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December 4, 2006

VIA E-MAIL (PUBLICCOMMENTS@BIS.DOC.GOV)
AND FAX (202-482-3355)

Ms. Sheila Quarterman
U.S. Department of Commerce
Bureau of Industry and Security
Regulatory Policy Division
Office of Exporter Services
14th Street and Pennsylvania Ave., NW
Room 2705
Washington, DC 20230

REF: RIN 0694-AD29

RE: NCITD Comments on Advance Notice of Proposed Rulemaking Regarding Revisions and Clarification of Export and Reexport Controls for the People's Republic of China and New Authorization Validated End-User

Dear Ms. Quarterman:

The National Council on International Trade Development (NCITD) is pleased to respond to the Bureau of Industry and Security's (BIS) request for comments on proposed changes to the Export Administration Regulations ("EAR") that would impact existing regulatory requirements and policies with respect to the export and reexport of certain products to the People's Republic of China ("PRC").¹

I. NCITD Background

NCITD, founded in 1967, is a nonprofit trade association of large and small U.S. exporters and importers who are advocates of policies that are consistent with national security, foreign policy, and a flexible export transaction process that promotes export trade. Our membership includes large, mid-size, and small firms, exporters and importers, freight forwarders and brokers, banks, attorneys, trade groups, and

¹ 71 Fed. Reg.38,213 (July 6, 2006). These comments are timely filed since the comment period was extended to December 4, 2006. See 71 Fed. Reg. 61,692 (Oct. 19, 2006).

consulting firms. Many of our members export products to and have significant manufacturing operations in the PRC. Our members clearly understand the importance of their role in preventing exports and reexports of U.S. origin products and technology that might be contrary to the national security and foreign policy interests of the United States.

II. Comments and Analysis of Proposed Rule

As set forth below, the members of the NCITD believe that the proposed rule modifying export and reexport controls for the PRC has many flaws. Despite its good intentions, the proposed rule would significantly raise compliance costs and would unfairly restrict trade in highly competitive markets without enhancing the national security of the United States. Therefore, as discussed below, the NCITD encourages BIS to reevaluate the utility of the proposed rule and urges BIS to make the changes described below before issuing any final rule.

A. Revision of Licensing Review Policy and Additional Licensing Requirements on Certain Exports to the PRC

The proposed rule published on July 6, 2006 states that it is intended to “strengthen U.S. efforts to prevent U.S. exports to the PRC that would make a material contribution to the PRC’s military capabilities.” In order to do so, BIS proposes to impose licensing requirements (with a policy of denial) on a wide range of products that the U.S. has determined “will contribute to the advancement of Chinese military capabilities.” Specifically, the proposed rule will implement a new control on exports to the PRC of certain items listed on the Commerce Control List (“CCL”) when the exporter has “knowledge” that such items are “destined for military end-use in the PRC.”

1. Definition of Military End-Use and “Material Contribution”

NCITD and its members have a number of concerns with these proposed changes to the EAR. First, there is a lack of clarity on what constitutes a “military end-use”. While the proposed rule defines “military end-use” as “incorporation into, or use for the production, design, development, maintenance, operation, installation, or deployment, repair, overhaul, or refurbishing” of certain specified “defense articles” and certain ECCNs on the CCL, exporters do not always have accurate information on the specific end-use of their products. As a result, an undue burden will be placed on U.S. industry to determine the licensing requirements on transaction-by-transaction basis. This is particularly problematic in China, where it is often difficult to determine whether a company is affiliated with the People’s Liberation Army or not.

In addition, it is not clear how far a U.S. company will have to go, in terms of due diligence, to determine whether a product will have a military end-use. For example, it is often very difficult for U.S. exporters to obtain accurate information or intelligence from third-country or Chinese distributors regarding the names of the end-users or the

intended end-use of a product. As a result, the proposed rule may actually encourage certain customers to provide inaccurate or misleading information to their supplier regarding the end-use of a product in China because they are aware that such information may delay or prohibit the export of a product from the United States.

Second, NCITD's members are concerned that all licensed exports will be reviewed through the murky lens of whether the item will make a "material contribution to the military capabilities of the People's Republic of China." The net outcome of this review may not be an increase in U.S. national security. Rather, it is more likely to lead to a further erosion of the U.S. industrial base as China turns more and more to non-U.S. suppliers.

A better approach would be to shift the burden away from exporters by having BIS publish a list, similar to the Unverified List or Entity List, which would name specific prohibited military end-users in China. A list of prohibited military end-users that is established and maintained by BIS is a much more transparent, practical and objective way for U.S. exporters to ascertain the likelihood that a product being exported to the PRC will be for a military end-use or not.

2. Foreign Availability

China represents a key long-term and large-scale growth market opportunity for many companies. Thus, NCITD's members are very concerned that the proposed rule is overbroad and will be unusually burdensome to administer. The proposed rule imposes new controls on a number of products, many of which are of limited strategic value. Many of the 47 ECCNS that would be prohibited from being sold to military end-users in China are readily available in the global marketplace. In fact, many of the products falling within the 47 ECCNs are actually produced in China. These broad restrictions will not achieve the desired effect to limit China's access to sensitive items. We believe that if these restrictions are enacted that it will hinder many U.S. companies from competing globally. This is particularly true since many other countries that produce these products, including those produced in countries that are members of the Wassenaar Arrangement, do not have similar export controls.

C. Authorized Validated End-Users

The proposed rule contemplates the establishment of a new authorization for "validated" end-users, known as Authorization VEU. The proposed authorization, would allow the export, reexport, and transfer of eligible items to validate end-users in the PRC. To become an eligible VEU, the end-user in China would have to meet a number of criteria, including a "demonstrated record of engaging only in civil end-use activities and not contributing to the proliferation of weapons of mass destruction or otherwise engaged in activity contrary to U.S. national security or foreign policy interests."

At first glance the Authorized VEU proposal seems like a reasonable way to “facilitate legitimate exports to civilian end-users” in China. However, upon closer scrutiny, the Authorized VEU program is unlikely to facilitate trade in the manner that BIS officials expect. First, it is unlikely that many Chinese companies will agree to the terms of the Validated End User designation. Based upon the experience of our members, non-U.S. companies are usually unwilling to submit to audits conducted by foreign governments. In addition, VEUs will be required to comply with recordkeeping requirements, have procedures in place to ensure compliance with the terms and conditions of Authorization VEU and submit annual reports to BIS. While affiliates of U.S. companies may be willing to implement these enhance requirements in order to become a VEU, it is unclear as to how many companies will actually want to undergo the enhance scrutiny to become a VEU, particularly if becoming a VEU will impose additional costs and requirements on the importer.

Second, the proposed rule states that a list of VEUs will be published in a supplement to the EAR. However, because of company there exists a strong potential for some Chinese importers, particularly those affiliated with U.S. companies, to be encouraged not to participate in the VEU program for fear that they will lose sales to competitors.

Third, the proposed rule fails to address whether the proposal to publish the names of VEUs in the EAR is permissible under the confidentiality provisions of the Export Administration Act (“EAA”). Section 12(c) of the EAA provides for the confidentiality of export-related information obtained by the government under the EAA. See 50 U.S.C. App. § 2411(c). Specifically, section 12(c) of the EAA states that certain information submitted to BIS “shall be withheld from public disclosure unless the release of such information is determined by the Secretary to be in the national interest.” 50 U.S.C. App. § 2411(c). Many Chinese companies that choose to apply to become a VEU may not want their names to be made publicly available. At a minimum, assuming the VEU program is adopted, applicants should be given the opportunity to determine whether they want their names to be made publicly available.

Finally, before BIS chooses to proceed with the VEU program, we strongly encourage the agency to ensure that it has adequate resources to operate such a program in an effective manner. The proposed rule would require VEUs to submit a great deal of information to BIS. The proposal also contemplates having BIS staff conduct “on-site visits by U.S. Government officials to verify their compliance with the conditions of VEU.” As noted above, it is not certain how many Chinese companies would choose to participate in this process. Nevertheless, it appears that conducting even a small number of VEU verifications would require significant resources. Therefore, if BIS chooses to proceed with the VEU program it must ensure that it has the adequate resources in the U.S. and in China to vet and issue VEU authorizations in an efficient and timely manner.

D. End-User Certificates

The proposed rule would modify section 748.10 of the EAR by requiring exporters to obtain an End-User Certificate, issued by the PRC Ministry of Commerce, for all items that both require a license to the PRC for any reason and exceed a total value of \$5,000 per ECCN entry. Presently, a PRC End-Use Certificate is only required for items controlled for national security reasons. The proposed rule also proposes to amend several sections of the EAR to eliminate the current requirement that exporters submit PRC End-User Certificates to BIS with their license applications, while requiring exporters to retain such certificates for five years.

While we concur with the proposed change to the EAR that would eliminate the requirement for exporters to submit PRC End-User Certificates to BIS with their license applications, we strongly disagree with the proposal to greatly expand the PRC End-User Certificate requirements for the following reasons.

First, requiring PRC End-User Certificates for all items that require an export license to the PRC and exceed a total value of \$5,000 would dramatically increase the number of export transactions that would require such a certificate. Based upon public data contained in Appendix F of BIS's 2005 Annual Report, BIS received 1303 applications to export controlled products to the PRC in fiscal year 2005. Due to the increasing volume trade between the U.S. and China, it is likely that the number of applications to export controlled products to the PRC in 2006 increased from 2005. While it is not possible for us to predict with certainty how many additional PRC End-User Certificates would be required if the propose change in policy is implemented, based upon information obtained from our members we believe that U.S. companies would be required to obtain a significant number of additional PRC End-User Certificates than are currently required. This is particularly true if BIS chooses to proceed with the proposal outlined above that would impose export licensing requirements on certain categories of products destined for military end-use, assuming that exporters chose to submit license applications for those types of products.

Second, obtaining PRC End-User Certificates from China's Ministry of Commerce (MOFCOM) is a non-transparent, challenging, time-consuming and costly endeavor. While the proposed states that MOFCOM's "Export Control Division 1" is responsible for issuing PRC End-User Certificates, obtaining any information from MOFCOM on the specific requirements needed to apply for an end-user certificate is very difficult, unless a company employs a Chinese law firm or consultant. Moreover, we have been advised by BIS officials that the actual procedure for obtaining a PRC End-User Certificate should commence at the provincial level in China. In addition, U.S. exporters that have navigated the PRC-End User Certificate process, report that MOFCOM's Export Control Division is understaffed and only works specified hours during the week, leading to significant delays in the issuance of certificates. Our members report that it can take nearly one year to obtain an end-user certificate from MOFCOM. Thus, it is likely that increasing the number of transactions requiring MOFCOM end-user certificates will lead

to lost sales by U.S. companies, since their overseas competitors will not require such certificates.

Third, there is conflicting information on the fees imposed by MOFCOM for applying for and obtaining a PRC End-User Certificate. Based upon the experience of our members, the reported MOFCOM fee for obtaining a PRC-End User Certificate can range from hundreds to thousands of U.S. dollars. The inconsistent information and transparency associated with end-user certificate application fees required by MOFCOM to process and issue end-user certificates may require U.S. exporters to increase their FCPA-compliance costs to ensure that no prohibited payments are made.

Fourth, it is unclear whether the increased costs of requiring an expanded universe of PRC End-User Certificates will actually lead to any benefit of enhancing compliance with U.S. export controls. The proposed rule states that "facilitation of end-use checks should facilitate increased U.S. exports to the PRC." We respectfully disagree. Since the Government of the PRC will be the ones conducting the end-use checks and issuing the certificates, the PRC Government may have incentive to issue end-user certificates for products that they want to purchase and to delay end-user certificates associated with products that may compete with PRC Government industries. This is akin to having the "fox watching the hen house." Moreover, while BIS has a representative in China to work with MOFCOM on conducting end-user checks, a lone (or even multiple) BIS representative will be unable to perform the necessary oversight to ensure that the end-user certificates that are issued are accurate and issued in a timely manner.

For these reasons, we recommend that BIS refrain from enacting the proposed changes to the EAR with respect to PRC End-User Certificates. If BIS chooses to proceed with this proposal, we recommend that the threshold for issuing a PRC End-User Certificate be increased to a much higher dollar, such as sales exceeding \$250,000

III. Conclusion

The members of NCITD welcome the opportunity to submit these comments on the proposed changes to the EAR. We trust that BIS will find consider these comments in determining whether to issue a final rule containing the specific changes to the EAR that are contemplated.

Respectfully submitted,



Michael J. Ford
Chairman

National Council on International Trade Development