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CLIENT ALERT

ZTE Settlement: Implications for Re-exporters of U.S.-Controlled Items

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On March 7, 2017, Zhongxing Telecommunications Equipment Corporation ("ZTE Corporation") and its subsidiaries reached a settlement with the U.S. Departments of Justice, Commerce, and Treasury for over $1 billion, covering civil and criminal charges levied against the company. The charges stem from allegations that ZTE exported U.S.-controlled goods to Iran and North Korea in violation of the International Emergency Economic Powers Act ("IEEPA") and then attempted to cover up those activities. It was also alleged that ZTE resumed some of its illicit sales after the government's investigation had begun. See prior briefings on export restrictions placed on transactions involving ZTE, issued here, here, and here.

In the settlement with the Department of Justice—which still must be approved by the court—ZTE agreed to plead guilty to knowingly and willfully conspiring to violate IEEPA, obstruction of justice, and making a material false statement, and as part of the settlement, agreed to pay $430 million. The settlements with Treasury and Commerce were for nearly $101 million and $661 million, respectively. To deter ZTE from future violations Commerce suspended $300 million of their penalty for a seven-year probationary period. In addition, ZTE also agreed to active audit and compliance requirements designed to prevent and detect future violations and a seven-year suspended denial of export privileges, which could be reactivated if ZTE fails to comply with the settlement. Finally, conditioned on court approval of the DOJ agreement, Commerce's Bureau of Industry and Security ("BIS") has agreed to recommend ZTE be removed from the Entity List. Removal from the Entity List would allow ZTE to once again receive U.S. exports and re-exports without a license.

The penalties are the biggest imposed by the U.S. government in an export control case. These high penalties were due in part because the government alleged individuals at ZTE were aware of the export violations for a significant period of time before and after the government began their investigation. Commerce Secretary Wilbur Ross commented on the settlement: "We are putting the world on notice: the games are over." Secretary Ross noted, "Those who flout our economic sanctions and export control laws will not go unpunished – they will suffer the harshest of consequences."

The recent penalties follow other sanctions imposed on ZTE in March 2016, including ZTE's addition to the Entity List. Its addition to the Entity List meant that any company that wished to sell to ZTE must first obtain a special license. Since that time, BIS has issued a series of temporary licenses, effectively functioning as waivers, with the latest one set to expire on March 29, 2017. Had the license requirement gone into full effect, ZTE would

practically not have been able to obtain any further U.S.-made goods or software without special permission. Additionally, it would likely not have been able to maintain a significant part of its products and services, which rely upon a U.S.-based supply chain. The license requirement and the new sanctions both illustrate how U.S. sanctions and export laws attach to U.S. goods, both around the world and within the United States.

Key Lessons

Non-U.S. companies should evaluate their products and supply chain to determine whether any of their products are subject to U.S. export control laws. The following are subject to U.S. export control laws: (1) all goods and technology located in the United States; (2) all U.S.-origin items, wherever located; (3) certain foreign-made items that incorporate controlled U.S.-origin commodities or controlled U.S.-origin software in quantities exceeding certain de minimis levels; and (4) certain foreign-made direct products of U.S.-origin technology or software.

Non-U.S. companies that trade in goods subject to U.S. export control laws should evaluate their export practices to ensure they comply with U.S. law. In particular, such companies should have a compliance program in place that accurately classifies any items it plans on exporting, determines if a license is needed in order to legally export the item, and screens the customer, end-user and potentially other third parties against U.S. government lists of restricted parties.

As we have noted in previous posts, a risk-based compliance program is one factor that can help to reduce any penalties the government may impose. Winston & Strawn's attorneys are experienced with helping companies navigate complex export control laws, and with setting up robust compliance programs.

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