring action to prevent the PRC from “exploit[ing] United States investors to finance the development and modernization of [the PRC’s] military.”²

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As detailed below, the Executive Order will prohibit U.S. persons³ from purchasing or investing in publicly traded securities⁴ of companies identified by the U.S. government as “Communist Chinese military companies.” The term “Communist Chinese military company” includes any company that the U.S. Department of Defense (“DOD”) has identified pursuant to Section 1237 of the National Defense Authorization Act for FY 1999. Currently, 31 companies meet this criterion, including two companies whose shares are traded on U.S. exchanges.⁵ The list of firms includes aerospace, shipbuilding, construction, technology and communication companies.

Starting January 11, 2021, U.S. persons will be prohibited from engaging in any purchase for value of publicly traded securities, or any securities that are derivative of, or are designated to provide investment exposure to such securities, of any Communist Chinese military company. The Executive Order provides a wind-down mechanism, allowing U.S. persons to divest of any such securities up until November 11, 2021. Notably, the consequences of continuing to hold the targeted securities beyond November 11, 2021 are unclear. For example, it is possible that, after November 11, U.S. persons will be required to treat the securities as blocked property and to file a blocking report with the U.S. Department of the Treasury’s Office of Foreign Assets Control (“OFAC”). The Executive Order authorizes the Secretary of the Treasury, in consultation with the Secretary of State, the Secretary of Defense, the Director of National Intelligence, and other agency heads, to promulgate rules and regulations implementing the Executive Order’s prohibitions. We therefore anticipate that OFAC (or another agency) will issue guidance regarding the wind-down mechanism in the coming weeks.

With respect to any future designations, a similar prohibition would apply on the date that is 60 days after a company subsequently is determined by the U.S. government to be a Communist Chinese military company. The Executive Order

¹ White House, Executive Order on Addressing the Threat from Securities Investments that Finance Communist Chinese Military Companies (Nov. 12, 2020), <https://www.whitehouse.gov/presidential-actions/executive-order-addressing-threat-securities-investments-finance-communist-chinese-military-companies/>.

² *Id.*

³ The Executive Order defines “U.S. person” to 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.”

⁴ The Executive Order defines “securities” with reference to the broad definition of “security” in section 3(a)(10) of the Securities Exchange Act of 1934, *see* 15 U.S.C. § 78c(a)(10), and notes that “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” also qualifies as a security for purposes of the Executive Order.

⁵ U.S. Dep’t of Defense, DOD Releases List of Additional Companies, in Accordance with Section 1237 of FY99 NDAA (Aug. 28, 2020), <https://www.defense.gov/Newsroom/Releases/Release/Article/2328894/dod-releases-list-of-additional-companies-in-accordance-with-section-1237-of-fy/>.

authorizes divestment-related transactions for a period of one year from the date that is 60 days after an entity subsequently is determined to be a Communist Chinese military company.

The Executive Order will require *all* U.S. investors (*i.e.*, institutional and individual investors alike) to assess their holdings and determine whether they have a direct, indirect, or derivative ownership interest in any of the companies designated as Communist Chinese military companies. U.S. fund managers may be required to engage in divestment-related transactions that they otherwise would not have contemplated, and to notify limited partners of their legal obligation to do so. Along similar lines, U.S. persons who are limited partners in investment funds—who do not always have visibility into the companies in which they have indirect holdings—may be required to seek additional information from fund managers and general partners to determine whether they have any exposure under the Executive Order. While the Executive Order provides for an extended wind-down period—through November 2021, at the earliest—U.S. investors would be well advised to begin assessing their exposure under the Executive Order as soon as practicable, to mitigate the Executive Order’s financial impact.

More generally, the Executive Order underscores the continued, tense relationship between the United States and China. As discussed in our prior [Alert](#), over the past year, the U.S. government has embarked on a coordinated effort to ratchet up pressure on China across several fronts, including new export restrictions and economic sanctions, publication of supply chain alerts, and intense scrutiny of investments in U.S. businesses by China- and Hong Kong-based investors. These efforts appear unlikely to subside in the near term, notwithstanding the results of the U.S. presidential election.