ZTE Saga Encourages Cos. To Play Ball With Commerce

By Alex Lawson

Law360, New York (March 30, 2016, 7:37 PM ET) -- The U.S. Commerce Department's recent decision to grant temporary reprieve to telecom giant ZTE for alleged Iran sanctions violations is a groundbreaking development that attorneys say should serve as a lesson to multinationals about the agency's might and the value of close cooperation with probes.

At a glance, the agency's March 22 decision to grant a temporary reprieve to China's ZTE Corp. and one of its subsidiaries just over two weeks after bringing down the hammer could be construed as an example of Commerce buckling to pressure from the telecommunications industry or the Chinese government.

But that reading ignores the basic power dynamic at play in sanctions probes, according to Jacobson Burton Kelley PLLC attorney Doug Jacobson, who said that the relief likely came only after Commerce's bombshell move forced ZTE to be more cooperative.

"I think [Commerce] sent the message loud and clear that they needed in order to get them to comply," Jacobson told Law360. "The company, within that two-week period, basically rolled over and said, 'Whatever you want, we will do.'"

The ordeal began on March 8 when Commerce's Bureau of Industry and Security said it was placing ZTE and a fleet of its business units on its Entity List, effectively blocking the company off from any new transactions with U.S. firms. The action stemmed from allegations that ZTE had supplied U.S.-origin hardware and software to an Iranian telecommunications company.

According to Jacobson, the decision to add ZTE to the Entity List was not one that BIS entered into lightly as most companies on the list are of little commercial significance. ZTE, on the other hand, is a titan of the telecom industry, and the fallout from the agency's maneuver was immediately evident.

"It was definitely a last resort," Jacobson said. "It's the nuclear option."

ZTE's inclusion on the Entity List sent shock waves through the industry as the company sources parts from all over the globe to make its products. Commerce’s decision shut the company off not only from potential U.S. suppliers but also from companies in third countries that may have had U.S. inputs in their supply chains.

"It shows you the power of the Entity List," Jacobson said. “This is classic extraterritorial jurisdiction
because it prevented even non-U.S. companies to sell to ZTE as long as there was a U.S. jurisdictional hook.”

Rumblings of ZTE's dalliance with Iran began to emerge in 2012, meaning that BIS has likely been looking closely at the company for quite some time and eventually opted to use the Entity List as a stick to prod the company into action.

Just 16 days after the export restrictions were put into effect, BIS sharply reversed course by granting a temporary license that allowed companies to continue their normal business with ZTE and its affiliate ZTE Kangxun Telecommunications Ltd.

Sutherland Asbill & Brennan LLP partner Mark D. Herlach said that the quick action by Commerce indicates that a more forthcoming approach from companies targeted for the Entity List could go a long way.

"For the private bar, I think it suggests a new avenue of engagement if one has a client with some issues that need to be addressed," he said. "In that sense, I think it's constructive. It's constructive for the private sector and also for the government if they can use the process in this way to engage."

At the same time, Herlach acknowledged that it would be foolish to think that ZTE's prominence in the marketplace did not play a role in the speed with which BIS moved to reverse course on its export restrictions.

"You also have to keep in mind the importance of ZTE. I'm not sure you'll see this policy with every company that's faced with this," he said.

Following Commerce's grant of the temporary license, ZTE issued a statement vouching for its full cooperation with U.S. authorities and expressing hope that it would soon be removed from the Entity List permanently.

Jacobson doubted that BIS would take that step until any criminal or civil penalties are finalized, but the office essentially has two other options before the temporary license expires at the end of June.

First, it could opt to extend the relief for another three months or some other length of time. BIS could also do away with the relief entirely and put ZTE and all of its subsidiaries back on the Entity List. The critical factor in determining the government’s next move will be the extent to which ZTE continues to comply with BIS directives.

Herlach said that it is difficult to assess the precise impact of the ZTE saga while the investigation is still going on behind closed doors, but its implications have been undeniable.

"We are all sort of watching shadows on the cave wall. We don't quite know what all this means," he said. "The only thing we can say with certainty is that it's an interesting development if there's going to be more of this, and it illustrates a new way to use the Entity List to try to get cooperation."

--Editing by Christine Chun and Katherine Rautenberg.

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