

September 28, 2017

**VIA REGULATIONS.GOV**

Ambassador Robert E. Lighthizer  
U.S. Trade Representative  
Office of the United States Trade Representative  
600 17th Street NW  
Washington, DC 20508

Re: **USTR-2017-0016**—*Initiation of Section 301 Investigation; Hearing; and Request for Public Comments: China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation*

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Dear Ambassador Lighthizer:

On August 24, 2017, the Office of the United States Trade Representative (“USTR”) initiated an investigation pursuant to Section 302(b) of the Trade Act of 1974 “to determine whether acts, policies, and practices of the Government of China related to technology transfer, intellectual property, and innovation are unreasonable or discriminatory and burden or restrict U.S. commerce.”<sup>1</sup>

The Initiation Notice requested comments on topics including (i) the tools used by the Chinese government to “require or pressure the transfer of technologies and intellectual property to Chinese companies”; (ii) practices of the Chinese government that “deprive U.S. companies of the ability to set market-based terms in licensing and other technology-related negotiations with Chinese companies and

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<sup>1</sup> *China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation*, 82 Fed. Reg. 40,213 (Office of the U.S. Trade Rep. Aug. 24, 2017) (notice of initiation of investigation; hearing; and request for comments) (“Initiation Notice”).

undermine U.S. companies' control over their technology in China"; (iii) Chinese government direction or facilitation of "investment in, and/or acquisition of, U.S. companies and assets by Chinese companies and assets by Chinese companies to obtain cutting-edge technologies and intellectual property and generate large-scale technology transfer in industries deemed important by Chinese government industrial plans"; and (iv) the Chinese government's "conducting or supporting unauthorized intrusions into U.S. commercial computer networks or cyber-enabled theft of intellectual property, trade secrets, or confidential business information."<sup>2</sup>

On behalf of Wiley Rein, LLP ("Wiley Rein"), we hereby submit the following comments on the issues listed above. We urge USTR to find that the acts, policies, and practices of the Chinese government related to technology transfer, intellectual property ("IP"), and innovation are unreasonable and discriminatory and burden and restrict U.S. commerce, and to act decisively to protect U.S. businesses and workers from further harm.

Respectfully Submitted,

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<sup>2</sup> *Id.* at 40,213-14.

**BEFORE THE UNITED STATES TRADE REPRESENTATIVE**

**CHINA'S ACTS, POLICIES, AND  
PRACTICES RELATED TO  
TECHNOLOGY TRANSFER,  
INTELLECTUAL PROPERTY, AND  
INNOVATION**

Docket No. USTR-2017-0016

**COMMENTS ON CHINA'S ACTS, POLICIES, AND PRACTICES RELATED TO  
TECHNOLOGY TRANSFER, INTELLECTUAL PROPERTY, AND INNOVATION**

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## I. INTRODUCTION

Writing about “China’s drive for indigenous innovation” in 2010, a study by the U.S. Chamber of Commerce and the Global Intellectual Property Center noted concerns about China’s *National Medium- and Long-Term Plan for the Development of Science and Technology (2006-2020)*: “[T]he plan is considered by many international technology companies to be a blueprint for technology theft on a scale the world has never seen before.”<sup>1</sup> More recently, the U.S. Chamber has reported on China’s *Made in China 2025* plan, which it describes as “a broader strategy to use state resources to alter and create comparative advantage in [ten strategic] sectors on a global scale.”<sup>2</sup> The Information Technology and Innovation Foundation (“ITIF”) recently warned that “the unremitting and even accelerating ‘innovation mercantilist’ behavior on the part of the Chinese government represents a threat not only to the U.S. economy, particularly its advanced industries, but indeed to the entire global trade system.”<sup>3</sup>

These and other plans, policies, laws, and regulations together make up a pervasive “web of industrial policies” designed to “absorb, assimilate, and re-innovate” foreign technology and IP, and to create an artificial advantage for Chinese firms and the Chinese government across the broad spectrum of economic and national security affairs. Recent statements by President Xi Jinping echo long-standing Chinese policy that treats acquisition and control of strategic technologies and IP as a combined economic and national security priority, and that justifies rote mercantilism under the guise of national security concerns.<sup>4</sup> According to Xinhua, President Xi recently stressed that:<sup>5</sup>

- “A firm fence of cyber security should be consolidated, and efforts should be made to better safeguard cyber security and key information infrastructure.”
- “[T]he development of core technologies should be facilitated and early warning and monitoring of cyber security should be strengthened, in addition to ensuring the security of big data.”
- China should “[enhance] capacity building in terms of materials, technology, equipment, talent, law and mechanism[s] to safeguard national security.”

While there may be some legitimate national security concerns in these areas, China’s acts, policies, and practices sweep far more broadly than is reasonable or necessary.<sup>6</sup> They often seem

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<sup>1</sup> James McGregor, Global Intellectual Property Center, U.S. Chamber of Commerce, *China’s Drive for ‘Indigenous Innovation’: A Web of Industrial Policies* (July 28, 2010) at 4.

<sup>2</sup> The U.S. Chamber of Commerce, *Made in China 2025: Global Ambitions Built on Local Protections* (2017) at 6.

<sup>3</sup> Robert D. Atkinson et al., Information Technology & Innovation Foundation, *Stopping China’s Mercantilism: A Doctrine of Constructive, Alliance-Backed Confrontation* (Mar. 2017) at 1.

<sup>4</sup> See, e.g., *Xi’s Speech a Rallying-Call for National Security*, China-U.S. Focus (Apr. 30, 2014) (describing President Xi’s speech calling for a “national security path with Chinese characteristics” that includes “economic security as its basis”).

<sup>5</sup> *Xi Calls for Overall National Security Outlook*, Xinhua (Feb. 17, 2017).

<sup>6</sup> See Office of the U.S. Trade Rep., *National Trade Estimate Report on Foreign Trade Barriers* (2017) at 80 (noting that China’s 2015 National Security Law “includes sweeping provisions addressing economic and industrial policy”).

to operate under an assumption that any and all non-Chinese ownership, control, or commercialization of key technologies and IP in the Chinese market is an inherent security threat to be minimized by any means necessary.<sup>7</sup> This overly broad conception of economic and national security places an unreasonable burden on the legitimate commercial interests of foreign companies in what has become the world's largest market for many high-tech goods and services. Many of the tools that the Chinese government uses have already been documented and discussed at length in USTR's reports to the President and Congress. USTR, for example, recently observed that:

China's promotion of self-sufficient, indigenous innovation through policies on patents and in related areas, including standards and competition law, implicates a cross-cutting set of concerns. China must ensure that present and future Information and Communications Technology (ICT) policies (and other policies) do not disadvantage foreign IP-intensive industries by, *inter alia*, conditioning market access on the disclosure of IP and proprietary information, the localization of research and development, or by invoking "secure and controllable" standards, risk criteria, product reviews, or similar requirements that are disadvantageous to foreign firms. Also critical is that China eliminate discriminatory requirements and incentives to transfer technology to, or develop technology in, China.<sup>8</sup>

As discussed below, China continues to use these tools to the disadvantage of U.S. businesses, their workers, and the U.S. economy. USTR should find that these acts, policies, and practices are unreasonable and discriminatory, and that they burden and restrict U.S. commerce.

## **II. THE ACTS, POLICIES, AND PRACTICES OF THE CHINESE GOVERNMENT RELATING TO TECHNOLOGY TRANSFER, IP, AND INNOVATION ARE UNREASONABLE AND DISCRIMINATORY**

The Chinese government uses all tools at its disposal to create a competitive advantage for Chinese firms *vis-à-vis* foreign firms with respect to technology, IP and innovation. While these tools frequently overlap, the unreasonable and discriminatory acts, policies, and practices generally fall into the following categories: (i) industrial policy and state support, (ii) national security laws and regulations, (iii) state-supported theft of IP and other trade secrets, and (iv) competition policy and enforcement. Together, these acts, policies, and practices create a regulatory environment that effectively conditions market access on technology transfer and otherwise engineers artificial advantages for Chinese technology firms in both the Chinese and global markets.

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<sup>7</sup> See, e.g., *National Economic Security Under the Circumstances of Economic Globalization* (经济全球化背景下的国家经济安全), Ren Min Wang (Mar. 16, 2007) ("The distinct advantage of [developed country] multinational companies in controlling technology allows them to enhance barriers to market entry, which provides a natural guarantee of security in foreign investments. This is the very reason that developed countries place so much emphasis on intellectual property rights.") (跨国公司在技术及管理上的独特优势可以增加行业准入壁垒, 为海外投资提供比较自然的安全保障。这便是发达国家十分关注知识产权的关键所在).

<sup>8</sup> Office of the United States Trade Representative, *Special 301 Report* (2017) at 28-29.

**A. The Chinese Government Uses Industrial Policy Planning and Strategic Acquisitions to Direct Unfair State Support to Chinese Technology Firms in Domestic and Global Markets**

The Chinese government continues to use industrial policy planning to direct unfair state support to firms in strategic technology sectors. China's 13<sup>th</sup> Five Year Plan, applicable to the period 2016-2020, "reiterates the Chinese government's state-directed strategy started under the 12<sup>th</sup> FYP, including 'indigenous innovation,'" giving rise to continued concerns that Chinese industrial policy "inherently discriminates against foreign firms by seeking to replace foreign technology with products and services from Chinese firms."<sup>9</sup> The U.S.-China Economic and Security Review Commission notes that "the 13<sup>th</sup> FYP . . . makes it clear that market access is encouraged only to the extent that greater access for foreign companies benefits China's economic priorities."<sup>10</sup>

The most prominent statement thus far of the Chinese government's priorities for high-tech industries in the 13<sup>th</sup> Five Year Plan period is the "Made in China 2025" plan. Made in China 2025 applies to (i) new energy vehicles, (ii) next-generation IT, (iii) biotechnology, (iv) new materials, (v) aerospace, (vi) ocean engineering and high-tech ships, (vii) railway, (viii) robotics, (ix) power equipment, and (x) agricultural machinery.<sup>11</sup> These industries account for nearly 40% of China's industrial value added,<sup>12</sup> such that the plan's discriminatory framework aims to exclude foreign enterprises from vast swathes of the Chinese market.

The plan's priorities were incorporated into the 13<sup>th</sup> Five Year Plan, as part of the government's broader "goals for China's economy to become an 'innovative nation' by 2020, an international innovation leader by 2030, and a world powerhouse of scientific and technological innovation by 2050."<sup>13</sup> Under Made in China 2025 and related industrial policy initiatives,

The political leadership intends to gradually substitute foreign technology with Chinese technology . . . . Chinese high-tech industries, in particular the national champions, are expected to acquire the capabilities to create independent innovative technological solutions and replace their foreign competitors on the domestic market and increasingly on global markets.<sup>14</sup>

In pursuit of these objectives, the Chinese government continues to rely on unreasonable and discriminatory policies and practices, including grants, capital injections and preferential loans, equity investments through state-owned or -controlled investment funds, discriminatory

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<sup>9</sup> Katherine Koleski, U.S.-China Economic and Security Review Comm'n, *The 13<sup>th</sup> Five-Year Plan* (Feb. 14, 2017) at 7.

<sup>10</sup> U.S.-China Economic and Security Review Comm'n, Annual Report to Congress (2016) at 51.

<sup>11</sup> U.S. Chamber, *Made in China 2025* at 10.

<sup>12</sup> *Id.*

<sup>13</sup> Koleski, *The 13<sup>th</sup> Five-Year Plan* at 6.

<sup>14</sup> Jost Wubbeke et al., Mercator Institute for China Studies, *Made in China 2025: The Making of a High-Tech Superpower and Consequences for Industrial Countries*, MERICS Papers on China No. 2 (Dec. 2016) at 20.

government procurement policies, and even internal local-content requirements that are withheld from publication to avoid international scrutiny.<sup>15</sup>

The Chinese government's industrial policies for the 13<sup>th</sup> Five Year Plan period, however, do not rely solely on state support for independent technological development by Chinese firms. To a greater extent than previous industrial policy initiatives, which relied primarily on the willingness of foreign enterprises to transfer technology into China as the price of admission, the Chinese government is "supporting acquisition strategies of Chinese state-owned and state-supported companies [in] priority sectors."<sup>16</sup> According to APCO Worldwide, "Perhaps the most crucial part of Made in China 2025 has been overseas technology acquisition, often politically driven and financially supported by Chinese government funds. This is crucial if China is to meet its Made in China 2025 objectives."<sup>17</sup>

The Chinese government's establishment of foreign acquisitions as a key plank of its industrial policy plans for high-tech sectors has coincided with a broader reassertion of state control over the outbound investment activities of Chinese firms. In August, the State Council and the National Development and Reform Commission ("NDRC") published rules to formalize a *de facto* crackdown on "irrational" overseas investments.<sup>18</sup> Included in NDRC's list of "encouraged" outbound investments are those that "enhance China's technical standards, research and development[.]"<sup>19</sup>

Particularly with respect to Chinese investment in the United States, "The surge in global takeover offers in the semiconductor industry is the most notable example of the industrial policy-outbound investment nexus."<sup>20</sup> Semiconductor technology is identified as a key component for several of the Made in China 2025 industries under the *Technological Roadmap for Made in China 2025 Priority Sectors*.<sup>21</sup> According to the Council of Advisors on Science and Technology, "The Chinese government, motivated by economic and national-security goals, has publicly asserted its desire to build a semiconductor industry that is far more advanced than today and less reliant on the rest of the world."<sup>22</sup> This "strategy relies in particular on large-scale spending, including \$150 billion in public and state-influenced private funds over a 10-year period, aimed at subsidizing investment and acquisitions as well as purchasing technology."<sup>23</sup>

In August 2016, for example, the State-Owned Assets Supervision and Administration Commission ("SASAC") approved the formation of a \$30 billion venture capital fund by state-owned banks and holding companies "to invest in innovative technology and industrial upgrading

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<sup>15</sup> *Id.* at 20-21.

<sup>16</sup> U.S. Chamber, *Made in China 2025* at 22.

<sup>17</sup> Ryan Morgan, *Two Sessions: Made in China 2025*, APCO Forum (Mar. 26, 2017).

<sup>18</sup> *See, e.g., China Codifies Crackdown on 'Irrational' Outbound Investment*, Bloomberg (Aug. 18, 2017).

<sup>19</sup> *Id.*

<sup>20</sup> Thilo Hanemann, Testimony Before the U.S.-China Economic and Security Review Commission, *Chinese Direct Investment in the United States: Recent Trends and Policy Implications* (Jan. 26, 2017) at 4.

<sup>21</sup> U.S. Chamber, *Made In China 2025* at 19-20.

<sup>22</sup> President's Council of Advisors on Science and Technology, Report to the President, *Ensuring Long-Term U.S. Leadership in Semiconductors*, Executive Office of the President (Jan. 2017) at 8.

<sup>23</sup> *Id.*

projects” and “implement national strategies.”<sup>24</sup> Reports indicate that there are now hundreds of similar funds throughout China, including the \$22 billion China IC Industry Investment Fund, which directed nearly 20 percent of its investments towards overseas acquisitions as of 2016, as well as numerous funds established by sub-central governments to promote high-tech development and acquisitions.<sup>25</sup> On September 13, 2017, President Trump issued an order blocking an attempted acquisition of Lattice Semiconductor Corp., in part due the connections between the Chinese government and the China Venture Capital Fund Corporation, Ltd., the parent of one of the potential purchasers.<sup>26</sup> Acquisitions of non-U.S. technology firms by state-backed Chinese investors raise concerns as well, as recent takeovers of German semiconductor and robotics firms by Chinese buyers demonstrate.<sup>27</sup> While these deals are scrutinized in the United States on national security grounds if and when U.S. subsidiaries are involved, they also put U.S. competitors at a commercial disadvantage by (i) inflating the price of potential acquisition targets above commercial levels and (ii) transferring valuable technology to subsidized Chinese firms that ultimately compete with U.S. companies around the world.

The emergence of these funds reveals a troubling aspect of the Chinese government’s promotion and support of high-tech firms, including overseas acquisitions of strategic technologies: its efforts to disguise the role of the state in directing and financing the transactions. The Chinese government increasingly has sought to blur the lines between state and private by, for example, (i) creating additional layers between the state and enterprises, as with the investment funds discussed above, or (ii) by reducing formal government equity ownership while applying less transparent political oversight through entities like Party Committees.<sup>28</sup> As a result, “it is difficult to properly classify SOEs, and the distinction between private and state-owned companies for policy analysis based on nominal equity ownership is problematic.”<sup>29</sup> In considering the true extent of state support for Chinese technology firms, therefore, it is important to emphasize that “state involvement can be pervasive, even if a firm is nominally privately owned.”<sup>30</sup>

The Chinese government thus continues to provide extensive support to domestic firms as part of a far-reaching policy to promote “indigenous innovation” and to replace foreign with domestic technologies in the Chinese and global markets. These policies place U.S. technology

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<sup>24</sup> *China Launches \$30 bln State-Controlled Venture Capital Fund*, Reuters (Aug. 18, 2016)

<sup>25</sup> Bien Perez, *China’s Chip Industry Bolstered by Acquisitions Worth US\$6.61 Billion by Government-Backed Fund*, South China Morning Post (Mar. 30, 2016); Don Weinland, *China Uses Investment Funds to Lead Reform Push*, Financial Times (July 16, 2017).

<sup>26</sup> Ana Swanson, *Trump Blocks China-Backed Bid to Buy U.S. Chip Maker*, N.Y. Times (Sept. 13, 2017).

<sup>27</sup> *See, e.g.*, Paul Mozur and Jack Ewing, *Rush of Chinese Investment in Europe’s High-Tech Firms Is Raising Eyebrows*, N.Y. Times (Sept. 16, 2016); Xie Yu, *Midea Emerges from the Shadows with Kuka Offer*, South China Morning Post (July 29, 2016).

<sup>28</sup> *See, e.g.*, Curtis J. Milhaupt and Wentong Zheng, Paulson Policy Memorandum, *Why Mixed-Ownership Reforms Cannot Fix China’s State Sector*, Paulson Institute (Jan. 2016) at 2 (“China’s institutional environment blurs the boundary between SOEs and privately owned firms, which permits the state to exercise significant influence over firms irrespective of its equity ownership stakes and where firms of all ownership types compete for state-generated rents.”).

<sup>29</sup> Hanemann, *Chinese Direct Investment in the United States* at 4.

<sup>30</sup> *Id.*



enterprises at a distinct competitive disadvantage, since they are forced to compete with the deep pockets of the Chinese state.

**B. The Chinese Government Applies Overly Broad National Security Rules and Standardization Policies that Limit Market Access for Foreign Technology Firms**

In recent years, the Chinese government has increasingly turned to purported national security concerns to justify its attempts to restrict competition with foreign technology firms. As noted above, the Chinese government's pursuit of technological dominance at the expense of foreign companies has frequently been cast in terms of national security. The Chinese government's lines between national security and economic interests are particularly vague in its policies regarding information technology and cybersecurity. In a speech before the first meeting of the Leading Small Group on Internet Security and Informationization in 2014, President Xi Jinping argued that "without internet security, there is no national security, and without informationization, there is no modernization. To build a national internet power, we need to have our own technology, and we need to have mastery of that technology."<sup>31</sup> Much of this national security rhetoric has been directed explicitly at the commercial operations of specific U.S. enterprises in the Chinese market, some of which have been characterized as U.S. "guardian warriors" that have "infiltrated" the Chinese market.<sup>32</sup>

Soon after President Xi's 2014 speech, the Chinese government began to issue new rules requiring government agencies and state enterprises to purchase only "secure and controllable" software. The first of these rules was issued by the China Banking Regulatory Commission ("CBRC"), which required companies selling hardware to Chinese banks "to turn over secret source code, submit to invasive audits, and build so-called back doors into hardware and software."<sup>33</sup> Following publication of the CBRC rules, "{f}oreign companies . . . began reporting the loss of major contracts with Chinese state-owned banks based on the perception that foreign ICTG products were not acceptable."<sup>34</sup>

While these rules have been "suspended,"<sup>35</sup> the "secure and controllable" requirement has been incorporated into subsequent laws, including the National Security Law and the Cybersecurity Law. Despite a lack of public clarity regarding the actual meaning of "secure and controllable," banks, state enterprises, and other entities involved in procurement are operating under the assumption that "the ultimate goal of the Chinese government is to push for domestic procurement of ICT security products."<sup>36</sup> Reports also indicate that the Chinese government has engaged in backchannel communications with foreign technology firms, seeking commitment that

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<sup>31</sup> Xi Jinping: Transforming Our Country from a Large Internet Country to Building a National Internet Power (习近平：把我国从网络大国建设成为网络强国), Xinhua (Feb. 27, 2014) (没有网络安全就没有国家安全，没有信息化就没有现代化。建设网络强国，要有自己的技术，有过硬的技术)。

<sup>32</sup> USCC Annual Report (2016) at 54-55.

<sup>33</sup> Paul Mozur, *New Rules in China Upset Western Tech Companies*, N.Y. Times (Jan. 28, 2015).

<sup>34</sup> U.S. China Business Council, *Technology Security and IT in China: Benchmarking and Best Practices* (July 2016) at 16.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

they will comply with Chinese security standards, including by turning over intellectual property and promising “to accept supervision from all parts of society, to cooperate with third-party institutions for assessment and verification that products are secure and controllable, and that user information is protected, etc., to prove actual compliance with these commitments.”<sup>37</sup>

The Chinese government has also begun to develop standards under the Cybersecurity Law that potentially pressure foreign technology firms to disclose IP. Draft standards published by the National Information Security Standardization Technical Committee in November 2016 “laid out an untested approach to assign a score to ICT products for cybersecurity using subjective and inappropriate benchmarks,” including “the extent to which a party discloses sensitive IP.”<sup>38</sup> China’s promotion of indigenous standards for purported national security reasons often overlaps with simultaneous promotion of indigenous standards for purely commercial reasons. Policies related to Made in China 2025, for example, also reference “indigenous and controllable,” “secure and trustworthy,” and “secure and reliable.”<sup>39</sup>

The December 2015 *Development Strategy for Establishing National Standardization (2016-2020)* “encourage[s] . . . the inclusion of possessing indigenous intellectual property of key technologies in enterprise standards and association standards to spur technological innovation.”<sup>40</sup> With respect to “new generation information technology standardization,” it calls for drafting plans that will simultaneously “support innovation and development of information industries, promote overall increase in the level of informationization in all sectors, and safeguard indigenous and controllable internet security and information security.”<sup>41</sup> While the plan calls for a greater role for enterprises and non-governmental organizations in formulating national standards,<sup>42</sup> these organizations are expected to operate as instruments of the state to implement industrial policy directives.<sup>43</sup> With respect to the standard-setting process, they have frequently required foreign

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<sup>37</sup> Menchie Mendoza, *China Wants U.S. Tech Firms to Comply with Security Standards*, Tech Times (Sept. 18, 2015).

<sup>38</sup> USTR, Special 301 Report (2017) at 35.

<sup>39</sup> U.S. Chamber, *Made in China 2025* at 32.

<sup>40</sup> *Notice of the State Council Regarding Publication of the Plan for Development and Construction of the National Standardization System (2016-2020)* (国务院办公厅关于印发国家标准化体系建设发展规划(2016-2020年)的通知) at III(1) (发挥市场主体作用。鼓励企业和社会组织制定严于国家标准、行业标准的企业标准和团体标准,将拥有自主知识产权的关键技术纳入企业标准或团体标准,促进技术创新、标准研制和产业化协调发展)。

<sup>41</sup> *Id.* at IV(5) (新一代信息技术标准化工程。编制新一代信息技术标准体系规划,建立面向未来、服务产业、重点突出、统筹兼顾的标准体系,支撑信息产业创新发展,推动各行业信息化水平全面提升,保障网络安全和信息安全自主可控)。

<sup>42</sup> *Id.* at III(1).

<sup>43</sup> Br. of Amicus Curiae The Ministry of Commerce of the People’s Republic of China In Supp. of the Defs’ Motion to Dismiss the Compl., *Animal Sci. Prods. v. Hebei Welcome Pharm. Co. Ltd. (In re Vitamin C Antitrust Litig.)*, 2013 U.S. Dist. LEXIS 169083 (E.D.N.Y. 2013) (No. 06-MD-1738) (characterizing industry associations as “entit{ies} under the Ministry’s direct and active supervision that {play} a central role in regulating” the industries that they represent”); Guiding Opinion Regarding Encouraging, Supporting, and Guiding the Development of the Individual, Private, and Non-State-Owned Economy (国务院关于鼓励支持和引导个体私营等非公有制经济发展的若干意见), Guo Fa [2005] No. 3 (Feb. 19, 2005) (instructing industry associations to “strengthen guidance and policy coordination for the development of the non-state-owned economy”).

companies to turn over valuable IP or license it on non-market terms as a condition of participation, if they have allowed foreign participation at all.<sup>44</sup>

National security related pressure from the Chinese government, whether in spite of or because of continuing ambiguity of key terms like “secure and controllable,” has already begun to influence the investment and product development decisions of U.S. technology firms. For example:

- In May 2017, Microsoft announced that it had cooperated with a Chinese state enterprise to develop a unique version of Windows 10, specifically for the Chinese government (“Windows 10 China Government Edition”), and that it had cooperated with Chinese authorities in a security review of the new operating system.<sup>45</sup>
- In July 2017, Apple announced that it would invest \$1 billion to build a data center in China to store information in compliance with the country’s Cybersecurity Law.<sup>46</sup>
- In January 2016, Intel announced a “strategic collaboration” with state-controlled Tsinghua University and Montage Technologies to develop computer processors in accordance with the Chinese government’s security requirements.<sup>47</sup>

China’s national security rules thus conflate economic and national security objectives and operate to (i) exclude U.S. technology firms from key sectors of the Chinese market; (ii) force U.S. technology firms to disclose or license intellectual property on no-market terms; and (iii) coerce U.S. technology firms to shift investment and product development to China that would otherwise occur elsewhere. As such, they are an unreasonable and discriminatory burden on U.S. commerce.

### **C. The Chinese Government Engages in or Sponsors IP and Trade Secret Theft**

In its 2013 Annual Report to Congress, the U.S.-China Economic and Security Review Commission highlighted “strong evidence . . . that the Chinese government is directing and executing a large-scale cyber espionage campaign against the United States.”<sup>48</sup> According to a detailed report published by U.S. cybersecurity firm Mandiant, a single Chinese group likely linked to the People’s Liberation Army had penetrated the networks of at least 141 companies, international organizations, and foreign governments since 2006, 81 percent of which were located or headquartered in the United States.<sup>49</sup> The Mandiant report followed other high-profile cyber-intrusions against U.S. firms or the U.S. government by Chinese entities, apparently with the support of the Chinese government.

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<sup>44</sup> See, e.g., USTR, 2017 NTE Report at 85 (noting that “Chinese government officials in some instances have reportedly pressured foreign companies seeking to participate in the standards-setting process to license their technology or intellectual property on unfavorable terms”).

<sup>45</sup> Josh Horwitz, *Microsoft Released a New Version of Windows That’s Tailor-Made for the Chinese Government*, Quartz (May 25, 2017); Aatif Sulleyman, *Microsoft Creates Mysterious New Version of Windows 10 for Chinese Government*, Independent U.K. (May 23, 2017).

<sup>46</sup> Paul Mozur et al., *Apple Opening Data Center in China to Comply with Cybersecurity Law*, N.Y. Times (July 12, 2017).

<sup>47</sup> USCC, Annual Report (2016) at 55.

<sup>48</sup> U.S.-China Economic and Security Review Commission, Annual Report to Congress (Nov. 2013) at 243.

<sup>49</sup> *Id.*

- In 2010, Google revealed that it was the victim of a cyber-intrusion originating in China that resulted in the theft of IP, including source code, as well as user data related to the political activities of Chinese dissidents and individuals under surveillance by the United States.<sup>50</sup> The intrusion into Google’s networks was part of a larger operation that targeted at least 34 companies, including Yahoo, Symantec, Adobe, Northrop Grumman, and Dow Chemical.<sup>51</sup>
- In May 2014, the U.S. Department of Justice (“USDOJ”) indicted five members of the Chinese military, accusing them of “economic espionage and other offenses directed at six American victims in the U.S. nuclear power, metals and solar products industries . . . to steal information from those entities that would be useful to their competitors in China, including state-owned enterprises.”<sup>52</sup>
- In May 2017, USDOJ revealed a criminal complaint accusing seven individuals of “engag[ing] in a systematic campaign to steal the trade secrets of a global engineering firm” engaged in design of dual-use naval technology “to benefit a manufacturer located in China.”<sup>53</sup>

Despite reports that aggressive enforcement actions in the United States have caused the Chinese government to curtail its industrial espionage activities, U.S. “[i]ndustry continues to identify trade secret protection as one of their most pressing concerns in China.”<sup>54</sup> The fear that IP and trade secrets are perpetually at risk of being stolen and used by competitors in China, with implicit or explicit support from Chinese authorities, is one of the primary obstacles to U.S. firms in conducting business in China or in global markets in competition with Chinese firms.

#### **D. The Chinese Government Uses Competition Policy Enforcement to Restrict the Operations of Foreign Technology Firms**

The Chinese government uses Antimonopoly Law enforcement, including both pricing and merger review, to extract concessions from foreign technology firms. According to the Information Technology and Innovation Foundation, “U.S. companies have . . . been targeted by China’s discriminatory use of anti-monopoly laws as an industrial development tool . . . . For the Chinese government, ‘abuse’ means charging market-based IP licensing fees to Chinese companies.”<sup>55</sup> The nature of the Chinese government’s competition policy enforcement has led to concerns that the Chinese government is using the Antimonopoly Law to force lower prices or

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<sup>50</sup> USITC Pub. 4199 at 4-12; Ellen Nakashima, *Google Gained Access to Sensitive Data, U.S. Officials Say*, Washington Post (May 20, 2013).

<sup>51</sup> Ariana Eunjung Cha and Ellen Nakashima, *Google China Cyberattack Part of Vast Espionage Campaign, Experts Say*, Washington Post (Jan. 14, 2010).

<sup>52</sup> Press Release, *U.S. Charges Five Chinese Military Hackers for Cyber Espionage Against U.S. Corporations and a Labor Organization for Commercial Advantage*, U.S. Department of Justice (May 19, 2014).

<sup>53</sup> Press Release, *Seven People Charged with Conspiring to Steal Trade Secrets for Benefit of Chinese Manufacturing Company*, U.S. Department of Justice (May 24, 2017).

<sup>54</sup> USTR, Special 301 Report (2017) at 30.

<sup>55</sup> Letter from Nigel Cory, Information Technology & Innovation Foundation, to USTR, re: *Comment in Response to Executive Order Regarding Trade Agreements Violations and Abuses* (July 31, 2017) at 11.

otherwise disadvantage foreign firms in relation to their Chinese competitors.<sup>56</sup> According to the U.S.-China Business Council:

China's legal framework for antitrust enforcement provides opportunities for protectionism and industrial policy to sway decisions. For example, MOFCOM merger reviews can consider non-competition factors including those related to industrial policy. . . . Some high profile cases appear to reflect broader Chinese industrial policy concerns on intellectual property, standards, and the protection of domestic industries, as opposed to the interests of fair competition.<sup>57</sup>

In 2014, NDRC conducted broad investigations of pricing practices by foreign-invested enterprises in the auto industry, alleging that the companies "have unlawfully affected China's auto-part prices, car prices and bearings prices, and hurt the interest of downstream manufacturers and consumers."<sup>58</sup> The investigations resulted in agreements by the car companies to cut prices by as much as 50 percent.<sup>59</sup> In 2015, NDRC alleged that chip maker Qualcomm's licensing terms for smartphone technology violated the Antimonopoly Law and reached a settlement agreement under which Qualcomm limited royalty fees to 65 percent of the retail price of the phone.<sup>60</sup> According to one expert, "Those lodging the complaints are the Chinese businesses" that stand to benefit from lower prices.<sup>61</sup> Soon after the antimonopoly action, Qualcomm also formed a joint venture with China's largest chipmaker, SMIC, and Huawei to develop next-generation semiconductor technology.<sup>62</sup>

MOFCOM has also conducted delayed, extra-territorial merger reviews to extract concessions related to IP licensing fees. In 2014, MOFCOM reviewed Microsoft's acquisition of Nokia's handset business. In response to complaints by Chinese phone manufacturers, the Chinese government imposed restrictions on the deal, including (i) requiring Microsoft to continue licensing standards-essential patents on the same terms as prior to the acquisition, and (ii) to accept restrictions on its ability to take legal action in China regarding alleged patent infringements.<sup>63</sup> Behavioral remedies such as these not only result in unreasonable restrictions on foreign companies' ability to exercise legal rights in China, but also frequently "restrict or eliminate the legitimate business value of conducting the transaction in the first place."<sup>64</sup>

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<sup>56</sup> See, e.g., U.S.-China Business Council, *Competition Policy and Enforcement in China* (Sept. 2014) at 1.

<sup>57</sup> *Id.* at 13.

<sup>58</sup> See, e.g., Tom Mitchell, *Mercedes-Benz Accused of Breaching China Anti-Monopoly Laws*, Financial Times (Aug. 18, 2014); *China Fines Japan Auto-Parts Makers \$200 Million*, Wall St. J. (Aug. 20, 2014).

<sup>59</sup> Tom Mitchell, *Mercedes-Benz Accused of Breaching China Anti-Monopoly Laws*, Financial Times (Aug. 18, 2014).

<sup>60</sup> Noel Randewich and Matthew Miller, *Qualcomm to Pay \$975 Million to Resolve China Antitrust Dispute*, Reuters (Feb. 10, 2015).

<sup>61</sup> Laurie Burkitt and Colum Murphy, *China Using Antimonopoly Law to Pressure Foreign Businesses*, Wall St. J. (Aug. 4, 2014).

<sup>62</sup> USCC, Annual Report (2016) at 55.

<sup>63</sup> Ina Fried, *China Approves Microsoft's Nokia Deal, but Expresses Patent Concerns*, Recode (Apr. 8, 2014).

<sup>64</sup> U.S.-China Business Council, *Competition Policy and Enforcement in China* (Sept. 2014) at 19.

### **III. THE ABOVE ACTS, POLICIES, AND PRACTICES OF THE CHINESE GOVERNMENT BURDEN AND RESTRICT U.S. COMMERCE**

As demonstrated above, the Chinese government employs a wide variety of unreasonable and discriminatory acts, policies, and practices related to technology transfer, intellectual property, and innovation. These activities in turn burden and restrict U.S. commerce at both the individual company level and the U.S. economy overall.

The well-being of U.S. companies and their workers, as well as the entire U.S. economy, depends on effective protection of intellectual property rights and enabling U.S. companies to innovate. It is estimated that 45 million U.S. jobs directly or indirectly rely on intellectual property-intensive industries.<sup>65</sup> Moreover, intellectual property-intensive companies account for over 39 percent of U.S. gross domestic product, and drive 52 percent of U.S. exports.<sup>66</sup>

U.S. companies that fall victim to China's actions suffer direct harm. Their investment in intellectual property and innovation is literally stolen, taking away significant portions of each company's value. This hinders their ability to continue to invest in future growth and innovation. Adding to this burden, U.S. companies are denied the ability to fairly compete and gain market share in the Chinese market. Being forced out of one of the world's largest and fastest growing economies prevents U.S. companies from generating the revenues needed to grow, innovate, and invest. Finally, U.S. companies then suffer from the unfair advantages given to Chinese companies as a result of the Chinese government's actions. With myriad forms of support from the Chinese government and not having to invest in intellectual property and innovation, Chinese companies unfairly compete against U.S. companies in both the U.S. market and elsewhere. The sum result is that U.S. companies lose their competitiveness, are financially undermined, suffer decreased revenue, and must cut employment.

However, the negative impact of the Chinese government's acts, policies, and practices goes beyond the harm to individual companies. The U.S. economy suffers and the ability for future economic growth is put at serious risk. The effective protection of intellectual property rights furthers innovation, creates certainty for investment, and creates high-paying jobs. Research and development expenditures have a direct link to economic growth. Thus, the health and competitiveness of the U.S. economy depends on the investment in and commercialization of technology, intellectual property, and innovation.

China's actions threaten to take away this engine for U.S. economic growth. The United States' technology base may be lost and the competitiveness of the entire U.S. economy put at risk if U.S. companies can no longer benefit from their innovation and face unfair competition. Once these technical capabilities are lost, they will be difficult to retrieve. This will particularly be true in high-technology sectors with high barriers to entry. Chinese companies would be able to employ "winner-take-all" strategies to keep U.S. companies from regaining market share. Therefore, it is clear that the Chinese government's actions burden and restrict U.S. commerce.

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<sup>65</sup> Office of the United States Trade Representative, Special 301 Report (2017) at 7.

<sup>66</sup> U.S. Chamber of Commerce, *2017 Special 301 Submissions* (2017) at 1.

**IV. USTR SHOULD TAKE ALL APPROPRIATE ACTION TO OBTAIN THE ELIMINATION OF THE CHINESE GOVERNMENT'S ACTS, POLICIES, AND PRACTICES**

As demonstrated above, the acts, policies, and practices of the Chinese government related to technology transfer, intellectual property, and innovation are unreasonable and discriminatory and burden and restrict U.S. commerce. These unfair and inequitable actions deny U.S. companies and American workers the benefit of their innovation, both in terms of fair compensation and competitiveness. They constitute a clear and coordinated effort by China's government to give Chinese companies unfair advantages in a wide range of high technology and other industries. As a result, they are certainly actionable under Section 301(b)(1) of the Trade Act of 1974.

The immense scope of the Chinese government's actions and their significant negative impact on U.S. companies, workers, and innovation demands that USTR take all appropriate and feasible action to eliminate the Chinese government's acts policies, and practices. Sections 301(b)(2) and 301(c) provide USTR a wide range of options and significant discretion in selecting the appropriate actions. USTR should thoroughly consider all available options and fully exercise its discretion to identify the appropriate actions, including seeking from the President direction to use appropriate and feasible action within the power of the President. The magnitude and breadth of China's acts policies, and practices will require an equal range and scope of actions by USTR. Preserving the overall competitiveness of the U.S. economy, now and in the future, will require nothing less.

It is important to note that while Section 301(b)(2) enables actions with respect to trade in goods and services, this provision also allows actions within the power of the President "with respect to any other area of pertinent relations with the foreign country." Therefore, while restrictions on Chinese goods and services may be a part of USTR's actions, USTR can and should seek broader authority from the President to more effectively address China's activities.

This could include a stricter review of Chinese companies' investments in the United States that considers both the national security and economic implications of such investments. Such review could particularly be required for any investments by Chinese state-owned enterprises or companies otherwise supported or directed by the Chinese government. USTR could also seek to impose on Chinese companies doing business in the United States reciprocal regulatory and administrative measures comparable to those faced by U.S. companies in China. This could include the initiation and extent of antitrust review, investment limitations and requirements, and the level of intellectual property right protection. In addition to the above (but not instead), USTR could seek better cooperation with other countries to seek elimination of China's actions.

In sum, USTR should take a comprehensive set of actions to address the expansive nature of China's acts, policies, and practices; their institutionalization within the Chinese government; and their extensive current and future harm to the U.S. economy, its companies, and its workers. These actions will need to be multifaceted and go beyond the traditional responses of tariffs and other import restrictions to eliminate the growing and cumulative negative impacts of China's activities. Thus, USTR should fully use the authority provided by Section 301.