



How Important is it to Screen Your Suppliers? Ask ZTE.

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I recently took an Uber in New York City and noticed that the drivers tend to have their smartphones mounted on their dash to allow them to use city maps. What humored me was seeing that my driver didn't have the most common iPhone or Samsung Galaxy device, instead he had a Zhongxing Telecommunications Equipment (ZTE) smartphone. I chuckled at the irony and thought, "well that's the last ZTE phone he'll ever own," at least for the next seven years.

ZTE is the fourth-largest smartphone vendor in the U.S. and sells to major mobile carriers such as AT&T, T-Mobile, and Sprint [1]. As the second largest telecommunication provider in China, they are a manufacturer and integrator of networking apparatuses and handheld devices [2]. The most common ZTE models include the Tempo X, Prestige 2, and Majesty Pro.

Not All Press is Good Press

Throughout the last couple of years, ZTE has made U.S. trade compliance news multiple times, but on April 20, 2018 they made headlines in bold font. ZTE had the unfortunate honor of achieving the highest export monetary penalty issued by the Bureau of Industry and Security (BIS) at \$1.9 billion. This penalty was originally issued in March 2017 but ZTE was granted monetary deferrals and delays of suspensions, therefore April 20, 2018 was the official activation date.

Along with this hefty financial penalty, ZTE is no longer able to receive products from the United States. The impact of this on ZTE has been so substantial to its bottom line that they have had to halt operations [3].

So how does this apply to the Uber driver with his ZTE smartphone? Now that ZTE is frozen from receiving exports from the U.S.—or on behalf of the U.S.—his friendly retailer can no longer purchase from ZTE.

Why? Multiple exports occur in order to buy handheld devices from ZTE.

Export one: The retailer needs to request making a purchase, likely by email.

Export two: Then they will need to send a purchase order.

Export three: Finally, they must pay for the devices to be shipped from China, or a third party.

In between these transactions, there may have been additional communication by email or phone, which are all exports and are therefore banned. While the Federal Communications Commission (FCC) grapples with the conflict between consumer interest and regulatory compliance, ZTE device owners have to wonder, will they be able to receive operating system downloads [4]?

Why ZTE Was Issued This Penalty

ZTE received components and equipment from the U.S. that were then transshipped to Iran and North Korea. In some cases, these products were not transformed but were shipped as is, and in other cases, they were put into telecommunications equipment to modernize the capabilities of the respective country—i.e. Iran and North Korea. This was a direct violation of U.S. sanctions.

Export compliance consultants and practitioners everywhere have been screaming, “screen your suppliers,” and now ZTE has given us a tangible example of why it is so crucial to practice export compliance within the supply chain.

The Nature of Their Deceit

It started back around January 2010, when ZTE began bidding on two Iranian projects where they would install cellular and landline network infrastructure. Through 2016 those contracts resulted in the illegal transfer of approximately \$32,000,000 of U.S.-origin items, which were installed and used in Iran. During this time, it was also discovered that ZTE made 283 shipments of U.S. products to North Korea, these shipments included routers, microprocessors, servers, etc.

ZTE’s senior management knew they were in the wrong. In the summer of 2012, they required each employee involved with sales to Iran to sign nondisclosure agreements in which the employees agreed to keep all information related to the company’s exports to Iran confidential [5]. This resulted in employees providing false end user details to U.S. exporters and manufacturers.

During the two settlements in 2016 and 2017, ZTE had assured that all employees would be trained on compliance with U.S. export regulations and process updates. They also advised that internal audits would be conducted, and most importantly, top executives directly involved in the sales to North Korean and Iran would be disciplined for their actions, including the possibility of dismissal and at minimum a loss of bonuses. Earlier this year, the Department of Commerce (DOC) followed up with ZTE on the 2016 settlement requirements (internal audits, discipline of senior managers, implementation of compliance processes in line with U.S. regulations), as ZTE was allowed to continue business with the United States—a case of the U.S. attempting to maintain a flow of commerce—with the assumption that they would fulfill these requirements. However, ZTE failed to comply and falsely stated that all requirements were met, which has led to their current situation [6].

The Impact on U.S. Exporters

Not only is the ZTE ruling a hindrance to those who sell to or purchase from ZTE, but it is also impacting legal, legitimate, and profitable business for U.S. suppliers. As a manufacturer, ZTE has been involved in the modernization of telecommunication networks in many countries. For the U.S. exporter, sometimes ZTE is their customer and at other times, they are simply the middle man—the

integrator, installer or operator. The ban on exports not only forbids new sales to ZTE, it also halts any pre-existing contracts, if ZTE is listed or known as an intermediary party on those contracts, mainly to entities that are based around Asia Pacific and the Middle East.

U.S. corporations must consider the impact this will have on ongoing services and maintenance requirements of existing telecommunications systems involving ZTE. If ZTE is the operator and has sold maintenance services to end users, ZTE is no longer able to purchase parts from the U.S.—directly or indirectly—or receive technical information to conduct that service or maintenance.

The Moral of the Story

We all understand that diverting goods to Iran or North Korea is against U.S. sanctions, but why was there such a hefty penalty? Well, ZTE had its own Hollywood-style-drama of lies and deceit which included making false statements to U.S. and Chinese attorneys and investigators, falsifying customs documentation, and mixing U.S. product with Chinese origin product in attempt to hide it.

What all of this tells us is just how important it is to ensure your vendors are compliant with U.S. export and import regulations. It also tells us to avoid single-sourcing providers, integrators, installers, etc. to help avoid major impacts to your business, if a situation like this arises.

A Chance for a Third Strike

After the April 20, 2018 penalty activation, ZTE did file documentation with the DOC again, stating they will train and audit their staff and processes, as well as discipline their senior team. The DOC has stated they are willing to see evidence.

Will ZTE have an opportunity for a third strike? With U.S. component—or chip—manufacturers suffering from a significant drop in export sales due to the inability to ship to ZTE, and the realization of possibly losing 75,000 jobs in Beijing China, we can expect ZTE to stay a topic of trade news for months to come. Also, due to the ongoing fear of a trade war with China, the BIS's decision may be overturned by the Executive Branch.

President Trump has offered his assistance in resolving the issues between ZTE and the U.S. government [7]. How that help will be facilitated is unclear but does assure that ZTE will be a household name throughout 2018, with constant media attention. It is imperative for U.S. importers and exporter to stay current on trade news to assure compliance, as well as understand how these issues may impact their organization and bottom line.

Footnotes

- [1] "Company Overview," ZTE USA. Retrieved on May 17, 2018 from <<https://www.zteusa.com/about-us/>>.
- [2] Meyer, David, "One of the World's Biggest Phone Firms Is Stopping Operations Because of a Ban on Buying U.S. Parts," Fortune, May 10, 2018. Retrieved on May 17, 2018 from <<http://fortune.com/2018/05/10/zte-components-china-technology-denial-order/>>.
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- [5] "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," The United States Department of Justice, March 7, 2017. Retrieved on May 17, 2018 from <<https://www.justice.gov/opa/pr/zte-corporation-agrees-plead-guilty-and-pay-over-4304-million-violating-us-sanctions-sending>>.
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