

January 4, 2021

New Guidance Clarifies OFAC's Broad Interpretation of Recent Sanctions Against Communist Chinese Military Companies

On December 28, 2020 and January 4, 2021, the U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") issued eagerly anticipated guidance clarifying the application of President Trump's November 12, 2020, Executive Order "Addressing the Threat from Securities Investments that Finance Communist Chinese Military Companies" (the "Order").¹ The guidance consists of six Frequently Asked Questions ("FAQs") defining key terms and explaining the scope of the Order's prohibitions. Despite earlier press reports suggesting that OFAC would, over the objection of the U.S. Department of Defense ("DoD") and the U.S. Department of State, "water down" the Order,² the FAQs clarify that OFAC will interpret the Order's prohibitions broadly.

As explained in our prior memorandum,³ the Order, which goes into effect after a 60-day grace period ending on January 11, 2021, will prohibit U.S. persons⁴ from engaging in transactions in publicly traded securities (or any securities that are derivative or otherwise designed to provide investment exposure to such publicly traded securities) of any identified "Communist Chinese military company" ("CCMC"). In the Order, President Trump cited the national security threat posed by the People's Republic of China's (the "PRC") national strategy of Military-Civil Fusion, and, specifically, the threat posed by PRC companies that sell securities to U.S. investors and then invest this capital to finance the development and modernization of the Chinese military.

To date, the U.S. government has identified 35 PRC companies as CCMCs, including the three principal telecom companies in the PRC, China Telecommunications Group, China Mobile Communications Corp., and China United Network Communications Group. As a result of this identification, and following OFAC's issuance of the FAQs, the New York Stock Exchange on December 31, 2020 announced its intention to delist those three companies' U.S. subsidiaries' securities and suspend trading in such securities on January 11, 2021.⁵ The NYSE reversed course on January 4, 2021, announcing that after further consultation with regulators regarding OFAC's guidance, it has decided not to move forward with delisting at this time.⁶ The NYSE's actions are indicative of the ambiguities surrounding the scope and implementation of the Order that persist even following OFAC's guidance.

U.S. persons planning to acquire publicly traded CCMC securities or to facilitate trading in such securities should assess the implications of the Order and the OFAC guidance on their plans, and U.S. persons who hold such securities should consider the Order's potential impact on the marketability of such securities going forward.

Background on the Order

1. Identification as a CCMC

Under the Order, a CCMC means any person that is: (1) currently listed on the DoD list of CCMCs operating directly or indirectly within the United States (as defined by the National Defense Authorization Act for Fiscal Year 1999, as amended (the “Act”)) and listed in the Annex of the Order⁷; (2) identified at a future date by the Secretary of Defense or Secretary of the Treasury as a CCMC under the Act; or (3) any person publicly listed by the Secretary of the Treasury as a subsidiary of a CCMC.

DoD has been required to maintain classified and unclassified versions of a list of CCMCs and share such list with Congress and relevant U.S. government agencies annually since 1999, pursuant to the Act. Earlier this year, DoD issued the first public version of the CCMC list. Specifically, on June 24, 2020, DoD sent a public letter to U.S. Senator Tom Cotton that included an attachment listing 20 companies headquartered in the PRC that DoD determined to be CCMCs operating directly or indirectly in the United States.⁸ On August 28, 2020, DoD published a list of another 11 companies that DoD had determined to be CCMCs. These 31 entities were identified in an Annex to the Order and will be subject to the Order’s prohibitions after expiration of the initial grace period. On December 3, 2020, DoD identified an additional four companies as CCMCs.⁹ To date, DoD has publicly identified a total of 35 PRC companies as CCMCs for purposes of the Act (and therefore, by reference, also for purposes of the Order).

The Act defines the criteria for identification as a CCMC as:

- “[A]ny person identified in the Defense Intelligence Agency publication numbered VP-1920-271-90, dated September 1990, or PC-1921-57-95, dated October 1995, and any update of those publications for the purposes of [the Act];” and
- [A]ny other person that: (i) is owned or controlled by, or affiliated with, the People’s Liberation Army or a ministry of the government of the People’s Republic of China or that is owned or controlled by an entity affiliated with the defense industrial base of the People’s Republic of China; and (ii) is engaged in providing commercial services, manufacturing, producing, or exporting.”¹⁰

For purposes of the Act, the term “People’s Liberation Army” means the land, naval, and air military services, the police, and the intelligence services of the PRC, and any member of any such service or police force.

Changes to the CCMC list are to be made in consultation with the Attorney General, the Director of National Intelligence, and the Director of the Federal Bureau of Investigation.

2. *The Order's Prohibitions*

The Order, after a 60-day grace period ending on January 11, 2021, broadly prohibits U.S. persons 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 publicly traded securities, of currently listed CCMCs (*i.e.*, the 35 companies currently identified on the CCMC lists maintained by DoD). "Transaction" is defined for purposes of the Order to mean "the purchase for value of any publicly traded security." To the extent that a U.S. person holds publicly traded securities of a currently listed CCMC as of January 11, 2021, the Order allows a wind down period permitting the divestment of any such securities by such U.S. person until November 11, 2021.

With respect to any entity identified and listed as a CCMC after the date of the Order, the Order prohibits U.S. persons, wherever located, from transacting in that newly-listed entity's publicly traded securities (or any securities that are derivative or otherwise designed to provide investment exposure to such publicly traded securities) after 60 days from the date of the entity's listing as a CCMC. U.S. persons in possession of securities of such newly-listed CCMCs will have 365 calendar days from the date of that entity's listing to divest the securities of the CCMC that they hold. The Order also prohibits any transaction by a U.S. person or within the United States that evades or avoids, has the purpose of evading or avoiding, causes a violation or, or attempts to violate the prohibitions of the Order. The Order also prohibits any conspiracy (not limited to U.S. persons or within the United States) to violate the prohibitions of the Order.

The Order defines the term "U.S. person" to include "any [U.S.] citizen, permanent resident alien, entity organized under the laws of the United States...or any person [located] in the United States." For purposes of the Order, the terms "security" and "securities" have the same very broad definition as the term "security" under the U.S. Securities Exchange Act, which encompasses American depository receipts ("ADRs") and reads as follows:

"any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a 'security',

or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.”¹¹

The Order also states that 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...shall be a security for purposes of the [Order].”

OFAC Guidance and Implications

On December 28, 2020, OFAC published five FAQs designed to answer some of the questions raised by the Order, including the application of the Order to CCMC subsidiaries, certain financial instruments, and investments in U.S. and non-U.S. funds holding CCMC securities, the definition of “publicly traded securities,” and discrepancies in the names of entities identified by DoD as CCMCs and the names of issuers of publicly traded securities. On January 4, 2021, OFAC published an additional FAQ addressing whether U.S. persons must divest from the securities of the CCMCs identified in the Order prior to the end of the initial grace period on January 11, 2021.

U.S. persons dealing in CCMC securities (or any securities that are derivative or otherwise designed to provide investment exposure to such securities) should incorporate this guidance into their plans to comply with the Order prior to the end of the initial grace period on January 11, 2021.

Publicly Traded Securities of CCMC Subsidiaries. Because the Order itself suggests that its prohibitions will only apply to CCMC subsidiaries identified by DoD or the Treasury Department as CCMCs or *publicly listed* by the Treasury Department as subsidiary of a listed CCMC, it was unclear whether OFAC would apply its 50 percent rule (providing that entities owned 50 percent or more, in the aggregate, by OFAC-sanctioned persons must themselves be treated as OFAC-sanctioned persons, whether or not such entities have been explicitly sanctioned by OFAC) in the context of the Order. OFAC’s guidance clarifies that the 50 percent rule will not automatically apply (*i.e.*, that the Order’s prohibitions will apply to any subsidiary of a CCMC only after such subsidiary is publicly listed by OFAC); however, OFAC also states its intention to publicly list both CCMC subsidiaries that would fall under the scope of its 50 percent rule *and* entities it determines to be controlled by a CCMC.¹² Accordingly, the private sector can rely on OFAC’s publicly identified list of CCMC subsidiaries to diligence which entities are subject to the Order’s prohibitions. At the same time, OFAC has put the public on notice that CCMC subsidiaries may well be subject to public listing (and therefore the Order’s prohibitions) in the future.

Scope of Covered Financial Instruments. The Order’s prohibitions apply to any transaction in any securities that are derivative of, or are designed to provide investment exposure to publicly traded CCMC securities. While OFAC’s guidance does not define “designed” it does provide that the financial instruments captured by this prohibition include, but are not limited to, derivatives (*e.g.*, futures, options, swaps),

warrants, ADRs, global depositary receipts (“GDRs”), exchange-traded funds (“ETFs”), index funds, and mutual funds, to the extent such instruments also meet the definition of “security” as defined in the Order.¹³

This is consistent with U.S. Secretary of State Mike Pompeo’s press statement that the Order’s prohibitions apply to “all transactions by U.S. persons, including individuals, institutional investors, pension funds, university endowments, banks, bond issuers, venture capital firms, private equity firms, index firms, and other U.S. entities, including those operating overseas. This should allay concerns that U.S. investors might unknowingly support CCMCs via direct, indirect, or other passive investments including those linked to educational, ETFs, venture funds, private equity, Real Estate Investment Trusts, commodities, endowments, pensions, or any other investment funds tracking bonds, loans, lease lines, debt or equity indices that include securities of CCMCs or subsidiaries publicly listed by the U.S. government.”¹⁴

Investments in U.S. or non-U.S. Funds Holding CCMC Securities or Derivatives. OFAC’s guidance states that the Order’s prohibitions apply to U.S. persons’ investments in U.S. and non-U.S. foreign funds, such as ETFs or other mutual funds that hold publicly traded securities of a CCMC, noting that any transaction in publicly traded securities, or any securities that are derivative of, or are designed to provide investment exposure to such publicly traded securities, of any CCMC is prohibited regardless of such securities’ share of the underlying index fund, ETF, or other derivative of a CCMC publicly traded security.¹⁵ Accordingly, U.S. persons are prohibited from investing in any U.S. or non-U.S. fund that holds *any* CCMC security whatsoever. Given the prevalence of some of the CCMC securities in Asian markets, this interpretation presents significant due diligence challenges for investors, advisors, and funds seeking investment exposure in such markets.

Defining Publicly Traded Securities. OFAC’s guidance states that, for the purposes of the Order, OFAC intends to interpret the term “publicly traded securities” to include securities (as defined in section 4(d) of E.O. 13959) denominated in any currency that trade on a securities exchange or through the method of trading that is commonly referred to as “over-the-counter,” in any jurisdiction.¹⁶ This FAQ removes the possibility that the Order would apply only to securities traded on a public exchange.

Discrepancies between the Names of CCMCs Identified by DoD and Names of Issuers. In some cases, the names of the entities identified by DoD and CCMCs did not exactly match the names of issuers of publicly traded securities. OFAC’s guidance states that the Order applies with respect to publicly traded securities or any publicly traded securities that are derivative of, or are designed to provide investment exposure to, such securities) of an entity with a name that exactly or “closely matches” the name of an entity identified as a CCMC.¹⁷ In other words, ambiguity in the DoD identification will not be a bar against the application of the Order. To assist the public in identifying the CCMC entities, OFAC published a list on its website containing the names of the CCMCs identified by DoD along with other identifying information, such as aliases, issuer names, and equity tickers.¹⁸

Divestment From CCMC Securities by January 11, 2021 Not Required. OFAC's January 4, 2021 guidance clarifies that U.S. persons (including U.S. funds and related market intermediaries and participants) are *not* required to divest their holdings in publicly traded securities (and securities that are derivative of, or are designed to provide investment exposure to, such publicly traded securities) of the CCMCs identified in the Order by January 11, 2021.¹⁹ The guidance is silent as to whether U.S. persons will be permitted to continue to hold CCMC securities after the end of the divestment wind down period established by the Order (*i.e.*, November 11, 2021).

Significance of CCMC Identification to Exporters of U.S. Origin Goods

Finally, we note that on December 21, 2020, the U.S. Department of Commerce published the first ever Military End User List (the "MEU List") pursuant to the Export Administration Regulations (the "EAR").²⁰ The MEU List includes dozens of Chinese companies (many of which are also identified as CCMCs) and imposes restrictions on exports, reexports, and transfers of certain items that are subject to the EAR to these listed entities. As a part of its publication of the MEU List, the Department of Commerce also warned that any CCMC not currently included on the MEU List "would raise a Red Flag under the EAR and require additional due diligence by exporters, reexporters, or transferors."²¹ Accordingly, investors and others dealing in CCMC securities are not the only persons that need to be mindful of the universe of entities identified as CCMCs.

We will continue to monitor actions taken by the U.S. government related to the Order and provide further updates as appropriate.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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- ¹ The White House, “Executive Order on Addressing the Threat from Securities Investments that Finance Communist Chinese Military Companies,” (Nov. 12, 2020), available [here](#).
 - ² Financial Times, “US Treasury seeks to water down Trump’s Chinese securities ban,” (Dec. 17, 2020), available [here](#).
 - ³ Paul, Weiss, “President Trump Issues an Executive Order Prohibiting U.S. Persons from Investing in Listed “Communist Chinese Military Companies,” (Nov. 18, 2020), available [here](#).
 - ⁴ “U.S. persons” means, for purposes of the Order, U.S. citizens, permanent residents, entities organized under U.S. laws, or any person located within the United States.
 - ⁵ Intercontinental Exchange, “NYSE to Commence Delisting Proceedings in Securities of Three Issuers to Comply with Executive Order 13959,” (Dec. 31, 2020), available [here](#).
 - ⁶ Intercontinental Exchange, “NYSE Updates Guidance on Delisting Determination for Securities of Three Issuers in Relation to Executive Order 13959,” (Jan. 4, 2021), available [here](#).
 - ⁷ See U.S. Dep’t of Defense, Press Release, “DoD Releases List of Additional Companies in Accordance with Section 1237 of FY99 NDAA,” (Aug. 28, 2020), available [here](#); Annex to the Order, available [here](#).
 - ⁸ Office of Senator Tom Cotton, Press Release, “Cotton, Gallagher React to DoD List of Chinese Military Companies,” (Jun. 24, 2020), available [here](#).
 - ⁹ See U.S. Dep’t of Defense, Press Release, “DoD Releases List of Additional Companies in Accordance with Section 1237 of FY99 NDAA,” (Dec. 3, 2020), available [here](#).
 - ¹⁰ Strom Thurmond National Defense Authorization Act for Fiscal Year 1999, Pub. L. No. 105-261 § 1237 (1999), available [here](#).
 - ¹¹ Securities Exchange Act of 1934, Pub. L. 73-291 § 3(a)(10), as codified as amended at 15 U.S.C. 78c(a)(10).
 - ¹² OFAC, “Frequently Asked Question 857,” (Dec. 28, 2020), available [here](#).
 - ¹³ OFAC, “Frequently Asked Question 860,” (Dec. 28, 2020), available [here](#).
 - ¹⁴ U.S. Dep’t of State, Press Statement, “Protecting U.S. Investors from Financing Communist Chinese Military Companies,” (Dec. 28, 2020), available [here](#).
 - ¹⁵ OFAC, “Frequently Asked Question 861,” (Dec. 28, 2020), available [here](#).
 - ¹⁶ OFAC, “Frequently Asked Question 859,” (Dec. 28, 2020), available [here](#).
 - ¹⁷ OFAC, “Frequently Asked Question 858,” (Dec. 28, 2020), available [here](#).
 - ¹⁸ OFAC, “Non-SDN Communist Chinese Military Companies List,” (Dec. 22, 2020), available [here](#).
 - ¹⁹ OFAC, “Frequently Asked Question 858,” (Jan. 4, 2021), available [here](#).

²⁰ U.S. Dep't of Commerce, Press Release, "Commerce Department Will Publish the First Military End User List Naming More Than 100 Chinese and Russian Companies," (Dec. 21, 2020), available [here](#).

²¹ *Id.*