To: Ministry of Economy, Trade and Industry

From:
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Requests with Regards to the Extraterritorial Application of Chinese and United States Regulations

Focusing on China's Export Control Law and United States' Expanded Direct Product Rule

Firstly, we would like to express our gratitude for all the specific guidance given regarding industries' economic activities inside and outside our country.

In the midst of heightened tensions in US-China relations, successive export control regulations of both the US and China have been released which include excessive extraterritorial application of regulations. These have had a large impact on Japanese industries causing much anxiety and confusion.

Such a situation brings with it a significant negative impact on both the United States and China. The governments of both countries are expected to impassively implement these rules; however, we must ask Government of Japan to deal with the problem of extraterritorial application.

Japanese industries have up to this point, in cooperation with major industrial associations in the United States and Europe, continued to made requests to governments of both the United States and China regarding various regulations. However, we sincerely hope that the Ministry will understand the impact of recent regulations ofboth countries and the concerns of Japanese industries. As such, we respectfully request a government-based response.

1. China's Export Control Law and Related Regulations

The draft of China's Export Control Law, which was under deliberation by the Standing Committee of the National People's Congress (NPC), was enacted on October 17th, and will come into effect on December 1st, 2020.

Since submitting joint comments with major industrial associations from the United States and Europe on the first draft published in June 2017 by the Ministry of Commerce of China, CISTEC has just submitted further comments jointly with industrial associations from Japan, Europe and the United States on the first and second drafts published by the Standing Committee of the NPC.

The industrial associations of Japan, Europe and the United States welcome attempts by the Chinese government to work with the international community to improve its Export Control Law and fulfill its international obligations by ensuring dual useitems and technologies that are related to, not only weapons of mass destruction, but also conventional weapons, are subject to export controls.

However, the contents of the drafts had major problems from the outset. For example, there were contradictions when compared to international rules, such as WTO rules and international export control regimes, as well as significant obstacles in terms of trade and investment. With these concerns in mind, joint comments by industrial associations from Japan, Europe and the United States has made repeated requests that the system of export control, and how it is implemented, be in line with international rules.

Since the concerns we have about this law could significantly harm trade and investment with China, CISTEC has previously asked the Ministry on two occasions to take actions on China from a government level. In response to these calls, we would like to thank the Ministry of Economy, Trade and Industry for taking actions at various levels and for taking up the issue in the Report on Compliance by Major Trading Partners with Trade Agreements.

However, in spite of such efforts at the government level and from the industrial associations of Japan, Europe and the United States, many points remain unclear and matters of concern have not been resolved. What we have seen instead, are rules that give rise to even more concern.

As explained in previous requests to the Ministry, the concerns raised by the industrial associations fundamentally relate to trade and investment with China and will have a significant adverse effect on the trading and investment environment as well as posing a number of risks to trade itself with China. This is all a matter of very big concern.

We therefore would appreciate it if you could understand the following issues and concerns of the industrial world, and ask for cooperation on a trilateral government basis among Japan, the United States, and Europe.

1.1 Curb on Extraterritorial Application

(1) Re-export Controls (Article 45)

It remains unclear whether re-export controls are included in the enacted Export Control Law (hereinafter the "final version"). If, however they are included, it means that a license is required from the Chinese government to re-export products that incorporate items imported from China, which may damage the basis of trade and investment with China.

(2) Investigations to Verify End-Users and End-Uses in Country of Export (Article 17)

The final version stipulates that National Export Control Authorities can conduct investigations to verify end-users and end-use in the country of export. It is not clear whether these investigations include on-site inspections of importers and end-users, but if they do, they could be a problem under international laws as an exercise of extraterritorial public authority.

(3) Legal Accountability of Organizations and Individuals Outside of China by Applying Law Extraterritorially (Article 44)

This provision was added during the Standing Committee of the NPC's second draft, but in joint comments from the industrial associations of Japan, Europe and the United States it was requested that "the purpose and specific content of this newly created Article 44 are unclear, and this article is questionable under the territorial principle in international law, and also under the general legal principle that there should be no penalty imposed without a specific prohibition under the law. Moreover, since we believe this article will make the position of foreign companies doing business with China extremely unstable and will have a significantly negative impact on business with China, we request that this article be re-examined, or removed altogether from the draft."

1.2 Curb on Industrial Policy Controls

(1) Addition of the "National Interests" Viewpoint (Articles 2, 9, 10, and 12, etc.)

Regarding the provisions which require consideration of an impact on "trade and industrial competitiveness," "supply in the international market," and "technological development" as set out in the Ministry of Commerce's original draft as industrial policies, since these are inconsistent with international economic rules such as ¥the WTO, the industrial associations of Japan, Europe and the United States requested legislation from the perspective of maintaining national security and performing international obligations, in line with international export control regimes.

This request was reflected in the NPC's first and second draft with "national security"

and “performance of international obligations” as the main viewpoints. However, during the final stages, the phrase “national security and national interests” has been inserted into relevant articles in the final version, hence there is a strong concern that the law will be adopted in such a way as to maintain and develop China’s international competitiveness and superiority.

(2) Controlled Items Subject to Control Lists (Article 9)

From the outset, the industrial associations of Japan, Europe and the United States emphasized the importance that controlled items subject to Control Lists should be determined in compliance with items (including compliance with specifications) agreed by international export control regimes.

Based on the Regulations on Technology Import and Export Control, which are subordinate regulations of China’s Foreign Trade Law, a separate export control law, a revised version of the existing List of Technologies Subject to Export Bans and Restrictions was already made public and enforced on August 28, but this list seems to include not only items from a national security perspective, but also items that give an advantage to China. Similarly, we are concerned about the possibility that many items might be specified on Control Lists from the viewpoint of “national interests” based on the final version (we are also concerned about the possibility of designating “important strategic rare materials” such as rare earths, which was included as an aim of the draft of China’s Export Control Law).

1.3 Curb on Retaliation Measures

(1) Reinstatement of the Retaliation Clause (Article 48)

A retaliation clause has been stipulated in the final version to the effect that, “if any country or region abuses export control measures to endanger the national security and national interests of the People’s Republic of China, the People’s Republic of China may, based on the actual situation, take reciprocal measures against that country or region.” The Ministry of Commerce’s draft also stipulated an “Equality Principle,” but what was deleted in the first draft of the Standing Committee of the NPC has now been stipulated in a more direct way in the final version.

(2) Introduction of the Unreliable Entity List

On September 19, 2020, the Unreliable Entity List system was made public and enforced in line with the Foreign Trade Law, the National Security Law and other related laws and regulations. Under the provisions on the Unreliable Entity List, foreign entities that “endanger China’s national sovereignty, security or development interests” or “cause serious damage to the legitimate rights or interests of Chinese companies

through interrupting normal transactions or employing discriminatory measures" can face extensive sanctions in terms of trade, investment, visas and criminal penalties.

These retaliation provisions are considered to be contrary to WTO rules on dispute resolution, but the problem does not stop here. China's concept of national security is not limited to a general concept of security, but is more wide-ranging, based on a unified national security view that includes political security. Following the introduction of the Unreliable Entity List that stipulates strict sanctions, further clauses have been added to the final version with the addition of the retaliation clause and legal accountability by applying the law extraterritorially. This has a threatening and chilling effect on foreign companies engaged in business with China, giving us cause for grave concern.

China has been making efforts over the years to improve its trade and investment environment and has also announced measures to promote foreign investment under its reform and open-door policy, but the fact that the above-mentioned retaliation provisions and sanctions have successively been issued is causing significant anxiety and confusion for foreign companies. As such, we believe these measures will have a major negative impact on the trade and investment environment.

1.4 Ensure Sufficient Time to Prepare

The industrial associations of Japan, Europe and the United States requested that there be sufficient time, on a scale of a number of years, before the law comes into effect, but the final version will take effect December 1, 2020, just 40 days after it was made public. Nevertheless, even at this late stage, the subordinate rules and list of controlled items subject to regulation have not be published.

In such a situation where a large number of companies will be affected by such wide-ranging regulations, where there were none whatsoever before, we would like to expect that a sufficient period of time be given to allow these companies to comprehend and prepare for the changes, after all the related provisions and lists have been made public.

In understanding the problems we face and concerns we have regarding the China Export Control Law and other related laws and regulations as described above, we sincerely hope the government will work to ensure that the rules and implementation would be in accordance with international rules so that no damage is done to the trade and investment environment with China.

2. Expansion of the United States' Direct Product Rule

Regarding US re-export controls, industry has, for many years, raised issues with the United States Department of Commerce regarding the problems of extraterritorial application, as well as the problems of implementing and coping with such US rules. With this, we have been requesting US Department of Commerce that advanced countries with well-established export control systems should be exempted from US re-export controls, anduntil such exemptions can be achieved, we have requested that the burdens for coping with such re-export control be reduced as much as possible. As a result, certain successive improvements have been made by US Department of Commerce.

However, the Direct Product rule, which until now had only limited applicability on re-exports to countries of concern such as terrorist-supporting countries, was expanded without notice by the amendments of US Export Administration Regulations (EAR) in May and August of this year regarding re-exports to Huawei and its affiliates listed on the Entity List (hereinafter called Huawei). As a result, Japanese companies that re-exported products produced using certain US origin equipment and software to Huawei without violating the *de minimis* rule had to suddenly stop their reexports.

It seems that there are exceptional cases where re-exports are licensed, and in fact, some companies have been granted export licenses, but it is not clear on what criteria these licenses have been approved.

Another problem is that EAR stipulates the Direct Product rule which has been expanded to Huawei can apply to other companies and organizations on the Entity List by further amendment of US EAR any time. Even for Japanese companies companies which are legally dealing with companies listed on the Entity List, there is a possibility that the future trade will be suddenly cut off, which means a situation where predictability and legal stability are sorely lacking.

Moreover, the Direct Product rule itself is complicated and difficult to understand and the exact effects and contents of the rule cannot directly be ascertained, causing a great deal of confusion. Namely, we have to say there is a big problem in terms of clarity.

In any case, it must be said that it is unusual for regulations that have such a large impact on business to be enforced through the extraterritorial application of US laws and regulations.

Although we can understand the purposes of the US regulations under the current circumstances, the lack of fundamental regulatory requirements such as predictability, legal stability and clarity, in addition to the basic problem of the extraterritorial application, is not sound.

Moreover, if such improper application of extraterritorial regulations is repeated, it will be seen as a risk to use US products, meaning there is a very high chance that US products will

not be purchased or used in the medium to long term. Such a situation is not desired by Japanese industry, and of course it would also be most unwelcome to US industry.

With this in mind, we hope that, through discussions on a government-level, you will take into consideration ways of regulations that are right and proper while curbing excessive extraterritorial application of export control laws.

Attachments

Joint Comments by Industrial Associations of Japan, Europe and the United States on China's Draft Export Control Law (Standing Committee of the NPC's Second Draft) (dated August 11, 2020) (Japan-US and Japan-Europe Joint Comments — 2 documents)