

May 16, 2019

## President Trump Prohibits Most Trade and Transactions with Huawei of China and Sets the Stage for Similar Actions against other Chinese IT and Telecom Companies

*By the Customs and International Trade Team*

On May 15, 2019, President Trump issued an Executive Order (EO), “Securing the Information and Communications Technology and Services Supply Chain.” The EO directs the U.S. Department of Commerce to lead an interagency effort to develop and implement regulations that will prohibit a wide range of transactions with entities that are determined to be “controlled by, or subject to” the jurisdiction of “a foreign adversary.” These terms are not defined in the EO but it is expected that they will include the People’s Republic of China and some companies operating in China, including Chinese telecommunications equipment manufacturer Huawei.

On May 16, 2019, the Commerce Department issued an order adding Huawei Technologies Co. Ltd. of China and 68 of its non-U.S. affiliates to the Bureau of Industry and Security’s “Entity List.” The order is effective as of its date of first posting – May 16, 2019. As a result, it is now prohibited for persons subject to U.S. jurisdiction and all companies dealing in goods, software, and technology that are subject to U.S. export controls to do business with these Huawei entities.

Violations of the EO and Entity List listing can result in severe civil and criminal penalties, including civil penalties per transaction of up to \$300,000 or twice the value of the transaction and denial from participation in U.S. government contracts and denial of export privileges, in addition to criminal penalties of up to \$1 million and 20 years’ imprisonment. Companies doing business with Huawei and related companies should take immediate steps to protect their interests.

### Consequences of the Entity List Listing of Huawei and Its Affiliates

The Entity List is part of the Export Administration Regulations (EAR) (15 C.F.R. Part 730 *et seq.*). Pursuant to the EAR, U.S. companies and U.S. individuals (wherever located) are prohibited from supplying to listed entities any goods, software, or technology that is of U.S. origin or that has U.S.-origin content. Accordingly, the listing of Huawei and its affiliates means that U.S. companies must immediately cease most transactions with Huawei that involve goods, software, or technology of U.S. origin, in addition to certain foreign-made items that contain or use U.S.-origin content, software, or technology.

Note that while the Entity List order exempts shipments of such items that were “en route aboard a carrier to a port of export or reexport” on May 16, 2019, there is no allowance for continuing obligations under preexisting

contracts or arrangements (*i.e.*, no “grandfathering” provision). As a result, the order will impact virtually all trade in U.S. technology with Huawei after May 16, 2019.

### Details of the Executive Order

#### *What the EO Prohibits*

The EO prohibits a wide range of transactions, including “any acquisition, importation, transfer, installation, dealing in, or use of any information and communications technology or service” that involve “information and communications technology or services designed, developed, manufactured, or supplied, by persons controlled by, or subject to the jurisdiction of a foreign adversary.”

Such transactions may be prohibited when **any one** of three conditions is met:

1. The transaction poses an “undue risk” of sabotage or subversion of “design, integrity, manufacturing, production, distribution, installation, operation, or maintenance of information and communications technology or services in the United States.”
2. The transaction poses an undue risk of “catastrophic effects” on “the security or resiliency of United States critical infrastructure or the digital economy of the United States.”
3. The transaction “otherwise poses an unacceptable risk to the national security of the United States or the security and safety of United States persons.”

In other words, the broad prohibition envisioned by the EO will potentially penalize virtually any transaction with a designated company operating in a wide range of IT and telecom areas, including not only hardware and software developed by designated entities but also services – such as data centers, online platforms, IoT, and cloud PaaS, SaaS and IaaS solutions and networks – that employ equipment or software that were made or sold by designated entities.

While it remains to be seen exactly how the EO will be implemented through Department of Commerce and related agency rulemaking, we expect that given the U.S. government’s current stance against Huawei that the implementing regulations will likewise be very broadly drawn.

Commerce and related agencies have 150 days from the issuance of the EO (*i.e.*, until October 12, 2019) to implement the EO and make initial designations. However, the prohibition is to apply to any transaction that is initiated or pending or that will be completed after May 15, 2019. So while we will have to wait for the rulemaking to confirm, on its face the EO suggests that any ongoing relationships with the yet-to-be-designated entities could be the basis for liability.

#### **Potential Penalties Under the EO**

Because the EO was issued under the authority of the International Emergency Economic Powers Act (IEEPA), violations of the EO will trigger the civil and criminal penalty provisions of IEEPA, which currently include civil penalties per transaction of up to \$295,000 or twice the value of the transaction, whichever is greater, as well as criminal penalties of \$1 million and 20 years' imprisonment. As with the OFAC economic sanctions (which also are issued under IEEPA), civil penalties can be imposed on a strict liability basis – meaning that the presence of a prohibited person in the transaction chain could create liability even without actual knowledge on the part of the other parties involved in the transaction.

The U.S. Treasury Department is directed to assist in implementing the prohibition. Accordingly, we expect that Treasury and its Office of Foreign Assets Control (OFAC) will issue rules directing that banks and other financial institutions monitor payments and transactions for the presence of prohibited entities and transactions. In other words, banks will likely be deputized by the U.S. government to monitor, reject, and report on transactions violating the EO and its implementing rules.

#### **The EO Will Need to Be Implemented Through a Rulemaking Process**

The EO directs the Commerce Department and cooperating agencies to further develop definitions of key terms such as “covered telecommunications” and “information technology and services” and to provide for criteria pursuant to which countries and companies will be designated as “foreign adversaries” and “prohibited entities.” The EO defines the term “information and communications technology or services” as “any hardware, software, or other product or service primarily intended to fulfill or enable the function of information or data processing, storage, retrieval, or communication by electronic means, including transmission, storage, and display.” This is obviously very broad and would encompass a wide range of consumer, data center, internet and telecommunications infrastructure equipment, technology, and software.

Finally, the EO directs that the Commerce Department and cooperating agencies develop criteria and a process for the “negotiation of agreements to mitigate” concerns that may lead to the listing of a company or country as prohibited under the EO. Accordingly, the EO is leaving the door open for China or other countries and companies that may feel they will soon be designated under the order to negotiate terms with the United States.

For questions concerning the latest U.S. actions against Huawei, please contact the Drinker Biddle Customs and International Trade Team or your regular Drinker Biddle contact.

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