Attn. Legislative Affairs Commission, Standing Committee,
National People's Congress (NPC), People's Republic of China

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Joint Comments by Industrial Associations of the United States and Japan on China's Revised Draft Export Control Law

In response to the call for public comment on China's draft Export Control Law released by the Chinese Ministry of Commerce in June 2017 (hereafter called "Original Draft"), joint comments were submitted by nine major industrial associations in Japan in December 2017 and additional joint comments were submitted by 14 major industrial associations in the United States, Europe and Japan in February 2018. We refer to both these submissions as "2017/18 Industry Joint Comments" below.

Public comment on China's Revised Draft Export Control Law (hereafter called "Revised Draft") was solicited after deliberation at the 15th meeting of the 13th National People's Congress Standing Committee. We have reviewed the revisions and are submitting herewith joint comments on the Revised Draft designed to promote further improvements in the Revised Draft.

The following joint comments, like those submitted previously, are based on the common interests of both parties in promoting trade and investment between China and other countries, and as such, it is hoped that appropriate attention can be given to these comments.

Matters pointed out and requested in the 2017/18 Industry Joint Comments were as follows:[1]

1. Consistency with international trade rules administered by the World Trade Organization (WTO) and international export control regimes
   (1) "International Competitiveness," "Supply to International Markets" and "Equal Principles" (Retaliation Clause)
   (2) Scope of Application, Including "Protection of Important Strategic Rare Materials"
2. Reexamination of Systems That Could Become Major Hindrances to the Trade and Investment Environment
   (1) Reexamination of Reexport Regulation
   (2) Reexamination of Deemed Export Controls
   (3) Formulating a Controlled Items List Conforming to International Export Control Regimes
   (4) Curbing Unreasonable Demands for Technological Disclosure in Export Inspections
   (5) Reexamination of Methods and Conditions for On-site Investigations Regarding End

[1] * The text of the previous joint comments can also be found on the following CISTEC website. http://www.cistec.or.jp/service/china_law/180309-01-e.pdf

Users and Uses

3. Need for sufficient consideration for smooth implementation
   (1) Adequate Publicity regarding Work of Drafting Legislation and Ensuring Opportunities for Exchange of Views with Domestic and Foreign Industrial Sectors
   (2) Securing an Adequate Extension after Detailed Information Made Available and Stepwise Implementation of Regulations
   (3) Promoting Implementation that Encourages and Builds on Internal Compliance Mechanisms
   (4) Protecting confidential business information

- In the Revised Draft of the law, there are provisions that reflect the 2017/18 Industry Joint Comments; provisions from the Original Draft that were addressed but not resolved from the 2017/18 Joint Comments; and provisions which warrant further recommendations and consideration. We would like to address these points one by one as follows. Additionally, we request that industry is provided an additional opportunity to comment on subsequent implementation rules, due to the various undefined terms and processes that have yet to be articulated in this initial law, which will have a significant impact on exporters. For example, there is no definition of "export" in the Revised Draft.

(1) Areas where 2017/18 Joint Industry Comments have been reflected:

We appreciate the incorporation of the following recommendation from the 2017/18 Joint Industry Comments:

- The article stipulating on-site verification of end-users and end-uses (the 2nd provision of Article 28 of the Original Draft) has been removed and end users' obligation of pledge is stipulated, and thereby end-users would be added to a list of parties of concern in the event of their breach of this pledge (20(1) of the Revised Draft). These provisions are largely consistent with internationally common systems, which is a positive improvement from the original draft.

(2) Areas where 2017/18 Joint Industry Comments have been reflected but additional clarity and consideration is required:

- Consistent with the 2017/18 Joint Industry Comments recommending harmonization with international export control regimes, we recognize and welcome the deletion of provisions that were focused on industrial and trade policy, such as "Technological Development", "International Competitiveness", and "Supply to International Markets" in the formulation of controlled items and requirements for licensing (Article

16 and Article 22 (4) of the Original Draft/ Article 13 of the Revised Draft). Although the criteria for formulating the list of controlled items are simply referred to in Article 9 as "in accordance with export control policies", we ask that the criteria be limited explicitly to security-based export controls, as the temporary control provisions in Article 10 refer to "In accordance with the needs of fulfilling international obligations and maintaining national security". In addition, consistent with the 2017/18 Joint Industry Comments recommendation on "fulfilling international obligations", we recommend that the specifications of controlled items list be the same as those agreed upon by international export control regimes. Finally, in Article 9, we request that the list of controlled items consider categorical exclusions adopted by other export regimes, such as mass-market exceptions and open source software.

- It has been stipulated that, in order to encourage internal compliance systems for companies and organizations, exporters with good operations in this respect can be given preferential treatment for licensing (Article 14 of the Revised Draft). We request that the requirement for an internal compliance system be removed. The development of internal compliance programs should not be a mandatory requirement to afford exporters the flexibility to determine the compliance mechanisms appropriate for their business/industry. We ask that any future bulk-license and other licensing program features that allow flexibility and efficiency for businesses are not tied to an evaluation of a business's compliance program. As specific details of this provision have been consigned to lower regulations, we ask you to adopt the points requested in Section 3(3) of our previous joint comments (e.g., exceptions to export licenses for exports to group companies, and the adoption of a method that removes the requirement of reporting every six months for common licensees, etc.). In addition, we ask that the lower regulations provide guidance on the definition regarding exactly what type of actions constitute a major violation. This guidance will help provide certainty to businesses that are aiming to comply with the law.

(3) Areas that require further consideration:

The following recommendations reflect the 2017/18 Joint Industry Comments that have yet to be resolved. These recommendations are closely related to the trade and investment environment in China, and we ask for your continued consideration to avoid unintended consequences.

1. <u>"Equality Principle" (Retaliation Clause)</u>

We appreciate that the "Equality Principle" (or the retaliation clause; Article 9 of the

Original Draft) has been deleted. Concern remains, however, that substantial retaliatory measures could still be taken, given the following measures:

- General provisions of the Foreign Trade Law, the related law, have a similar "equality principle" provision (Article 7).
- The "Unreliable Entity List", on which the Chinese Ministry of Commerce has been reported to be working, could likely include retaliatory or sanctions provisions.
- If such measures were to lead to retaliation, there would be negative effects on industries of many Chinese and foreign companies. If potential disputes do occur, we urge that they be resolved in accordance with international rules, such as those of the World Trade Organization.

2. <u>"Protection of Important Strategic Rare Materials"</u>

As indicated in the 2017/18 Joint Industry Comments, there are no other examples around the world where rare mineral resources are subject to security export control regulations. Our comments called for prudent action based on strong concerns that rare materials regulation through export controls would be inconsistent with WTO rules, as has been found before regarding both rare earths and raw materials.

Reports that the Chinese government has been considering restricting the export of rare mineral resources, such as rare metals, raise strong concerns and we reiterate that restrictions on such exports may encourage the development of alternative suppliers and alternative resources, which may be unfortunate for both sides. From this point of view, we respectfully call for a cautious approach to this issue consistent with international rules.

3. <u>Re-export controls</u>

Although the independent clause referring to the *de minimis* rule in the Original Draft (i.e., Article 64 of the Original Draft) has been removed, the Revised Draft stipulates that re-exports, along with other export types, will "be implemented in accordance with relevant provisions of this law" (Article 45).

In this context, the term "re-export" in Article 45 can be taken to mean "re-export of what was exported to China from China" (*i.e.*, reshipment).The interpretation provided by a Chinese law firm states, however, that this is equivalent to what was stipulated in the above-mentioned Article 64 of the Original Draft ("re-export").

If this Revised Draft is synonymous with re-exports under Article 64 of the Original Draft, we remain strongly concerned.

As explained in detail in the 2017/18 Joint Industry Comments, re-export controls from non-Chinese countries raise not only concerns related to practical application and

burdens on re-exporters, but also regarding the implications for the Chinese economy, which also depends on strong participation in global value chains. If the re-export of products that incorporate products imported from China from non-Chinese countries require the approval of the Chinese government, then the substantial burden and risks involved are expected to create strong disincentives to the use of Chinese products, which could lead to a change in suppliers.

Even if the purpose of Article 45 is not to implement re-export controls immediately but to stipulate a policy to implement it in the future, such a policy itself is a strong deterrent to including China in global value chains or even investing in China.

For the above reasons, we again request that re-export controls provisions are be removed from Article 45. If re-export controls must be addressed in the law, we request that re-export controls are explained in meaningful detail in Article 2 of the law. Alternatively, if “re-export“ in Article 45 of the Revised Draft would mean the above-mentioned “reshipment”(i.e., re-export of what was exported to China from China), we encourage you to clearly stipulate this meaning.

4. <u>Article 2 recommendations on deemed export controls and further detail on intangible and services exports</u>

The deemed export controls provisions in Article 2 of the Revised Draft are largely unchanged from the original draft. As discussed above, we reiterate the concerns pointed out in Section 2(2) of the 2017/18 Joint Industry Comments and urge they be resolved.

As indicated in the 2017/18 Joint Industry Comments, if deemed exports were to be uniformly controlled, including exchanges with foreign employees within a company, there is a strong concern that daily corporate activities, such as meetings, consultations, e-mails, and access to internal databases could not be conducted smoothly and efficiently.

In order to prevent such interruptions, as previously requested we strongly urge the following systems to be implemented:

- Excluding full-time employees of companies and organizations in China from such controls.
- Limiting the control to foreign students, contractors, and non-affiliated researchers.
- Restricting controls to cases of providing technologies and source codes controlled by international export control regimes in China.
- Developing comprehensive license systems and license exception systems, such as exceptions on fundamental research, end-to-end encryption, patents, and limits on deemed re-exports to bona fide employees.

In addition, Article 2 specifies that this law covers the export of tangible (goods),

intangible (technology) and services. We believe it makes practical sense to limit dual-use items to physical goods, software, and technology only, and removing dual-use services. While the Chinese government has classified tangible goods using the 10-digit Chinese harmonized tariff schedule codes, this level of detail is not available for technology and services. If the Chinese government moves forward with the inclusion of services, we recommend providing detailed definitions and classifications for all controlled items, including technology and services in order to ensure exporters can fully comply with the law.

5. Curbing unreasonable demands for technology disclosures in export reviews and protection of confidential business information

We understand that our requests in Section 2(4) and 3(4) of the 2017/18 Joint Industry Comments are covered by the "Prohibition of Forced Technology Transfer by Administrative Means" clause in the separately enacted Foreign Investment Law. It is important that this clause be implemented to ensure the protection of intellectual property for foreign and Chinese entities.

Concerns remain, however, about whether the protection of intellectual property can be properly achieved through the implementation of the National Intelligence Law, the Cyber Security Law and its lower regulations (*e.g.*, data security management regulations, etc.). Concerns about these laws and regulations are being raised at government level in the United States, Europe and Japan, and we ask that you take measures to ensure thorough protection of intellectual property.

6. Obligation to uniformly submit documents in license applications

Article 33 of the Original Draft listed documents to be submitted at the time of license application, and it was a rule that these documents needed to be submitted uniformly regardless of the content of the application. In response to this provision, Section 3(3) in the 2017/18 Joint Industry Comments requested that, "this type of certificate (these kinds of documents as those set out in Article 33) should not be a requirement for each individual license/approval unless special circumstances, such as the sensitivity of the item or of the country of destination, would make it necessary."

Article 22 of the Revised Draft (which corresponds to the above-mentioned Article 33 of the Original Draft) indicates that this issue will be explicated further in the subsequent regulations, in which we hope will incorporate the recommendations above our 2017/18 Joint Industry Comments.

Article 17 of the Revised Draft states that "exporters must submit end-user and end-use certificates to the National Export Control Authorities". We have two concerns with this provision. First, this appears to be a uniform requirement regardless of the sensitivity.

Article 25 of the Original Draft conditioned the requirement of these certificates “based on the degree of sensitivity of controlled items and end-users.” This sensitivity condition was deleted in the Revised Draft, which is concerning. Uniformly obtaining certificates, regardless of the sensitivity, would be a considerable burden for exporters in filing applications and the time it takes to export would increase. Submitting certificates uniformly in such a way is not required by international export control regimes, and the requirement of the submission is limited to “particularly highly sensitive items for which there are concerns they may be diverted to uses related to WMD.” The same rule is adopted in the operation of systems in major countries. In light of these circumstances, we would like to ask that the phrase “based on the degree of sensitivity of controlled items” be inserted in Article 17 of the Revised Draft.

In addition, we ask you to consider that many governments do not issue end—user and end-use certificates. In some instances, certificates are produced and signed by the end-user themselves, not the importing country government. We encourage the inclusion of flexibility regarding the signatory of the end-user and end-use certificates to ensure trade between China and foreign nations is not hindered due to the various and unique practices and systems of importing countries.

(4) New Considerations

Below we have listed recommendations that were not included in our 2017/18 Industry Joint Comments. We appreciate your consideration of these requests.

- In Article 4, we suggest the establishment of a formal appeals process. Especially for sensitive and complex cases, we recommend a robust appeals process that allows parties with cases denied at the working level escalate the case to the highest decision-making authority for further review.

- In Article 10, the Revised Draft imposes a two-year deadline for lifting the ban on the export of identified controlled items. We recommend including more flexibility into this provision. For example, the ban could be reviewed at regular intervals throughout the two-year period by relevant authorities, to establish if the situations which led to the ban may have changed, in which case the ban may no longer be warranted.

- In Article 15, the Revised Draft includes a provision that requires the exporter to apply for a permit from the National Export Control Authorities if the exporter knows, or should have known, that the item being exported is associated with specified risks. We believe it could be challenging for an exporter to determine when they should

have known an item could be subject to control without a knowledge standard basis. Therefore, we ask that a “reason to know” standard is identified which can be applied throughout the provisions of this law as well as in the implementing lower regulations.

- We request a modification or removal of Article 18 entirely, specifically removal of the obligation for importers (or other parties not subject to CN jurisdiction) to report to China on changes to end-use/r. For dual-use items, expecting third parties outside of China to comply with this requirement is not possible.

- In Article 23 we recommend allowing for multiple shipments over a period of time under each license, and for license exemption/exceptions – including intra-company transfers, to reduce the burden on exporters.

- In Article 30, the Revised Draft addresses both inspections and investigations. We ask that you provide further detail and clarification regarding these two compliance processes. In regard to inspections, which are a routine aspect of export control compliance protocols, we request further specification on what types of actions can be expected in such an inspection. Further detail would also be appreciated in regard to which existing relevant authority allows for such investigations as to better understand the legal rights of the exporter. Finally, in Article 30 we request additional clarity on both the enforcement process as well as potential penalties under this part, (for example, the freezing of accounts, return transport of exported goods, and seizure of goods.)

- In Article 31, we request the consideration of adding a definition for the term trade secrets. It would be appreciated if this definition covered information submitted by exporters for license applications and the data related to responses from the government.

- In Article 33, we encourage the establishment of a process to determine the credibility of third-party reports of potential violations to discourage anti-competitive behavior and false reporting. We also ask that the new law include a provision that allows a company to avoid prosecution where they have voluntarily self-disclosed.

- In Article 37, we request limiting the scope of this provision to parties involved in the export transactions. For example, we ask that a third-party electronic trading platform that does not provide services related to the actual export of the goods is removed from the scope of the control. Additionally, we ask that the word knowledge is defined as actual knowledge. For example, we ask that this not apply to a financial services provider that generally provides financial services to an exporter, but rather only in cases where the financial services were knowingly provided services to

facilitate an export violation.

- In Articles 37, 38, and 39, we encourage the addition of provisions to ensure the appropriate application of enforcement measures. For example, if an exporter is, in earnest, attempting to comply with the law, but is found to have committed a violation due to voluntary disclosure or if a mistake is made, it would be appreciated if mitigating measures could be provided as a first step, before the consideration of the imposition of severe penalties.

- In Article 40, the Revised Draft provides the discretion to the National Export Control Authorities to restrict export activities for five years due to a violation. We ask that the types of violations are specified for which this five-year moratorium would apply and recommend that reviews are undertaken during the five-year period to determine if an exporter has adequately addressed the cause of the original violation in which case exporting privileges could be reinstated. Finally, we request a reconsideration of the lifetime ban on exporting. This is a particularly extreme consequence for a business that may be able to resolve criminal violations by, for example, terminating implicated employees or changing internal practices.

■ Conclusion

The Chinese government is working on further improving the trade and investment environment with the Foreign Investment Law that went into force in January 2019.

According to statistics from the Chinese Ministry of Commerce, the total imports and exports of foreign-invested enterprises in the period from January to October 2018 accounted for 41% of the national total, with 47% of the exports of foreign-invested enterprises being exports of high-tech new technology products which accounts for 64% of national high-tech new technology product exports. In this way, foreign investment companies play a major role in promoting the quantitative and qualitative development of foreign trade.

Due concern to the impacts on foreign investment, careful consideration should be applied when finalizing and implementing China's Export Control Law. While some of the requests put forward in the 2017/18 Joint Industry comments (in particular, the removal of provisions for on-site verification of end-users and end-uses) have been adequately reflected in the Revised Draft, we continue to recommend changes in a future draft to address significant outstanding concerns such as re-export control and deemed export control, among others.

With the lack of export control restrictions on commercial mass-market goods and technologies other than items related to weapons of mass destruction up until now, overseas industries have been actively promoting investment and trade in and with China. Under such

circumstances, from the viewpoint of fulfilling international obligations, the introduction of general export control regulations for commercial mass-market goods and technologies is welcome. The Revised Draft contains, however, provisions outside of international export control regimes, including a re-export control system and a deemed export control system (the deemed export control in the Revised Draft would be problematic if it would also control providing items to foreign nationals who are members of a corporation/organization), which, as we explained, will be a very significant constraint on corporate activities. If these two systems were to be enacted in this way, it would be regarded as a negative factor in China's investment and trade environment in comparison with other Asian and non-Asian countries that do not have such far-reaching systems in place.

Although the "Equality Principle" (retaliation clause), which was one of the major factors of concern, has been removed from this draft, similar clauses are stipulated in the general provisions of the Foreign Trade Law.

In addition to ensuring that the above-mentioned specific concerns of overseas industry are taken into account in the next draft of the China Export Control Law consistent with international export control regimes, we look forward to work with you to promote further trade and investment benefits between our countries and industries. Thank you for your consideration.