

International Trade Alert

June 12, 2018

Key Points

- Yesterday, BIS published a superseding settlement agreement with ZTE, levying the largest-ever monetary penalty by BIS against a non-U.S. company and imposing significant additional compliance measures in exchange for lifting the Denial Order previously activated by BIS on April 15, 2018.
- The earlier Denial Order prohibited ZTE from directly or indirectly participating in any way in any transaction involving any commodity, software or technology subject to the EAR or exported from the United States in response to false statements that ZTE made to BIS in the course of settlement negotiations in 2016 for prior violations of U.S. export control and sanctions laws.
- The superseding settlement agreement with ZTE is conditioned on ZTE's payment of an additional \$1 billion in fines and placement of \$400 million in an escrow account in a U.S. bank approved by BIS. ZTE must also implement additional compliance measures, including retaining a team of special compliance officers answerable to BIS and replacing its entire board of directors and senior leadership for both ZTE companies designated in the April 15 Denial Order.
- Per the FAQs issued by BIS in connection with the superseding settlement agreement, the Denial Order will not be lifted until ZTE has paid the fines required by the agreement; BIS will make an announcement when ZTE has been removed from the Denied Persons List and the April 15 Denial Order has been lifted.



Commerce Department Signs New Agreement with ZTE Lifting Denial Order in Exchange for Unprecedented Additional Penalties and Compliance Measures

Background

On Thursday, June 7, 2018, U.S. Secretary of Commerce Wilbur Ross announced that the administration had reached a “definitive agreement” with Chinese telecommunications and information technology company Zhongxing Telecommunications Equipment Corporation, of Shenzhen, China (“ZTE Corporation”), to modify and replace the U.S. Department of Commerce (DOC) current Denial Order. The

current Denial Order activated by the DOC's Bureau of Industry and Security (BIS) on April 15, 2018 (the "April 15 Denial Order"), against ZTE Corporation and ZTE Kangxun Telecommunications Ltd. ("ZTE Kangxun") (collectively, "ZTE") broadly barred ZTE from the U.S. supply chain for a period of seven years in response to ZTE's failure to comply with agreed terms related to ZTE's prior illegal sales to Iran and North Korea.

As we recently **reported**, Secretary Ross activated the previously suspended Denial Order on April 15, 2018, based on a determination that ZTE made false statements to BIS in the course of settlement negotiations in 2016 and during its probationary period in 2017. At the time of the settlement, ZTE paid \$892 million in penalties, and committed to dismissing four senior employees and disciplining 35 others for their conduct related to the prior sanctions violations. Instead, ZTE rewarded staff and senior management involved in the illicit conduct with bonuses. Upon identification of this breach of agreed terms, BIS activated the Denial Order that was initially suspended as a part of the 2017 settlement and that in turn, placed ZTE on the BIS Denied Persons List, broadly prohibiting any person from engaging with ZTE in export-related functions and transactions.

June 7, 2018, Superseding Settlement Agreement

The new **agreement** described by Secretary Ross and formally entered into by BIS and ZTE on June 7, 2018 (and published on June 11, 2018), confirms that BIS will levy its largest-ever monetary penalty against a non-U.S. company and will impose unprecedented compliance requirements. Under the new agreement, ZTE must pay an additional \$1 billion in fines and separately place \$400 million in an escrow account before BIS will remove ZTE from its Denied Persons List and lift the April 15 Denial Order. These penalties are separate and in addition to the \$892 million that ZTE paid under the March 2017 settlement, bringing the already record penalties to a new record of \$2.29 billion.

In addition, once payment is received, BIS will lift the Denial Order under the condition that ZTE completes certain additional requirements, including the following key actions:

- retain a team of special compliance officers, selected by and answerable to BIS, for a period of 10 years, and implement a comprehensive export control compliance program
- complete and submit nine audit reports of its compliance with U.S. export control laws, with respect to all exports, reexports or transfers (in-country) that are subject to the Export Administration Regulations (EAR)
- replace the entire board of directors and senior leadership at or above the senior vice president level for both ZTE entities and prohibit the rehire of those employees by ZTE and any of its subsidiaries and affiliates
- publish on its website the EAR classification and all Export Control Classification Numbers (ECCN) of all items that ZTE or its affiliates sell, supply, produce, manufacture, assemble, export, reexport or transfer (in-country), including *de minimis* calculations relating to items that include U.S.-origin content

- cooperate fully with U.S. government investigations pertaining to ZTE's historical conduct or potential violations of U.S. export control laws during the probationary period.

In the course of the past several weeks, ZTE has already replaced several top executives—signaling that the company is eager to take the steps necessary to lift the current ban as quickly as possible.

June 11, 2018, Frequently Asked Questions (FAQs)

On June 11, 2018, BIS published several [FAQs](#) clarifying that ZTE remains on the Denied Persons List and that the April 15 Denial Order remains in effect until such time as ZTE pays the aforementioned civil penalty and places the \$400 million into escrow. BIS also confirmed that the agency will make an announcement when the April 15 Denial Order is lifted.

The FAQs also reiterate that the lifting of the April 15 Denial Order will not relieve persons of obligations under part 744 of the EAR. In addition, the FAQs note that BIS continues to review §764.3(a)(2) waiver requests relative to the April 15 Denial Order and that, while the lifting of the Denial Order will render such requests moot, “any violations of the April 15, 2018 Order while it remains in effect would not be mooted or absolved even if that Order is later lifted.”

Congressional Action

The U.S. Congress is currently reviewing how and whether to respond to the Trump administration's deal with ZTE including legislation to block the lifting of the current Denial Order. Specifically, on June 7, the U.S. Senate announced a bipartisan amendment to the National Defense Authorization Act (NDAA) that would retroactively prohibit the executive branch from modifying existing civil penalties (including Denial Orders). We will continue to monitor and report on these and related developments as they emerge.

Conclusion

The nature of the most recent ZTE penalties continues to demonstrate the robust use of administrative authorities, such as the Denial Order, as powerful tools to drive compliance with U.S. export controls, economic sanctions and settlements with regulatory authorities. The superseding settlement further shows the significant consequences that can occur to companies that violate the terms of settlement agreement with civil agencies, including for the most senior management and boards of companies.

Contact Information

If you have any questions regarding this alert, or if we can be of any assistance as you navigate the impact of this agreement on current or pending engagements with ZTE or the DOC, please contact your Akin Gump lawyer or:

Jonathan C. Poling
jpoling@akingump.com
202.887.4029
Washington, D.C.

Tatman R. Savio
tatman.savio@akingump.com
+852.3694.3015 | 202.887.4000
Hong Kong / Washington, D.C.

Christian C. Davis
chdavis@akingump.com
202.887.4529
Washington, D.C.

Steve C. Emme
semme@akingump.com
202.887.4368
Washington, D.C.

Jaelyn Edwards Judelson
jjudelson@akingump.com
202.887.4437
Washington, D.C.

Chris Chamberlain
cchamberlain@akingump.com
202.887.4308
Washington, D.C.