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Biden Administration Ratchets Up Pressure by Refining Trump-Era Limits on Investing in PRC Companies

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On June 3, 2021, the Biden Administration amended a Trump Administration order that had prohibited U.S. persons from engaging in certain types of transactions involving publicly traded and derivative securities of companies listed as Communist Chinese Military Companies (“CCMCs”) pursuant to Section 1237 of the 1999 National Defense Authorization Act. The original Trump Administration order, [Executive Order \(“E.O.”\) 13959](#), issued in the waning days of that administration, was the subject of considerable confusion as to precisely which CCMCs and affiliated entities were or were not subject to the restrictions.¹ In a further effort to clarify its scope, the Trump Administration eventually amended the original order by issuing [E.O. 13974](#) on January 13, 2021.

The Biden Administration decided to start all over again with the new executive order, [E.O. 14032](#), which replaces both of the Trump Administration orders and creates a new designation, “Chinese Military-Industrial Complex Companies” (“CMICs”), based on—but clarifying and expanding—the CCMC List. E.O. 14032 has the practical effect of jettisoning the CCMC list (published by the Department of Defense) as the basis for determining which Chinese companies will be subject to the U.S. investment restrictions. The U.S. Treasury Department’s Office of Foreign Assets Control (“OFAC”) now has primary responsibility for both generating and administering the new CMIC List. Executive Order 14032 fully revoked E.O. 13974, leaving U.S. persons free to engage in CMIC- and CCMC-related transactions until the new executive order takes effect on August 2, 2021.

In an effort to avoid a repeat of the confusion that accompanied the initial roll-out of E.O. 13959, OFAC has published 8 new FAQs and revised 7 additional FAQs in connection with the issuance of E.O. 14032.

Executive Order 14032 and OFAC Guidance

Executive Order 14032 overhauled the investment ban by revoking E.O. 13974 in its entirety, replacing and superseding the majority of E.O. 13959, and replacing and superseding the Annex to the amended E.O. 13959 that had listed targeted sanctioned entities. As now drafted, the executive order’s restrictions are similar in effect to those in the original E.O. 13959: U.S. persons are prohibited from engaging in specified transactions involving “publicly traded securities, or any publicly traded securities that are derivative of such securities or are designed to provide investment exposure to such securities” of designated CMICs. Unlike the predecessor orders, the mere “possession” of CMIC-related securities past the effective date (now August 2, 2021) will not be prohibited. Effectively, U.S. persons may still retain

ownership over such securities but would not be able to transact in the securities for as long as the underlying CMIC remained designated. Further, the prohibitions on purchase-related transactions appear to cover all “purchases,” rather than “purchases for value” (a distinction that could affect certain financial institutions’ securities lending operations). The restrictions take effect on August 2, 2021 for all currently-designated companies, subject to a safe-harbor period solely for divestment activities until June 3, 2022.

As noted, OFAC has released extensive [guidance](#) on E.O. 14032 in the form of numerous FAQs. First, OFAC clarifies that in order for derivative transactions to be covered by the ban, those derivative instruments themselves must also be publicly traded, either over-the-counter or on an exchange. Second, U.S. persons buying and selling securities [can rely on](#) information available in the ordinary course of business when conducting due diligence for compliance with these sanctions. Third, individual U.S. persons [can work for](#) or [provide investment advice](#) to non-U.S. persons (for example, non-U.S. financial institutions abroad) transacting in securities covered by E.O. 14032 as long as the underlying transaction would not violate the Executive Order (e.g., not be for ultimate benefit of a U.S. person or designed to evade the Executive Order). Finally, though the same was implied under the former orders, OFAC expressly advises that E.O. 14032 only prohibits transacting in covered securities; it [does not prohibit transacting](#) in goods or services with [NS-]CMIC listed entities or their subsidiaries.

Executive Order 14032 also vests OFAC with the authority to designate additional companies as CMICs, in consultation with the State and Defense Departments. (The Secretary of Defense can no longer cause the securities of entities to be subject to the prohibitions of E.O. 14032 simply by designating them as CCMCs.) While E.O. 14032 also authorizes OFAC to designate subsidiaries and parents of listed entities, the so-called “50 percent rule”, under which companies owned 50% or more by blocked persons are themselves subject to blocking sanctions even absent separate designation, does not apply to CMIC-listed companies. Importantly, restrictions contained in E.O. 14032 [apply only to](#) entities with names that “exactly match” the CMIC list, extending the policy of OFAC General License 1A that was one of the first sanctions-related actions of the Biden Administration.

The New CMIC List

The Biden Administration has listed 59 entities as CMICs, the securities of which are subject to E.O. 14032’s prohibitions, including: 49 entities operating in the PRC’s defense and related materiel sector; 2 entities operating in the PRC’s surveillance technology sector (both of which were also listed as operating in the defense and related materiel sector); and 10 entities that are parents or subsidiaries of also-listed entities. Overall, there are 27 entities now designated as CMICs that were not listed as CCMCs and 16 CCMCs that were not included in the list of CMICs: the difference coming from the Biden Administration’s inclusion of several companies in the aerospace or aviation industry and communications-related companies and the removal of companies in a variety of industries, including chemicals, construction, and semiconductor industries.

Looking forward, OFAC’s FAQ 900 indicates that the Biden Administration plans to target entities engaged in “(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.” Though E.O. 14032 builds on the previous administration’s policy by expanding the categories of possible targets and listing additional entities, it remains to be seen whether this action actually represents a policy shift toward sanctioning a broader swath of the Chinese economy, or just a refined continuation of the last administration’s policies.

Conclusion

The Trump Administration's action to restrict CCMCs from accessing U.S. capital markets was controversial, and created confusion in the manner it was implemented. Instead of backing away from the measure, the Biden Administration has chosen to keep in place similar restrictions on Chinese companies, and has rooted the policy in a stronger legal foundation while expanding the restrictions such that they do not apply only to "military companies" with ties to the Chinese Government, but to all companies that operate—or have operated—in "the defense and related materiel sector or the surveillance technology sector" of the Chinese economy. Though this change is correctly seen as a rebuke against entities using Chinese surveillance technology to "facilitate repression or serious human rights abuse," the administration did not take the opportunity to sanction any additional companies on this basis. Further, by shifting the responsibility for designating companies whose securities are subject to the restrictions of E.O. 14032 away from the Department of Defense and to OFAC, the Biden Administration can expect to better navigate future legal challenges alleging a lack of factual basis for the designation; companies seeking to be removed from the CMIC List will now be required to follow a [process to file a petition for removal](#) from the CMIC List.

Additionally, this action is not taken in isolation; it is part of a broader program by the Biden Administration to counter the PRC government: on the same day (June 3, 2021), the Biden Administration also [declared](#) that anti-corruption initiatives were a "core United States national security interest," and identified a number of negative consequences of transnational corruption, including the undermining of "rule-of-law democracies" worldwide, from conduct that has been attributed to the current PRC government in various contexts. The coordinated timing of these announcements should not be seen as coincidental. They represent further coordination of policies through which the Biden Administration can continue to pressure the Chinese government where it believes appropriate.



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Washington, D.C. lawyers:

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¹ The CCMC List, as published by the Department of Defense, did not identify companies that necessarily had securities available for public trading. Accordingly, there was confusion about which entities were specifically subject to the restrictions of E.O. 13959, leading to several rounds of supplemental guidance to clarify that entities with names that "closely matched" the names of entities on the CCMC List were subject to the restrictions.

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