



**2014 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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Information Technology Industry Council
Semiconductor Industry Association
Software & Information Industry Association
Telecommunications Industry Association

I. INTRODUCTION	3
A. EXECUTIVE SUMMARY:.....	3
II. CHINA'S "INDIGENOUS INNOVATION" POLICIES.....	6
A. ANTI-MONOPOLY LAW	6
B. PROCUREMENT POLICIES.....	7
C. INTEGRATED CIRCUIT (IC) INDUSTRY SUPPORT MEASURES	8
III. INTELLECTUAL PROPERTY RIGHTS.....	9
A. ENFORCEMENT	10
B. SEMICONDUCTOR COUNTERFEITS	11
C. IPR RELATED POLICY ISSUES	12
IV. MARKET ACCESS AND TECHNICAL BARRIERS TO TRADE.....	16
A. TECHNOLOGY LICENSING	16
B. TECHNICAL STANDARDS	17
C. CUSTOMS VALUATION	19
D. CUSTOMS RELATED POLICY ISSUES	20
E. CONFORMITY ASSESSMENT AND TYPE APPROVAL.....	22
F. CYBERSECURITY/INFORMATION SECURITY POLICIES.....	25
V. NATIONAL TREATMENT	29
A. GOVERNMENT PROCUREMENT MEASURES FAVORING LOCAL CONTENT	29
B. PUBLIC PROCUREMENT TIED TO DOMESTIC IP	29
C. GOVERNMENT PROCUREMENT.....	30
D. TRANSPARENCY.....	31
E. ENVIRONMENT AND ENERGY EFFICIENCY REGULATIONS AND STANDARDS	32
1. ROHS.....	32
2. WEEE	33
3. ENERGY EFFICIENCY	34
GREEN PROCUREMENT, LOW CARBON ASSESSMENT, AND OTHER SUSTAINABILITY RELATED POLICY ISSUES.....	35
VI. COMMUNICATIONS & INFORMATION SERVICES.....	35
A. IMPEDIMENTS TO MARKET ACCESS	35
PROPOSED BROAD EXPANSION OF TELECOM SERVICES REGULATIONS	35
EXISTING CHALLENGES WITH CHINA'S COMMUNICATIONS & INFORMATION SERVICES REGULATIONS.....	37
B. TECHNOLOGY NEUTRALITY VS. MANDATED STANDARDS	41
APPENDIX: USITO INTRODUCTION	43

I. INTRODUCTION

We are pleased to have this opportunity 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 an effective means to recognize areas where progress has been made, raise issues of concern, and suggest approaches to resolve areas of disagreement with China's government over implementation of its WTO commitments.

A. EXECUTIVE SUMMARY:

China's Indigenous Innovation Policies: China's drive to promote "indigenous innovation" is embodied in numerous industrial policies and measures that systematically favor products and services of Chinese companies over those of foreign companies. These include the development of national standards that favor domestic technologies, industrial policy driven by the implementation of the *Anti-Monopoly Law*, conformity assessment regimes that can be arbitrarily applied to delay the approval of foreign products, and overt local favoritism in government procurement. Many of these regulations and standards continue to hinder China's efforts to join the WTO Government Procurement Agreement (GPA) and appear to be counter to the transition to a "market driven" economy as announced at the 3rd Plenum of the 18th Communist Party of China Central Committee in November 2013.

Intellectual Property Rights: Despite expanded efforts in the past years to deal with Intellectual Property Rights (IPR) problems, including the *Special IPR Campaign*, establishment of the State Council IPR Office, and repeated acknowledgement by senior Chinese leadership that IPR problems continue to create trade disputes and stunt economic growth, piracy and counterfeiting at the wholesale and retail level, and over the Internet, remain high due to inadequate penalties, uncoordinated enforcement among local, provincial, and national authorities, and the lack of transparency in China's administrative and criminal enforcement system.

Technology Licensing: USITO companies continue to be concerned about governmental 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 intellectual property. The State Intellectual Property Office (SIPO) has also issued a proposed draft regulation on the remuneration of employees' inventions that could interfere with contracts for compensation for patents filed by employees of multinational companies¹. During the 2004 JCCT, China agreed not to interfere in licensing negotiations between standards implementers and the owners of "essential" patents or other IPR standards, but has not

¹ SIPO sent an internal working draft to select companies and other stakeholders, but the draft has not been released for formal public comment.

confirmed that it will uphold this commitment. China also agreed not to adopt policies that would interfere with licensing negotiation.

Technical Standards Setting: China is aggressively implementing and utilizing technical standards to support development of key industries, especially 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. In addition, 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. USITO advocates for the adoption of open technical standards that promote innovation and global interoperability, for increased openness and transparency in Chinese standards development organizations, and for the adoption of global standards by relevant Chinese authorities that remain voluntary once implemented locally.

Industry has observed repeated instances of China's standards authorities implementing standards that favour domestic technologies and were developed without full opportunity for participation from relevant stakeholders (including foreign ICT companies). Additionally, China's *National Standards Law* only recognizes the validity of some global standards bodies, and excludes important organizations such as the Institute of Electrical and Electronics Engineers (IEEE) even though they satisfy relevant WTO criteria. Furthermore, voluntary standards often are made mandatory through various administrative measures, and without sufficient notice to foreign companies.

Customs Valuation: USITO continues to be informed of situations not in agreement with the WTO Customs Valuation Agreement. Of primary concern is China Customs questioning transaction value and instead utilizing valuation databases with reference prices. 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. Inconsistent treatment among ports is also prevalent, as well as preference for verbal agreements instead of issuing written, binding rulings. USITO recommends that China pursue Customs modernization efforts as outlined below, which are consistent with those of other WTO members.

Conformity Assessment & Type Approval: China's current type approval process for telecommunications equipment is not sufficiently transparent and stipulates burdensome, non-technology neutral testing and conformity assessment requirements that require the submission of unnecessary confidential business information. Through the JCCT and other channels, industry has advocated for transparent requirements, simplification and consolidation of redundant tests, shortening of testing periods, and elimination of unnecessary functionality tests. Industry strongly advocates for Ministry

of Industry and Information Technology (MIIT) and other relevant authorities to streamline its type approval process to one certification process, combining the Network Access License (NAL), Radio Type Approval (RTA), and China Compulsory Certification (CCC) processes, and to publish and maintain on the Internet an easily accessible list of testing requirements and specifications. Considering Chinese conformity assessment practices more broadly, China should have the burden to justify why its requirements such as source code disclosures are essential to prove conformity, and provide both a prompt appeal process and adequate procedures to protect any confidential information that is submitted.

Information & Cyber Security: There continue to be a number of cybersecurity and information security related areas in which China's policies create challenges for USITO member companies, especially for commercial and non-sensitive government sector market access for ICT products. This includes policies for product certification, encryption, and critical information infrastructure protection (CIIP). China's distrust of foreign technologies and governments often gives rise to unilateral approaches and exclusionary policies to increase reliance on indigenous technology. This is exacerbated by unclear distinction in China between commercial and government information systems and between information security and national security related concerns. Additionally, domestic stakeholders seek to benefit from market opportunities that might arise at the expense of foreign competitors from security concerns that are manifested in discriminatory Chinese policies.

Government Procurement: From environmental protection to energy efficiency to information security, wide-ranging policies have increased the administrative burden on companies participating in government procurement. Some of these policies preclude foreign companies from participating in certain bids or Requests for Proposals (RFPs). In the meantime, China's progress towards WTO GPA accession has been very slow. China's December 2012 offer still excluded state-owned enterprises and lower-level government departments, a critical shortcoming that, along with other broad exemptions it is proposing, needs to be addressed. USITO advocates clear and steady improvements in government procurement policy, building toward meaningful accession to the GPA as soon as possible.

Environmental Standards and Compliance Regulations: China's energy efficiency programs present a number of challenges to foreign companies, including standards that deviate from global standards, mandatory labelling requirements, and energy efficiency requirements related to government procurement and market access. While well intentioned, China's burgeoning programs for recycling and environmental protection, such as China WEEE and RoHS, have raised concerns about transparency and complexity to increase administrative burdens and delay the time to market due to conformity assessment.

Communications & Internet Services: Since China's WTO accession, some aspects of China's communications services regulations have improved, while others remain highly restrictive to foreign enterprises. China should continue to harmonize its regulations

with international norms in this area, including its *Telecom Law*, *Telecom Services Categories Catalogue*, and the *Administrative Measures for the Pilot Operation of New-Types of Telecom Services*, all of which are under revision but without clear timelines.

The draft-revised version of China's *Internet Information Services Administrative Measures* released in June 2012 poses market access barriers for global Internet services companies. The proposed revisions to the Measures clarify internet regulatory roles and responsibilities of different government agencies, continue to classify internet services as a telecom-value added service, and also contain numerous requirements and provisions for national security lawful access, data retention, data privacy, content filtering, and real-name ID registration requirements (which become, for the first time mandatory, for all internet service providers). While internet regulation may be necessary for societal stability, USITO urges the Chinese government to avoid country-specific regulations relating to the creation, release, and transmission of certain types of content can constitute trade barriers for global Internet services companies. In addition, the proposed rules run counter to the global nature of the Internet.

II. CHINA'S "INDIGENOUS INNOVATION" POLICIES

China's drive to promote "indigenous innovation" is embodied in numerous industrial policies and measures that systematically favor products and services of Chinese companies over those of foreign companies. These include the development of national standards that favor domestic technologies, massive efforts to support domestic players in the integrated circuit industry, conformity assessment regimes that can be arbitrarily applied to delay the approval of foreign products, and local favoritism in government procurement.

A. ANTI-MONOPOLY LAW

USITO is concerned that, amid accelerating government agency campaigns to promote domestic champions, Chinese antitrust enforcers have increasingly turned their sights on foreign companies with a flurry of recent investigations launched under the China *Anti-Monopoly Law* (AML). While the Chinese leadership continues to pledge that the market will play a "decisive" role in China's economy, government actions continue to advance industrial policies in a coordinated manner. Recent developments suggest that Chinese authorities are using a variety of policy tools – including technology standards, antitrust rules, and intellectual property policies – to reduce China's perceived dependence on foreign IP while protecting and promoting domestic Chinese companies.

One example of this trend is China's use of the AML as an industrial policy tool, which could affect a range of U.S. companies. National Development Reform Commission

(NDRC) officials have been publicly outspoken about the important role that industrial policy considerations should play in antitrust enforcement in China and their intention to broaden significantly the scope of their review of competitive practices in a wide range of “strategic sectors,” including automobiles, telecommunications, banking and petroleum.

Indeed, China has used the AML to prevent undue concentrations of market power, combat cartels and abuse of market dominance, and pursue other goals that enhance the overall competitive environment in China. However, in many cases involving foreign companies, China’s anti-monopoly enforcement agencies have skewed implementation of the AML and related statutes to support China’s industrial policy goals, including through discrimination and protectionism. Although the legal machinery of the AML has been used to protect competition and prevent monopolistic conduct, China has also employed it both domestically and extraterritorially to pursue objectives that have no place in a free, open, and fair market-based economy.

The Chinese companies that benefit from these policies are often national champions in industries that China considers strategic, such as commodities and high technology. Through the AML, China seeks to strengthen such companies and, in apparent disregard of the AML, encourages them to consolidate market power, contrary to the normal purpose of competition law. [1] By contrast, the companies that suffer are disproportionately foreign. In fact, all transactions blocked or conditionally approved by MOFCOM to date have involved foreign companies, and the curtailment of IP rights appears designed to strengthen the bargaining position of domestic licensees.

B. PROCUREMENT POLICIES

USITO also remains concerned with the implementation of China’s 12th Five Year Plan (FYP), which includes efforts to bolster seven strategic emerging industries, including next generation information technology (IT). While “indigenous innovation” product catalogues are not part of the policy portfolio supporting development of strategic emerging industries, the FYP gives officials the impetus to put forward preferential tax, fiscal, and procurement policies to support these industries and indicates the importance the Chinese government places on these sectors. In the same vein, policies on information security, telecommunications standards, and other areas often facilitate, or even encourage, discriminatory treatment of foreign technology.

USITO is concerned that MIIT and other agencies directly involved in the regulation of the ICT industry in China continue to utilize non-market, non-technology neutral regulatory approaches to encourage domestic industrial development. This not only creates a burdensome regulatory and trade environment, but also stifles innovation domestically.

USITO urges the Chinese government to encourage an environment that enhances opportunities for innovation in China, including the promotion of non-discriminatory and merit-based procurement and full and open competition in the Chinese market. This entails winning commitments from the highest levels of Chinese government to create an equitable environment for the operation of foreign businesses in China and enable foreign businesses to enjoy national treatment like their Chinese counterparts. USITO commends U.S. government efforts on this issue and supports the continuation of the Innovation Dialogue, created in 2010 to facilitate continued dialogue between both government officials and innovation experts from industry and academia on innovation policy best practices.

C. INTEGRATED CIRCUIT (IC) INDUSTRY SUPPORT MEASURES

Recent developments signal that China is prioritizing the development of an indigenous Chinese IC industry. On June 24, 2014, MIIT and three other central government bodies published the “Guidelines to Promote National IC Industry Development,” a central government document outlining aggressive measures to support “leapfrog” growth in China’s IC industry. Among other more specific objectives, the policy calls for China to transform itself into a “leading IC country” by 2030 in all key market segments.

The central government recently confirmed the establishment of a 120 billion RMB central government equity investment fund to be invested in the IC industry over the coming 3 years, and regions and municipalities are lining up to launch their own investment funds. Beijing has already raised a 30 billion RMB fund, while other cities such as Shanghai, Shenzhen and Wuhan are rumored to have equal, if not larger, funds in the pipeline. More than a dozen regions and municipalities have announced similar funds, creating the backdrop for a massive influx of capital into the Chinese IC sector. Thus far, the policy has been developed and implemented in a manner that lacks transparency. 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.

Each year, the World Semiconductor Council (WSC), an organization with participation by countries and regions representing over ninety-five percent of the worldwide market (including China and the United States) reaffirms its commitment to the healthy development of the worldwide industry. CEOs and government/authorities from all participating regions have approved the following principle:

“While the WSC supports appropriate stimulus measures by the respective governments and authorities, WSC confirms its views that government actions should be guided by market principles and avoid adoption of protectionist or discriminatory measures. WSC confirms that competitiveness of companies and their products, not the interventions of

governments and authorities, should be the principal determinant of industrial success and international trade, and that assistance should be provided in a market-oriented fashion.”

USITO urges the Chinese government to embrace an open and transparent process that enables foreign governments and industry to provide input on all elements of the new plan and the IC investment funds before they are fully implemented. In addition, USITO calls upon the Chinese government to ensure that the plan and IC investment funds, at the central and regional levels, are compatible and fully in line with China's commitments to the World Trade Organization (WTO), APEC, and the Government/Authorities Meeting on Semiconductors (GAMS), among other forums.

III. INTELLECTUAL PROPERTY RIGHTS

China's Central Government has taken a number of steps to reinforce the importance of sound IP protection policy and enforcement, including the passage of improved intellectual property laws and regulations in the areas of copyright, patents, semiconductor masks, trademarks (including domain names), and business proprietary information. In 2011-2012, the *Special Campaign* facilitated increased cooperation between industry and law enforcement authorities for certain categories of products. An IPR Coordinating Office, housed in the Ministry of Commerce and led by Premier Wang Qishan, was established at the end of 2011 to build upon the progress of the *Special Campaign*.

However, despite positive rhetoric and high-level policies, IPR protection remains a serious concern for our member companies, particularly in the areas of enforcement, anti-piracy and anti-counterfeit efforts, as well as in the treatment of patents in standards, conformity assessment regimes, and China's patent registration and protection system. At provincial and local government levels, there remains a lack of consistent and effective measures to protect IP.

Piracy and counterfeiting at the wholesale and retail level, and over the Internet, remain at significant levels due to inadequate penalties, uncoordinated enforcement among local, provincial, and national authorities, and the lack of transparency in China's administrative and criminal enforcement system. Indeed, the appropriation of IP in China has occurred on such a massive scale that it continues to influence international prices, disrupt supply chains, change business models, and likely permanently alter the balance between tangible and intangible values contained within commercial products.

Closely related to these troubling IP policies are the regulatory framework emerging around the development of technical standards, and the protection and disposal of IPR in drafting China's standards. These policies raise serious questions about China's WTO Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) commitments, which oblige signatories to protect private intellectual property rights.

For example, there have been recent efforts on the part of technical standardization committees in China to force transfer of printing and information security technology IP to domestic companies.

USITO advocates for China's implementation of transparent enforcement systems and clear delegation of administrative responsibility for IPR protection, enforcement, and accountability, as well as government leadership and central and local levels in propagating a culture of respect and value for IPR in China.

A. ENFORCEMENT

Enforcement actions should be measured against China's commitments under TRIPS to provide copyright owners "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).

At recent Joint Commission of Commerce and Trade (JCCT) meetings, China made significant commitments regarding IPR, specifically for software and academic journal anti-piracy. These commitments should be reinforced and upheld in anticipation of the 2013 JCCT process.

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.

Other promises regarding protection of IP remain unfulfilled, such as the commitment made at the 2006 JCCT to ensure use of legal software by government offices at the national, provincial, and local levels, and in state-owned and state-invested enterprises. During the 2011 *Special Campaign*, China again reaffirmed its commitment to procure licensed software in central government offices and in 30 large state-owned enterprises. But despite these efforts, software piracy in governments and SOEs remains a significant concern. Equally troubling, many recent software legalization initiatives by Chinese authorities also contain directives for purchase of 'indigenous' software products.

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. We believe the 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.

The various commitments made by the Chinese government in recent years are important steps that provide a strong basis for the Chinese government to take concrete action and provide reliable information on actions to improve IP enforcement.

B. SEMICONDUCTOR COUNTERFEITS

Semiconductors are the “brains” behind an incredibly diverse range of end products and systems such as healthcare and medical equipment, communication networks, emergency response systems, electric power grids (including nuclear and solar power generation systems), industrial and automation systems, and transportation systems and controls. Given the criticality of these end-use products and systems, counterfeit semiconductors pose risks to health and safety wherever they are used worldwide. In addition to counterfeit semiconductors creating a clear and present danger to the public, counterfeits also result in the loss of intellectual property for the original manufacturer. The sale of counterfeits erodes sales of legitimate products and causes job losses and damage to world economies. Semiconductor companies typically spend 15-20 percent of revenue on research and development (R&D), making IPR protection of utmost importance. In 2012, U.S. semiconductor companies invested \$32 billion in R&D, totalling 22 percent of sales.

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 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). The WSC has an Anti-Counterfeiting Task Force that is composed of experts from all the major semiconductor producing regions. 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.²

Data from the member companies of USITO Parent Association the Semiconductor Industry Association (SIA) and other sources has shown that semiconductor counterfeiting is a major issue. In April 2012, market research firm iHS iSupply reported “The five most prevalent types of semiconductors reported as counterfeits represent \$169 billion in potential risk per year for the global electronics supply chain.”³ 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 plead 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.

USITO is greatly encouraged by the groundbreaking commitments in the 24th JCCT deliverables to increase enforcement against counterfeit and substandard semiconductors and enhance cooperation on cross-border investigations. China’s Customs Agency and other law enforcement and market surveillance agencies should be encouraged to aggressively seize counterfeit products and take actions leading to the arrest of counterfeiters and counterfeit traders.

C. IPR RELATED POLICY ISSUES

USITO continues to register concern about Chinese government involvement in discussions of compensation for intellectual property and policies that are seemingly designed to disadvantage non-Chinese intellectual property holders.

² The World Semiconductor Council currently is composed of the European, Japanese, Chinese Taipei, Korean, Chinese, and U.S. semiconductor industries.

³ IHS iSupply press release, “Top 5 Most Counterfeited Parts Represent a \$169 Billion Potential Challenge for Global Semiconductor Market,” April 4, 2012: [http://www.isuppli.com/Semiconductor-Value-Chain/News/Pages/Top-5-Most-Counterfeited-Parts-Represent-a-\\$169-Billion-Potential-Challenge-for-Global-Semiconductor-Market.aspx](http://www.isuppli.com/Semiconductor-Value-Chain/News/Pages/Top-5-Most-Counterfeited-Parts-Represent-a-$169-Billion-Potential-Challenge-for-Global-Semiconductor-Market.aspx).

1. ***The ability of dominant (successful) companies to unilaterally and unconditionally refuse to license their IP should be preserved.*** Article 17(b) of SIAC's 5th draft of its *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 draft 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. 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. 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. We recommend that any damages award for a compulsory license be on terms that make the coerced licensor whole, such as Article 65's lost profits remedy. There is no rationale for a patent holder to receive less compensation under Article 57 than he would under Article 65 just because, for example, his 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 his losses as required by Article 31(h) of TRIPS. China is in the midst of amending its patent law for the fourth time. We urge SIPO to use that opportunity to close the gaps between the significant TRIPS restrictions on compulsory licensing and the *Patent Law's* compulsory licensing provisions.

2. ***The rights of patent pools should be narrowly construed.*** We urge all of China's technical committees to adopt reasonable IPR policies based on the IPR guidelines vetted and approved by IEC/ISO in 2011. IT Technical committees also should assure their members that patents they license as part of a patent pool for a given standard will not be considered as a commitment to license those patents for use in other standards, unless the individual members themselves – or the members of the IT standards setting body to which they belong – express no objection to such use. The Standardization Administration of China (SAC) is drafting in 2012 version three (3) of its *Regulations on Development and Amendment of National Standards Involving Patents*. The prior two versions received significant criticism because they undermined the rights of patent holders in a way that was not only WTO incompatible, but counterproductive to China's innovation objectives. USITO advocates for adoption of fair and transparent FRAND principles in this new version.
3. In April 2014, the State Intellectual Property Office (SIPO) released a new draft of its Service Invention Remuneration (SIR) Regulations. The proposed regulations, like the November 2012 version, represent a step backwards from the clarity which was created by the 3rd amendment to the patent law and corresponding implementing regulations, namely that "An entity which has been granted a patent can reach an agreement with the inventor(s) or designer(s), or stipulate in its legally formed company rules with regard to the form and amount of rewards and remunerations as mentioned in Article 16 of the Patent Law." While improvements have been made since 2012, the proposed amendments continue to undercut freedom of contract and impose additional onerous terms to be included in the employer and employee agreements and make it unclear if the aforementioned regulation is superseded or not by the proposed regulations. Further, the proposed amendments attempt to apply not only to patents but also to technical secrets, creating an impractical and unworkable burden on industry members. Invention remuneration should be determined between the employer and employee and that the employer and employee should be given the flexibility to craft agreements that meet the needs of both parties. High uncertainty, imposes an undue burden of compliance on employers, leaves the employer exposed to a risk of constant litigation, and deflects potential investors and investments in China.
4. ***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 problem there.⁵ The issuance of utility model patents is growing dramatically; they are quick, easy and inexpensive to obtain. Over 35 percent of all patent applications in China—roughly 740,000

⁵ Jia Lynn Yang, "Chinese firms put intellectual property lawsuits to work," Washington Post, August 30, 2012 available at http://www.washingtonpost.com/business/economy/chinese-firms-put-intellectual-property-lawsuits-to-work/2012/08/30/12d9a418-f1c3-11e1-adc6-87dfa8eff430_story.html

applications in 2012 alone—are for UMPs that have the same scope, presumption of validity and enforcement (or threat) value as substantively examined invention patents—despite contributing at most only an incremental advancement to technology⁶. UMP applications in China are also increasing; growing by 26 percent from 2011 to 2012, as well as through the first half of 2013 compared to the first half of 2012.⁷ Clearly this is an issue that is growing. 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. Two options would be as follows: amend Article 40 of the Patent Law to request prior art search and substantial examination of UMP applications or 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.

5. **Fourth Patent Law Amendments:** There are two major concerns with the draft fourth patent law amendments, which focus on enforcement of patents. First, the amendments create a greater gap between the SIPO Patent Reexamination Board (PRB) decision on validity and a decision by the courts or patent administrative authority on infringement. The proposed amendment in Article 46 makes the validity decision effective as of the date of announcement and the proposed amendment in Article 60 requires the courts or patent administrative authority to timely decide the patent infringement case after the PRB decision is announced. This means that a decision on infringement will be handed down even though the relevant parties may appeal the PRB decision. As a result, the above amendments will very likely force an infringement decision and the issuance of an injunction and damages award, even if the patent is later rendered invalid by the appellate court. Article 47 exacerbates this problem because it declares that if a patent right is held invalid, it will have no retroactive effect on any court or administrative decision made and enforced. USITO recommends against amendments that widen the gap between determination of validity and infringement because this will produce unfair results and harm innovation.

The second major concern is the greater power provided to administrative authorities on patent matters. The administrative authorities, under the proposed amendment in Article 64, are granted a full range of powers to investigate, including inspecting and duplicating company contracts, seizing products proved to “disrupt the market order” by willful patent infringement

⁶ State Intellectual Property Office of the People's Republic of China (SIPO), available at: <http://english.sipo.gov.cn/>, accessed on September 9, 2013.

⁷ Ibid.

and to punish willful patent infringement in accordance with the law, investigate and punish willful infringement, including levying punitive damages for willful infringement up to three times the amount of actual damages. USITO recommends against providing this additional authority to the administrative authorities there are insufficient procedural safeguards, especially around copying and seizing company property and lack of clarity about what constitutes “willful infringement” and “disrupting the market order”. This additional authority, especially without proper safeguards and training, could lead to frivolous actions and unfair results.

IV. MARKET ACCESS AND TECHNICAL BARRIERS TO TRADE

A. TECHNOLOGY LICENSING

The U.S. ICT sector continues to be concerned about governmental 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 intellectual property. 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.

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 Telecommunications Research (CATR), a government institution subordinate to MIIT.

These governmental practices are inconsistent with the fundamental rights conferred by patent to technology owners and constitute an express 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. As China launches 4G LTE services, USITO is concerned that previous 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 USITO member's face challenges is in the area of 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 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. 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.

B. TECHNICAL STANDARDS

We recognize the recent incremental reforms in China's standards policies, but remain concerned that China's standards policies continue to deny sufficient participation from global industry and often result in crucial deviations from existing global standards. China often mandates standards that are developed outside of global standard setting processes, and with limited consultation with industry stakeholders. Furthermore, 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 this byzantine 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 intellectual property 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.

Examples of specific standards-related issues in China include:

- MIIT's approval in 2012 of Enhanced Ultra-High Throughput (EUHT) wireless LAN technology as a voluntary industry standard. Development and approval of EUHT did not adhere to paragraphs F, L, N and O of the TBT Agreement Code of Good Practice;
- The China National Information Security Standards Technical Committee (TC260)'s continued discussion of office equipment information security requirements. Development of these standards did not adhere to paragraphs D, L, N and O of the TBT Agreement Code of Good Practice;
- CCC product safety standards, including GB 4943.1-2011, which contains significant deviations from global standards.

One particular concerning trend USITO has observed in China's standardization regime is general lack of compliance with the TBT Agreement Code of Good Conduct, which among other things 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 such as ZUC, TCM, and EUHT had comment periods of 15-30 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.

Chinese authorities should be encouraged to promote the use and adoption of voluntary, open, global and industry-led standards, as well as to promote active participation by Chinese organizations in global standards setting bodies and initiatives.

China remains focused on developing and maintaining unique Chinese standards that feature Chinese technologies, rather than relying on commercial demand to drive deployment. 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.

We would like to reiterate several principles for the development of technical standards that we believe are important to robust trade and investment. We believe that in general, standards should be voluntary and not mandated by government agencies. We also encourage 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 Electrical and Electronics Engineers (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. USITO also encourages China to follow the attributes of eligibility derived from the WTO principles including, but not limited to, openness, consensus, balance, and transparency.

Finally, while not a WTO requirement, 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.

C. CUSTOMS VALUATION

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:

1. The General Administration of Customs (GAC) uses an out-dated and arbitrary pricing methodology for valuation purposes that does not take account of modern, complex 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.

2. 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 Customs arbitrary and fictitious reference price. China customs officials should abandon the use of arbitrary and artificially created reference processes in ascertaining the transaction value of goods.
3. 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 Chinese Customs 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 Chinese Customs. 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 RELATED POLICY ISSUES

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.

1. ***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.
2. ***Resolution of Regulatory Issues:*** It continues to be difficult to address or resolve regulatory issues with Chinese customs officials. The General Administration of

- Customs (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. This should include GAC adoption of a systematic, repeatable, transparent, and sustainable structure to gather industry inputs (new industry trends, business challenges, supply chain problems) as well as a feedback mechanism for GAC to systematically respond to importer issues.
3. **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. Overall, a robust and efficient customs clearance capacity is an important aspect of an established supply chain, and the removal of administrative bottlenecks and procedural delays would substantially increase China’s ability to ensure trade facilitation for all stakeholders.
 4. **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.
 5. **Bonded Zones:**
 - a. **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.

- b. 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.

E. CONFORMITY ASSESSMENT AND TYPE APPROVAL

Industry is encouraged by the August 2013 announcement by the State Council to broadly streamline administrative approval systems. In particular, the Guidelines to Promote Information Consumption and Boost Domestic Demand emphasize the need to streamline administrative approval systems in the ICT industry by “reduc[ing] existing approval requirements, minimize record-keeping systems and remove non-administrative approval and certification requirements. Promot[ing] joint approval, one-stop service, processing time limits for remaining administrative approval systems.”⁸ There appears to be a clear recognition by the Chinese government that reforms to the existing conformity assessment process for the ICT industry are necessary. In addition, we would note the recently implemented reforms to the China Compulsory Certification (CCC) scheme and look forward to further reforms and streamlining of China’s conformity assessment and type approval systems that appear to be underway. We are encouraged to see that China designated some non-Chinese labs to undertake CCC-related testing in a recent supplementary designation of certification bodies and labs for CCC certification. We hope such openings will continue to expand with a clear timeline and roadmap that allows for additional non-Chinese labs to be designated for CCC-related testing.

⁸ State Council of the PRC, “Guidelines to Promote Information Consumption and Boost Domestic Demand” (Chinese: 国务院关于促进信息消费扩大内需的若干意见), website: http://www.gov.cn/zwqk/2013-08/14/content_2466856.htm

However, as China continues to develop new regulations, it appears that the current default conformity assessment requirements include mandatory third party certification, most always with in-country testing, even though such requirements may be more trade-restrictive than necessary. We believe that China would benefit from exploring and implementing a more open approach that considers alternative conformity assessment models that are based on the risk assessment of products.

China and the United States are among the 54 Member Bodies and 77 National Certification Bodies (NCBs) participating in the International Electrotechnical Commission's (IEC's) system for Conformity Testing and Certification of Electrical Equipment (IECEE CB Scheme). The CB Scheme is an essential vehicle to provide market access for products and eliminate redundant testing of products at multiple laboratories. There are both existing and developing programs within the IECEE that are aimed at improving data acceptance and harmonization of conformity assessment practices across countries. During recent years, China has engaged positively within the IECEE CB Scheme for product safety test report acceptance; however, laboratories in China today are not making the best use of these international programs, and China also continues to not fully accept manufacturing testing, as allowed under the CB Scheme.

Overall, the product testing and certification process in China is more burdensome than in other markets, which increases the costs of exporting products to China and getting them to market in a timely manner. Under China's Network Access License (NAL), unnecessary and undocumented testing requirements lead to delayed time-to-market and cost increases. Despite JCCT commitments, there have not yet been significant improvements to the streamlining of the system, or reduction of time or cost to attain conformity assessment. Recent mobile security regulations also stand to add new requirements to the network access license NAL process. USITO advocates for the NAL's scope to be limited to basic testing requirements for *network interoperability and functionality* and the elimination of test requirements that support specific indigenous technologies from the NAL.

Furthermore, MIIT's lack of clear labelling requirement rules for type approval is creating inconsistent application of labelling at the provincial level. Although MIIT has told companies that labels can be affixed to packaging, some provincial government officials continue to require companies to affix the label to the product. Given that NAL labels must be purchased from MIIT directly, this lack of certainty results in significant re-labelling costs for particular products. Written and transparent labelling requirements would reduce the amount of re-labelling required.

China's current certification requirements for telecommunications equipment conflict with its WTO obligations of limiting imported products to no more than one conformity assessment scheme and requiring the same mark for all products (Article 13.4(a) of China's WTO Accession). China has three different licensing regimes—the Radio Type Approval, the Network Access License, and the China Compulsory Certification. Therefore, for a given piece of equipment, it can cost between U.S. \$20,000-30,000 to test for all three licenses (NAL, RTA, CCC). MIIT indicates on its website that it processes

more than 4,000 applications a year, which represents approximately \$100 million in testing fees a year. It should also be noted that as smartphones and other devices evolve with new functionalities, the testing fees could increase for a particular device because these fees are dependent upon the number of functions on a particular device.

Lastly, some of China's certification programs require disclosure of unnecessary information, much of which is business confidential (e.g., source code and design information for telecom network products and product content and supplier lists for EHS/RoHS approvals). This is an increasing concern for foreign companies who are forced to provide sensitive information or forego market access.

USITO appreciates the work of the U.S. government in following up on China's 2011 JCCT commitment to continue engagement with MIIT to address these concerns. In the meantime, USITO urges the Chinese government to promote the fuller adoption of the IECEE CB Scheme and streamline its type approval process by:

- Encouraging acceptance of CB Scheme test reports by national laboratories;
- Joining most other countries in participation in the IECEE CB Scheme for Electromagnetic Compatibility (EMC);
- Reducing the number of tests required by the NAL to a minimum;
- Clarifying to provincial governments that manufacturers have the discretion to meet the type approval labelling requirements for products by affixing the label to either the packaging or on the product;
- Publishing all testing requirements in an accessible and transparent manner for industry in a consolidated location on the MIIT website, including all requirements for RTA and NAL tests;
- Establishing a regular, public stakeholder consultation mechanism to review proposed new type approval testing requirements and procedures to enable an ongoing dialogue with stakeholders on what is working and what may need improvement and/or re-evaluation; and
- Negotiating and concluding a Mutual Recognition Agreement for testing and certification with the United States.

Furthermore, new testing and factory audit requirements should also be announced with a minimum 60 days' notice to allow adequate time for industry to make the transition to any new requirements, and all testing requirements and specifications should be published and maintained on the Internet in an easily accessible format.

Finally, Chinese regulatory authorities should make sure that "conformity assessment procedures are undertaken and completed as expeditiously as possible" (TBT Art. 5.2.1), "information requirements are limited to what is necessary to assess conformity" (TBT Art. 5.2.3), and "the confidentiality of information about products originating in the territories of other Members arising from or supplied in connection with such conformity

assessment procedures is respected in the same way as for domestic products and in such a manner that legitimate commercial interests are protected” (TBT Art. 5.2.4).

F. CYBERSECURITY/INFORMATION SECURITY POLICIES

China continues to implement a number of cybersecurity - and information security-related areas in which China's policies create challenges for USITO member companies, especially for commercial and non-sensitive government sector market access for ICT products. This includes policies for product certification, encryption, and critical information infrastructure protection (CIIP). China's distrust of foreign technologies and governments often gives rise to unilateral approaches and exclusionary policies to increase reliance on indigenous technology. This is exacerbated by unclear distinction in China between commercial and government information systems, and between information security and national security related concerns. Additionally, domestic stakeholders seeking to benefit from market opportunities that might arise at the expense of foreign competitors from security concerns that are manifested in discriminatory Chinese policies.

Following are a number of specific policies and concerns that the U.S. ICT industry has about China's policies in this area.

1. **National Cybersecurity Review Regime:** The State Council Internet Information Office (SCIIO) recently confirmed in May of 2014 that the Chinese government will establish a “review mechanism which will review ICT products and services that may create risks to Chinese national security or “public interests.” According to SIIO: *“Critical information technology products and suppliers, with a focus on investigating the security and controllable aspects of products in order to prevent product suppliers from illegally controlling, disrupting, terminating users systems, or illegally collecting, storing, processing, and using user related information. Products and services that don't meet the related security requirements will not be able to be used within China.”*

According to USITO understanding the new review regime will indeed adopt the recently released draft for comment “Security Code of Conduct for ICT Suppliers” by TC260, China's national information security review commission for defining key aspects of the review regime including scope. According to the draft “code of conduct,” the scope of the review regime will be very broad to include the virtually commercial ICT products and or service: *“software and equipment having acquisition, storage, processing, transmission, control, exchange and display functionality of data or information, including computer and auxiliary devices, network equipment, automatic control equipment, operating system, database ,application software and services, etc.”* I

ITI is concerned that broad and vague nature of the proposed Chinese national cybersecurity review regime will have adverse negative effects not only on

foreign investors in the China market, but also Chinese consumers who could be blocked from purchasing advanced ICT goods. No other major economy has a similar review mechanism in place that would govern the transaction of commercial ICT goods within the private sector market.

2. **Multi-Level Protection Scheme (“MLPS”):** China continues gradual implementation of the MLPS regime for classification and protection of critical information infrastructure information (CII) systems, with restrictions on use of foreign security technology in the top three MLPS-ranked levels (of five). USITO advocates for removal of such restrictions as well as – for ICT products sold into all MLPS levels – mandatory product assurance testing requirements to unique Chinese standards, and enforcement of the 1999 commercial encryption regulations outside their normal and limited jurisdiction.
 - a. Analysis done by USITO’s parent associations demonstrates that a wide swath of Chinese commercial infrastructure is now under the jurisdiction of MLPS. Based on an analysis of available market data, USITO parent association ITI estimates that MLPS likely covers 60-70 percent, 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.
 - b. MLPS is a technical mandate that has been under development for many years and is part of China’s overall national information assurance strategy. In June 2007, China issued the *Administrative Measures for the Multi-Level Protection of Information Security*, a mandate that sets down guidelines to categorize information systems according to the extent of damage a breach in the system could pose to social order, public interest, and national security. The mandate also provides detailed technical standards and certification requirements for products used in information systems, which are to be categorized from level 1 (least sensitive systems) to level 5 (extremely sensitive systems related to national security requiring specialized oversight and inspection).

Each 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. In addition, encryption requirements in the *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. Despite China agreeing at the 2012 JCCT to engage in technical discussions with the U.S. government regarding market access barriers due to the MLPS scheme, these talks have yet to begin.

3. **Commercial Encryption Regulations:** After four years of ongoing revision, the State Encryption Management Bureau (SEMB) recently indicated to industry and government that revision of the 1999 *Commercial Encryption Regulations* was likely to be completed in late 2013 or sometime in 2014. USITO continues to advocate for the full deregulation of commercial encryption, including that commercial encryption not be classified as a state secret, and that companies not be required to obtain a license to import, develop, or sell commercial encryption products in China. China’s 1999 commercial encryption regulation deems all *commercial* encryption a “state secret” and generally prohibits the use of foreign encryption products. In 2000, as a result of widespread foreign government and industry opposition, the Chinese government clarified that foreign ICT products with encryption can be sold in China, through an exemption process, if their “core function” is not encryption. Foreign encryption products themselves are still banned from the China market. Additionally, the State Cryptography Administration (SCA) 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.
4. **ZUC Encryption Standard:** ZUC is China’s government-developed indigenous encryption algorithm created for usage in 4G LTE networks, and perhaps in other national communications networks. ZUC is the first encryption algorithm that China proactively brought to the international standards community—it was approved as an international voluntary standard by 3GPP in September of 2011. Although we welcome China’s taking its standard through the international standardization process, China’s SCA has confirmed that implementation of the ZUC algorithm and related standards will be mandatory in the commercial market – namely for all base-stations, mobile devices, and mobile management equipment (MME) that connects to a 4G network in China. This is outside of global norms as no other major country has mandated a specific algorithm for usage in the commercial telecom market as a baseline for market access, and represents a significant expansion of the core-function test (see entry above) to general-use commercial ICT products. While we remained concerned about the mandate and lack of choice Chinese carriers have in implementing encryption standards, we do note that the Chinese government backed away from implementing onerous ZUC testing and certification requirements. Previous versions of SEMB’s encryption module draft testing specifications would have

required ZUC-compliant equipment to undergo an extensive testing process that includes a review of source code and other proprietary information. Industry had asked MIIT and SCA to respect its various commitments towards technology neutrality in the commercial market, and not engage in any additionally mandatory encryption-related testing that would force disclosure of sensitive IP. We note that, according to the TBT Agreement, members are required to “specify technical regulations based on product requirements in terms of performance rather than design or descriptive characteristics.” (TBT Art. 2.8). We are glad to see MIIT embraced these principles in its final testing specifications that were entirely based on performance requirements. China in 2013 also made a commitment at the JCCT to not require company confidential information or trade secrets in the process of testing and certifying telecom devices that support ZUC.

5. **Cloud Computing Security Standards:** With the increasing deployment of cloud computing services in China, including in the public sector, the Chinese government has begun to aggressively develop related technical security standards. With the China National Information Security Standardization Technical Committee TC260 as the lead, a number of problematic standards have been drafted such as *Information Security Technology: Government Department Cloud Computing Service Provider Basic Security Requirements*. These requirements advocate for the in-country hosting of cloud data, usage of Chinese cloud providers, and so on. USITO advocates for the Chinese government to take a balanced approach towards cloud computing security in China that respects the need for additional security measures within the government realm, but also allows for the adoption of global norms and standards.
6. **Office Equipment Security Standards:** For five years, TC260 has been developing office equipment information security technical requirements that previously included burdensome security requirements for microchips in printers and printer consumables. As of August 2013, TC260 is now developing testing and certification requirements for office equipment security that may include technology mandates and a review of proprietary business information including cryptographic protocols. USITO recommends that the standard exclude explicit security requirements for microchips, removable storage, hardware interface protocols, and require testing for non-proprietary business secrets.
7. **China Compulsory Certification For Information Security (“CCCi”):** In 2007, China announced through a WTO TBT notification the development a new testing and certification framework under the China Compulsory Certification (CCC) program for 13 categories of information security products sold into the commercial market. Foreign industry and the European Union, Japan and the United States reacted very negatively to the initiative, as it would have unnecessarily disrupted global trade and potentially discriminated against foreign IT products. As a result, in 2012 China cut the scope of CCCi regulations

back to the government procurement market. Nonetheless, due to requirements for source code disclosure and product testing in government-affiliated laboratories, the framework has been virtually unworkable for foreign companies and foreign companies have not applied for the certification. As of the end of August 2012, out of 200-information security product certified under CCCi, only one is from a foreign company.

V. NATIONAL TREATMENT

A. GOVERNMENT PROCUREMENT MEASURES FAVORING LOCAL CONTENT

In February 2012, the Ministry of Finance (MOF) issued its *Key Points for Government Procurement Work Plan 2012*, which states that the department intends to finalize the *Regulation of Government Procurement of Domestic Commodities*, a policy first released for comment in 2010 which stipulates a 50 percent 'domestic content' requirement. MOF has not yet released for public comment a draft of these regulations. USITO advocates for an exemption from this regulation for ICT products due to their complex global supply chain.

B. PUBLIC PROCUREMENT TIED TO DOMESTIC IP

Indigenous innovation refers in general to a set of national and regional policies promoting development of local technology and IP, and more particularly to a specific set of policies that incentivize public procurement of products with 'indigenous' IP. In 2011, the MOF and Ministry of Science and Technology (MOST) each repealed key indigenous innovation policies, which industry generally views as a positive development. However, while the Central Government has clearly reiterated China's commitment to foreign investment and suspended publication of a national Indigenous Innovation Product Catalogue during bi-lateral talks with the United States, some provincial and local governments continue to implement various 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 value⁹. Limiting government procurement to products

⁹ See, e.g., draft National Competition Policy Statement of the Government of India (July 28, 2012) (citing to an OECD survey which indicates that "savings to public treasuries between 17 percent and 43 percent have been achieved in some developing countries through implementation of competitive procurement processes.")

based on nationality of IP ownership or brand registered location or other indigenous innovation factors fails to appreciate the truly global and cross-border nature of innovation and product development, as well as the very substantial and critical contributions that multinational technology companies are making to China's own capacity as a global innovation leader. USITO asks that 2011 pro-competitive procurement policy decisions by MOST and MIIT are fully implemented at all levels of government, that China ensure that its procurement policies are consistent with GPA norms as reflected in prior JCCT commitments, and that China promptly joins the GPA on strong commercial terms.

C. GOVERNMENT PROCUREMENT

China's progress towards WTO GPA accession has been very slow. China's multiple revised accession offers continue to have many critical shortcomings that need to be addressed. 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 Strategic and Economic Dialogue (S&ED) and JCCT sessions. The U.S. ICT industry recommends that, based on the priorities below, U.S. government officials use the JCCT meeting 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.¹⁰ Sub-central government entities should include (1) the governments of the Administrative Divisions (“Provinces”) (sheng); (2) the governments of the five autonomous regions (zizhiqu); (3) the governments of the four municipalities¹¹ (shi); and (4) any “body governed by public law”¹² enacted by these governments (i.e., subordinate entities of the Sub central 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.¹³
- 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.¹⁴

D. TRANSPARENCY

USITO noted the positive steps taken with the 2008 implementation of China’s National Ordinance on Openness of Government Information. It has been hoped that this step would act as a catalyst to give individuals and organizations the legal right to request information from the government in an orderly manner. It is important for the U.S.

¹⁰ Article II of government procurement law states that the following entities are subject to the *Government Procurement Law*: “Government Procurement” refers to the purchasing activities conducted with fiscal funds by government departments, institutions and public organizations at all levels, where the goods, construction and services concerned are in the centralized procurement catalogue compiled in accordance with law or the value of the goods, construction or services exceeds the respective prescribed procurement thresholds.

¹¹ The governments of the 4 municipalities are considered “provincial-level administrative units under the management of the Central Government,” and approved by the Chinese National People’s Congress. These cities are subject to the laws and administration of the State Council.

¹² Any “body governed by public law” enacted by these governments is a body:

-- Established for the specific purpose of meeting needs in the general interest, and not having an industrial or commercial character, and -- Having legal personality, and -- Financed, for the most part, by the Provincial, Autonomous or Municipal authorities, governed by public law, or subject to management supervision by those bodies, or having an administrative, managerial or supervisory board, more than half of whose members are appointed by Provincial, Autonomous or Municipal authorities or by other bodies governed by public law.

¹³ See Paragraph 47 of the REPORT OF THE WORKING PARTY ON THE ACCESSION OF CHINA, WT/ACC/CHN/49, 1 October 2001.

¹⁴ See Paragraph 46 of the REPORT OF THE WORKING PARTY ON THE ACCESSION OF CHINA.

government to continue pressing China to meet its WTO and JCCT commitments on government transparency, including those relating to the formulation of industry policies.

Specifically, the long overdue Telecom Law has yet to be completed and the drafting process is opaque. The same 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. Transparent opportunities to participate in China's rulemaking process are necessary for industry to have confidence in stable investment opportunities.

E. 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, Certification and Accreditation Administration (CNCA), and other Chinese ministries and agencies on a number of issues including environmental regulations, product energy efficiency standards, as well as eco-design related products standards. Below are some overarching principles that we recommend to the Chinese government in this space:

- Regulations should be open, transparent, non-discriminatory, and based on sound technological specifications and market statistics.
- Partnerships between governments and industry should be encouraged to develop and make more readily available the benefits of new technologies.
- When China considers a substance restriction regulation or manufacturing process replacement, it should consider existing international standards and base development of such regulation on life cycle environmental impact analyses.
- The high tech industry encourages industry consultations at each stage of regulation development to achieve consistency and transparency.

We review below key examples of regulatory areas in China involving issues of concern for USITO, its parent associations and member companies.

1. RoHS

Industry appreciates the openness of MIIT officials in their regular communication with the industry on the implementation and development of the China RoHS program.

On June 4, 2012, MIIT released the revised *Electronic and Electrical Products Pollution Controlling Management Measures* (China RoHS II) for public comment. The subsequent

release of the *Draft Norms on Enterprise Conformity Declarations for Control of Pollution in Electronic and Electrical Products* in July 2012 for public comment was further welcomed by USITO as MIIT's efforts for more transparent rule development.

USITO highly recommends the adoption a self-declaration of compliance (SDOC) approach in China RoHS II. We advocate for China's elimination from its RoHS program any requirements for disclosure of proprietary information, including suppliers and material composition of ICT products. USITO members also look forward to commenting on the draft FAQ documents later this year.

The state-promoted voluntary certification program by MIIT and CNCA, which was implemented on November 1, 2011, was billed as a means to promote awareness of RoHS issues. The rules require companies to use only authorized Chinese testing facilities, which in turn require disclosure of proprietary information in order to obtain RoHS certification. CNCA and MIIT have jointly released a list of China RoHS accreditation institutions, including CQC, CESI and Jianheng Agency, as well as a list of accredited testing laboratories. The rules also require factory inspections. Industry is continuing to work with the U.S. government and Chinese authorities to discuss these concerns and their implications for trade and market access. The fact that this certification program currently is voluntary does not reduce its significance, as Chinese officials have ways through government procurement pressure, Waste Electrical and Electronic Equipment (WEEE) fee reduction, and otherwise to make such programs *de facto* mandatory. USITO emphasizes the need for continued industry-government dialogue and collaboration. USITO also encourages China's inclusion of internationally accredited testing facilities in and outside of China as authorized RoHS testing facilities.

2. WEEE

China's Regulation on WEEE is a national E-waste collection and recycling regime. On May 30, 2012, the MOF released the final version of the China WEEE Fund Collection Measures. Fund collection for the first batch of both imported products and domestically manufactured products started July 1, 2012.

The "Administrative Regulation on Recycling and Treatment of Waste Electrical Appliances" entered into effect January 1, 2011. The regulation contains provisions that may provide WEEE fee reduction for the RoHS voluntary certification, and therefore promotes the troublesome certification over other RoHS conformity models. Second, under a first batch of the catalogue of products subject to China WEEE requirements, five categories of products are subject to mandatory recycling. The five product categories might be expanded over time to include others, via successively issued batches of the product catalogues. Furthermore, according to the recycling data released by MEP, hundreds of millions dollar fee paid by USITO members have been paid to qualified recyclers of used refrigerators, washing machines, televisions, and air conditioners. By July 2013, there is no data available on recycled used computers.

Currently, USITO is concerned about:

- Lack of a dedicated computer WEEE fund despite computer manufacturers' full support of the fee collection activities.
- Further expansion of mandatory WEEE product catalogue without a thorough review of the phase I implementation of China WEEE regulation and a science-based evaluation of recycling models for each product category.

We recommend the Chinese government to:

- Restructure the China WEEE fund to ensure fees collected from each product category is dedicated to recycling of used products that fall into such category.
- Complete a review of the China WEEE regulation implementation for the first batch of five product categories and solve key implementation problems before catalogue expansion.

3. Energy Efficiency

China's energy efficiency programs present a number of challenges to foreign companies, including onerous compliance requirements, extremely tight timeframes to comply, and more importantly potential inconsistency with globally adopted technical standards in some cases.

Energy conservation has become a priority for China with the central government seeking ways to make China an "energy-saving" society. For the ICT sector, China has finished or is revising the standards for printers/copiers, computers, and monitors. Other Minimum Energy Performance Standards (MEPS) the China National Institute of Standardization (CNIS) is planning to develop include data centers and servers. The increased regulatory activity in this sector can raise significant issues for foreign ICT companies.

We recommend the following overarching standards development principles in the area of Chinese MEPS:

- **Quality Data Collection:** analysis of product energy performance data should be based on the full range of products and technologies that are currently available to customers in the market place, taking into consideration future market trends.
- **Scientific Calculation Model:** standard drafters should evaluate product energy consumption via the scientific calculation models. A technically sound approach is fundamentally important to the MEPS development.
- **Global Alignment:** Chinese MEPS should be in alignment with globally adopted standards, such as the Energy Star Program technical requirements, including exemptions. ICT companies are deeply invested in this set of technical specifications. Any deviation from the global norm would unnecessarily place onerous burden on the manufacturers.

Green Procurement, Low Carbon Assessment, and Other Sustainability Related Policy Issues

ITI recognizes the Chinese government's role in promoting environmentally friendly products. We fully support China's goal of becoming a sustainability leader in the green procurement and other sustainability-related realms. We provide the following industry recommendations to the Chinese government:

- **Green Procurement:** Work closely with industry stakeholders to stay updated on key green procurement standards development, *i.e.* IEEE 1680 series.
- **Low Carbon Assessment:** Fully assess the available carbon emission evaluation technical tools in the market and consider consolidation of existing low carbon-related standards, voluntary certifications, and eco-labelling regime before launching any new low-carbon certification.
- **Supply Chain Sustainability:** Adopt a science-based approach in considering phasing out manufacturing process that may generate perceived environmental impacts. Open a dialogue on ICT sector environmentally sound practices.

VI. COMMUNICATIONS & INFORMATION SERVICES

A. IMPEDIMENTS TO MARKET ACCESS

Proposed Broad Expansion of Telecom Services Regulations

There does not appear to have been any movement to adopt the draft revisions to the *Catalogue of Telecommunication Service Categories* (Telecom Services Catalogue) and the draft *Administrative Measures for the Trial Operation of New Types of Telecommunications Businesses* (Trial Operations Measure) by MIIT; however, we remain deeply concerned with the draft policies due to the potentially significant setback in the liberalization of China's telecom market. While we applaud the efforts of MIIT to address the dramatic changes in the ICT sector, the draft revisions to the Catalogue and the draft Measure would provide MIIT with a greatly expanded level of regulatory oversight while creating new market access barriers and imposing new investment restrictions.

The draft revisions to the Telecom Services Catalogue and draft Trial Operations Measure do not appear to be consistent with China's WTO GATS commitments. These measures would restrict the ability of foreign service suppliers to acquire licenses and furthermore, demonstrate a bias in favor of domestic over foreign license applicants, which at a minimum, are in tension with China's WTO commitments on domestic regulation, market access, and national treatment.

Most troubling is that the draft revisions to the Telecom Services Catalogue and the draft Trial Operations Measure broaden the licensing scheme to new categories of ICT services and increase the level of control for certain services that are already subject to licensing requirements. Contributing to these concerns is that the draft revisions to the Catalogue and the draft Measures incorrectly classify a wide range of ICT technologies and services as telecom services, when in fact they are computer or business services that utilize the public telecom network as a method of delivery. We have identified four initial areas of concern with regard to China's WTO commitments:

- *Licensing Procedures As Barriers to Market Access*: China committed to not use its licensing procedures and conditions as a barrier to market access or in a manner more trade restrictive than necessary, but the draft revisions to the Catalogue and the draft Measure would subject a broad set of services to cumbersome, unreasonable, and unnecessary licensing restrictions.
- *Not Respecting "Acquired Rights"*: China committed to ensure that foreign service suppliers that enjoyed certain rights prior to China's accession to the WTO would have these rights preserved after China's accession, but the draft revisions to the Catalogue and the draft Measure alter such rights insofar as the draft revisions to the Catalogue and the related licensing regulations impose new conditions on telecommunications service suppliers with longstanding business in China.
- *Discrimination*: China has committed to afford foreign telecommunications service suppliers treatment not less favorable than "like" domestic service suppliers, but the draft revisions to the Catalogue and draft Measure effectively prohibit or, at the very least, restrict the availability of telecommunications services licenses to foreign-invested telecommunication enterprise suppliers.
- *Denial of Market Access*: China has committed to refrain from impeding market access to foreign suppliers of computer and related services, but China's domestic classification notwithstanding, certain computer and related services such as cloud computing are arguably so impeded.

As mentioned previously, some services are inappropriately redefined under the draft revisions to the Telecom Services Catalogue, which would impose a variety of new restrictions on market access (*e.g.* through equity caps, joint venture requirements, and minimum capitalization requirements) for the provision of services that are improperly considered telecom services. It is well settled in WTO jurisprudence that a service can only fall under a sector or sub-sector and cannot fall under two sectors or two sub-sectors.¹⁵ Below is a preliminary list of services in the draft revisions to the Telecom

Services Catalogue that we have found to be inconsistent with established WTO jurisprudence:

- Cloud-based computing is improperly identified in category B1, B21, and B25 as various different types of telecommunication services. Yet while cloud computing services may use telecommunications networks and services, they are supplying computer related services (CRS).
- E-Commerce is improperly identified in category B21 as an Online Data Processing Service, when it should remain under China's existing WTO Service Schedule Category 4.E or Distribution Services - Wholesale or retail trade services away from a fixed location. Under this category, there are no limitations on foreign investors.
- 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.

Such improper identification of services in the draft revisions to the Telecom Services Catalogue, read together with existing restrictions on foreign investment in value-added telecom services, would impose more stringent limitations on a wide range of business services, which appears to be inconsistent with China's WTO accession commitments under its Service Schedule.

The ICT industry continues to be a dynamic and innovative industry in China and around the world. The process of revising the Telecom Services Catalogue and drafting the Trial Operations Measure should be used as an opportunity to further enhance the ICT ecosystem in China by reducing barriers to entry in basic services, VAS, and services that utilize the Internet (*i.e.* over the top services), rather than create additional impediments to innovation and restrictions to access to these important services to Chinese customers, which will ultimately hinder economic growth. USITO urges China to re-evaluate the draft revisions to the Telecom Services Catalogue and the draft Trial Operations Measure in light of the apparent inconsistencies with China's GATS commitments and broader WTO commitments.

Existing Challenges with China's Communications & Information Services Regulations

As noted in our previous submissions, since China's WTO accession some aspects of the communications & information services market have changed for the better. Foreign investment in telecoms services is no longer banned, and we are encouraged by the current direction of the Chinese government to broadly implement market-oriented reforms as announced at the 3rd Plenum of the 18th Communist Party of China Central Committee in November 2013. The high-level policy direction is now being manifested through the process to draft amendments to the *Radio Regulation of the People's Republic of China* (Radio Regulation), the Shanghai Pilot Free Trade Zone (SFTZ), and the

implementation of the Virtual Mobile Network Pilot Project, among other areas of incremental reform.

The draft amendments to the Radio Regulation represent a major update to an important set of regulations for the telecom sector, and USITO was pleased to have the opportunity to provide comments to the initial draft and would encourage the Chinese government to use an iterative process with additional comment periods prior to finalizing the amended Radio Regulation. A positive development in the Radio Regulation is the potential to increase reliance on market forces through auctions for the allocation of spectrum in the future.

While the SFTZ does offer some benefit to foreign investors in the ICT sector, the scope of market liberalization is narrowly defined, which limits the commercial benefits for foreign investors. USITO would urge the Chinese government to continue to advance the range of ICT market reforms in the SFTZ, 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.

The implementation of the *Mobile Communication Resale Business Pilot Plan* in 2014 is a welcomed development, as it will encourage competition and innovation in China's domestic mobile telephone market. However, we would recommend that the Pilot plan be opened to participation by foreign companies.

While in some cases these measures provide incremental reforms that positively impact foreign investment and represent a welcomed trend towards partial opening of the telecom services sector, there remain many restrictions to foreign investment and the general business environment in the telecom services sector.

China limits foreign direct investment in telecommunications to 49 percent for basic services and 50 percent for value-added services (VAS). A further problematic restriction is the requirement that foreign telecom service providers may enter into a joint venture only with one of the three existing state-owned enterprise telecom providers. Market entry opportunities for U.S. telecommunications providers in China are also limited by several additional factors, including an overly narrow definition of VAS for value added network service licensing that is not consistent with generally accepted international practices.

Protection of the rights of VAS providers in China's market is insufficient. First, it is critical for VAS providers to have access to basic telecommunications network elements on a non-discriminatory basis and at cost-oriented prices. Indeed, in most liberalized countries, a primary policy reason for distinguishing between basic and VAS is to ensure that basic service providers do not abuse control over essential transport facilities to distort competition in the more competitive valued-added markets.

Second, it is critical that MIIT interpret the definition of VAS in a manner that is consistent with China's explicit WTO commitment and widely accepted international standards. The definition within China's commitment includes several tests of what qualifies as a VAS. Whereas some of the alternative tests are specific services (*e.g.*,

electronic mail, voice mail, electronic data interchange), other of the alternative tests are functionalities that can exist in a variety of innovative services (*e.g.*, code and protocol conversion, on-line information and data base retrieval, on-line information and/or data processing). The inclusion of these functionality tests in the China commitment on VAS is consistent with the VAS definitions applied internationally, and China should follow through to interpret their definition in accordance with international standards and expectations.

In addition to encouraging a more expansive licensing approach to VAS in China, the U.S. government should consider encouraging China to replace the current conservatively applied vertical service classification guidelines (*i.e.*, basic/value-added) with more objective and transparent guidelines for Type I (facilities-based) and Type II (non-facilities based) licenses in order to accelerate service provider market entry. This approach would provide certainty to investors by permitting the provision of any non-facilities based service on the same terms and conditions as VAS, thus allowing companies to innovate and provide services as technology evolves.

China's unreasonably high capitalization requirement for basic telecommunications services has further greatly limited market access. Basic services licenses are subject to a U.S. \$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. A foreign service provider otherwise meeting the licensing qualifications is unlikely to allocate such capital to a new and risky enterprise, and a Chinese joint venture partner is unlikely to divert this capital from its core business. 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. USITO encourages the U.S. government to place a high priority on working with China to 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 efficiently and fairly public telecom suppliers' commercial disputes over their agreements;
- 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.

USITO also encourages U.S. government to press China to provide reasonable notice and the opportunity for public comment on proposed regulations.

The above restrictions directly constrain meaningful competition from foreign participants. This holds back service innovation and reliability from reaching world-class levels. In turn, business customers cannot obtain the value-added services they need to run efficient companies. Ultimately, this undermines China's information and communications technology policy goals and deprives Chinese consumers of access to new innovative technologies and of a broader choice of telecommunications services.

One example is that China's policies restrict the use of VoIP to closed user groups. China should allow all VoIP providers to offer services that connect to the PSTN on an unlicensed basis and eliminate joint venture requirements that apply to non-Chinese companies who wish to offer VoIP services in China.

International companies seek reasonable terms of competition to enter China's market. There is significant interest among foreign carriers and value-added service providers in China. The dearth of companies applying for foreign invested telecom enterprise (FITE) licences is not due to a lack of interest in the market, but to the unfavourable terms of entry that currently characterizes the relevant regulations.

The following critical changes would help stimulate investment and competition in China's value-added telecom services market:

- The scope of the VAS Catalogue should be expanded significantly to include international connectivity rights.
- The Catalogue should be worded so as to leave no ambiguity over the scope of permissible services.
- We recommend classifying basic services as the operation of basic network transmission and access facilities only, with all other services being value-added. This is a common classification scheme internationally.
- An interconnection regime should be introduced giving licensed VAS providers wholesale pricing for network facilities and services. This regime would ensure that VAS providers have access to the basic network facilities they need at pricing levels that enable them to be commercially viable. Such a reform would also make a whole new set of domestic companies available as partners to foreign investors because, without an interconnection regime, investors can deal only with incumbent carriers. Yet these incumbents have shown little interest in establishing FITE joint ventures.
- Early drafts of the Telecom Law are disappointingly shallow and lacking in detail about future interconnection access and charging principles for wholesale

facilities. Interconnection regulations are critical to rationalizing competition even among the incumbent players.

- The draft Telecom Law has been in debate in China for far too long and should be aired publicly and rapidly implemented. There is substantial data from other liberalized markets that can enable China to rapidly craft and implement an appropriate regime that meets international norms but also embeds appropriate Chinese characteristics.

Revisions to PRC Internet Information Services Administrative Measures

On June 6, 2012 MIIT and the State Council Internet Information Office (SCIIO) released for comment a draft revised version of China's *Internet Information Services Administrative Measure*, which were last updated in the year 2000. These are critically important rules for any company in the China market that provides "internet information services" to Chinese customers over the public Internet. The proposed revisions clarify internet regulatory roles and responsibilities of different government agencies, continue to classify internet services as a telecom-value added service, and also contain numerous requirements and provisions for national security lawful access, data retention, data privacy, content filtering, and real-name ID registration requirements (which become for the first time mandatory for all internet service providers).

USITO believes that while Internet regulation may be necessary for societal stability, country-specific regulation relating to the creation, release, and transmission of certain types of content can constitute trade barriers for global Internet services companies. In addition, the Internet is global in nature. As such, country-specific Internet industry regulations, including content management and regulation of emerging Internet services categories such as micro-blogs and online forums, lead to fragmentation and balkanization of the global Internet. More specifically, the draft revised Measure 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 ISPs and 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.

B. TECHNOLOGY NEUTRALITY VS. MANDATED STANDARDS

Finally, we continue to urge the Chinese government to subscribe to the principle of technology neutrality on the part of the regulator. Technology neutrality is a key principle for regulated sectors like telecommunications. Markets and innovation benefit most when ICT manufacturers and suppliers engage in demand-driven competition,

standards are openly and competitively developed, and governments do not interfere to choose technology winners and losers.

In recent years, China has routinely favored domestic standards and technology over international standards and technology. In 2009, after the issuance of 3G spectrum, the Chinese government, through its agencies, research institutions, and state-owned enterprises, promoted and supported its own 3G mobile phone standards, TDSCDMA. Shortly thereafter, the Chinese version of WiFi – that is, WAPI – was mandated on all mobile devices through China's type approval process. In addition, USITO is concerned about China's development of the Enhanced Ultra-High Throughput (EUHT) standard, and required use of the domestically developed ZUC encryption algorithm. Most recently, MIIT issued 4G licenses to telecom services providers for the Chinese originated TD-LTE technology in December 2013, while delaying the issuance of 4G trial licenses for FDD-LTE to June 2013 for the purposes of testing compatibility between the two 4G technologies and limiting the geographic scope of the FD-LTE licenses. Technology neutral policies will help ensure that one technology does not have an unfair advantage over another in China's market.

We appreciate this opportunity to provide our comments and look forward to working with the U.S. and Chinese governments on addressing the issues set out herein.

APPENDIX: USITO INTRODUCTION

Since its founding in late 1994, the U.S. Information Technology Office (USITO) has grown to become the leading policy-centered independent 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. USITO also accepts corporate memberships from those U.S. companies in the information technologies industry that seek direct representation. Currently, USITO has about 45 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 does research and writing on 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-connected events.

USITO comprises a consortium of four U.S. industry associations: the Information Technology Industry Council (ITI), the Software & Information Industry Association (SIIA), the Semiconductor Industry Association (SIA), and the Telecommunications Industry Association (TIA).

- The Information Technology Industry Council (ITI) is the premier group of the nation's leading high-tech companies and widely recognized as the tech industry's most effective lobbying organization in Washington, in various foreign capitals, and the WTO.
- The Semiconductor Industry Association (SIA), being one of the leading hi-tech associations in America, represents over 85% of the American semiconductor industry and represents their interests both at home and abroad.
- The Software & Information Industry Association (SIIA) is the principal trade association of the software and digital content industry representing more than 500 software publishers, developers, and service providers from around the world.
- The Telecommunications Industry Association (TIA) is the leading U.S. non-profit trade association serving the communications and information technology industry. TIA provides a market-focused forum for its 500 member companies, which manufacture or supply the products and services used in global communications.