GIBSON DUNN

Judith Alison Lee is a partner and R.L. Pratt is an associate at Gibson, Dunn & Crutcher LLP. Ms Lee can be contacted on +1 (202) 887 3591 or by email: jalee@gibsondunn.com. Mr Pratt can be contacted on +1 (202) 887 3785 or by email: rpratt@gibsondunn.com.

Published by Financier Worldwide Ltd

Trump administration using a variety of measures to target Chinese tech companies

BY JUDITH ALISON LEE AND R.L. PRATT

The broad targeting of Chinese trade with multiple rounds of tariffs may have the most significant effects on American markets and consumers. However, the Trump administration's use of more targeted trade controls against specific Chinese entities has also had significant effects, threatening the viability of the targeted companies and deepening trade tensions.

The administration's reliance on these targeted trade restrictions reflects several features of its approach to China and to trade policy generally – most obviously a longstanding hostility toward Chinese trade practices. Additionally, key officials have shown unprecedented affinity for restricted party lists – which can be used unilaterally, independently and quickly. The administration has also relied on a wider set of targeting tools, including obsolescent statutory provisions and new authorities. Finally, the president seems more willing than his predecessors to deploy these tools for political reasons.

Given their significant impact and president Trump's reliance on these tools, potential Chinese targets and those doing business with Chinese entities should be aware of their triggers and consequences and proactively manage the associated risks.

Tools for targeting

There are a wide variety of legal authorities and regulatory tools that may be used to restrict Chinese trade and investment, including by targeting specific companies. Many of these more-targeted trade controls take the form of restricted party lists, including those described below. Each list has different triggers and consequences, and each list is independent. Designation to one does not portend or preclude designation to another.

Entity List. Originally developed as a tool for listing companies likely to divert exported items they received, the Entity List has since expanded considerably. Entities may now be designated for engaging in activities contrary to US national security or foreign policy interests.

Additional restrictions are placed on the export of US-origin items to designated entities, often including additional licensing

requirements and more stringent licensing policies. Designation does not generally prohibit engaging with the listed companies but makes it significantly more difficult to export US-origin items to designated entities. The added restrictions may be limited to exports of specific items or may broadly prohibit the export of all US-origin items to the designated entity.

The designation of Huawei to the Entity List in May 2019 marked the beginning of a spike in Chinese Entity List designations. Along with Huawei, BIS designated 68 of its affiliates and later, in August 2019, designated an additional 46 affiliates. Five separate Chinese entities were designated on 24 June 2019, including a US-Chinese joint venture.

Denied Persons List. Designation to the Denied Persons List (DPL) is imposed as a penalty for prior export controls violations. Designated companies are broadly prohibited from participating in or benefiting from transactions involving exports of US items. The prohibitions of the DPL extend far beyond simply prohibiting exports of US items to the denied party. For example, other entities may not service the denied party's US-origin equipment or provide maintenance using US-origin tools. Designation severely limits the target's ability to do business with any kind of a US connection.

The designation in April 2018 of Chinese telecommunications company ZTE to the DPL is a high-profile example of both the cost of designation and the Trump administration's unorthodox use of these targeted trade controls. ZTE was added to the DPL after allegedly violating the terms of a settlement negotiated in a prior sanctions-enforcement action. The broad prohibition, which cut ZTE off from critical US inputs, effectively shut down ZTE's operations. In the context of trade negotiations with the Chinese, president Trump tweeted that the penalty on ZTE should be removed, and the company was de-listed in July 2018.

Unverified List. The Unverified List (UVL) is relatively unknown, but may still impose significant burdens on trade with designated entities. A company may be designated if the US government cannot confirm its identity, location or lawful use of US-origin items it has received previously. If the US government cannot confirm an entity's *bona fides* or its proper use of exported items during a site visit or compliance check, the entity may be designated to the UVL.

Designation does not prohibit doing business with US companies or receiving US goods, but it does add requirements for exporting US items to designated entities. Exporters may have to apply for a licence to export to a UVL designee where one would not have been otherwise required, or to obtain additional certifications from the designee before exporting. Exporters to designated entities must also provide additional data to the government regarding their exports.

There has been significant growth in UVL designations focusing on Chinese entities. Approximately 40 percent of current UVL entities were designated during the Trump administration. Sixty percent of those are Chinese entities. The most recent designations in April 2019 expanded the list by 20 percent, including 37 Chinese entities.

Specially Designated Nationals and Blocked Persons (SDN) List. OFAC's SDN List is among the most commonly used and most impactful restricted party lists. Entities may be designated to the list for a variety of reasons determined to be threats to US national security, foreign policy or economic interests, including engagement with North Korea, certain Iran-related transactions, certain Russian defence companies, narcotics traffickers or other SDNs.

As a result of designation, US persons may not engage in or facilitate transactions with the SDN or its property. SDN's US assets are frozen, and transactions involving SDN assets in the US must be blocked. The SDN is effectively cut off from the US, including the US financial system. SDNs also often find it harder to do business with non-US entities that are concerned about the risk of being designated themselves.

Last year was a banner year for SDN designations, with approximately 1500 persons, including some of the world's largest firms, added to the SDN List – 50 percent more than any other year. OFAC also collected billions of dollars of fines for sanctions violations in 2017 and 2018. The risks of designation and enforcement have increased as several new sanctions programmes have come online and may continue to increase with possible new China-focused sanctions, described further below.

New tools for targeting

Recent additions to the arsenal of targeting tools will also likely result in additional restrictions on Chinese companies.

Alongside the designation of Huawei, president Trump issued an executive order declaring a national emergency with respect to US information and communications technology and services (ICT) infrastructure and authorising

the imposition of restrictions on certain types of transactions with ICT from 'foreign adversaries'. Until implementing regulations are issued in October 2019, the exact scope of these restrictions is unclear. However, the issuance of the executive order in tandem with Huawei's designation suggests that Chinese technology companies will likely be targeted.

Additionally, the National Defense Authorization Act of 2019 included provisions prohibiting US government agencies from acquiring telecommunications equipment or services from certain Chinese companies, including Huawei, ZTE, Hytera, Dahua, or Hickvision, or from third parties that use those Chinese companies' products in certain systems. These restrictions may be expanded to cover additional companies with ties to the Chinese government.

Consequences of targeting

For many targeted companies, designation may cut critical supply chains and introduce new supply chain risks. Suppliers may be legally required to end their relationships with designated entities or may do so out of an abundance of caution. Non-designated companies that engage in sanctioned countries or with sanctioned persons could be held liable for 'causing' their US suppliers to violate their sanctions compliance obligations by indirectly supplying goods to sanctioned end-users – further encouraging US suppliers to terminate relationships with risky customers and introducing additional compliance risks into supply chains.

Designation may also cut Chinese entities off from their customers. SDNs and Denied Parties may no longer provide goods or services to US customers. Entities subject to the new NDAA restrictions on government contractors may not do business with government agencies, and a wide range of US customers that are government contractors may eliminate their engagements with targeted entities.

These restrictions often result in lost market share that can be difficult to regain. Recent designations and general trade volatility may push customers towards competitors in 'less risky' jurisdictions. Concerns about designation may even motivate potential targets to de-risk, for example by eliminating operations in sanctioned jurisdictions.

Mitigating targeting risk

The factors triggering designation may be beyond the company's ability to avoid or change (e.g., the company's products or proximity to the Chinese government). However, Chinese companies can take certain steps to minimise the risk of designation. Most critically, companies can avoid engagement with restricted persons or countries. Several recent high-profile Chinese designations related directly to dealings with sanctioned countries or persons. If such engagement is unavoidable, companies should limit the scope and frequency of such transactions and otherwise avoid the types of transactions restricted by US sanctions.

Maintaining a robust export compliance programme can also mitigate the risk of designation. Such compliance initiatives should conform to recent government-issued guidance to ensure they are consistent with the regulators' expectations. Companies must also continually monitor legal developments and adjust their compliance tools appropriately. Non-US companies should pay particular attention to the restrictions of US secondary sanctions – which target certain non-US activities of non-US persons occurring outside of the US – and US export controls, which apply regardless of an exporter's nationality or location.

It is also beneficial to be transparently compliant. Companies can notify suppliers, customers and other trading partners about their compliance efforts. When compliance questions arise or the US government raises questions on its own, companies can engage cooperatively with the US government. Such transparency could reduce designation risk, prevent unnecessary de-risking and help a company to develop a positive reputation as a low-risk trade partner. ■