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Trump Administration Comes to a Close Amidst a Flurry of Export Controls and Associated Regulatory Developments, Primarily Targeting China

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In the waning days of the Trump administration, each of the U.S. Departments of Commerce, Defense and Treasury, as well as the White House, has taken significant actions intended to marginalize China. There has been a particular focus on Chinese companies deemed to support Chinese military and intelligence capabilities pursuant to China's "military-civil fusion" program, which the administration has deemed a threat to U.S. national security. Given the multitude of measures, as yet not all companies on these newly developed restricted party lists may be included in commercially available third-party interdiction software and screening tools. As a consequence, it is all the more important that parties to international transactions be vigilant about cross-checking their counterparties to ensure that their activities are conducted in compliance with U.S. law.

The View from Washington

Among the few issues that have enjoyed broad bipartisan consensus in Washington is the perception of China as a strategic economic and national security threat. Accordingly, in recent years the U.S. government has, among other measures, limited Chinese foreign investment in the U.S.; more stringently controlled exports of emerging technologies; and hindered the ability of certain Chinese conglomerates, such as Huawei Technologies Co., Ltd. ("Huawei"), to procure items that are subject to U.S. export controls requirements. The recent actions taken by Commerce, Defense, Treasury and the White House represent a coordinated, holistic campaign to restrict access to U.S. technology and capital by Chinese companies alleged to be linked to the

Chinese military, to thwart data collection by Chinese-developed software applications, to further impair Huawei and to inhibit the Chinese semiconductor manufacturing industry.

As noted below, certain members of Congress are advocating for tougher restrictions, which, when coupled with bipartisan concerns over China, suggests that the incoming Biden administration may be disinclined to substantially change course in its approach to China issues in the context of national security, sanctions and export controls.

For its own part, the Chinese government recently has issued its own rules pertaining to security review of foreign direct investment and has [overhauled its export controls regime](#). In addition, on January 9 the Chinese government implemented measures designed to counteract the impact on China caused by unjustified extra-territorial application of foreign legislation.

Some of the most notable China-facing U.S. investment and export controls developments over the last several months include the following:

Publication of Military End Users List

In April 2020, the Bureau of Industry and Security (“BIS”) within the U.S. Department of Commerce (“Commerce”) expanded the scope of the military end user and end use restrictions for China, Russia and Venezuela set forth in Section 744.21 of the U.S. Export Administration Regulations (“EAR”). BIS subsequently amended its license review policies for national security-controlled items that will make a “material contribution” to the “development, production, maintenance, repair, or operation” of weapon systems, subsystems and assemblies in these countries.

On December 23, 2020, BIS published [a new “Military End User List”](#) in connection with Section 744.21 of the EAR. As a consequence, BIS specifically “is informing” exporters, reexporters and transferors that a license will be required to export, reexport or transfer (in-country) to these Chinese and Russian entities any item described in Supplement No. 2 to Part 744 of the EAR, which includes a broad range of items listed on the Commerce Control List (but not items classified as “EAR99”). However, BIS also mentioned that this list is not exclusive, and that entities that meet the definition of “military end user” will be subject to restrictions even if not listed.

Note that while this new BIS list is more expansive than the U.S. Department of Defense (“Defense”) list described below, not every entity on the Defense list is

included on the BIS list, and being included on the Defense list does not automatically trigger the EAR's military end user restrictions. BIS explicitly recognized this issue, commenting that "parties not listed on the MEU List in this final rule, but included on the lists made public pursuant to Section 1237 of the National Defense Authorization Act of Fiscal Year 1999, 50 U.S.C. 1701 note, would raise a Red Flag under the EAR and would require additional due diligence by the exporter, reexporter or transferor to determine whether a license is required under [Section] 744.21 [of the EAR]."

Additions to Defense List of Communist Chinese Military Companies and Publication of FAQs Regarding Securities Investments that Finance Communist Chinese Military Companies

In June and August 2020, Defense identified 31 entities as "Communist Chinese military companies" operating directly or indirectly in the U.S. in accordance with the statutory requirement of Section 1237 of the National Defense Authorization Act for Fiscal Year 1999. Subsequently, on December 3, 2020, Defense [supplemented the list with four additional entities](#), including Semiconductor Manufacturing International Corporation ("SMIC").

While not a restricted party list per se, the Defense list potentially could act as a precursor to actions taken by other agencies, which has been borne out by the recent Commerce action described above, and the U.S. Department of the Treasury ("Treasury") actions (and a related action by the New York Stock Exchange) detailed below.

Treasury Frequently Asked Questions. On November 12, 2020, President Trump [issued an Executive Order](#) entitled "Addressing the Threat from Securities Investments that Finance Communist Chinese Military Companies" to prohibit U.S. persons from engaging in transactions involving publicly traded securities tied to the companies designated by Defense as associated with the Chinese military. As was highlighted in our previous [Alert](#), the Executive Order triggered a number of questions, certain of which Treasury sought to address through [Frequently Asked Questions](#) issued on December 28, 2020, and the publication of a new Non-SDN Communist Chinese Military Companies List, which was [subsequently reissued](#) on January 8, 2021.

One key issue that Treasury squarely addressed is whether the prohibitions set forth in the Executive Order applied to subsidiaries of the listed Chinese entities. Treasury

clarified that the prohibitions do not extend automatically to subsidiaries, as would be the case for 50%-or-greater-owned subsidiaries of entities appearing on the List of Specially Designated Nationals and Blocked Persons or the Sectoral Sanctions Identification List, but stated that it intends to specifically list such subsidiaries, as well as other entities it determines to be controlled by the listed entities, in coming publications. The U.S. State Department [published a comparable list](#) that may be a preview of subsidiaries to be included.

Treasury also clarified that the term “publicly traded securities,” as used in the Executive Order, should be understood “to include securities . . . 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.”

Further, Treasury explained that the prohibition pertaining to “any transaction in . . . any securities that are derivative of, or are designed to provide investment exposure to such” publicly traded securities should be understood to include, but should not necessarily be limited to, “derivatives (e.g., futures, options, swaps), warrants, American depositary receipts (“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 Executive Order.”

Finally, Treasury confirmed that investments in U.S. or foreign funds, such as ETFs or other mutual funds, that hold publicly traded securities of a Communist Chinese military company, fall within the scope of the Executive Order, noting that “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 is prohibited regardless of such securities’ share of the underlying index fund, ETF, or derivative thereof.”

On January 4, 2021, Treasury issued an [additional FAQ](#) confirming that the Executive Order does not require U.S. persons, including U.S. funds and related market intermediaries and participants, to divest their holdings in the publicly traded securities of the listed companies by January 11, 2021.

On January 6, 2021, Treasury issued three additional FAQs, as follows:

- Treasury first [clarified](#) that U.S. persons are permitted to provide the following support services with respect to covered securities to the extent that these services are not provided to U.S. persons in connection with prohibited transactions:

clearing, execution, settlement, custody, transfer agency, back-end services, as well as other such support services.

- Second, Treasury **directed** that transactions in the securities of any Communist Chinese military company subsidiary (whether expressly listed or not) are prohibited if the subsidiary's name exactly or closely matches the name of these or any other entities identified in the Annex to the Executive Order or the name of any Communist Chinese military company listed by the Departments of the Treasury or Defense. Treasury specifically identified three Chinese telecommunications companies in this FAQ that are subsidiaries of listed Chinese companies. (Notably, this guidance may be in tension with the FAQ detailed above regarding the treatment of non-listed subsidiaries, though with the publication of the revised Non-SDN Communist Chinese Military Companies List on January 8, this issue has been resolved).
- Further, Treasury **clarified** that the facilitation of divestments is permitted: "Market intermediaries and other participants may engage in ancillary or intermediary activities that are necessary to effect divestiture during the relevant wind-down periods or that are otherwise not prohibited under the [Executive Order]."

A compendium of all of the FAQs pertaining to the Chinese military companies' sanctions can be found at <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/topic/5671>.

Presumably in light of the uncertainty created by OFAC's guidance regarding entities with names that closely match those of the listed entities, on January 8 OFAC also issued **General License 1**, which authorizes transactions with such entities to the extent they have not yet been specifically listed until 9:30 a.m. EST on January 28, 2021.

New York Stock Exchange Actions. As a consequence of the November 12 Executive Order, on December 31, 2020, the New York Stock Exchange ("NYSE") **announced the delisting** of three Chinese telecommunications companies, but abruptly **reversed course** on January 4, 2021, following consultations with Treasury. Although the stock exchange did not further elaborate, its decision may have been tied to the fact that the companies proposed for delisting are subsidiaries of listed Chinese companies that had not themselves yet been listed, an issue that Treasury seems now to have addressed through the publication of its January 6 FAQ and the subsequent publication on January 8 of its updated companies list. Indeed, also on January 6, the NYSE **announced that it would again move forward** with the delistings. On January 7, the NYSE **further advised** that "an issuer's determination that a transaction in its listed securities would violate [the Executive Order] is material news that must be

immediately disclosed to the marketplace in accordance with applicable NYSE Group exchange rules”

Executive Order Addressing the Threat Posed By Applications and Other Software Developed or Controlled By Chinese Companies

On January 5, 2021, President Trump [issued an Executive Order](#) intended to thwart the ability of “Chinese connected software applications [to] access and capture vast swaths of information from users, including sensitive personally identifiable information and private information.” This Executive Order, which takes effect after 45 days (and, therefore, after inauguration of the Biden administration), prohibits:

any transaction by any person, or with respect to any property, subject to the jurisdiction of the United States, with persons that develop or control the following Chinese connected software applications, or with their subsidiaries, as those transactions and persons are identified by the Secretary of Commerce (Secretary) under subsection (e) of this section: Alipay, CamScanner, QQ Wallet, SHAREit, Tencent QQ, VMate, WeChat Pay, and WPS Office.

This Executive Order echoes those that previously targeted TikTok and WeChat, which orders have since been suspended or enjoined. It remains to be seen exactly whether and to what extent the incoming Biden administration will implement the Executive Order, including how the Commerce Department will identify the transactions and persons subject to restrictions.

Publication of Huawei-Specific Foreign-Produced Direct Product Rule FAQs

When Huawei was first added to the Entity List, it became apparent to BIS that certain items manufactured outside the U.S. were still being supplied to Huawei because they fell outside the scope of the EAR. Accordingly, BIS altered the foreign-produced direct product rule set forth in the EAR to capture certain non-U.S. manufactured items that were being built to Huawei specifications. Effective August 17, 2020, BIS [further revised the Huawei-specific foreign direct product rule](#) under the EAR to cover instances where the foreign-produced item will be incorporated into, or will be used in

the “production” or “development” of any “part,” “component” or “equipment” produced, purchased or ordered by Huawei, regardless of whether the item is considered designed by Huawei, thereby imposing restrictions on a far wider swath of foreign-manufactured items that are derivative of certain U.S. semiconductor, digital computing and telecommunications technologies.

On December 18, 2020, BIS updated its compilation of [Frequently Asked Questions](#) pertaining to the Huawei-specific foreign-produced direct product rule. The FAQs do not specifically address the concerns expressed, in particular, by the semiconductor industry that: (i) BIS licensing determinations pertaining to Huawei are being made inconsistently; and (ii) that industry would benefit from more clearly delineated guidelines regarding the criteria being employed by BIS, as well as other interagency stakeholders, in making licensing decisions. However, the FAQs do clarify certain issues that had arisen since August 2020, such as the treatment of items produced outside the U.S. using test equipment classified either as 3B991 or 3B992.

Based on published reports and statements made by certain U.S. semiconductor companies during recent earnings calls, certain U.S. and non-U.S. semiconductor companies have received BIS licenses authorizing exports to Huawei. On December 17, 2020, Sen. Marco Rubio (R-FL) [wrote to Commerce Secretary Ross](#) questioning the legality of Huawei’s efforts to order equipment, and U.S. suppliers’ efforts to stockpile equipment, in anticipation of either the issuance of BIS export licenses or the removal of Huawei from the Entity List.

It is unclear whether pressure from Sen. Rubio will affect BIS licensing determinations pertaining to Huawei, but BIS might otherwise take steps to limit technology transfers to the company. Specifically, in June 2020, BIS authorized certain technology transfers to Huawei without a license, in connection with international standards-setting activities, but a proposed rule that recently appeared on the website of the Office of Information and Regulatory Affairs suggests the possibility of a regulatory rollback.

Addition of Entities to the Entity List

While Huawei is a high-profile consumer of semiconductors, the largest Chinese producer of semiconductors, SMIC, also was targeted by U.S. export controls restrictions in 2020. Specifically, exports, reexports and in-country transfers of certain items that are “subject to the EAR” reportedly were the subject of letters specifically

issued to a number of companies by BIS in 2020 that identified SMIC as a Chinese military end user pursuant to Section 744.21 of the EAR. On December 18, 2020, SMIC, a number of its affiliates, and several other prominent Chinese companies [were added to the Entity List](#). In the case of SMIC, the Entity List designation was based on “evidence of activities between SMIC and entities of concern in the Chinese military industrial complex.” As a consequence, all items that are “subject to the EAR” require a license to be exported, reexported or transferred to SMIC, though items uniquely required for production of semiconductors at advanced technology nodes above 10 nanometers are subject to a “case-by-case” license review policy. Given the distinction made between the manufacture of semiconductors above 10 nanometers and those at or below 10 nanometers, Sen. Rubio and Rep. Michael McCaul (R-TX) questioned the efficacy of the restrictions in a [December 22, 2020, letter](#) to Commerce Secretary Ross.

Removal of Hong Kong as a Separate Destination under the EAR

On December 23, 2020, and in accordance with a July 2020 Executive Order, BIS [took action to amend the EAR](#) to remove certain provisions affording Hong Kong special and differential treatment from China. As a result, exports to Hong Kong will no longer enjoy eligibility for certain license exceptions previously accorded and instead will be treated the same as China under the EAR, except in certain circumstances that do not provide preferential treatment.

Key Takeaways

- The issuance of new lists by Commerce, Defense and Treasury significantly expand the universe of authorities that U.S. and non-U.S. persons alike should consult before engaging in China-related transactions. It is not yet clear whether these lists will be compiled by the U.S. government or incorporated into commercial third-party screening solutions.
- Accordingly, parties to international transactions should consider what enhancements to their screening programs are required, and confirm with their service providers whether these new and expanded lists will be included in standard screening solutions.
- Until the Secretary of Commerce takes action to implement the January 5 Executive Order, there will be considerable uncertainty regarding what transactions involving

the developers of the targeted software applications will be prohibited.

- The Biden administration likely will face pressure from varying political interests with respect to these recent measures targeting Chinese companies. While it is not clear whether the new administration's approach will be to modify, maintain or possibly enhance the current restrictions, it seems reasonable to expect that careful scrutiny of potential national security risks posed by China will continue.

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Suggested Reading

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- 12 January 2021 Blog Post Final Carbon Sequestration Tax Credit Regulations Shorten Recapture Period, Provide Guidance on “Utilization”
- 12 January 2021 Press Release Kirkland Represents Clearhaven Partners and TimeTrade Systems on Acquisition of SilverCloud LLC

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