U.S. Department
of Transportation

**Maritime
Administration**

Administrator

400 Seventh Street, S.W.
Washington, D.C. 20590

July 12, 2002

Vice Minister of Communications Hong Shanxiang
Ministry of Communications
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Beijing, People's Republic of China
FAX No. (86 10 6) 5292345

Dear Mr. Minister:

I am writing to you to provide further views of my government on the Regulations on International Maritime Transportation that your government issued in December of 2001 (hereinafter referred to as the Regulations) and to convey comments of my government on the draft Implementing Rules for the Regulations that were published for comment on June 21, 2002 (hereinafter referred to as the Rules).

Regrettably, the restrictions in the Regulations that I raised in my letter of February 7 have not been removed or ameliorated by any change in the Regulations themselves or by clarifications through the Rules. The Rules, indeed, have neither liberalized nor clarified the Regulations but have added restrictions to those in the Regulations. The Regulations impose new limits on the activities of commercial entities that collectively constitute the international shipping market in a manner prejudicial to the interests of China's trading partners. The Regulations empower the Ministry of Communications (MOC) to control liner service pricing terms, including service contract prices, and to impose unduly burdensome licensing, registration and other requirements on business activities of non-Chinese companies which are inconsistent with existing internationally accepted requirements for such operations. Taken as a whole the Regulations represent significant interference in the international shipping market. This conclusion is discussed in detail in the Attachment to this letter.

Against this background, the test of the Rules is simple: do they make it significantly *easier* for non-Chinese businesses to operate in China by providing clear, market-oriented elaboration of the Regulations? The answer to this question, unfortunately, is: no. None of the Regulations has been rendered less restrictive by the Rules and in some instances the Rules have added new burdens. To cite only a few examples, the Rules introduce additional penalties for seemingly innocuous behavior, and go far beyond the substantial ones already enumerated in the Regulations. Moreover, Article 79 of the Rules adds the requirement for an "annual check" by Chinese authorities of the activities of seemingly every type of international maritime company, thus establishing the basis for further government interference in, and burdens on commercial activity. Although the language fails to make clear whether this applies to foreign-owned international liner operators, it does appear to apply to all other foreign invested providers of auxiliary services, including NVOCCs (Non-vessel Operating Common Carriers), ship agency, ship management, etc. In addition, the Rules are unclear in many places and the English

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translation contains errors leading to confusion in meaning. One of the largest problems with both the Regulations and the Rules is that many important terms and classifications of enterprises are not defined and the authority to determine their meaning is at the discretion of MOC. These issues are specifically discussed in the Attachment to this letter.

The international shipping and trading community -- including carriers, shippers and intermediaries -- does not expect such interference by governments. International maritime companies and their customers are accustomed to a market-based government approach (including regulatory regimes) that: ensures confidentiality of freight rate and service contract information, as well as proprietary data; provides competitive access for all carriers and intermediaries; and insures a transparent, non-intrusive regulatory process. Under the Regulations and the Rules, however, the Chinese government seeks to exert a central dominating position over commercial activities that is fundamentally inconsistent with international standards.

Despite China's commitment -- as part of its accession to the World Trade Organization (WTO) -- to provide market access and national treatment in international transport services, the Regulations and Rules impose new and unreasonable barriers to entry. These new restrictions include the required payment of prohibitively large bank deposits (or "sureties") in order to gain market access by NVOCCs and the use of subjective and burdensome licensing, application and approval criteria. We note that China committed that its licensing procedures and conditions would not act as barriers to market access and would not be more trade restrictive than necessary (WTO Working Party Report, paragraph 308).

Essential operating functions, such as vessel agency services are still the preserve of a small handful of companies controlled by Chinese nationals and designated by MOC that are usually direct competitors of the non-Chinese shipping companies for whom they act as agents. In addition, geographic and quantitative restrictions imposed on branch offices have not been addressed in the Regulations and Rules, and representative offices of non-Chinese companies are not permitted to perform normal, profit-making business functions. Unlike China's WTO commitments, the phase-out of barriers on market access by foreign freight forwarding agencies and storage and warehousing companies is not reflected in either the Regulations or Rules. Neither the Regulations nor Rules appear to leave room for the negotiation of improved market access on a bilateral basis, in accordance with the exemption to most-favored-nation treatment that China has taken under Article II of the General Agreement on Trade in Services.

During bilateral consultations held at the U.S. request in March, in Beijing, to discuss the Regulations, the U.S. delegation that I chaired expressed the concerns of the U.S. industry and government with respect to the Regulations. The Chinese delegation that you led responded with assurances that China wished to regulate shipping in a manner that is consistent with international practice. However, many of the verbal assurances that we were given in Beijing as to how the Regulations would be implemented and interpreted have not been reflected in the Rules, nor have the Regulations themselves been changed in response to the concerns we raised at that time. We request that you point out in writing where you believe the Rules have satisfied the concerns that we have expressed here and in earlier written communications.

I have stated publicly that the Regulations, as well as the manner in which they were issued and implemented, have created a serious credibility problem with respect to China's attitude toward international shipping and trade. In my view, the Rules do not improve the situation.

China is a major player in international maritime trade. Its state-owned shipping companies, such as COSCO, SINOTRANS and China Shipping Group, have established significant market presence worldwide without uncertainty as to what laws, rules and regulations apply to them. These companies have benefited significantly from easy access to U.S. and foreign markets under the market-based trade rules in the United States and around the globe. Yet China continues to restrict severely access of non-Chinese companies to its market through the promulgation and enforcement of these Regulations that have now been reinforced with increased restrictions by the Rules. If China expects that its companies will continue to benefit from the rules of the world shipping market, then it clearly must conform its own laws to well-established international standards of transparency, non-discrimination and openness.

I urge your government to reconsider the implementation of the restrictive policies embodied in the Regulations and the Rules and to commit itself to a genuinely market-oriented approach. I look forward to an early written response from you on these matters.

Sincerely,

William G. Schubert

Captain William G. Schubert
Maritime Administrator

Attachment

ATTACHMENT

DETAILED COMMENTS ON REGULATIONS AND DRAFT RULES

General Provisions -- Licensing Requirements for non-Chinese Companies

Many terms used in the Regulations and Rules are not defined. For example: "international shipping service company" (used in both the Regulations and the Rules) and "international maritime transportation business operations" are not defined. There are several terms used for what appear to be the same type of entity: "international shipping operator" [Article 16] appears to be the same as "international liner services" [Article 16], "international liner operator" [Article 18] and "international liner service operator" [Article 20], but this is unclear. The term "auxiliary business operations relating to international maritime transportation" is defined in the Regulations' Article 2, as including "international shipping agency services, international ship management, loading and unloading, storage and warehousing of international shipments and international container freight station and container yard services, etc."; it is unclear what "etc." might include. "International shipping services" [Regulations, Article 5] appear to be different from "international liner services," but it is unclear how these terms differ. Article 74 of the Rules discusses the application of Chapter II of the Regulations, but does little to allay our concerns. This same article introduces a new description, "registered within Chinese territory." The Rules only add to the problem by failing to define the terms used in the Regulations and by adding further undefined terms.

The Regulations appear to require any company (foreign or domestic) to have a business license to operate vessels to and from Chinese ports and to perform auxiliary activities, including non-vessel-operating common carrier (NVOCC), agency, and ship management services [Articles 5-15]. One of the stated requirements for a license to perform vessel operations is the operation of at least one Chinese-flag vessel. To qualify as an "international maritime transportation business" a company must operate at least one Chinese-flag vessel [Article 6]. Since no non-Chinese company can operate Chinese-flag vessels, it appears from a straightforward reading of the Regulations that no non-Chinese company can qualify for an "international maritime transportation business" license.

From information conveyed by MOC orally in various settings to members of the shipping industry and representatives of the U.S. Government, including in our meetings in March, this requirement does not apply to foreign companies that operate vessels in China's foreign trade. Nevertheless, the recently issued draft implementing Rules do not adequately reflect this interpretation of the Regulations. This has contributed to concern and confusion in the maritime industry with respect to this provision. We note also that there is no such caveat in the plain text of the Regulations that would relieve non-Chinese vessel operators from the flag requirement of Article 6. It is clear that MOC has already interpreted other sections of Chapter II, namely Articles 7 and 8, to apply to Chinese and

foreign NVOCCs alike. We understand that international liner services are one type of international shipping services operating on fixed routes and mainly engaged in container transport, but neither the Regulation or the Rules make this clear. The distinction in the Regulations and the Rules between Chinese and foreign companies remains unclear with respect to registration requirements and qualifications, but it is clear that they discriminate against foreign entities.

Competitive Assessment

Article 6 of the Regulations also requires that government authorities shall assess the level of competition in evaluating a business application. Without specific information on the assessment criteria, the authority to grant market access appears to be a form of an economic needs test. If this Article applies to foreign-invested or foreign-owned operators of liner services, it constitutes a wholly new and unacceptable barrier to market access.

NVOCCs -- "Sureties" and other Limitations on Market Access

The Regulations limit the operation of an NVOCC business in "China" to a Chinese corporation, thus potentially barring foreign NVOCCs from doing business in China [Articles 7 and 8 of the Regulations]. Article 13 requires the applicant to "register," but it is unclear if foreign NVOCCs can qualify. It is not specified how non-Chinese freight forwarders that are already established in China (Class A license holders), and that appear to do many of the same services as NVOCCs, are affected by the Regulations. The Rules do not appear to address this concern.

According to Articles 7 and 8, of the Regulations, NVOCCs must register their bills of lading ("B/Ls") and "deposit" RMB 800,000 yuan (approximately U.S. $100,000) into a designated Chinese bank. U.S. NVOCCs have complained that this is a significant barrier to market access. Performance guarantees can be more equitably accomplished, as is the customary international practice, through surety bonds, which are readily provided by the U.S. insurance industry. Furthermore, the plain text of the Regulations calls for surety bonds, [Articles 7, 8, 21, 26, 43, and 51] but it now appears that this term means a cash deposit in a Chinese bank. Further, it is unclear how claims against these deposits are made or may be challenged. It is not clear to what extent these deposits are administered by MOC as opposed to the bank in which they are held. These concerns are not addressed by the Rules.

Special Restrictions on Foreign-Invested Companies

Chapter IV [Articles 31-34] of the Regulations contains special rules which are applicable only to foreign-invested companies doing certain types of services. Foreign-invested companies (liner operators, shipping agents, shipping management companies) are subject to special restrictions under Articles 31-34 regarding what business they may (and implicitly may not) do in China; wholly-Chinese-invested operators are not subject to the restrictions and limitations of Chapter IV.

Article 32 of the Regulations provides that foreign investors may do the following activities only through equity or contract joint ventures having a majority Chinese partner, and with Chinese management: international shipping services, international shipping agency services, international ship management services, international maritime cargo warehousing, and international maritime container freight station and container yard services. Furthermore, Articles 32 and 33 of the Regulations provide that Wholly Foreign Owned Enterprises (WFOEs) may only perform international maritime cargo warehousing services; or the following services -- canvas cargo, issue bills of lading, settle freight and sign service contracts -- *for their owned or operated vessels*. There are no such limitations on U.S. carrier activities that China committed to in 1996 (see Memorandum of U.S.-Sino Maritime Discussions, signed June 14, 1996, in Beijing). Foreign-invested enterprises are apparently barred from performing these services for carrier partners' vessels or unrelated vessels. This is a significant limitation on carriers that seek through alliances and cooperative vessel sharing arrangements to achieve efficient services that translate into reduced shipping costs. This limitation (for "owned or operated vessels") also implies that foreign-invested NVOCCs cannot issue bills of lading, as, by definition, they do not operate their own vessels. However, there appears to be a contradiction with Article 7 of the Regulations which specifically authorizes NVOCCs to issue bills of lading. This is not clarified by the Rules.

It is unclear from Articles 29 and 33 of the Regulations, which establish both permission and limitations of services that can be provided, whether "foreign-invested liner operators, whether incorporated in China or not," can use the services of other foreign operated joint ventures, cooperative joint ventures or WFOEs other than their own. Finding suitable joint venture or cooperative partners may be impossible or difficult at best; setting up a WFOE for the activities listed in Article 33 of the Rules appears to be even more difficult as it has only been permitted after protracted government-to-government negotiations. This is clearly a restriction on market access

Requirements to Use a Chinese Agent

Also, prior to the issuance of the Regulations, foreign carriers were specifically prohibited from applying directly for licenses; this had to be done through a Chinese agent, which was usually a subsidiary of a direct competitor of the applicant. It is unclear whether this continues to be the case. It is not clear whether already-established WFOEs established in China will be required to use Chinese agents to submit the applications or notifications for liner operations, or for shipping agent, and shipping management business licenses under the Regulations. WFOE NVOCCs (if allowed to do business at all) will continue to be required to use Chinese agents for these applications. Furthermore, Article 33 of the Regulations requires foreign operators who have not established a Chinese joint venture or WFOE to perform these services to engage a Chinese company as agent and it is not clear whether that requirement would allow employment of a joint venture with foreign investment engaged in the business of a shipping agent.

Representative Offices --Limitations on Business Activities

Finally, Article 34 of the Regulations continues the limitations on foreign operators' representative offices, which still have no ability to "do business" and still must get approval from MOC. Domestic operators appear to have no such regulatory limitations on their ability to establish fully-functioning branch offices, which in turn gives them the ability to serve customers anywhere in China. Foreign operators of international maritime services and auxiliary businesses can, with approval, establish representative offices in China subject, however, to the important limitation that those offices "are forbidden to operate business activities." [Article 34] This is another limitation on market access, and for a company seeking to do business in China for the first time it is particularly onerous. It is only through a few branch offices that established U.S and foreign carriers are authorized to do business. It would appear that WFOE and joint venture branch offices are still limited (by joint MOC/MOFTEC rules) to doing business in the port cities in which they (or their partners) have monthly vessel calls. If the joint MOC/MOFTEC rules are still in effect, Article 6 of the Rules would appear to provide preferential treatment for Chinese-dominated joint ventures over WFOEs. China must eliminate this arbitrary geographic restriction for all operators.

Applications/Approvals for NVOCCs and Vessel Operators

Article 31 of the Regulations states that Chapter IV covers "foreign invested international maritime business and related auxiliary business" in China. However, with respect to the list of types of businesses of Article 2 of the Regulations, neither NVOCCs nor ocean freight forwarders are specifically covered. It is unclear whether, according to the provisions of Articles 7, 26, 27, and 32 of the Regulations (purporting to apply to foreign-invested shipping companies), foreign-invested companies are barred from operating NVOCCs. NVOCC is not listed as a type of enterprise in Article 32. It appears to imply that foreign NVOCCs are only able to operate in China through an MOC-licensed joint venture or Chinese agent. There is no provision in Chapter IV (foreign-invested companies) relating specifically to NVOCCs. Thus, NVOCCs that are WFOEs may not perform all normal NVOCC activities in China.

MOC has stated that for vessel operators, the vessel call application system has become a "registration" system, and that in lieu of the previously required approvals, only notification will be required. [Article 17 of the Regulations] This is, however, not the case for *all* international vessel services from the PRC. The plain language of Article 57 of the Regulations and Paragraph 3 of the December 27, 2001 Notice allude to this. Article 57 of the Regulations reads, "No foreign operators of international shipping service, without being *approved* by the competent communications department of the State Council, shall be allowed to engage in the shipping services between Chinese mainland and Hong Kong SAR or Macao SAR, nor *engage in two-way direct sailings or shipping services via a third place between Chinese mainland and Taiwan region*" (emphasis added). Paragraph 3 of the December 27, 2001 MOC "Public Notice" reads, "The maritime freight and passenger transportation *between the two sides of the Taiwan Strait, between the two sides of the Taiwan Strait via a third place*, and between the

mainland and Hong Kong SAR and the Macao SAR *still need to be approved by the Ministry of Communications*" (emphasis added). This appears to contradict the verbal assurances that we were given that the Regulations do not represent an attempt to regulate the movement of cargo between Taiwan and a third country or that the vessel call approval system would be completely abolished by the Regulations. Please clarify this discrepancy.