CLIENT ALERTS & INSIGHTS

The ZTE Case: U.S. Sanctions and Export Control Laws

MAY 5, 2017

Authors: Lianzhong Pan, Jonathan R. Todd

The settlement reached by China's giant telecommunication company, ZTE Corporation ("**ZTE**") with various U.S. government agencies, including U.S. Attorney's Office, U.S. Department of Justice, U.S. Department of Commerce's Bureau of Industry and Security ("**BIS**") and the Department of the Treasury's Office of Foreign Assets Control ("**OFAC**"), was in the headlines during much of March, 2017. ZTE pleaded guilty to violating U.S. laws on sanction and export control and agreed to pay forfeiture and fines to the U.S. government totaling almost US$900,000,000, with an additional US$300,000,000 suspended fine which will be imposed if ZTE violates its settlement agreement with BIS.

The ZTE settlement affords an opportunity for U.S. exporters and foreign importers to assess compliance with U.S. sanctions and export control laws that carry substantial civil and criminal liabilities.

Overview of U.S. Sanctions and Export Control Laws

The major U.S. sanctions and export control laws include the following:

- **International Emergency Economic Powers Act** (the "**IEEPA**"). The IEEPA authorizes the U.S. President to block transactions and freeze assets to deal with an unusual and extraordinary threat to the national security, foreign policy, or economy of the U.S. OFAC administers a number of U.S. economic and trade sanctions based on the IEEPA by maintaining several sanctions lists that may have different prohibitions on dealings with countries such as Iran and North Korea, as well as with a large number of specific individuals and entities identified on the List of Specially Designated Nationals (the "**SDN List**").

- **International Traffic in Arms Regulations** (the "**ITAR**"). The ITAR prohibit exports and re-exports from either the U.S. or abroad of U.S.-origin defense articles and services that are inherently or predominantly suited for military applications as listed on the U.S. Munitions List (the "**USML**"). All manufactures, exporters and brokers of defense articles and services as listed in the USML are required to register with the U.S. Department of State Directorate's of Defense Trade Controls ("**DDTC**"). Any person or company who intends to export or temporarily import defense articles or services is required to obtain a license from DDTC.
- **Export Administration Regulations** (the "**EAR**"). The EAR play a major role in the U.S. export control system as administered by BIS. The EAR regulate exports, re-exports and deemed-exports of a broad range of U.S.-origin commodities, software and technology, including those that have both civil and military or proliferation applications regardless of their intended civil use. All items specifically controlled by the EAR are enumerated on the Commerce Control List (the "**CCL**"). Responsibility for compliance with the EAR extends to almost all persons or companies that participate in transactions of controlled items.

Parties Subject to U.S. Sanctions and Export Control Laws

Many companies believe that simply because they are not U.S. registered companies or, even if they are U.S. registered companies they do not export "dangerous" items from the U.S., the U.S. sanctions and export control laws don't apply. This is WRONG!

Generally, the U.S. seller and the direct foreign buyer of goods subject to the EAR are the principal parities in interest and are responsible for compliance with the EAR. However, freight forwarders, carriers, consignees or other agents acting on behalf of the principal parties are also responsible for their own actions, regardless whether they take place inside or outside the U.S.

For purpose of U.S. sanctions laws, the following persons and companies are included in the definition of "U.S. persons" who are obligated to comply:

- U.S. citizens or permanent resident aliens of the U.S., even if located outside the U.S. and/or acting on behalf of a non-U.S. company;
- Foreign persons or companies acting inside the U.S. territory or causing actions in the U.S. in breach of rules, even if acting on behalf of a non-U.S. company;
- Companies that are incorporated, organized or based in the U.S., including overseas branches or divisions of U.S. companies.

Transactions Subject to U.S. Sanctions and Export Control Laws

BIS not only regulates general export of controlled items subject to the EAR, it also regulates re-export and deemed export of those items. If a company outside the U.S. wishes to export or re-export a product that is of U.S.-origin or has a U.S. connection, then such product may require a license from BIS.

Re-export. A re-export is the shipment or transmission of an item subject to the EAR from one foreign country to another foreign country. A re-export also occurs when there is a release of

technology or software or source code subject to the EAR in one foreign country to a national of another foreign country. The ZTE case is a good example of violation of the re-export control rules. ZTE used multilayer intermediate companies organized in China and other foreign countries to transport ZTE products containing U.S.-origin components to Iran, which is on the U.S.'s sanctioned country list.

Deemed export. Under the EAR, the release of controlled technology to a foreign person in the U.S. is deemed to be an export to the person's country of nationality and the releasing party is obligated to obtain an export license before releasing. Typically, universities and research institutions conducting high technology, bio-chemical, medical, computer and other scientific research and development activities are the deemed export license applicants, especially when they need to release controlled information to foreign students or visitors in the U.S.

Compliance with U.S. Sanctions and Export Control Laws

Violation of the U.S. sanctions and export control laws may result in stringent criminal and/or civil penalties. All persons and entities involved in transactions of U.S.-origin goods, software, technology and services must pay close attention to the compliance with the U.S. sanctions and export control laws.

In general, in order to reduce the likelihood of violation of U.S. sanctions and export control laws in commercial transactions, the parties participating in such transaction should first consider the following key factors in determining whether the export is permitted and, if so, whether an export license is required:

- **The item being exported.** If the item for export has a specific Export Control Classification Number ("**ECCN**") on the CCL, then it is a dual-use item for export control purposes. You can also find out the reasons for control based on the ECCN.
- **The final destination of the being exported item.** If the reasons for control listed in the ECCN entry matches with the country of final destination in the EAR Country Chart, you may determine that your export or re-export transaction requires an export license unless a license exception is available under the applicable EAR.
- **The end-user and end-use of the being exported item.** If the end-user and/or end use of the item being exported is under special restrictions (e.g., the end-user or end-use involves in weapons proliferation activities) under the EAR, then a license is still required, even though a license is not required based on the final destination determination.

The EAR is the broadest export control regime, and therefore, the EAR compliance is of particular concern to businesses involved in global trade. However, a diligent client will also need to manage compliance with the ITAR and OFAC compliances, since each of the regimes is unique and separately enforced. For example, because OFAC's embargoes and sanction programs are dynamic, it is very important for clients to check the SDN List on a regular basis to ensure that any transaction with the latest restricted countries, individuals and entities will not be engaged in, or, otherwise a special authorization from OFAC has been obtained. In addition, clients shall note that the ITAR includes a list of proscribed countries that are subject to U.S. arms embargoes, and the list

of ITAR proscribed countries is significantly broader than the SDN list of countries subject to the U.S. economic sanctions as maintained by OFAC.

Conclusion

As summarized above, the U.S. sanctions and export control laws have extremely broad jurisdictional (including extra-territorial) reach. They are administered and enforced by multiple U.S. government agencies driven by combination of national security, trade protection, foreign policy, anti-terrorism and other political concerns and objectives. To fully understand and comply with the U.S. sanctions and export control laws, a case-by-case consultation with your qualified legal and compliance advisor is required.

For more information on this topic, please contact:

Alan Goldner at agoldner@beneschlaw.com or 216.363.4623

Lianzhong Pan at lpan@beneschlaw.com or 216.363.4426 | 86.21.3222.0388

Jonathan Todd at jtodd@beneschlaw.com or 216-363-4658