



**WISCONSIN PROJECT**  
ON NUCLEAR ARMS CONTROL

# Lesson Learned or Business as Usual?

Record U.S. penalties imposed on ZTE may not be enough to deter the Chinese telecom giant and others from violating Iran sanctions



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## Introduction

Over a period of six years, Zhongxing Telecommunications Equipment Corporation (ZTE), China's largest publicly traded telecommunications manufacturer and the fourth largest in the world,<sup>1</sup> engaged in a scheme to ship more than 20 million U.S.-origin items to Iran.<sup>2</sup> ZTE used multiple avenues to evade U.S. sanctions and export control regulations, including establishing shell companies, falsifying customs documents, and then actively misleading investigators when details of the conspiracy came to light. Top executives were instrumental in orchestrating the scheme and the attempted cover up.

ZTE recently reached a plea agreement and settled with the U.S. Department of Justice (DOJ), the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC), and the U.S. Department of Commerce's Bureau of Industry and Security (BIS) for a combined penalty of \$1.19 billion.<sup>3</sup> The agreement was approved by a federal judge in Dallas on March 22<sup>4</sup> and ZTE and its subsidiary were removed from Commerce's Entity List on March 29.<sup>5</sup>

Media reports and government press releases about the case have focused on the size of the monetary penalty. It is OFAC's largest settlement to date with a non-financial entity and the largest criminal fine ever for an International Emergency Economic Powers Act (IEEPA) violation.<sup>6</sup> But does it go far enough? The fine and probationary measures may not be sufficient to deter ZTE and companies like it from pursuing similar illegal actions in the future.

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<sup>1</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3-17CR-0120K, Factual Resume, p. 3, March 7, 2017, available at <https://www.justice.gov/opa/press-release/file/946281/download>, accessed on March 9, 2017.

<sup>2</sup> Settlement Agreement between Zhongxing Telecommunications Equipment Corporation, et al. and the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC), ENF 40001, p. 4, March 7, 2017, available at [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307\\_zte\\_settlement.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307_zte_settlement.pdf), accessed on March 9, 2017.

<sup>3</sup> "ZTE Corporation Agrees to Plead Guilty and Pay Over \$430.4 Million for Violating U.S. Sanctions by Sending U.S.-Origin Items to Iran," Press Release, U.S. Department of Justice, March 7, 2017, available at <https://www.justice.gov/opa/pr/zte-corporation-agrees-plead-guilty-and-pay-over-4304-million-violating-us-sanctions-sending>, accessed on March 9, 2017.

<sup>4</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3:17-CR-00120-K, Judgment, March 22, 2017, accessed via PACER on March 30, 2017.

<sup>5</sup> Removal of Certain Persons from the Entity List; Addition of a Person to the Entity List; and EAR Conforming Change, U.S. Department of Commerce Bureau of Industry and Security, Federal Register, Vol. 82 No. 59, March 29, 2017, available at <https://www.gpo.gov/fdsys/pkg/FR-2017-03-29/pdf/2017-06227.pdf>, accessed on March 29, 2017.

<sup>6</sup> "Treasury Department Reaches \$100 Million Settlement With Zhongxing Telecommunications Equipment Corporation," Press Release, U.S. Department of the Treasury, March 7, 2017, available at <https://www.treasury.gov/press-center/press-releases/Pages/sm0023.aspx>, accessed on March 9, 2017; "ZTE Corporation Agrees to Plead Guilty and Pay Over \$430.4 Million for Violating U.S. Sanctions by Sending U.S.-Origin Items to Iran," Press Release, U.S. Department of Justice, March 7, 2017, available at <https://www.justice.gov/opa/pr/zte-corporation-agrees-plead-guilty-and-pay-over-4304-million-violating-us-sanctions-sending>, accessed on March 9, 2017.

ZTE's orchestrated, company-wide, multi-year effort to circumvent U.S. export controls and sanctions landed it and some of its affiliates on the Commerce Department's Entity List.<sup>7</sup> However, ZTE and its China-based subsidiary ZTE Kangxun were almost immediately granted a temporary general license, thus exempting them from any U.S. trade restrictions.<sup>8</sup> And at least two companies used by ZTE to supply U.S.-origin goods to Iran and North Korea were left off the Entity List entirely. In addition, the corporate compliance and oversight changes mandated in ZTE's plea and settlement agreements may not be far-reaching enough to guarantee a change in behavior. Only a handful of officials directly implicated in the conspiracy were removed, while many other top officials likely aware of the illegal activity remain in place. Finally, an exemption in the plea agreement stipulates that ZTE, whose largest shareholder is a Chinese state-owned enterprise,<sup>9</sup> may not be required to turn over documents that the Chinese government deems "state secrets." This may allow the company to conceal evidence of U.S. export control and sanctions violations in the future.

## Re-Export Scheme

In the first months of 2010, ZTE and its Tehran-based affiliate, ZTE Parsian, negotiated a contract with the Telecommunication Company of Iran (TCI) to provide equipment and services needed to further expand TCI's telecommunication network.<sup>10</sup> TCI has a monopoly on Iran's fixed line infrastructure<sup>11</sup> and reportedly is controlled by the Iranian government.<sup>12</sup> The contract covered items like internet protocol multimedia systems, multiplexers, LAN switches, internet protocol televisions, and operational support systems.<sup>13</sup> Fulfilling the contract required U.S.-origin goods and components, many of which are

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<sup>7</sup> Additions to the Entity List, U.S. Department of Commerce Bureau of Industry and Security (BIS), Federal Register, Vol. 81 No. 45, March 8, 2016, available at <https://www.federalregister.gov/documents/2016/03/08/2016-05104/additions-to-the-entity-list>, accessed on March 31, 2017.

<sup>8</sup> Temporary General License, U.S. Department of Commerce Bureau of Industry and Security (BIS), Federal Register, Vol. 81 No. 57, March 24, 2016, available at <https://www.federalregister.gov/documents/2016/03/24/2016-06689/temporary-general-license>, accessed on March 31, 2017.

<sup>9</sup> "2015 Annual Report," ZTE Corporation, p. 105, available at <http://www.zte.com.cn/MediaFiles/9/9/9/%7B9995F466-8BBB-44BE-800D-DB0ADE4EDAC9%7DE1.pdf>, accessed on March 30, 2017.

<sup>10</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3-17CR-0120K, Factual Resume, p. 10, March 7, 2017, available at <https://www.justice.gov/opa/press-release/file/946281/download>, accessed on March 9, 2017; Settlement Agreement between Zhongxing Telecommunications Equipment Corporation, et al. and the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC), ENF 40001, p. 4, March 7, 2017, available at [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307\\_zte\\_settlement.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307_zte_settlement.pdf), accessed on March 9, 2017.

<sup>11</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3-17CR-0120K, Factual Resume, p. 10, available at <https://www.justice.gov/opa/press-release/file/946281/download>, accessed on March 9, 2017.

<sup>12</sup> Steve Stecklow, "Special Report: Chinese firm helps Iran spy on citizens," Reuters, March 22, 2012, available at <http://www.reuters.com/article/us-iran-telecoms-idUSBRE82L0B820120322>, accessed on March 10, 2017.

<sup>13</sup> Ibid, p. 11.

controlled by the Commerce Department for national security or anti-terrorism reasons.<sup>14</sup> ZTE would, therefore, need a license from Commerce's BIS for such items,<sup>15</sup> and, because of the general embargo levied by the Iranian Transactions and Sanctions Regulations (ITSR), a license from OFAC in order to export any item to Iran.<sup>16</sup>

Later in 2010, ZTE signed a contract with another Iranian telecommunications company, Ertebatat Tamin Shams Novin (Tamin), to provide the equipment needed to set up 1000 cell towers in Iran.<sup>17</sup> This contract, too, would require U.S.-origin, Commerce-controlled goods.<sup>18</sup>

According to internal company documents, ZTE was aware of the legal requirements.<sup>19</sup> However, the company did not put its efforts into properly assuring compliance with the law or terminating the contracts. Instead, ZTE established an elaborate re-export scheme that involved lying to U.S. suppliers by declaring China to be the end-use destination, co-mingling U.S.-origin products with ZTE products in shipments to Iran,<sup>20</sup> and deliberately falsifying customs declarations to omit the U.S.-origin goods.<sup>21</sup> ZTE executives also tasked a committee with finding "isolation companies," or third-party companies that could be used to facilitate both the procurement of U.S. goods and their re-export to Iran, while

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<sup>14</sup> Ibid, p. 12 and Appendix B.

<sup>15</sup> See Export Administration Regulations (EAR) and the Commerce Control List (CCL) available via U.S. Department of Commerce at <https://www.bis.doc.gov/index.php/regulations/export-administration-regulations-ear>.

<sup>16</sup> Iran Transactions Regulations, Final Rule, U.S. Department of the Treasury Office of Foreign Assets Control (OFAC), Federal Register Vol. 77 No. 204, October 22, 2012, available at [https://www.treasury.gov/resource-center/sanctions/Programs/Documents/fr77\\_64664.pdf](https://www.treasury.gov/resource-center/sanctions/Programs/Documents/fr77_64664.pdf), accessed on March 17, 2017.

<sup>17</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3-17CR-0120K, Factual Resume, p. 14, March 7, 2017, available at <https://www.justice.gov/opa/press-release/file/946281/download>, accessed on March 9, 2017; Settlement Agreement between Zhongxing Telecommunications Equipment Corporation, et al. and the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC), ENF 40001, p. 4, March 7, 2017, available at [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307\\_zte\\_settlement.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307_zte_settlement.pdf), accessed on March 9, 2017.

<sup>18</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3-17CR-0120K, Factual Resume, p. 15 and Appendix D, available at <https://www.justice.gov/opa/press-release/file/946281/download>, accessed on March 9, 2017.

<sup>19</sup> See "Report Regarding Comprehensive Reorganization and the Standardization of the Company Export Control Related Matters," and "Proposal for Import Export Control Risk Avoidance," ZTE Corporation, available via U.S. Department of Commerce at <https://www.bis.doc.gov/index.php/about-bis/newsroom>, accessed on March 31, 2017.

<sup>20</sup> Settlement Agreement between Zhongxing Telecommunications Equipment Corporation, et al. and the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC), ENF 40001, p. 3, March 7, 2017, available at [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307\\_zte\\_settlement.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307_zte_settlement.pdf), accessed on March 9, 2017.

<sup>21</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3-17CR-0120K, Factual Resume, p. 12, March 7, 2017, available at <https://www.justice.gov/opa/press-release/file/946281/download>, accessed on March 9, 2017.

concealing ZTE's involvement.<sup>22</sup> Two such companies are identified by name in official documents related to the case: Beijing 8-Star and Far East Cable Co. Ltd.<sup>23</sup> ZTE was not successful in using Beijing 8-Star because it was not known to U.S. exporters, who were hesitant to do business with it.<sup>24</sup> A later collaboration with Far East Cable was more successful.

The re-export scheme did not entirely escape notice. In March 2012, *Reuters* published a special report revealing that ZTE had sold TCI a ZXMT surveillance system capable of monitoring landline, mobile, and internet communications.<sup>25</sup> As part of this investigation, *Reuters* uncovered what it described as a "backdoor way" for Iran to obtain U.S. technology.<sup>26</sup> A 907-page ZTE packing list for a 2011 shipment to Iran listed hardware and software from major U.S. companies, including "HP computer parts and printers, Microsoft Windows software, Cisco switches, Dell flat-screen monitors, Oracle database products and Symantec anti-virus software."<sup>27</sup> Following the release of the *Reuters* report, the American companies launched internal inquiries, and OFAC,<sup>28</sup> BIS, and the FBI initiated investigations.<sup>29</sup> These joined an ongoing investigation by the House Permanent Select Committee on Intelligence into the security threat posed by Chinese telecommunications companies doing business in the United States – including ZTE – with potential ties to the Chinese government or military.<sup>30</sup>

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<sup>22</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3-17CR-0120K, Factual Resume, p. 18, March 7, 2017, available at <https://www.justice.gov/opa/press-release/file/946281/download>, accessed on March 9, 2017.

<sup>23</sup> Settlement Agreement between Zhongxing Telecommunications Equipment Corporation, et al. and the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC), ENF 40001, p. 3, March 7, 2017, available at [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307\\_zte\\_settlement.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307_zte_settlement.pdf), accessed on March 9, 2017.

<sup>24</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3-17CR-0120K, Factual Resume, p. 12, March 7, 2017, available at <https://www.justice.gov/opa/press-release/file/946281/download>, accessed on March 9, 2017.

<sup>25</sup> Steve Stecklow, "Special Report: Chinese firm helps Iran spy on citizens," *Reuters*, March 22, 2012, available at <http://www.reuters.com/article/us-iran-telecoms-idUSBRE82LOB820120322>, accessed on March 10, 2017.

<sup>26</sup> *Ibid.*

<sup>27</sup> *Ibid.*

<sup>28</sup> Settlement Agreement between Zhongxing Telecommunications Equipment Corporation, et al. and the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC), ENF 40001, p.8, March 7, 2017, available at [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307\\_zte\\_settlement.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307_zte_settlement.pdf), accessed on March 9, 2017.

<sup>29</sup> "Secretary of Commerce Wilbur L. Ross Jr. Announces \$1.19 Billion Penalty for Chinese Company's Export Violations to Iran and North Korea," Press Release, U.S. Department of Commerce, March 7, 2017, available at <https://www.commerce.gov/news/press-releases/2017/03/secretary-commerce-wilbur-l-ross-jr-announces-119-billion-penalty>, accessed on March 31, 2017.

<sup>30</sup> "Investigative Report on the U.S. National Security Issues Posed by Chinese Telecommunications Companies Huawei and ZTE," Permanent Select Committee on Intelligence, U.S. House of Representatives, 112<sup>th</sup> Congress, October 8, 2012, available at [https://intelligence.house.gov/sites/intelligence.house.gov/files/documents/huawei-zte%20investigative%20report%20\(final\).pdf](https://intelligence.house.gov/sites/intelligence.house.gov/files/documents/huawei-zte%20investigative%20report%20(final).pdf), accessed on March 17, 2017.



Despite these probes, ZTE again proved itself to be a determined sanctions evader. The company secretly resumed transactions with Iran in November 2013<sup>31</sup> while lying to its own defense counsel about the resumption—causing ZTE lawyers to make false statements to the Justice Department.<sup>32</sup> When ZTE’s defense counsel requested that an independent forensic accounting firm be granted access to ZTE’s internal records, ZTE leadership formed a 13-person "contract data induction team" (CDIT) to sanitize all documentation related to the Iran deals.<sup>33</sup> The CDIT team's emails were subject to an auto-delete function that erased its communications every 24 hours.<sup>34</sup> ZTE took other steps to cover its tracks, including having employees involved with the Iran contracts sign nondisclosure agreements<sup>35</sup> and requiring all employees to use coded terms in emails, such as “YL” and “Qatar” to refer to Iran and “YD,” “YA,” and “YC” to refer to Iranian customers.<sup>36</sup>

ZTE also began using a Chinese "isolation company," Far East Cable, to continue its exports of U.S.-origin goods to Iran.<sup>37</sup> According to the Justice Department, ZTE continued to procure U.S.-origin goods and then provided them to Far East Cable for re-export to Iran, first removing the ZTE logo and other references to the company from packages in order to conceal its involvement.<sup>38</sup> Between January 2014 and January 2016, ZTE prepared 34 Iran-bound consignments, with the intention that Far East Cable

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<sup>31</sup> Settlement Agreement between Zhongxing Telecommunications Equipment Corporation, et al. and the U.S. Department of the Treasury’s Office of Foreign Assets Control (OFAC), ENF 40001, p.8, March 7, 2017, available at [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307\\_zte\\_settlement.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307_zte_settlement.pdf), accessed on March 9, 2017.

<sup>32</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3-17CR-0120K, Factual Resume, pp. 21-22, March 7, 2017, available at <https://www.justice.gov/opa/press-release/file/946281/download>, accessed on March 9, 2017.

<sup>33</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3-17CR-0120K, Factual Resume, p. 23, March 7, 2017, available at <https://www.justice.gov/opa/press-release/file/946281/download>, accessed on March 9, 2017.

<sup>34</sup> Ibid.

<sup>35</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3-17CR-0120K, Factual Resume, p. 21, March 7, 2017, available at <https://www.justice.gov/opa/press-release/file/946281/download>, accessed on March 9, 2017.

<sup>36</sup> Settlement Agreement between Zhongxing Telecommunications Equipment Corporation, et al. and the U.S. Department of the Treasury’s Office of Foreign Assets Control (OFAC), ENF 40001, p.3, March 7, 2017, available at [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307\\_zte\\_settlement.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307_zte_settlement.pdf), accessed on March 9, 2017.

<sup>37</sup> Settlement Agreement between Zhongxing Telecommunications Equipment Corporation, et al. and the U.S. Department of the Treasury’s Office of Foreign Assets Control (OFAC), ENF 40001, pp. 8-9, March 7, 2017, available at [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307\\_zte\\_settlement.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307_zte_settlement.pdf), accessed on March 9, 2017.

<sup>38</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3-17CR-0120K, Factual Resume, p. 19, March 7, 2017, available at <https://www.justice.gov/opa/press-release/file/946281/download>, accessed on March 9, 2017.

would ensure their shipment to Iran.<sup>39</sup> Trade records confirm that the hand-off was successful: Far East Cable made at least 16 shipments to Iran during that time frame.<sup>40</sup> The Justice Department confirms that Far East Cable was fully aware of U.S. export laws and of the U.S. government's investigation into ZTE's shipments to Iran.<sup>41</sup>

According to documents released by the U.S. government as part of the settlement, ZTE's business with Iran and its activities relating to the cover-up continued until March 2016.<sup>42</sup> In total, ZTE shipped 21,219,092 U.S.-origin goods to Iran.<sup>43</sup> Combined, the contracts with the Iranian telecommunications companies were worth over \$2 billion.<sup>44</sup>

## U.S. Government Response

The breadth of ZTE's re-export scheme came to light in March 2016, when, following a four year investigation,<sup>45</sup> the Commerce Department added ZTE, ZTE Kangxun Telecommunications Ltd., ZTE Parsian, and Beijing 8-Star to the Entity List.<sup>46</sup> In an unusual move, Commerce also released a trove of ZTE internal documents exposing the scheme.<sup>47</sup> However, Commerce almost immediately granted a

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<sup>39</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3-17CR-0120K, Factual Resume, pp. 19-20, March 7, 2017, available at <https://www.justice.gov/opa/press-release/file/946281/download>, accessed on March 9, 2017.

<sup>40</sup> Far East Cable Co. Ltd, Shipments, April 2015-February 2016, accessed via Panjiva on March 30, 2017.

<sup>41</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3-17CR-0120K, Factual Resume, p. 19, March 7, 2017, available at <https://www.justice.gov/opa/press-release/file/946281/download>, accessed on March 9, 2017.

<sup>42</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3-17CR-0120K, Factual Resume, p. 3, March 7, 2017, available at <https://www.justice.gov/opa/press-release/file/946281/download>, accessed on March 9, 2017.

<sup>43</sup> Settlement Agreement between Zhongxing Telecommunications Equipment Corporation, et al. and the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC), ENF 40001, p.4, March 7, 2017, available at [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307\\_zte\\_settlement.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307_zte_settlement.pdf), accessed on March 9, 2017.

<sup>44</sup> TCI contract = \$160,000,000, Tamin contract = \$1,986,355,000; United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3-17CR-0120K, Factual Resume, pp. 11, 14, March 7, 2017, available at <https://www.justice.gov/opa/press-release/file/946281/download>, accessed on March 9, 2017.

<sup>45</sup> "Secretary of Commerce Wilbur L. Ross Jr. Announces \$1.19 Billion Penalty for Chinese Company's Export Violations to Iran and North Korea," Press Release, U.S. Department of Commerce, March 7, 2017, available at <https://www.commerce.gov/news/press-releases/2017/03/secretary-commerce-wilbur-l-ross-jr-announces-119-billion-penalty>, accessed on March 31, 2017.

<sup>46</sup> Additions to the Entity List, U.S. Department of Commerce Bureau of Industry and Security (BIS), Federal Register Vol. 81 No. 45, March 8, 2016, available at <https://www.bis.doc.gov/index.php/forms-documents/about-bis/newsroom/1440-81-fr-12004-entity-list-final-rule/file>, accessed on March 17, 2017.

<sup>47</sup> See "Report Regarding Comprehensive Reorganization and the Standardization of the Company Export Control Related Matters," and "Proposal for Import Export Control Risk Avoidance," ZTE Corporation, available via U.S. Department of Commerce at <https://www.bis.doc.gov/index.php/about-bis/newsroom>, accessed on March 31, 2017.

temporary general license to ZTE and its China-based subsidiary ZTE Kangxun.<sup>48</sup> This permitted ZTE to continue transactions with U.S. companies while it negotiated a settlement agreement. The temporary license was consistently renewed<sup>49</sup> until last month, when, as part of the settlement ZTE and ZTE Kangxun were removed from the Entity List.<sup>50</sup> Thus, ZTE's addition to the Entity List was largely a symbolic gesture.

On March 6, 2017 ZTE ultimately pleaded guilty to three felony counts: one count of conspiracy to unlawfully export, one count of obstruction of justice, and one count of making false statements to federal investigators.<sup>51</sup> A federal judge in Dallas approved the settlement on March 22.<sup>52</sup>

As part of its plea agreement with the Justice Department, ZTE must pay an approximate \$287 million fine, forfeit approximately \$144 million to the United States, and pay a \$1,200 special assessment fee.<sup>53</sup> As part of its settlement agreements with Treasury and Commerce, ZTE must pay approximately \$101 million and \$661 million respectively.<sup>54</sup> However, \$300 million of the Commerce penalty will be suspended and waived if, after a period of seven years, ZTE has a proven record of compliance.<sup>55</sup>

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<sup>48</sup> Temporary General License, U.S. Department of Commerce Bureau of Industry and Security (BIS), Federal Register, Vol. 81 No. 57, March 24, 2016, available at <https://www.federalregister.gov/documents/2016/03/24/2016-06689/temporary-general-license>.

<sup>49</sup> Temporary General License: Extension of Validity, U.S. Department of Commerce Bureau of Industry and Security (BIS), Federal Register, Vol. 81. No. 124, June 28, 2016, available at <https://www.gpo.gov/fdsys/pkg/FR-2016-06-28/pdf/2016-15228.pdf>, accessed on March 17, 2017; <sup>49</sup> Temporary General License: Extension of Validity, U.S. Department of Commerce Bureau of Industry and Security (BIS), Federal Register, Vol. 81 No. 161, August 19, 2016, available at <https://www.gpo.gov/fdsys/pkg/FR-2016-08-19/pdf/2016-19828.pdf>, accessed on March 17, 2017; Temporary General License: Extension of Validity, U.S. Department of Commerce Bureau of Industry and Security (BIS), Federal Register, Vol. 81 No. 223, November 18, 2016, available at <https://www.gpo.gov/fdsys/pkg/FR-2016-11-18/pdf/2016-27772.pdf>, accessed on March 17, 2017; Temporary General License: Extension of Validity, U.S. Department of Commerce Bureau of Industry and Security (BIS), Federal Register, Vol. 82 No. 36, February 24, 2017, available at <https://www.gpo.gov/fdsys/pkg/FR-2017-02-24/pdf/2017-03664.pdf>, accessed on March 17, 2017.

<sup>50</sup> Removal of Certain Persons from the Entity List; Addition of a Person to the Entity List; and EAR Conforming Change, U.S. Department of Commerce Bureau of Industry and Security, Federal Register, Vol. 82 No. 59, March 29, 2017, available at <https://www.gpo.gov/fdsys/pkg/FR-2017-03-29/pdf/2017-06227.pdf>, accessed on March 29, 2017.

<sup>51</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, C-17CR-0120K, Plea Agreement, March 7, 2017, available at <https://www.justice.gov/opa/press-release/file/946276/download>, accessed on March 10, 2017.

<sup>52</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, 3:17-CR-00120-K, Judgment, March 22, 2017, accessed via PACER on March 30, 2017.

<sup>53</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, C-17CR-0120K, Plea Agreement, March 7, 2017, pp. 3-4, available at <https://www.justice.gov/opa/press-release/file/946276/download>, accessed on March 10, 2017.

<sup>54</sup> Settlement Agreement between Zhongxing Telecommunications Equipment Corporation, et al. and the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC), ENF 40001, p.11, March 7, 2017, available at [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307\\_zte\\_settlement.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307_zte_settlement.pdf), accessed (footnote continued)



In addition to these financial penalties, ZTE must submit a series of audit reports detailing all of its exports and re-exports, employ an independent monitor for three years tasked with ensuring full compliance with U.S. law, and cooperate with the Commerce, Justice, and Treasury Departments regarding any request for documentation or end-use verification.<sup>56</sup> ZTE already has reported changes to its legal and compliance departments, including the hiring of a U.S. lawyer as Chief Export Compliance Officer.<sup>57</sup> In a further development, former Texas judge James M. Stanton<sup>58</sup> was named on March 22 as the independent monitor mandated by the settlement.<sup>59</sup>

The U.S. government wants this settlement to be seen as a model for future enforcement and proof of tough-mindedness in the face of sanctions violators. Commerce Secretary Wilbur L. Ross described the settlement this way: "We are putting the world on notice: the games are over. Those who flout our economic sanctions and export control laws will not go unpunished – they will suffer the harshest of consequences."<sup>60</sup>

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on March 9, 2017; Settlement Agreement between Zhongxing Telecommunications Equipment, et al. and the U.S. Department of Commerce's Bureau of Industry and Security, p. 3, March 7, 2017, available at <https://www.bis.doc.gov/index.php/forms-documents/about-bis/newsroom/1659-zte-settlement-agreement-signed/file>, accessed on March 10, 2017.

<sup>55</sup> Settlement Agreement between Zhongxing Telecommunications Equipment, et al. and the U.S. Department of Commerce's Bureau of Industry and Security, p. 3-4, March 7, 2017, available at <https://www.bis.doc.gov/index.php/forms-documents/about-bis/newsroom/1659-zte-settlement-agreement-signed/file>, accessed on March 10, 2017.

<sup>56</sup> Settlement Agreement between Zhongxing Telecommunications Equipment, et al. and the U.S. Department of Commerce's Bureau of Industry and Security, March 7, 2017, available at <https://www.bis.doc.gov/index.php/forms-documents/about-bis/newsroom/1659-zte-settlement-agreement-signed/file>, accessed on March 10, 2017; see also Settlement Agreement between Zhongxing Telecommunications Equipment Corporation, et al. and the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC), ENF 40001, March 7, 2017, available at [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307\\_zte\\_settlement.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170307_zte_settlement.pdf), accessed on March 9, 2017; United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, C-17CR-0120K, Plea Agreement, March 7, 2017, available at <https://www.justice.gov/opa/press-release/file/946276/download>, accessed on March 10, 2017.

<sup>57</sup> "ZTE Corporation Reaches Settlement with U.S. Authorities," Press Release, March 7, 2017, ZTE World Wide Web site, <http://www.zte.com.cn/global/about/press-center/news/201703ma/0307ma>, accessed on March 10, 2017.

<sup>58</sup> "James M. Stanton," Stanton LLP World Wide Website, <http://www.stantonllp.com/team/james-m-stanton>, accessed on April 3, 2017.

<sup>59</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, C-17CR-0120K, Plea Agreement, Attachment A (Modified) Independent Corporate Compliance Monitor, March 22, 2017, accessed via PACER on March 30, 2017.

<sup>60</sup> "Secretary of Commerce Wilbur L. Ross Jr. Announces \$1.19 Billion Penalty for Chinese Company's Export Violations to Iran and North Korea," Press Release, U.S. Department of Commerce, March 7, 2017, available at <https://www.commerce.gov/news/press-releases/2017/03/secretary-commerce-wilbur-l-ross-jr-announces-119-billion-penalty>, accessed on March 31, 2017.

## Analysis and Conclusion

The cumulative size of the financial penalties levied on ZTE – \$892 million in fines and forfeitures – is indeed historic. In part as a result of the settlement, ZTE announced a net loss of \$342 million for 2016.<sup>61</sup> However, fines and related probationary measures may not be sufficient to deter ZTE and companies like it from pursuing similar illegal actions in the future.

First, the company has not undertaken the kind of executive house-clearing that would reflect a true change in corporate compliance culture. And no individual charges were brought against the former ZTE executives directing the scheme. The two executive vice presidents, Tian Wenguo and Qiu Weizhao, were forced to step down last April.<sup>62</sup> Shi Lirong, ZTE's Chief Executive Officer since 2010, was replaced in April 2016; however, reportedly he continued to work at ZTE as a "non-executive director" until February 2017.<sup>63</sup> He stepped down as a condition imposed by the settlement agreement<sup>64</sup> and was added to Commerce's Entity List on March 29.<sup>65</sup> Shi was replaced as CEO by Zhao Xianming,<sup>66</sup> previously ZTE's Chief Technology Officer and an executive vice president, who has been with the company since 2001.<sup>67</sup> Then, on March 14, ZTE announced that Yin Yinmin, who has served different executive functions at the company since 2004, would take over the role of Chairman of the Board, a position previously held concurrently by the CEO.<sup>68</sup> In sum, Yin, Shi, and Zhao constituted ZTE's leadership during

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<sup>61</sup> Gaurav Raghuvanshi, "ZTE Swings to 2016 Loss After \$892 Million Fine for Violating U.S. Sanctions," The Wall Street Journal, March 7, 2017, available at <https://www.wsj.com/articles/zte-swings-to-2016-loss-after-892-million-fine-for-violating-us-sanctions-1488937915>, accessed on March 31, 2017.

<sup>62</sup> Juro Osawa, "China's ZTE to Replace Three Senior Executives," The Wall Street Journal, April 4, 2016, available at <https://www.wsj.com/articles/chinas-zte-to-replace-three-senior-executives-1459588482>, accessed on March 30, 2017.

<sup>63</sup> Juro Osawa, "China's ZTE to Replace Three Senior Executives," The Wall Street Journal, April 4, 2016, available at <https://www.wsj.com/articles/chinas-zte-to-replace-three-senior-executives-1459588482>, accessed on March 30, 2017; "ZTE reports \$111m loss after \$1.2bn US fine," Global Telecoms Business, March 8, 2017, available at <http://www.globaltelecomsbusiness.com/article/3667778/ZTE-reports-111m-loss-after-12bn-US-fine.html#.WMxHmlUrLcs>, accessed on March 17, 2017.

<sup>64</sup> United States of America v. ZTE Corporation, United States District Court for the Northern District of Texas Dallas Division, C-17CR-0120K, Plea Agreement, p. 10, March 31, 2017, available at <https://www.justice.gov/opa/press-release/file/946276/download>, accessed on March 10, 2017.

<sup>65</sup> Removal of Certain Persons from the Entity List; Addition of a Person to the Entity List; and EAR Conforming Change, U.S. Department of Commerce Bureau of Industry and Security, Federal Register, Vol. 82 No. 59, March 29, 2017, available at <https://www.gpo.gov/fdsys/pkg/FR-2017-03-29/pdf/2017-06227.pdf>, accessed on March 29, 2017.

<sup>66</sup> "ZTE Corporation Reaches Settlement with U.S. Authorities," Press Release, March 7, 2017, ZTE World Wide Web site, <http://www.zte.com.cn/global/about/press-center/news/201703ma/0307ma>, accessed on March 10, 2017.

<sup>67</sup> "Zhao Xianming-President/Executive Director, ZTE Corp," Bloomberg, available at <https://www.bloomberg.com/profiles/people/16021560-xianming-zhao>, accessed on March 29, 2017.

<sup>68</sup> "ZTE Names Yin as Chairman," Global Telecoms Business, March 14, 2017, available at <http://www.globaltelecomsbusiness.com/article/3669244/ZTE-names-Yin-as-chairman.html#.WMw3JVUrLcs>, accessed on March 17, 2017.

the re-export scheme. They were listed as ZTE's three "executive directors" in November 2015.<sup>69</sup> However, of the three, only Shi has been removed.

Second, ZTE may not be required to provide the kind of cooperation intended by the agreement. Both the Commerce and Justice Department settlement agreements include an exception for "state secrets privilege," meaning that ZTE is not required to disclose information that would violate China's state secrets laws.<sup>70</sup> As Reed Smith's Eric Dubelier told *Bloomberg*, "That covers, like, everything."<sup>71</sup> Commerce has attempted to close this loophole by enumerating the type of document that ZTE has previously provided as a precedent for what would not qualify under the state secrets clause. These include "contracts, purchase orders, invoices, letters of credit, credit advices, internal reports and memoranda, and emails."<sup>72</sup>

Still, ZTE has a history of enacting state secrets privilege in a U.S. government inquiry. During a multi-year investigation by the House Select Committee on Intelligence that concluded in October 2012, ZTE refused to answer Congressional questions about the company's compliance with U.S. export law and its contracts with Iran.<sup>73</sup> ZTE also was not forthcoming about its U.S. contracts and its ties to the Chinese government.<sup>74</sup> According to the Committee's final report, ZTE "argued at great length that it could not provide internal documentation or many answers to Committee questions given fear that the company would be in violation of China's state-secrets laws."<sup>75</sup> The Committee concluded that ZTE "cannot be trusted to be free of foreign state influence and thus pose[s] a security threat to the United States and

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<sup>69</sup> "List of Directors and Their Role and Function [as of November 25, 2015]," ZTE Corporation, available at [http://www.zte.com.cn/en/about/investor\\_relations/company/201511/P020151125645789105570.pdf](http://www.zte.com.cn/en/about/investor_relations/company/201511/P020151125645789105570.pdf), accessed on March 16, 2017.

<sup>70</sup> *United States of America v. ZTE Corporation*, United States District Court for the Northern District of Texas Dallas Division, C-17CR-0120K, Plea Agreement, p.6, March 7, 2017, available at <https://www.justice.gov/opa/press-release/file/946276/download>, accessed on March 10, 2017; Settlement Agreement between Zhongxing Telecommunications Equipment, et al. and the U.S. Department of Commerce's Bureau of Industry and Security, pp. 12-13, March 7, 2017, available at <https://www.bis.doc.gov/index.php/forms-documents/about-bis/newsroom/1659-zte-settlement-agreement-signed/file>, accessed on March 10, 2017.

<sup>71</sup> Greg Farrell and Tom Korosec, "ZTE Pleads Guilty to Violating Sanctions on Iran Tech Sales," *Bloomberg*, March 22, 2017, available at <https://www.bloomberg.com/news/articles/2017-03-22/zte-pleads-guilty-to-violating-sanctions-on-iran-tech-sales>, accessed on March 29, 2017.

<sup>72</sup> Settlement Agreement between Zhongxing Telecommunications Equipment, et al. and the U.S. Department of Commerce's Bureau of Industry and Security, p.13, available at <https://www.bis.doc.gov/index.php/forms-documents/about-bis/newsroom/1659-zte-settlement-agreement-signed/file>, accessed on March 10, 2017.

<sup>73</sup> "Investigative Report on the U.S. National Security Issues Posed by Chinese Telecommunications Companies Huawei and ZTE," Permanent Select Committee on Intelligence, U.S. House of Representatives, 112<sup>th</sup> Congress, pp. 42-43, October 8, 2012, available at [https://intelligence.house.gov/sites/intelligence.house.gov/files/documents/huawei-zte%20investigative%20report%20\(final\).pdf](https://intelligence.house.gov/sites/intelligence.house.gov/files/documents/huawei-zte%20investigative%20report%20(final).pdf), accessed on March 17, 2017.

<sup>74</sup> *Ibid*, pp. 36-43.

<sup>75</sup> *Ibid*, p. 36.

to our systems."<sup>76</sup> The Committee also called on American companies to "consider the long-term security risks associated with doing business with ZTE" and "strongly encouraged" companies to seek out "other vendors."<sup>77</sup>

Finally, the financial penalties are still smaller than the total value of ZTE's known contracts with Iran, which were worth approximately \$2 billion. And Iran is not the only U.S.-sanctioned country with whom ZTE did business. Its internal documents show that the company had contracts in Cuba, North Korea, Sudan, and Syria that included U.S.-origin goods, indicating that ZTE was willing to risk potential penalties in order to trade with sanctioned countries.<sup>78</sup> While the settlement agreement is vague about ZTE's dealings in these countries, Commerce reports that the company made 283 shipments to North Korea;<sup>79</sup> trade data indicates that direct shipments from ZTE to North Korea took place as recently as 2015.<sup>80</sup> And internal company documents describe how ZTE used a "cooperating company" to trade with North Korea, in order to mask its involvement.<sup>81</sup> The documents describe the tactic as "fairly effective."<sup>82</sup> Unfortunately, none of the settlement documents name the company that helped ZTE trade with North Korea, potentially allowing this company to continue providing U.S.-origin goods to sanctioned destinations.

Employing third-party companies for sanctions evasion is clearly a favored tactic of ZTE that must be countered. Yet thus far, only Beijing 8-Star has been added to any U.S. restricted party list. Far East Cable, which actively supported ZTE's Iranian contracts, has never been designated. This company is still active and bills itself as the largest wire and cable manufacturer in China.<sup>83</sup> Far East has also maintained consistent business with U.S. companies, exporting \$6.4 million worth of goods in the last two years, with the most recent shipment occurring on March 20, 2017.<sup>84</sup>

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<sup>76</sup> Ibid, p. 45.

<sup>77</sup> Ibid, p. 45.

<sup>78</sup> See "Report Regarding Comprehensive Reorganization and the Standardization of the Company Export Control Related Matters," and "Proposal for Import Export Control Risk Avoidance," ZTE Corporation, available via U.S. Department of Commerce at <https://www.bis.doc.gov/index.php/about-bis/newsroom>, accessed on March 16, 2017.

<sup>79</sup> "Secretary of Commerce Wilbur L. Ross, Jr. Announces \$1.19 Billion Penalty for Chinese Company's Export Violations to Iran and North Korea," Press Release, U.S. Department of Commerce, March 7, 2017, available at <https://www.commerce.gov/news/press-releases/2017/03/secretary-commerce-wilbur-l-ross-jr-announces-119-billion-penalty>, accessed on March 30, 2017.

<sup>80</sup> ZTE, Shipments, April 2015-October 2015, accessed via Panjiva on March 16, 2017.

<sup>81</sup> See "Report Regarding Comprehensive Reorganization and the Standardization of the Company Export Control Related Matters," ZTE Corporation, available via U.S. Department of Commerce at <https://www.bis.doc.gov/index.php/about-bis/newsroom>, accessed on March 16, 2017.

<sup>82</sup> Ibid.

<sup>83</sup> "About Us: Company Profile," Far East Cable Co. Ltd World Wide Web site, <http://en.fe-cable.com/index.php?m=list&a=index&cid=52&pid=1>, accessed on March 29, 2017.

<sup>84</sup> Far East Cable Co., Ltd., Shipments April 2015-March 2016, accessed via Panjiva on March 20, 2017.

ZTE may be an example of a company that is "too big to sanction," or at least to sanction properly. It has a large and growing presence in the U.S. market, is critically dependent on U.S. technology suppliers, and supports American jobs. Indeed, in a press release about the settlement, the company emphasized its "strong partnerships with many U.S. suppliers that support nearly 130,000 high tech jobs."<sup>85</sup>

However, this economic consideration must be balanced against the national security imperative to punish ZTE's multi-year effort to contravene U.S. export controls and sanctions in order to supply Iran, and ZTE's willingness to obstruct a multi-agency U.S. government investigation. Such punishment is necessary not only to deter similar activities by ZTE in the future, but to send a message to other companies who may be comparing the financial incentives of violating U.S. sanctions with the potential penalties.

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<sup>85</sup> "ZTE Corporation Reaches Settlement with U.S. Authorities," Press Release, March 7, 2017, ZTE World Wide Web site, <http://www.zte.com.cn/global/about/press-center/news/201703ma/0307ma>, accessed on March 10, 2017.