



**2017 Written Comments to the
U.S. Government Interagency Trade Policy Staff Committee
In Response to Federal Register Notice Regarding China's Compliance with its
Accession Commitments to the World Trade Organization (WTO)**

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Computing Technology Industry Association (CompTIA)

Information Technology Industry Council (ITI)

Semiconductor Industry Association (SIA)

BSA | The Software Alliance (BSA)

Telecommunications Industry Association (TIA)

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I. INTRODUCTION

We are pleased to provide input to the Interagency Trade Policy Staff Committee’s annual assessment of China’s World Trade Organization (WTO) compliance. The review provides USITO and its members with a means to recognize areas where progress has been made, raise issues of concern, and suggest approaches to resolve disagreement with China’s government over the implementation of its WTO commitments.

A. EXECUTIVE SUMMARY

INDUSTRIAL POLICY

- **China’s Industrial Policy Contradicts the Spirit of the WTO:** China’s drive to promote domestic or “indigenous innovation” is embodied across industrial policy that systematically favors Chinese products and services. A number of high-level programs, including *China Manufacturing 2025*, the *Artificial Intelligence Development Plan*, and the *Three Year Cloud Computing Action Plan*, are being implemented in an opaque fashion, creating uncertainty for multinational companies in China, and in the worst cases, serving as discriminatory import substitution.
- **Public Procurement tied to Domestic IP:** A main thrust of China’s indigenous innovation campaign are a specific set of policies that incentivize the public procurement of products with ‘indigenous’ IP. USITO advocates that China implement pro-competitive procurement policy decisions at all levels of government and ensure that procurement policies are consistent with the Agreement on Government Procurement (GPA), which China is in the process of acceding.
- **Integrated Circuit (IC) Industry Support Measures:** China seeks to develop a completely indigenous and controllable end-to-end semiconductor industry. This includes moving aggressively to implement a comprehensive program designed to localize technology through acquisition and development, market access restrictions, and other preferential policies. In particular, the *IC Promotion Guidelines* go against the Chinese government’s commitment to not directly influence commercial decisions of state-owned enterprises (SOEs) under Section 6 of the WTO Accession Protocol.

INTELLECTUAL PROPERTY (IP)

- **Patents and Licensing:** The U.S. ICT sector continues to be concerned about government interference in licensing agreements. The Chinese government has publicly articulated a policy to limit royalties for patented technologies paid to foreign companies and to promote the domestic development of essential IP. China seeks to foster the domestic development of innovative technologies and IPR in part through technology mandates or promotion of unique national standards that are then turned into technical regulations. This policy is also implemented through direct or indirect interference by Chinese authorities in licensing negotiations between Chinese and foreign technology companies. Such

interference is a dramatic departure from how business is conducted and technology transfer arrangements are concluded in the global market.

- **Enforcement:** Enforcement actions should be measured against China's commitments under the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) to provide copyright owners with "effective action against any act of infringement in intellectual property rights covered under this Agreement" (Article 41) and if the infringement amounts to "wilful trademark counterfeiting or copyright piracy on a commercial scale" to provide for criminal penalties including imprisonment and monetary fines sufficient to provide a deterrent to future acts of piracy (Article 61). Though there have been several positive IPR enforcement developments, effective criminal or civil enforcement remains wholly inadequate and unreliable.
- **Trade Secrets:** China does not currently have a standalone trade secrets law, and trade secrets remain one of the most at-risk types of IP for multinational companies in China. Article 39 of TRIPS states that members shall protect "undisclosed information" and "data submitted to governments or governmental agencies" using effective measures. To fulfill commitments to trade secrets protection and enforcement, China should follow the Best Practices in Trade Secret Protection and Enforcement Against Misappropriation as adopted by the Asia-Pacific Economic Cooperation (APEC) and develop a comprehensive trade secrets law.
- **Counterfeit Semiconductors:** Data suggests that China is a major source of counterfeit semiconductors that undermine the quality and reliability of electronics products both inside and outside of China. China's General Administration of Customs (GAC) and other law enforcement and market surveillance agencies should encourage the seizure of counterfeit products and take actions leading to the arrest of counterfeiters and counterfeit traders.

MARKET ACCESS

- **Telecoms, Cloud, and Communication & Information Services:** China's market remains problematic for companies operating in telecoms, cloud, and communications and information services. The updated 2016 Telecom Services Catalog incorrectly classifies a wide range of ICT technologies and services as telecom value-added services subjecting multinational firms to explicit limitations on market access. Cloud computing, despite being identified as an area of strategic development in China, remains largely off limits to foreign ICT companies, due to several policy challenges, including equity caps, investment restrictions, connectivity requirements, and market entry barriers. Similar barriers exist in for providers of content delivery networks and information services, such as interactive online platforms. On top of these concerns, the Chinese government continues to expand control of communication and information services, including through censorship.
- **Technical Standards:** China is aggressively implementing and utilizing technical standards to support development of key industries, especially in the ICT industry. Challenges for USITO members include China's development of indigenous standards that (i) aim to displace global standards when mandated, (ii) create

significant interoperability issues because they possess important diversions from global standards, (iii) lack sufficient safeguards to protect the IP at issue in standards-setting activities, and (iv) are developed without adequate transparency and participation rights for foreign companies. Furthermore, voluntary standards often are made mandatory through various administrative measures, and without sufficient notice to foreign companies. USITO encourages China's government to adopt technology neutral policy and let the market select technology and standards.

- **Cybersecurity:** With the *Cybersecurity Law* coming into force on June 1, 2017, USITO has been closely monitoring the release of related implementation measures in addition to tracking existing concerns with the law. The law imposes a number of cybersecurity restrictions on a broad array of activities, including imposing restrictions on the cross border movement of data for network operators and operators of critical information infrastructure. China's broad definition of critical information infrastructure will impose significant burdens on companies whose activities fall under China's expansive scope. Problematic implementing measures or programs include the *Cybersecurity Review Regime*, the retroactively implemented *Cyber Critical Equipment and Cybersecurity Specific Product Catalogue*, and *Commercial Encryption Regulations* and a Draft *Cryptography Law* that do not align with international encryption principles.

NATIONAL TREATMENT

- **Government Procurement:** While China's trade partners have made considerable efforts to persuade China to join the Agreement on Government Procurement (GPA), China is not yet a party and has been unenthusiastic in meeting its binding commitment to join the GPA. China was accepted as an observer to the GPA on February 21, 2002. USITO advocates clear and steady improvements in government procurement policy, building toward accession to the GPA as soon as possible.
- **Environment and Energy Efficiency Regulations and Standards:** USITO has provided feedback to Chinese ministries and agencies on a number of issues that are in violation of WTO commitments, including environmental regulations, product energy efficiency standards, and eco-design related products standards. In particular, USITO has concerns regarding the Restriction of Hazardous Substances (RoHS) and the Waste Electrical and Electronic Equipment Directive (WEEE Directive).

CUSTOMS

- **Information Technology Agreement (ITA) Expansion:** The expanded ITA now covers an additional 201 products, including next-generation semiconductors known as multi-component semiconductors (MCOs). However, in January, China temporarily increased tariffs on some MCO product lines, in apparent violation of its ITA commitments. USITO urges the Chinese government to issue an immediate tariff adjustment to provide duty-free treatment for MCOs and any other ITA-covered product consistent with China's ITA commitments.

- **Customs Valuation and Trade Facilitation:** As part of its WTO accession agreement, China agreed to implement its obligations under the Agreement on Customs Valuation (GATT Article VII) upon accession, without any transition period. It is USITO's experience that China is deviating from requirements by using an outdated and arbitrary pricing methodology for valuation, questioning the transaction value of imports, and conducting customs valuation determinations in a way that is not transparent and varies from port to port.
- **Customs Implementation:** Inconsistent, inefficient, and opaque customs rules and procedures contradict the direction of China's WTO commitments to a trading regime that fosters harmonization, transparency and simplified customs formalities. Key concerns include (i) vague and inconsistent regulations, (ii) difficulty in addressing or resolving regulatory issues with Chinese customs officials, (iii) limited customs working hours on weekdays and on weekends, (iv) reliance on paper declarations, and (v) simplification of bonded goods between special supervision zones.

II. INDUSTRIAL POLICY

A. CHINA’S INDUSTRIAL POLICY CONTRADICTS THE SPIRIT OF THE WTO

China’s drive to promote “indigenous innovation” is embodied across industrial policy that systematically favors Chinese products and services. A number of high-level programs are being implemented in an opaque fashion, creating uncertainty for multinational companies in China, and in the worst cases, serving as discriminatory import substitution. In the 13th Five Year Plan period (2015-2020), China continues to emphasize indigenous development and import substitution of key technologies related to cloud computing, the Internet of Things, and Big Data. Chinese industrial policy also contradicts the spirit of the WTO by promoting “going out” and “national champions”. The following high-level plans call for China to develop internationally recognized brands in certain industries, while these industries are increasingly, or completely, closed to foreign participation.

China Manufacturing 2025: This industrial policy maps out China’s road to becoming a strong manufacturing nation, and emphasizes indigenous innovation and domestic companies in upgrading manufacturing. The plan includes domestic market share targets in industries such as mobile equipment, mobile chips, operating systems & industrial software, industrial control systems, robotics parts and products, and autonomous vehicles.

Artificial Intelligence (AI) Development Plan: This ambitious plan aims for China to become a world leader in AI technology by 2030, and includes support for components (such as semiconductors) and end-uses of AI (such as telecoms, big data and cloud computing). The latter are areas where multinational companies are prohibited from conducting business. Being barred from these industries means that multinational companies are being locked out of the ecosystem for AI systems, blocking access to a core AI market estimated to be worth more than RMB 1 trillion by 2030.

Cloud Computing Three Year Action Plan: This plan sets targets for cloud research and development (R&D), standards development, and cybersecurity to be reached by 2019. The plan also promotes cloud applications in areas like the automobile industry, where foreign participation is already limited. The plan states that China’s cloud computing industry will grow to RMB 430 billion by 2019, and currently foreign companies are not able to capture that market share outside of providing technical expertise to domestic cloud companies.

B. PUBLIC PROCUREMENT TIED TO DOMESTIC IP

A main thrust of China’s indigenous innovation campaign are a specific set of policies that incentivize the public procurement of products with ‘indigenous’ IP. In 2011, the Ministry of Finance (MOF) and Ministry of Science and Technology (MOST) each repealed key indigenous innovation policies, which industry generally viewed as a positive development. While the central government has reiterated China’s commitment to openness, some local governments continue to implement government procurement

policies that favor products developed with local IP, or even products with IP from a particular province or municipality, over foreign ones.

Transparent, merit-based, technology neutral, non-discriminatory and pro-competitive procurement ensures that the government as a user of technology obtains the best goods and services for the best value. Limiting government procurement to indigenously developed products, whether defined by nationality of IP ownership, security and controllability, or any other factors, fails to appreciate the truly global and cross-border nature of innovation and product development. USITO advocates that China implement pro-competitive procurement policy decisions at all levels of government and ensure that procurement policies are consistent with the Agreement of Government Procurement (GPA) which China is in the process of acceding.

C. INTEGRATED CIRCUIT (IC) INDUSTRY SUPPORT MEASURES

China seeks to develop a completely indigenous and controllable end-to-end semiconductor industry. This includes moving aggressively to implement a comprehensive program designed to localize technology through acquisition and development, market access restrictions, and other preferential policies. The program was introduced through the *IC Promotion Guidelines* publicly announced in June 2014 (several months after it was made available to domestic stakeholders). Shortly after, the central government confirmed the establishment of a RMB 138 billion central government equity investment fund, or the National IC Fund. Since then dozens of local funds have also been established by provincial and municipal governments.

This funding has partly gone towards rapid construction of semiconductor fabrication plants (or fabs) throughout China. For example, Tsinghua Unigroup established a memory technology partnership with the National IC Fund and the Hubei Provincial Government called Yangtze River Storage Technology Co. The company is the parent company of Wuhan XMC, which received national funding to build a \$24 billion memory-chip fab in the city of Wuhan.

There is widespread concern that the combined effect of the central and regional government funds could prove disruptive to the global IC market, unfairly propping up Chinese companies and potentially leading to overcapacity. Thus far, the program and related policies have been developed and implemented in a manner that lacks transparency. The *IC Promotion Guidelines* go against the Chinese government's commitment to not directly influence commercial decisions of SOEs under Section 6 of the WTO Accession Protocol.

USITO advocates that foreign governments and industry be able to provide input on all elements of China's IC promotion efforts and investment funds before they are fully implemented. In addition, the plan and IC investment funds, at the central and regional levels, should be fully in line with China's commitments to the World Trade Organization (WTO), APEC, and the World Semiconductor Council Government/Authorities Meeting on Semiconductors (GAMS), among other forums.

III. INTELLECTUAL PROPERTY RIGHTS

A. PATENTS AND LICENSING

The U.S. ICT sector continues to be concerned about government interference in licensing agreements. The Chinese government has publicly articulated a policy to limit royalties for patented technologies paid to foreign companies and to promote the domestic development of essential IP. China seeks to foster the domestic development of innovative technologies and IPR in part through technology mandates or promotion of unique national standards that are then turned into technical regulations. This policy is also implemented through direct or indirect interference by Chinese authorities in licensing negotiations between Chinese and foreign technology companies. Such interference is a dramatic departure from how business is conducted and technology transfer arrangements are concluded in the global market.

3G Essential IP: MIIT has effectively precluded foreign companies that own essential IPR for third-generation (“3G”) wireless communications standards from negotiating technology licenses and royalty agreements directly with Chinese companies, which is the customary business practice globally. Rather, at the risk of being denied access to the Chinese market, foreign companies have been pressured to enter into negotiations involving royalty rates and other licensing terms with a committee led by the China Academy of Information Communications Technology (CAICT), a government institution subordinate to MIIT.

These governmental practices are inconsistent with the fundamental rights conferred by patent to technology owners and constitute an expressed violation, or at least nullification or impairment, of TRIPS patent provisions. Chinese government-imposed limitations on 3G royalties operate as impermissible price controls that are not authorized under China’s protocol of accession to the WTO. USITO is closely monitoring China’s commitments of non-interference on commercial contracts including but not limited to royalty negotiations, licensing agreements, and mandating of standards are not being honored.

A new area in which USITO members face challenges is technology licensing for information security and cryptography standards. Chinese *Commercial Encryption Regulations* require that only government-approved algorithms be adopted by industry, yet many of the essential IPR, technology usage, and licensing guidelines for these standards have not been made public. Foreign firms are at a disadvantage by not being aware of key technology licensing agreements for mandatory national standards.

There have been no signs of any change in China’s policy on this issue since the 2004 Joint Commission on Commerce and Trade (JCCT) meeting, where China promised not to interfere in royalty negotiations at least for 3G licenses. The U.S. government should continue to press China on this matter by (i) clarifying that its 2004 commitment extends to all government and quasi-government personnel, and is not limited to “Chinese regulators” alone; and (ii) expanding that commitment, based on WTO requirements so that it does not apply solely to 3G licenses. Interfering in royalty negotiations violates fair trade and allowing market demand to determine prices for such IP. Chinese manufacturers should be permitted to negotiate directly with foreign IP holders. Otherwise, the PRC government will continue to find ways to interfere in royalty negotiations.

Refusal to License: The ability for dominant (successful) companies to unilaterally and unconditionally refuse to license their IP (in the absence of an obligation to do so) should be preserved. The purpose of granting IP rights is to enable an IPR holder to control technology so that it can secure an adequate return on one's investment in developing and commercializing the invention at issue. Indeed, Article 28 of TRIPS makes it clear that the right to exclude others from the invention is fundamental to and a lawful and proper exercise of IPR.

- Article 17(b) of the State Administration for Industry and Commerce's (SAIC's) *IP Guidelines for Anti-Monopoly Enforcement* would prohibit an unconditional, unilateral refusal to license IPR when the refusal "will cause [the potential] licensee not to be able to compete effectively and negatively affect competition and innovation in the relevant market." Among other possible conduct, Article 11 of the guidelines defines "negative impact to competition" as refusing to license IPR to "control technologies and other resources." Chapter 6 of China's *Patent Law* also currently permits compulsory licensing when a patentee has failed to sufficiently exploit the patent, without providing guidance as to how "sufficient exploitation" would be determined.
- Some of the existing provisions in Chapter 6 of China's *Patent Law* do not comply with all compulsory licensing restrictions in Article 31 of TRIPS. For instance, Article 49 of the law permits compulsory licensing when it is in the "public interest" without defining those words. The substantive grounds referred to in TRIPS Article 31 which governs compulsory licensing are very narrow; they include "national emergencies or other circumstances of extreme urgency," but not the general "public interest" recited in Article 49. In China, "public interest" might be defined very broadly.
- This same issue also is raised by Article 52 of the *Patent Law*, which allows compulsory licensing of semiconductor technology in the "public interest," even though TRIPS Article 31(c) makes it clear that compulsory licensing "in the case of semiconductor technology shall only be for public non-commercial use or to remedy a practice determined after judicial or administrative process to be anti-competitive." The important and limiting term "public non-commercial use" in TRIPS Article 31(c) is significantly more restrictive than the "public interest." As a final example, under TRIPS Article 31(h) compensation needs to be based on "the economic value of the authorization."
- Article 57 of the *Patent Law* proscribes for an award of "reasonable royalties" for a compulsory license grant. There is no rationale for a patent holder to receive less compensation under Article 57 than under Article 65 just because, for example, the patent is deemed important (e.g. for public health). Rather, it is equally important, indeed more so, that compulsory license awards fully compensate the patent holder for losses as required by Article 31(h) of TRIPS. China is in the midst of amending its patent law for the fourth time. The State Intellectual Property Office (SIPO) should use this opportunity to close the gaps between the significant TRIPS restrictions on compulsory licensing and the Patent Law's compulsory licensing provisions.

Service Invention Regulations (SIR): In April 2015, the Legislative Affairs Office of the State Council (SCLAO) published a draft of the *Service Invention Regulations* for public comment that broadened the scope of inventions requiring remuneration, increased minimum payment amounts, and imposed additional administrative requirements on employer remuneration programs. In October 2015, the *Law on Promoting Commercialization of Scientific and Technological Achievements* was amended to require that revenue from the investment, sale, or licensing of research results, including unpatented ideas, be divided equally among contributing personnel if the employer had not previously established a reward mode and amount in consultation with staff. These requirements are rigid and administratively burdensome.

IP and Standards: In April 2015, the State Intellectual Property Office (SIPO) issued another revision of amendments to China's *Patent Law*, including Article 82 on the disclosure of Standard Essential Patents (SEPs). Article 14 states that the exercise of patent rights "shall comply with good faith principles," and not "harm public interests," "improperly exclude or restrict competition," or "impede the advancement of technology." Otherwise, such conduct is deemed as an abuse of IP.

IP abuse is a concept rooted in competition law, not patent law. The broad principles in Article 14 dealing with good faith, public interests and the advancement of technology have no limiting parameters. This is not in compliance with the relevant requirements in TRIPS and could be used to force technology transfer from successful foreign ICT companies to emerging domestic competitors. USITO submitted comments on the draft but were disappointed to see that in the revised draft released by SCLAO on December 2, 2015, few revisions had been made.

Another key concern is the development of technical standards, and the protection and disposal of IPR in drafting China's standards. TRIPS obliges signatories to protect private IPR. The most recent version of the *Patent Law* includes an article (Article 82) requiring compulsory licensing of patents in standards in the event of non-disclosure in the standards formulation process, causing foreign companies to question the safety of their IP. This article should be deleted from the *Patent Law* in order for China to be compliant with the TRIPS agreement.

Utility Model Patents (UMPs): The low level of inventiveness and the lack of substantive review for utility model patents in China create the potential for the emergence of a patent assertion entity (PAE) problem. The issuance of utility model patents is growing dramatically because they are quick, easy and inexpensive to obtain. The problem is compounded by shortcomings in the enforcement system; and by subsidies and quotas that encourage the filing of UMPs merely to raise patent numbers regardless of quality or the innovative contribution. We urge consultations with industry and other governments to investigate remedies to this potential problem. This type of IPR abuse violates TRIPS, specifically articles 8.2 and 40. Two options to remedy this would be to amend Article 40 of the Patent Law to request prior art search and substantial examination of UMP applications, or to revise current *Patent Law* Article 22.3 to raise the examination criteria for inventiveness for UMPs to the same level as that for invention patents.

B. ENFORCEMENT

Enforcement actions should be measured against China's commitments under TRIPS to provide copyright owners with "effective action against any act of infringement in intellectual property rights covered under this Agreement" (Article 41) and if the infringement amounts to "wilful trademark counterfeiting or copyright piracy on a commercial scale" to provide for criminal penalties including imprisonment and monetary fines sufficient to provide a deterrent to future acts of piracy (Article 61).

Though there have been several positive IPR enforcement developments, including the adjustment of thresholds and penalties for IPR infringement and cooperation of courts and law enforcement agencies, effective criminal or civil enforcement remains wholly inadequate and unreliable. When China entered the WTO, China agreed to maintain fair, impartial, and objective judicial review (Article X: 1 of GATT and TRIPS), however, China has failed to uphold those obligations in IP courts.

USITO advocates for China to take concrete steps to carry out its original 2006 commitment, a commitment that has been repeated each year without much progress, by purchasing and using licensed software without discriminating between Chinese and foreign producers and products. The current IPR environment for software suffers from slow, cumbersome, and ineffective enforcement, as well as insufficient penalties and fines.

USITO believes that adequate attention, investment, and training by enforcement agencies, including the Public Security Bureau (PSB), are essential to improving the IPR environment for software. Although Chinese authorities have undertaken some administrative enforcement actions against infringing entities, the lack of transparency with regard to sharing information about actions against infringers makes it impossible for rights-holders to accurately assess the real impact of China's enforcement efforts.

Finally, the IPR provisions in the Criminal Code have not been revised since 1997, even after China joined the WTO in 2001, and even though other key IPR laws, including the *Patent Law*, *Trademark Law*, and *Copyright Law*, have been amended to bring them into compliance with China's TRIPS commitments. IPR provisions in the Criminal Code should be revised to be fully compliant with TRIPS—most importantly, to provide criminal penalties "that are sufficient to provide a deterrent" (TRIPS, Art. 61) against piracy and counterfeiting.

For example, Chinese courts currently interpret the "for profit" requirement that exists under Article 217 of the Criminal Code in a manner that is significantly narrower than the "on a commercial scale" requirement of Article 61 of TRIPS. As a result, it is effectively impossible to obtain criminal remedies against corporate end user software piracy (despite the clear commercial impact and purpose of such piracy), hard disk loading software piracy, and online software piracy. Such loopholes should be fixed either by amending the IPR provisions in the Criminal Code or by clarifying its scope in a new judicial interpretation. Otherwise, China will continue to violate its obligations under Article 61 of TRIPS to provide criminal remedies "sufficient to provide a deterrent" to these forms of commercial-scale piracy.

USITO advocates that Chinese authorities refrain from further expanding administrative power in civil patent disputes and instead focus on improving quality in the new amendment to the *Patent Law* and impartial and objective ruling in the judicial system.

C. TRADE SECRETS

China does not currently have a standalone trade secrets law, and trade secrets protection remains under the purview of the Anti-Unfair Competition Law (AUCL) and parts of China's Criminal Law. Trade secrets protection and enforcement is a key concern for USITO companies who have long called for the development of a comprehensive trade secrets law to protect information with commercial value. Furthermore, trade secrets remain one of the most at-risk types of IP for multinational companies in China as government approvals and regulatory compliance often require unnecessary information disclosure.

Article 39 of TRIPS addresses the protection of "undisclosed information," or trade secrets, by stating that members shall protect undisclosed information and "data submitted to governments or governmental agencies" using effective measures. In 2016, the Asia-Pacific Economic Cooperation (APEC) Leaders and Ministers endorsed Best Practices in Trade Secret Protection and Enforcement Against Misappropriation which included eight markers for better protection and enforcement of trade secrets.¹

As summarized by the U.S. Trade Representative best practices include:²

- Broad standing to claims for the protection of trade secrets and enforcement against trade secret theft;
- Civil and criminal liability, as well as remedies and penalties, for trade secret theft;
- Robust procedural measures in enforcement proceedings; and
- Adoption of written measures that enhance protection against further disclosure when governments require the submission of trade secrets.

In order to fulfill commitments to trade secrets protection and enforcement, China should deliver on the best practices as outlined above, and take strides in developing a standalone trade secrets law.

D. COUNTERFEIT SEMICONDUCTORS

Counterfeit semiconductors pose risks to health and safety wherever they are used worldwide and result in the loss of IP for the original manufacturer eroding sales of legitimate products and causing economic damage. While semiconductor companies rely on patents, copyrights, and trademarks to protect much of their IP, semiconductor layout design protection provides unique legal rights that are particularly useful in certain circumstances. This form of protection is specifically included in the TRIPS

¹ Best Practices in Trade Secret Protection and Enforcement Against Misappropriation <https://ustr.gov/sites/default/files/11202016-US-Best-Practices-Trade-Secrets.pdf>

² <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2016/november/obama-administration-welcomes-apec>

agreement as a separate category. China adopted regulations to protect semiconductor mask work (layout design) IP in 2001. As China's market and industry continue to grow, the successful implementation of this law is increasingly important.

The China Semiconductor Industry Association (CSIA) is a member of the World Semiconductor Council (WSC) and an active participant in the Anti-Counterfeiting Task Force. Through this task force, the WSC has laid out a position on the implementation of national layout design laws (such as clarifying the law in light of recent improvements in automated design tools that allow semiconductor layout designs to be made by copying a protected layout design with virtually no intellectual effort), and measures to improve patent quality in the six WSC regions.³

Data from the member companies of the Semiconductor Industry Association (SIA) and other sources has shown that semiconductor counterfeiting is a major issue. Data also suggests that China is a major source of counterfeit semiconductors that undermine the quality and reliability of electronics products both inside and outside of China.

Counterfeits can be purchased openly at electronics malls in China. In January 2014, a co-conspirator in a scheme to traffic counterfeit goods into the United States pled guilty for his role in bringing 289 shipments of counterfeit integrated circuits (ICs) from China. The U.S. Attorney's Office in the State of Maryland that handled the case found that the defendant imported all of the counterfeit ICs with the help of co-conspirators based in China.

China's Customs Agency and other law enforcement and market surveillance agencies should encourage the seizure of counterfeit products and take actions leading to the arrest of counterfeiters and counterfeit traders.

IV. MARKET ACCESS AND TECHNICAL BARRIERS TO TRADE

A. TELECOMS, CLOUD, AND COMMUNICATIONS & INFORMATION SERVICES

Expansion of Telecom Services Regulations: In March 2016, a new *Telecom Service Catalog* went into effect, expanding the scope of China's telecoms regulation and imposing a host of associated market access restrictions on foreign firms in activities not typically regulated as telecom in the rest of the world. The measures incorrectly classify a wide range of ICT technologies and services as telecom value-added services, when in fact they are computer or business services that utilize the public telecom network as a method of delivery. For example, the catalogue classified cloud computing, content delivery networks and online interactive platforms (called information services) as telecommunications services. Foreign firms that provide value-added services in China can only operate through joint ventures, of which they may own no more than 50%. In short, because of the update, foreign firms that provide a range of ICT services, are now subject to explicit limitations on market access, and indirectly, mandatory technology transfer to the local partners of joint ventures.

³ The World Semiconductor Council currently is composed of the European, Japanese, Chinese Taipei, Korean, Chinese, and U.S. semiconductor industries.

Since China committed under the General Agreement on Trade in Services (GATS) not to restrict market access for computer-based offerings, the inappropriate classifications outlined in the Catalog revision violate its WTO obligations. The new provisions likewise fail to uphold the principle of “acquired rights,” China’s commitment that foreign service suppliers who enjoyed certain rights prior to its WTO entry would have those rights preserved after accession.

The impact of the Catalog has been especially severe for foreign providers of cloud computing, a key growth market for technology firms and one in which U.S. companies have already staked out a leading role. The *Catalog* classifies cloud computing as a type of Internet data service, which means vendors must obtain that specific license to operate. Multinational companies are not able to procure Internet data center licenses. China committed upon WTO accession not to use licensing procedures as a barrier to market access, to offer national treatment, and not impose requirements that are more trade restrictive.

The catalog also violates WTO jurisprudence that a service cannot fall under two sub-sectors of the same regulation. USITO has compiled a list of services in the new *Telecom Services Catalog* that are inconsistent with established WTO jurisprudence:

- Audio, video, and application software is improperly identified in category B25 as an information service when it should remain under China’s existing WTO Service Schedule Category 2.D, or Audio/Visual Services. Under this category, there are no limitations on the percentage of equity that a foreign service supplier may hold in a joint venture.
- The catalogue distinguishes between domestic VPN (B-13) and International VPN services (A-14-4), classifying the former as Value Added Telecom Service and the latter as a more restrictive Basic Telecom Service.

The improper identification of services, paired with existing restrictions on foreign investment in value added telecoms services (VATS), unfairly handicaps foreign ICT companies in China. USITO recommends that China remove restrictions on VATS in accordance with international norms, including eliminating equity caps for foreign companies.

Cloud Market Access: Cloud computing, despite being identified as an area of strategic development in China, remains largely off limits to foreign ICT companies, due to several policy challenges, including equity caps, investment restrictions, connectivity requirements, and market entry barriers.

In September 2014, the China National Information Security Standards Technical Committee (TC260) approved and formally released two standards that are designed to establish a security framework for public sector cloud computing deployments in China. These standards are likely to become mandatory for government procurement, along with critical infrastructure systems under the Multi-level Protection Scheme (MLPS) regime. USITO recommends that the Chinese government provide greater clarity and opportunities for participation on standards and regulations related to cloud computing.

China's deployment of cloud computing technologies will be better facilitated by adopting global standards and policies that reflect the international and borderless nature of this emerging industry.

MIIT's release of the draft *Notice on Regulating Business Behaviors in the Cloud Service Market* at the end of 2016 introduces an unprecedented level of government interference into the operations of cloud service operator partnerships, without articulating the rationale for why these restrictions might be necessary, or how they would benefit China's market economy. This regulation has systematically increased restrictions on the ability of foreign cloud service providers to not only participate on equal terms within the China market, but also their ability to partner on reasonable terms with Chinese companies. USITO recommends removing these requirements.

Communications & Information Services Regulations:

In addition to the market access restrictions, the protection of the rights of value-added service (VAS) providers in China's market is insufficient. First, it is critical for VAS providers to have access to basic telecommunications network elements on reasonable terms and on a non-discriminatory basis. In light of the limited competition in China's market and the fact that its three principle carriers are state-owned, the Chinese government has an important responsibility to ensure adherence to the principles laid out in the GATS Annex on Telecommunications. Furthermore, China should eliminate the FDI restrictions and JV requirement for VAS licenses to stimulate competition and ease market access for foreign providers.

In addition to the market access restrictions on new services created by China's expansive Telecommunications Services Catalogue, China imposes even greater restrictions on any entity seeking to provide traditional, or "Basic," telecommunications services in China. In order to obtain a license to provide basic telecommunications services, a foreign company must enter into a partnership with one of China's State Owned incumbent carriers, limit its investment to 49% equity, and obtain approval from MIIT. In addition, China imposes unreasonably high capitalization requirement for basic telecommunications services. Basic services licenses are subject to a USD 163 million joint venture capitalization requirement, which is 100 times larger than the joint venture capital requirement for China's VAS licensees, and comprises an excessively burdensome restriction that violates Article VI of the GATS. China has already established a precedent for lowering its foreign joint venture capitalization thresholds in other sectors, including insurance and trading companies, and it should now remove this barrier to market access in the telecom sector.

Furthermore, China has not implemented its WTO Reference Paper commitment to establish an independent regulator. The Chinese government still owns and controls all major operators in the telecommunications industry, and the MIIT still regulates the sector. China should establish a regulatory body that is separate from, and not accountable to, any basic telecoms supplier, and that is capable of issuing impartial telecom decisions and rules. Specifically, it is important that the regulatory body adopts the following:

- Transparent procedures for drafting, finalizing, implementing, and applying regulations and decisions;
- Appropriate measures, consistent with the WTO Reference Paper to prevent dominant suppliers from engaging in, or continuing, anticompetitive practices;
- A defined procedure – as it has done for interconnection – to resolve public telecom suppliers' commercial disputes over their agreements efficiently and fairly;
- An independent and objective process for administrative reconsideration of its decisions; and
- Appropriate procedures and authority to enforce China's WTO telecom commitments, such as the ability to impose fines, order injunctive relief, and modify, suspend, or revoke a license.

Shanghai Free Trade Zone (FTZ): While the Shanghai Free Trade Zone does offer some benefit to foreign investors in the ICT sector, the scope of market liberalization is narrow, which limits the commercial benefits for foreign investors. USITO supports including further increases in FDI limits for services delivered over the Internet and the removal of FDI restrictions on data centers in the SFTZ, among other actions.

Increased Control over Internet: Revisions to the *Internet Information Services Administrative Measures* are viewed as unnecessary regulations that hinder foreign business in China. In June 2016, the Cyberspace Administration of China (CAC) released regulations on Internet service providers and mobile application and requires real-name ID registration for users, government access of data, data retention, content filtering and data privacy. Country-specific regulation relating to the creation, release, and transmission of certain types of content can constitute trade barriers for global Internet services companies. More specifically, the draft revised Measures would hold telecom and other Internet service providers liable for all content passing through their respective networks and their products.

China's actions in the area of Internet policy and regulation may influence other governments to adopt heavy-handed policies that ultimately stunt the growth of the Internet and innovative capacity of Internet service providers (ISPs) and Internet content providers (ICPs) to contribute to the growth of cyberspace. We strongly believe that a global, borderless, and industry-centered approach is the only way to effectively manage the growth of the Internet while minimizing burdens that may stunt its development. Internet censorship violates WTO trade obligations because it restricts market access for foreign Internet companies.

B. TECHNICAL STANDARDS

China is aggressively implementing and utilizing technical standards to support development of key industries, especially in the ICT industry. Challenges for USITO members include China's development of indigenous standards that (i) aim to displace global standards when mandated, (ii) create significant interoperability issues because they possess important divergences from global standards, (iii) lack sufficient safeguards

to protect the IP at issue in standards-setting activities, and (iv) are developed without adequate transparency and participation rights for foreign companies. Furthermore, voluntary standards often are made mandatory through various administrative measures, and without sufficient notice to foreign companies. While understanding China's desire to grow its ICT sector, we encourage China's government to adopt technology neutral policy and let the market select technology and standards.

Chinese regulators and standards development organizations' lack of adherence to the Agreement on Technical Barriers to Trade (TBT Agreement) Code of Good Practice, both from the perspective of content of technical standards and notifications to the TBT Agreement, presents significant challenges for foreign industry. Industry has observed repeated instances of China's standards authorities implementing standards that favor domestic technologies and were developed without full opportunity for participation from relevant stakeholders (including foreign ICT companies).

USITO encourages China to adopt the multi-path approach to the development of international standards, rather than relying exclusively on the ISO, IEC, and ITU. World-class standards are today developed by a variety of standards development organizations and industry consortia, including organizations that have achieved global prominence because of the international relevance and the broad range of participation in development of their standards. Examples include the Institute of IEEE, the Internet Engineering Task Force (IETF), and the Worldwide Web Consortium (W3C).

The WTO has outlined requirements for organizations that seek to be considered as developers of international or global standards, and we encourage China to recognize the broader WTO definition of "international standardization bodies or systems" contained in Annex 1 of the TBT Agreement, which includes any standardization body that is open to all WTO members and meets the criteria set forth in the Decision of the TBT Committee on Principles for the Development of International Standards that is contained in Annex 4 to the Second Triennial Review of the Operation and Implementation of the Agreement on Technical Barriers to Trade.

In addition, the implementation of 'voluntary' standards as 'mandatory' standards, often times through the conformity assessment process, is a significant impediment for U.S. companies' growth in the China market. These barriers continue to lead to the significant delay in the introduction of cutting edge U.S. ICT products to the China market as firms are forced to navigate the standards process. More importantly, adoption of both mandatory and voluntary China-specific national and industry standards impedes innovation by restricting both the ability of Chinese companies to serve other markets as well as foreign importers to serve domestic markets.

We strongly advocate for the principle of national treatment by China, so that foreign companies have the same access to and voting rights in Chinese standards setting bodies as Chinese companies, and ensure that there is no "presumption of participation" in Chinese standards setting laws, rules or administrative regulations that would allow the Chinese government to unfairly procure the IP of foreign companies on non-market or royalty free terms. Additionally, to the extent such mandatory and voluntary Chinese standards unnecessarily deviate from relevant and effective international standards, as they often do, China potentially violates its commitments under Articles 2.2 and 2.4 of

the WTO TBT Agreement and Paragraphs E and F of the TBT Agreement Code of Good Practice, respectively.

We urge that foreign-owned enterprises be permitted – and encouraged – to participate in Chinese standards-development efforts on an equal and non-discriminatory basis. The global practice for the development of standards has been an open, interactive process, in which enterprises from around the world can openly participate. The openness of these processes helps account for their undeniable commercial effectiveness and helps ensure that any national standard is not more trade restrictive than necessary. We believe that fair, open, and equal access to participation, including the right to vote, in standards development efforts by Chinese and non-Chinese enterprises alike will result in superior Chinese standards and superior Chinese proposals for consideration by global standards bodies.

Finally, the TBT Agreement Code of Good Conduct, calls for a 60-day comment period and mandatory reply to all comments received by domestic and international stakeholders. China has demonstrated its ability to provide for 60-day comment periods in some circumstances, which reinforces our concerns that many of China's ICT standards had comment periods of 30 days, hardly sufficient to facilitate translation and expert review of the standard. In addition, USITO has almost without exception never once received a written response to any formal comments submitted to the Chinese government.

Enterprise Standards: Enterprise standards and its related measures, as outlined in the most recent version of the *Standardization Law*, are not only unique to China, but also represent an unprecedented overlap between consumer protection concepts and the legal framework for a healthy standardization system. Enterprise standards, as described in the law, are an individual company's proprietary product or services specifications. This is highly proprietary, confidential information that often is protected by a range of intellectual property rights (including patents, copyrights and trade secrets). While the most recent draft of the *Standardization Law* merely "encourages" businesses to disclose enterprise standards (Article 27), we are concerned that some officials may still interpret disclosure as mandatory.

There is no country in the world that requires public disclosure of comprehensive lists of standards which are implemented in products or services. Industry participants do make limited standards disclosures to the extent required to adhere to customer procurement requirements or for limited marketing purposes, but never more expansive or comprehensive lists. Implementation decisions vary from product to product, and the engineering and legal verification overhead for such a disclosure requirement would be extremely burdensome and act as a disincentive to market participation.

WTO Obligations: As industry has noted in response to consultations on drafts of the *Standardization Law*, it is important to keep in context that signatories to the WTO should create legal and policy frameworks for standardization that adhere to the Technical Barriers to Trade Agreement. The current draft of the China *Standardization Law* does not sufficiently establish the legal framework for central government

standardization efforts to adhere to the WTO TBT. In addition, development of all national and industry standards must include a period of at least 60 days for the submission of comments by interested parties (TBT Annex 3, paragraph L) and the draft law should encourage inclusion of a 60-day comment period for all other standards developed (TBT article 4.1).

C. CYBER SECURITY POLICY

No other major economy has a similar review mechanism in place that governs the transaction of commercial ICT products within the private sector.

Cybersecurity Law: The *Cybersecurity Law*, promulgated in November 2016 and effective in June 2017, covers ICT product and service reviews and certifications, data privacy and localization regulations, cyber-security standards, data-breach, data residency, and cross-border data transfer requirements. The broad scope and far reach of the law creates undue burden on commerce without meaningfully improving China's cybersecurity. Key terminology in the law, such as "secure and trusted," "important business information," "critical information infrastructure," "network operator," and "critical networks," are left broad and vaguely defined, and are further not defined or clarified in the implementation measures, making the law and subsequent implementation measures unenforceable and open to interpretation.

The law imposes significant constraints and regulatory burdens on companies' ability to transmit data outside of China, creates a data localization requirement and discriminates against global companies across economic sectors operating in China. The law establishes data localization for network operators and operators of Critical Information Infrastructure. While the data restrictions for network operators are more flexible and establish a self-assessment framework for transferring data out of China, China's draft implementing regulations for operators of critical information infrastructure indicate that China is going to take a broad view of what constitutes critical information infrastructure and will include things like cloud computing and big data. Given that cloud computing and big data analytics are increasingly becoming critical components in the new and innovative services across an array of economic sectors, China's approach will result in unreasonable and discriminatory requirement for non-Chinese suppliers of services in the Chinese market. If China chooses to move forward with strict data localization requirements for operators of critical information infrastructure, it should narrowly define the scope of CII to national security critical operations and create a more flexible framework around which operators of CII can transmit data outside of China. This is particularly important as the global market for the Internet of Things continues to develop and becomes incorporated in the operations of companies across different industries.

The law calls for the universal implementation of the Cybersecurity Classified Protection Scheme (CCPS) (previously known as Multi-Level Protection Scheme, "MLPS"), which classifies all information systems, and at level 3 or higher (level 1 is least sensitive, 5 is of highest sensitivity) restricts the use of foreign security technology. Each CCPS level comes with its own specific product and management requirements. For example, information security products in information systems classified at level three and above

are required to have core technology with independent IPR in China, undergo a national information assurance certification, and the product developers and manufacturers must be invested or owned by Chinese citizens or legal persons. According to the law, critical information infrastructure (CII) should be given prioritized protection on top of CCPS and are selected from CCPS 3 or higher level information systems, which means that CII has restrictions for the use of foreign security products.

In addition, encryption requirements in the original MLPS measures may include the mandatory use of Chinese encryption algorithms or divulgence of cryptographic source code. A myriad of information systems, such as those in banks and power utilities (which have been regular customers of foreign suppliers of information security products) are classified at level three. Because of the onerous testing requirements involved in obtaining that classification (such as forced disclosure of source code), many foreign security products will likely be excluded from those “critical infrastructure” systems.

Analysis done by USITO's parent associations demonstrates that a large swath of Chinese commercial infrastructure is under the jurisdiction of MLPS. ITI estimates that MLPS likely covers 60-70%, or \$35.2 billion-\$41.0 billion, of China's \$58.6 billion total 2010 enterprise and public sector IT spending. This estimate is based on an analysis of the vertical industry sectors in the apparent scope of MLPS – banking and finance; local and central government; insurance; health care; power distribution; aviation and transportation; oil and gas; education; and news and media – and their approximate percentage of the Chinese economy.

This violates the Trade Related Investment Measure (TRIMs) and infringes GATT Articles III and XI. These articles clearly state that discrimination of imported products and the creation of import restrictions in the form of local content requirements that are discriminatory in nature are in direct violation of the TRIMs Agreement. USITO is concerned that MLPS will gradually be expanded to new fields such as cloud, big data, IoT, and industrial control systems if the problem is not addressed now.

Cybersecurity Review Regime: In May 2017, the Cyberspace Administration of China (CAC) officially released the *Interim Security Review Measures for Cyber Products and Services* which have been in the works since 2014. The review examines important cyber products and services procured for use in networks and information systems related to national security and focuses on the “security and controllability” of the product or service.

Under this regime, the Cybersecurity Review Office, an office created for this purpose within Cybersecurity Bureau of CAC, will decide whether to review a product or service at the request of state relevant department, national industry association or based on the voice of the users. Industry regulators in finance, telecommunications, energy and transportation will conduct cybersecurity review work in their respective sectors. If a cyber product or service fails to pass the cybersecurity review, it will be barred from CII procurement.

This regime goes against China's WTO commitment to an open market and global trade. It also creates adverse negative effects for foreign investors in the China market as well as for Chinese consumers who could be blocked from purchasing certain ICT products.

Cyber Critical Equipment and Cybersecurity Specific Product Catalogue: The *Catalogue of Network(Cyber) Critical Equipment and Cybersecurity-Specific Products (Batch 1)* was jointly released by CAC, MIIT, MPS and CNCA on June 9, with retroactive effect from June 1, 2017, without a comment period or consultation with industry. The Catalogue introduces a market-entry requirement for the equipment and products in the catalogue, mandating that they be certified or tested in accordance with the mandatory requirements of relevant national standards before entering the market, and including those that have not previously faced mandatory market access requirements, including, for example, routers, switches, servers and programmable logic controller (PLC) equipment. This constitutes a technical regulation as defined by Annex 1, par. 1 of the WTO TBT Agreement. All draft technical regulations that are not based on or deviate from relevant international standards, and which will have a significant effect on cross-border trade like this one, must be notified to the WTO secretariat as early as possible at a time when amendments can still be introduced and taken into account. However, China failed to notify WTO/TBT on the catalogue for interested parties to comment. As these notification provisions also apply to the conformity assessment procedure that will be developed to implement the regulation, USITO will keep urging China to notify WTO/TBT when developing conformity assessment methods.

The catalogue also requires that testing conform to Chinese standards and “other mandatory requirements,” which remain unspecified at this time. It is not clear whether such requirements being developed or adopted will be aligned with applicable international standards, and be consistent with the WTO TBT Agreement obligation that technical regulations follow international standards where such standards exist (see TBT Agreement, Art. 2.4). USITO urges that the “security test requirements” and “other mandatory requirements” referred to in the regulation should be consistent with another set of TBT obligations (see TBT Agreement, Art. 2.2) and should not be “prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade”.

Commercial Encryption Regulations: A 1999 commercial encryption regulation deemed all commercial encryption products as “state secrets” and prohibited the use of foreign encryption products. Unless companies can demonstrate that the ‘core function’ of the products they wish to sell are not encryption, then the product is banned from the Chinese market. Additionally, the State Commercial Cryptography Administration (OSCCA) requires companies to turn over source code and other proprietary information for testing by state laboratories in order to gain market access for certain encryption products. Discriminatory policies are in violation of China’s WTO commitment and specifically the TRIMs Agreement. Policy should not be used to close the market to foreign competition.

Draft Cryptography Law: The *Draft Cryptography Law*, released for comments in April, 2017, is China’s first law governing cryptography, classified into core cryptography, common cryptography and commercial cryptography. While core and common cryptography are related to state secrets and are off limits to foreign participation, commercial cryptography is partly open for foreign participation. Overall, the draft Law adopts an overly-broad regulatory approach towards commercial cryptography, which is

counter to the global nature of ICT products and services, and appears to be inconsistent with China’s 2000 “core function” test commitment and commitment to observe World Semiconductor Council (WSC) encryption principles.

The draft *Law* impose a unique licensing scheme over the sale, use, import and export of the commercial cryptography with no clear delineation of a narrowly- defined scope, which could be more trade restrictive than necessary and largely impact the ICT trade in China. Further, the licensing scheme, if follows the past approaches, requires the disclosure of source code which counters Articles 5.2.3 – 5.2.4 of the WTO TBT agreement that prohibits government demands for information that is unnecessary to assess conformity and requires the protection of confidential information.

The draft *Law* also requires the State to develop a “full series of cryptographic standards,” but does not indicate to which category of encryption such standards would apply. As signatory to the WTO Technical Barriers to Trade (TBT) Agreement, China has committed to using relevant international standards as the basis for its technical regulations and national standards unless the relevant international standard is ineffective or inappropriate to fulfill a legitimate objective, such as national security (Article 2.4, Annex 3, Paragraph F). China has also committed to ensuring that standards are not prepared, adopted, or applied with a view to, or with the effect of, creating unnecessary obstacles to international trade. The draft *Law*’s emphasis on mandatory national standards, if applied to commercial encryption applications, would not only be inconsistent with China’s WTO TBT and WSC/GAMS commitments, it also would be at variance with the work of the Chinese National Body in ISO/IEC JTC1’s SC27 where the Chinese delegation has initiated or supported several projects strengthening international standardization in cryptography used in commercial applications.

V. NATIONAL TREATMENT

A. GOVERNMENT PROCUREMENT

Government procurement in China falls under two national laws, the Government Procurement Law and the Tender Law, as well as local government procurement measures. The Government Procurement Law was amended in August 2014, and *GPL Implementation Regulations* were revised and released on January 2015.

The GPL does not define domestic goods, projects and services, instead the State Council is authorized to determine the definition. In the *Implementation Regulations*, “domestic goods” are defined as goods manufactured within the territory of China, and domestic manufacturing cost is vaguely set as “above a certain percentage.” “Domestic projects and services” are defined to be projects and services provided by Chinese citizens, legal persons or other organizations. USITO advocates for an exemption from this regulation for ICT products due to the complexity of the global supply chain.

While China’s trade partners have made considerable efforts to persuade China to join the WTO Agreement on Government Procurement (GPA) before and after China’s WTO accession China has not yet become a party and has been unenthusiastic in meeting its

binding commitment to join the GPA. As part of its Protocol of Accession to the WTO, China committed to joining the GPA, and was accepted as an observer to the GPA on February 21, 2002. Since then, China has not joined GPA, nor has China sought to identify areas to be covered by GPA commitments. USITO advocates clear and steady improvements in government procurement policy, building toward accession to the GPA as soon as possible.

USITO recommends the U.S. government continue engaging the Chinese government in discussing the issue in the Comprehensive Economic Dialogues. The U.S. ICT industry recommends that, based on the priorities below, U.S. government officials use the Comprehensive Economic Dialogues to continue addressing the following concerns with China's revised offer:

- An implementation date of 16 years after accession is unique amongst GPA signatories.
- As for product coverage, the U.S. ICT industry strongly urges that the U.S. government pursue a negative list approach that assumes all products are covered, unless justified otherwise, and that the commitment by China includes a broad coverage of services comparable to that provided by other Parties to the GPA.
- The proposed thresholds are far above those of other signatories to the GPA, and lack a meaningful basis for implementation of China's commitments.
- It is essential that the coverage of entities be meaningful and effective. Some wholesale carve-outs lack justification and are unwarranted.
- We urge that the coverage of the commitment be as comprehensive as possible at the central and sub-central government level.

The U.S. ICT industry continues to urge the U.S. government to pursue a comprehensive approach whereby central government entities are included in the commitment predicated on the key underlying laws that establish the organization of the State Council, and that regulate personnel appointments. At minimum, the obligation should include any entity that is subject to the Government Procurement Law. Sub-central government entities should include (i) the governments of the Administrative Divisions (Provinces); (ii) the governments of the five autonomous regions; (iii) the governments of the four municipalities; and (iv) any "body governed by public law" enacted by these governments.

It is essential that a meaningful Annex 3 (addressing state-owned enterprises (SOEs)) should be included. Much remains to be done in this regard. Moreover, it must be noted that China's WTO accession agreement included many provisions that directly or indirectly addressed state-owned (and state-invested) enterprises. Specifically:

- China agreed at that time that laws, regulations, and measures relating to the purchase by state-owned (and state-invested) enterprises of goods and services for commercial sale, production of goods or supply of services for commercial sale or for non-governmental purposes will be subject to certain WTO rules, and

that such laws, regulations, and measures would not be considered to be laws, regulations, and measures relating to government procurement.

- China also agreed that state-owned and state-invested enterprises would make purchases and sales based solely on commercial considerations, such as price, quality, marketability, and availability; would be on non-discriminatory terms and conditions; and that the government would not influence the commercial decisions of state-owned or state-invested enterprises.

Transparency: USITO notes that the Chinese government took some positive steps over the years to improve the information transparency of government procurement. We hope this would act as a catalyst to give individuals and organizations the legal right to request information from the government in an orderly manner. The lack of transparency affects regulations, which continue to be issued without prior public discussion, a most fundamental requirement of a transparent administration. Since regulations directly affect the welfare and opportunities of industry participants and end-users, these groups have a direct interest—and expertise—to contribute to developing sound regulation.

B. ENVIRONMENT AND ENERGY EFFICIENCY REGULATIONS AND STANDARDS

Over the past few years, USITO has provided feedback to the National Development and Reform Commission (NDRC), the Ministry of Environmental Protection (MEP), the MIIT, the Certification and Accreditation Administration (CNCA), and other Chinese ministries and agencies on a number of issues that are in violation of WTO commitments, including environmental regulations, product energy efficiency standards, as well as eco-design related products standards.

Restriction of Hazardous Substances (RoHS): In January 2016, MIIT released a revised version of *Electronic and Electrical Products Pollution Controlling Management Measures (China RoHS II)*. This June, MIIT released a supporting document on the conformity assessment catalogue for public comment. USITO encourages China to comply with WTO regulations on such assessments. We have been working with the Chinese government to discuss such concerns around the CNCA and labelling process. The labelling process violates Article II of the WTO TBT for constituting measures that are “more trade-restrictive than necessary” to protect the environment. We highly recommend the adoption of a self-declaration of compliance (SDOC) approach in China RoHS II and advocate for the elimination of any requirements that include disclosure of proprietary information, including suppliers and material composition of ICT products so that China is not in violation of their WTO TRIPs agreement.

Waste Electrical and Electronic Equipment Directive (WEEE Directive): China's Regulation on WEEE is a national E-waste collection and recycling regime. The *Administrative Regulation on Recycling and Treatment of Waste Electrical Appliances* entered into effect January 1, 2011, and a new, expanded product catalogue was issued in February 2015. The regulation contains provisions that may provide WEEE fee reductions for the RoHS voluntary certification, promoting a troublesome conformity model. Secondly, under the current catalogue of products subject to China WEEE requirements, numerous categories of products are subject to mandatory recycling, with

the possibility of further expansion in the future. According to the recycling data released by MEP, this cost USITO members hundred of millions of dollars in fees paid to qualified recyclers of used refrigerators, washing machines, televisions, and air conditioners. The structure of the recycling fee is detrimental to imported appliances and the fees appear to be inconsistent with WTO TRIMs agreement as well as articles 1:1 (a and b) and articles III: 2 and III: 4 of the GATT.

Energy Efficiency: China's energy efficiency programs present a number of challenges to foreign companies, including onerous compliance requirements, tight timeframes for compliance, and inconsistencies with globally adopted technical standards. Energy efficiency has become a priority for China, and this can be felt across the ICT sector. The China National Institute of Standardization (CNIS) has developed Minimum Energy Performance Standards (MEPS) stretching across a broad range of products, including servers, PCs and data centers. The server energy efficiency standard, in particular, is problematic as the standard China tries to draft lacks the fundamental metrics to scientifically capture the actual server efficiency. Such energy efficiency requirements and standards are likely to be at variance with global standards and violate GATT Article III on national treatment. Chinese regulators should be in alignment with globally adopted standards such as the Energy Star Program technical requirements and Server Efficiency Rating Tool. ICT companies are deeply invested in this set of technical specifications and any deviation from the global norm would unnecessarily place onerous burdens on the manufacturers.

VI. CUSTOMS

A. ITA EXPANSION

On July 1, 2016 the expanded Information Technology Agreement (ITA) went into effect, expanding duty-free coverage to an additional 201 high-tech products, including next generation semiconductors known as multi-component semiconductors (MCOs). Together, the ITA and its expansion cover USD 1.7 trillion in annual trade. However, in January, China temporarily increased tariffs on 10 MCO product lines that were previously duty-free, in apparent violation of its ITA commitments.

The World Semiconductor Council (WSC) sent a letter to the Chinese government asking for an explanation of its tariff treatment for MCOs and requested that they reinstate zero tariffs on the 10 MCO product lines that saw a tariff increase. USITO urges the Chinese government to honor its ITA commitment to eliminate tariffs on MCOs and all items covered by the ITA.

B. CHINA'S DRAFT EXPORT CONTROL LAW

In June of this year, the Ministry of Commerce (MOFCOM) released China's draft Export Control Law covering military and dual-use items. Troublingly, the draft Law includes multiple references to protecting economic interests, such as conducting a competitiveness assessment and using "market supply" as a factor for licensing. The

law also includes a reciprocity principle, stating China may act in a “reciprocal” manner towards any export control regimes it finds “discriminatory”.

USITO encourages Chinese authorities to reconsider the basis for the export control system and to place national security as the foundation. Export control principles based on reciprocity and economic competitiveness are not consistent with other multilateral export control regimes. These goals are also contrary to the aims of the World Trade Organization (WTO) and with WTO principles. In addition, an underlying purpose of the multi-lateral export control system is to contribute to regional and international security and stability by promoting transparency and greater responsibility in transfers of conventional arms and dual-use (i.e. those having civil and military uses) goods and technologies.

C. CUSTOMS VALUATION AND TRADE FACILITATION

In September 2015, the Chinese government accepted the WTO's Trade Facilitation Agreement, indicating the determination and confidence of the General Administration of Customs (GAC) to fully implement WTO trade facilitation policies, including provisions to expedite the movement, release, and clearance of goods as well as cooperation on customs compliance.

As part of its WTO accession agreement, China agreed to implement its obligations under the Agreement on Customs Valuation (GATT Article VII) upon accession, without any transition period. The purpose of this agreement is to make certain that the customs value of imported goods for duty assessment purposes is determined in a “neutral and uniform manner” that avoids arbitrary or fictitious valuation. It is our experience that China is deviating from these requirements in three notable areas:

- The GAC uses an out-dated and arbitrary pricing methodology for valuation purposes that does not take into account modern supply chain models. In particular, customs authorities do not appear to understand transfer pricing, inbound and outbound bonded zone valuation, and customer rebate/sales discounts associated with today's supply chain complexity. This has resulted in customs challenges to modern pricing methodologies and a desire by officials to enforce unreasonable valuation adjustments, based on their sole acceptance of a customs declaration value that is presumed to always become higher through the entire supply chain. For instance, it is well known that in some business situations the selling price will be reduced to offer a rebate or sales discount to customers. That price could be lower than the values declared in preceding supply chain steps, including the value declared on the inbound customs declaration at the time products are imported. Chinese customs authorities should make concerted efforts to understand the complexities and pricing mechanisms associated with modern supply chain models and accept transaction value declared on the basis of these models.
- Customs in China is also using valuation databases for determining the value of goods and increasingly questioning the transaction value of imports. There are some situations in which Chinese customs uses a “reference price” to ascertain customs value, a process that has caused transaction values declared by an

importer to be rejected by customs officers because this value is lower than the GAC's arbitrary reference price. China customs officials should abandon the use of arbitrary and artificially created reference processes in ascertaining the transaction value of goods.

- The process for customs valuation determinations varies from port to port and is not transparent. This is a lack of willingness on the part of GAC officials to issue written binding agreements on valuation in many instances. Oral agreements are employed, but these agreements remain in effect only as long as that individual remains employed by GAC. There should be uniform handling across all Chinese ports of entry, and all agreements should be written and available for all companies to view.

D. CUSTOMS IMPLEMENTATION

In 2015, GAC expanded regional clearance zones beyond the Beijing-Tianjin- Hebei integrated region and the Yangtze and Pearl River Deltas to include coverage in northeastern China and along the proposed route for the New Silk Road Economic Belt. USITO looks forward to eventual nation-wide clearance integration. As China maintains a dual clearance system, we hope that there will be greater coordination between China's customs departments and quality supervision departments. We also hope that there will be harmonization of different Customs offices when handling the same consignment.

Inconsistent, inefficient, and opaque customs rules and procedures are inconsistent with the direction of China's WTO commitments to a trading regime that fosters harmonization, transparency and simplified customs formalities. Key issues are listed in detail below.

- **Vague and Inconsistent Regulations:** Many existing Customs regulations lack clarity and precision, and they are drafted and enforced in an inconsistent manner. For example, a regulation dealing with duty-exemption assets in China states that once a 5-year customs supervision period expires, the duty-exempted asset will be de-bonded automatically. While this automatic expiration means there is not a need to contend with a formal customs de-bonding process, the regulation does not state whether bonded zones are covered. The result is that Customs officials in some localities require a company to deal with de-bonding formalities once the 5-year period ends, while Customs officials in other locations permit automatic de-bonding. Customs rules, written at a high-level and therefore lacking direction concerning operational details, fail to cover numerous import-related areas. For example, there is very little regulatory guidance in current regulations on how to record, track, and reconcile high volume items placed in a PRC bonded zone for later consumption in China factory production.
- **Resolution of Regulatory Issues:** It continues to be difficult to address or resolve regulatory issues with Chinese customs officials. The GAC maintains no systematic, repeatable, transparent, and sustainable system to gather industry inputs, including but not limited to new business trends, business challenges, or supply chain problems. GAC also lacks a feedback mechanism to systematically

respond to pressing industry issues. Enterprises strive to communicate effectively with GAC, but the process is laborious and conducive to unsatisfactory outcomes. GAC should establish a clear, formal process to ensure timely and substantive responses to importer issues along with a process that allows escalation of issues where disputes arise.

- **Need for “24x7” Customs Clearance:** Many factories in China operate on a “24 x 7 x 365” basis and need customs capacity that supports shipping and receiving operations at all times. Customs clearance still relies on manual procedures in China and is relatively slow compared to the other Southeast Asian countries. Insufficient access to customs personnel by importing parties, due to limited customs working hours on weekdays and on weekends, significantly hampers efficiency of supply chain management. Consequently, companies have borne additional costs due to goods languishing in a warehouse, as well as incurring customer dissatisfaction because of delayed delivery of goods. A lack of uniformity in customs work schedules and practices across the country exacerbates the problem, with some local authorities having extended hours of operation and others having more restricted operational schedules (such as weekends). This inconsistent operating model significantly hampers the ability to provide predictable logistical services in the shipment and delivery of goods.
- **Customs Modernization:** In China, customs clearance still relies principally on submission and processing of a paper declaration. Some cities are starting to implement “e-Customs” solutions and paperless declaration pilots, but each city is implementing different solutions and different plans. China could very substantially increase the efficiency of its customs operations by establishing paperless, efficient, and end-to-end paperless Customs solutions that are standardized across all regions. The nationwide paperless clearance system was expanded beyond exports in 2015 to include most imported goods, reducing the time required for import declarations by about 10 hours. While we commend China Customs’ efforts to facilitate trade, we hope further improvements can be made by implementing the credit management system and increasing the percentage of declaration and accompanying documents that can be stored by enterprises, reducing and simplifying the requirements for accompanying documents, and delivering digitized rather than scanned accompanying documents.
- **Bonded Zones:** Simplification of bonded goods between special supervision zones remains an issue of concern. Facilitation measures do not cover all types of bonded goods and zones. The existing transit mode severely restricts the efficient transfer of goods in special supervision zones and does not align with the government’s push for environmental protection. We recommend that GAC expand the applicable scope of this system as soon as possible, revise existing policies, and allow enterprises to truly realize “batch delivery, centralized Customs declaration, and self-transportation.”
 - **Efficiency:** Customs processes in a bonded zone in China continue to be inefficient. Many operations in China are located in bonded zones along with customers and suppliers. A big challenge in China is the bonded air transfer process. According to Chinese law, GAC must supervise any

bonded air transfer between two bonded zones. There are four customs-related organizations involved in the entire process at the following points: (1) departure zone, (2) departure city airport, (3) arrival city airport, and (4) arrival or receiving zone. Based on the current standard bonded transfer process, it is required that three bonded transfers be completed between these four customs authorities. The process is very complex with long lead times, impacting supply chain efficiency. GAC should simplify the bonded air transfer process across all the regions in China to alleviate shipment delays and burdens.

- Compliance Requirement: Many bureaucratic tracking and reconciliation requirements exist relative to bonded zones. This challenges a bonded zone company to track and reconcile everything, including high volume manufacturing inputs (even tiny items like a nut, bolt, or screw). GAC should streamline and simplify these requirements through risk management and management-by-account procedures for trusted entities such as companies with an “AA” or “A” status under China’s enterprise rating system.

VII. APPENDIX: USITO INTRODUCTION

Since its founding in late 1994, the U.S. Information Technology Office (USITO) has become the leading policy-centered NGO focused on the ICT industry in China. USITO acts as the joint office in China of several U.S.-based trade associations representing the high-tech industry, including:

- The Computing Technology Industry Association (CompTIA)
- The Information Technology Industry Council (ITI)
- The Semiconductor Industry Association (SIA)
- BSA | The Software Alliance (BSA)
- The Telecommunications Industry Association (TIA)

USITO also accepts corporate memberships from those U.S. companies in the information technologies industry that seek direct representation. Currently, USITO has about 47 corporate members.

USITO monitors and expresses support for legislation conducive to U.S. exports and investment and promotes further opening of China's telecommunications and information technology markets. The organization researches issues of cross-cutting interest to U.S. companies involved in China's telecommunications and high-tech sectors. USITO also assists its parent organizations with trade shows, delegations, meetings, and other China-related events.

VIII. GLOSSARY

AI	Artificial intelligence
CAC	Cyberspace Administration of China
CAICT	China Academy of Information Communications Technology
CCPS	Cybersecurity Classified Protection Scheme
CII	Critical information infrastructure
CNCA	Certification and Accreditation Administration
CNIS	China National Institute of Standardization
CSIA	China Semiconductor Industry Association
FDI	Foreign direct investment
GAMS	WSC Government/Authorities Meeting on Semiconductors
GATS	General Agreement on Trade Services
GATT	General Agreement on Tariffs and Trade
GPA	Agreement on Government Procurement
IC	Integrated circuit
ICP	Internet Content Provider
ICT	Information and communications technology
IEEE	Institute of Electrical and Electronics Engineers
IETF	Internet Engineering Task Force
IP	Intellectual property
ITA	Information Technology Agreement
ISP	Internet Service Provider
JCCT	Joint Commission on Commerce and Trade
MEP	Ministry of Environmental Protection
MEPS	Minimum Energy Performance Standards
MCO	Multi-Compound Semiconductor
MIIT	Ministry of Industry Information Technology
MLPS	Multi-Level Protection Scheme
MOF	Ministry of Finance
NDRC	National Development and Reform Commission
OSCCA	State Commercial Cryptography Administration
PAE	Patent assertion entity
PBS	Public Security Bureau
PLC	Programmable logic controller
R&D	Research and development
RoHS	Restriction of Hazardous Substances
SAIC	State Administration of Industry and Commerce
SCLAO	Legislative Affairs Office of the State Council
SEP	Standard essential patent
SDOC	Self-declaration of compliance
SIR	Service Invention Regulations
SIPO	State Intellectual Property Office
SFTZ	Shanghai Pilot Free Trade Zone
SOE	State-owned Enterprise
TBT	Agreement on Technical Barriers to Trade

TC260	China National Information Security Standards Technical Committee
TRIMS	Agreement on Trade-Related Investment Measure
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
UMP	Utility model patent
VAS	Value added services
VATS	Value added telecoms services
W3C	Worldwide Web Consortium
WEE	Waste Electrical and Electronic Equipment
WSC	World Semiconductor Council
WTO	World Trade Organization