

ALERT

D.C. District Court Blocks Xiaomi Designation as “Communist Chinese Military Company”

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On March 12, 2021, the U.S. District Court for the District of Columbia granted a preliminary injunction in favor of Xiaomi Corporation (Xiaomi) against implementation of Executive Order (EO) 13959, a November 2020 order issued by President Trump invoking the International Emergency Economic Powers Act (IEEPA) to prohibit equity investments by U.S. persons in all “Communist Chinese Military Companies” (CCMC). This means that restrictions under EO 13959 will not apply to Xiaomi pending further order by the Court.

The D.C. District Court found that there was insufficient evidence justifying the designation of Xiaomi as a CCMC. The U.S. Department of Defense (DOD) had determined that Xiaomi is a CCMC pursuant to the Section 1237 of the 1999 National Defense Authorization Act (NDAA), which was subsequently amended by Section 1260(H) of the 2021 National Defense Authorization Act. While this preliminary injunction applies only to Xiaomi, it could compromise other CCMC designations by the DOD and significantly weaken the impact of Executive Order 13959.

Section 1237 of the 1999 NDAA allowed the President to invoke IEEPA authority to restrict “commercial activity in the United States” by entities designated as CCMCs. The NDAA defined a CCMC as any entity that “is owned or controlled by the People’s Liberation Army” and “is engaged in providing commercial services, manufacturing, producing, or exporting.” In EO 13959, President Trump determined that China’s “national strategy of Military-Civil Fusion . . . increases the size of the country’s military-industrial complex by compelling civilian Chinese companies to support its military and intelligence activities,” including when “those companies raise capital by selling securities to United States investors that trade on public exchanges

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both here and abroad . . .” On this basis, the EO prohibited trading by U.S. persons in publicly traded shares of any company determined to be a CCMC.

On January 13, 2021, EO 13959 was amended by EO 13974 to require all U.S. persons to fully divest any holdings of shares in CCMCs. On January 14, 2021, the DOD transmitted to Congress a “fifth tranche” of CCMCs that included Xiaomi. In total, DOD identified 44 Chinese companies as CCMCs from June 2020 to January 2021.

The D.C. District Court’s preliminary injunction cited the Administrative Procedure Act in finding that DOD did not develop sufficient evidence to support its designation of Xiaomi as a CCMC. Notably, Section 1260(H) of the 2021 NDAA significantly amends Section 1237 of the 1999 NDAA and defines CCMCs with a greater degree of specificity. This change will increase the evidentiary burden on DOD going forward in compiling administrative records for CCMC designations. Further, the D.C. District Court’s March 12 ruling leaves future CCMC designations, as well as the 43 other existing CCMC designations, vulnerable to legal challenge and may thereby ultimately render Executive Order 13959 ineffective.

Businesses should be aware that CCMC designations have legal implications beyond EO 13959 for U.S. government contractors and other companies participating in the U.S. government’s supply chain. Notably, the Federal Acquisition Regulations (FAR) Section 4.2102 prohibit U.S. government agencies from “procuring or obtaining” “any equipment, system, or service” that utilizes “covered telecommunications equipment or services” for certain critical technology or a “substantial or essential component of any system.” Although the regulations identify several Chinese companies as being subject to the FAR prohibitions (4.2101(4)), the statute and implementing regulations nevertheless apply to any other company “that the Secretary of Defense . . . reasonably believes to be an entity owned or controlled by, or otherwise connected to, the government of a foreign country.” Moreover, the DOD’s supplement to the FAR, the Defense Federal Acquisition Regulation Supplement (DFARS, Subpart 225.770), prohibits the acquisition of items covered by the United States Munitions List from a CCMC.

Further, Section 514 of the Consolidated Appropriations Act for 2018 specifies that for “high-impact or moderate-impact” information systems, agencies must review the “supply chain risk,” including the risk related to cyber-espionage or sabotage by entities identified by the U.S. Government “including but not limited to, those that may be owned, directed, or subsidized by the People’s Republic of China.”

The CCMC designations were also recently referenced in the U.S. Department of Commerce’s December 23, 2020 final rule on export licenses to ‘military end users’ (MEUs). The Department of Commerce’s Bureau of Industry and Security (BIS) (the unit charged with export controls on dual-use items) identified specific MEUs and announced that they would be subject to enhanced export licensing requirements under the Export Administration Regulations (EAR). Although only the Aviation Industry Corporation of China (AVIC) is listed both as a MEU and a CCMC, the agency nevertheless cautioned that CCMCs (as well as other non-listed parties) could be MEUs (or require licenses for items that are restricted for “military end uses”) and that additional due diligence ought to be exercised by potential exporters to determine whether export restrictions apply.

Ultimately, while federal agencies are granted broad discretion in undertaking assessments of national security risks when exercising legal authorities, if CCMCs are involved in any transaction that the U.S. government regulates, including procurement, further legal challenges to CCMC designations may limit the government’s ability to incorporate the CCMC designations into their risk assessments.

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