

Alerts & Publications



President Trump Issues Executive Order Prohibiting US Investments in Companies with Ties to the Chinese Military

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The Trump Administration's assertive national security policy towards China has taken a new turn, now focusing on limiting outbound US investment in China. On November 12, 2020, President Trump issued an [Executive Order](#) prohibiting US individuals and entities from investing in Chinese companies that the US Government has identified as having ties with the Chinese military. (The November 12, 2020 [Executive Order](#) was amended on January 13, 2021 by a subsequent Executive Order that clarified certain provisions of the original Executive Order.) Beginning on January 11, 2021, US individuals and entities will be prohibited from engaging in transactions in publicly-traded securities, or securities derivative of or designed to provide investment exposure to such publicly-traded securities, of 31 designated Chinese companies, including Huawei, China Telecom, China Mobile, and Sinochem. The Executive Order is the latest in a series of actions by the Trump Administration targeting China and Chinese companies deemed to pose threats to US national security. See our prior alerts [Trump Administration Continues to Target TikTok and Huawei](#); [President Trump Issues Executive Orders Prohibiting Transactions with TikTok and WeChat](#). This action has a potentially significant impact on US individual and institutional investors, and could lead to retaliatory measures by China, although the near-term likelihood of that is probably low. The Executive Order is also reportedly the first of several post-election Trump Administration steps against China under consideration intended to cement the Trump Administration's legacy vis-à-vis China.

Executive Order Findings and Prohibition

The Executive Order asserts that the Chinese Government is pursuing a national strategy of "Military-Civil Fusion" and is increasing the size of its military-industrial complex by compelling private and civilian Chinese companies to support the Chinese government's military and intelligence activities. In parallel, the Executive Order states that those private and civilian Chinese companies raise capital by selling securities to US investors, thereby exploiting "United States investors to finance the development and modernization of its military."

The Executive Order targets Chinese companies that the US Department of Defense (“DOD”) has identified as “Communist Chinese military companies.” As required by Section 1237 of the FY1999 National Defense Authorization Act, as amended, DOD is required to identify companies engaged in commercial activities that are owned or controlled by the Chinese military and operate in the United States. To date, DOD has publicly listed 31 such companies.¹

The Executive Order prohibits US individuals (citizens, permanent residents, and individuals in the United States) and entities (including foreign branches but not foreign subsidiaries) from engaging in transactions in the 31 designated Chinese companies’ publicly-traded securities, or securities derivative of or designed to provide investment exposure to such securities, beginning on January 11, 2021. The terms “derivative of” and “designed to provide investment exposure” are not defined in the Executive Order and await the issuance of regulations for clarification, but these terms appear intended to capture funds invested in the publicly-traded securities and other financial instruments related to the securities. The Executive Order also prohibits such transactions with any additional companies designated by the US Government, 60 days after any such determination.

In addition, the Executive Order provides for a 10-month grace period in which US investors who hold designated company securities prior to January 11, 2021 will be permitted to divest through November 11, 2021. Similarly, holders of securities of companies designated in the future will have a one-year period from the date of designation to divest their interests. Possession of any such securities by a US person after November 11, 2021, or the one-year period from the date of designation, is prohibited.

Implications

The Executive Order is limited to transactions in securities of the designated companies, and does not otherwise prohibit US persons from engaging in transactions with them (for example, supplier-customer trading relations are not impacted by the Executive Order), subject to other US laws and regulations. Nevertheless, the Executive Order will likely have a significant impact on both investors who hold individual securities and funds invested in securities of the 31 designated companies. It remains to be seen whether the incoming Biden Administration will adopt a different strategy as it forges its broader China policy.

While the Executive Order could lead to retaliatory action by China, the near-term likelihood of that seems low. In particular, it is not obvious what China’s interest would be in a symmetrical or reciprocal restriction on Chinese investment in public-traded securities of US companies. Although the Executive Order will not do much to improve recent tensions across the Pacific, the Chinese authorities seem content to ‘sit tight’ for the incoming

Biden administration. Indeed, as if to signal as much, China moved to officially congratulate President-Elect Biden and Vice President-Elect Harris for their recent success in the US presidential election within hours of the Executive Order's publication.

That said, to the extent that the Executive Order is of a piece with other recent measures taken by the Trump Administration directed at China, China has been laying the groundwork for a broad response to the United States. Most notably, in China's recently adopted Export Control Law, effective December 1, 2020, beyond merely setting out rules for China to regulate the export of sensitive materials and technologies overseas, the law also contained provisions stating that "if any country or region abuses export control measures to endanger the national security and national interests of the People's Republic of China, the People's Republic of China may, based on the actual situation, take reciprocal measures against that country or region." Similarly, in September 2020, China adopted regulations creating the framework for an "unreliable entities" list—echoing the various lists maintained by the United States. The China unreliable entities list is directed at foreign individuals, enterprises, or organizations that are found either (i) to have done something that endangers national sovereignty, security, or development interests of China or (ii) to have engaged in irregular trade actions against Chinese individuals, enterprises, or organizations. Inclusion on the list can result in broad-reaching consequences, including restrictions on import and export activities related to China and restrictions on investment in China.

While these mechanisms have yet to be invoked in practice, they create a legal basis for China to respond to US governmental policies targeting China. If Beijing's immediate response to the Executive Order is "wait and see," the probability of this translating into a more general détente is unclear.

¹ On July 24, 2020, the United States Department of Defense [identified](#) twenty companies headquartered in the People's Republic of China as "Communist Chinese military companies." The Department of Defense [identified](#) an additional eleven companies as "Communist Chinese military companies" on August 27, 2020. The full list of companies is: Aviation Industry Corporation of China (AVIC); China Aerospace Science and Technology Corporation (CASC); China Aerospace Science and Industry Corporation (CASIC); China Electronics Technology Group Corporation (CETC); China South Industries Group Corporation (CSGC); China Shipbuilding Industry Corporation (CSIC); China State Shipbuilding Corporation (CSSC); China North Industries Group Corporation (Norinco Group); Huawei; Hangzhou Hikvision Digital Technology Co.; Inspur Group; Aero Engine Corporation of China; China Railway Construction Corporation (CRCC); CRRC Corp.; Panda Electronics Group; Dawning Information Industry Co. (Sugon); China Mobile Communications Group; China General Nuclear Power Corp.; China National Nuclear Corp.; China Telecommunications Corp.; China Communications Construction Company (CCCC); China Academy of Launch Vehicle Technology (CALT); China

Spacesat; China United Network Communications Group Co Ltd; China Electronics Corporation (CEC); China National Chemical Engineering Group Co., Ltd. (CNCEC); China National Chemical Corporation (ChemChina); Sinochem Group Co Ltd; China State Construction Group Co., Ltd.; China Three Gorges Corporation Limited; China Nuclear Engineering & Construction Corporation (CNECC).

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