

The Regulation of Encryption Products in China

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Introduction

The Chinese encryption products market has been developing strongly since the early 1990s with a market size estimated to be over 100 billion Yuan in 2009.¹ The major Chinese encryption product companies include Wuxi Jiangnan Information Security Engineering Center, Chengdu Westone Information Industry Co., Ltd., Shandong Dean Information Technology Co., Ltd., Beijing Watchdata Intelligent Technology Co., Ltd. and Xing Tang Telecommunications Technology Co., Ltd.² Meanwhile, famous Chinese companies such as Lenovo, Huawei, Tsinghua Tongfang, and Aigo also appear to be actively involved in this market.³ Foreign investment in this area remains very difficult with limited opportunities.

However, many states have been cooperating on such business by participating in the Wassenaar Arrangement. The Wassenaar Arrangement ("WA") is an international agreement, established on July 12, 1996, and focuses on "contributing to regional and international security and stability by promoting transparency and responsibility in the transfer of conventional arms and dual-use goods and technologies."⁴ States that have become a party to the WA include Australia, Canada, France, Germany, Italy, Japan, New Zealand, the Republic of Korea, the Russian Federation, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.

China is not a member of the Wassenaar Arrangement at present, thus WA member states are not allowed to export chip technology into China. Also, China does not control encryption products based on their encryption strength. However, importing encryption products and equipment containing encryption technology is restricted in China as China is focused on strengthening commercial encryption management, protecting information security, and safeguarding the national security interests.

The Chinese Encryption Administration Bureau ("SEAB") is the national authority responsible for matters in relation to the importation of products and equipment containing encryption technology to China. Together with the Chinese Customs General Administration ("CCGA"), it formulates, adjusts, and publishes the *Management Catalog on Importing of Encryption Products and Equipment Containing Encryption Technology* ("Management Catalog"),⁵ and enforces import restrictions for encryption products in the form of issuing or refusing import licenses.

Key Regulations

Below is a list of key regulations governing encryption products in China.⁶

I. Regulations for the Administration of Commercial Encryption ("RACE")

Issued by the State Council of China on October 7, 1999, the RACE has been in effect since October 7,

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1999. The RACE is the only administrative regulation focused on the actual management of commercial encryption products. All other regulations and rules are issued pursuant to this regulation. These regulations set out provisions regarding the research, manufacture, distribution, import/export, use, security and storage of encryption products in China.

II. Regulations for the Administration of Sale of Commercial Encryption Products

These regulations were issued by the SEAB on December 11, 2005, and have been in operation since January 1, 2006. Article 13 states that all encryption products developed and/or manufactured outside of China shall not be sold in China.

III. Regulations for the Administration on the Use of Commercial Encryption Products

These regulations were issued by the SEAB on March 24, 2007. According to Article 9, foreign investment enterprises, including Sino-foreign equity joint ventures, Sino-foreign contractual joint ventures, foreign-funded enterprises, foreign investment enterprises and so on, may use encryption products manufactured overseas only if they are requested for communicating abroad.

IV. Regulations for the Administration on the Use of Commercial Encryption Products by Foreign Organizations and Individuals in China

These regulations were issued by the SEAB on March 24, 2007. According to Article 6, foreign enterprises and individuals may apply for approval of importing encryption products manufactured overseas for their own use.

V. Announcement No. 18 by the SEAB and CCGA ("Announcement 18")

This was issued by the SEAB and the CCGA on December 10, 2009, and came into force on January 1, 2010. This announcement resulted in the publica-

tion of the Management Catalog which lists out all the products that require a valid import license.

Definitions

"Encryption Products" refers to products "which provide encryption protection or security authentication but does not involve any state secrets."⁷ Another definition is: "Products which provide encryption protection or security authentication for information via encryption technology, including encryption products manufactured inside or outside of China."⁸

"Commercial Encryption" is defined as "encryption technology and encryption products which are used for protecting information or for security certification, but those involving state secrets are excluded."⁹

Meanwhile, according to the Beijing Encryption Authority's website,¹⁰ "commercial encryption products" refer to those "special hardware and software products with the functions of encryption and decryption operation or safety certification by adopting of commercial encryption technology." The website classifies them into "communication encryption products" and "non-communication encryption products." Communication encryption products include but are not limited to cipher phones, cipher faxes, cipher cards with various bus interfaces, computer application layer cipher machines, computer network layer cipher machines, and computer link layer cipher machines. Non-communication encryption products include authentication and storage encryption products such as intelligent IC cards, intelligent encryption keys, a variety of security systems, and database encryption systems.

Enforcement and Management Authorities

In accordance with Article 4 of the RACE, the State Encryption Administration Committee (now known as the SEAB) is the national authority responsible

for managing commercial cipher codes (i.e. encryption products and technology). In general, the SEAB is in charge of the specific management of researching, manufacturing, selling and using of commercial encryption products in China. The general tasks entrusted to the relevant provincial and local departments of the SEAB are:

1. Controlling the sale and use of encryption products;
2. Preliminary examination of the qualification of encryption product research organizations on behalf of the SEAB;
3. Investigation of claims of violation of the RACE.
4. Handling of the use of encryption products by foreign enterprises in China.
5. Handling import declarations for encryption product and equipment with encryption technology and reporting to the SEAB for issuing relevant import licenses.

Interestingly, the SEAB itself does not have any direct enforcement powers. In order to enforce the relevant regulations, it needs to rely on other Chinese government departments with enforcement powers such as the Customs, State and/or the local Administrations for Industry and Commerce, and the Ministry of Commerce. We note that reported enforcement of the network of encryption regulations discussed in this article has been sporadic at best.

What Kinds of Products Require Import Permits?

Article 1 of the Issues Relevant to Regulations for the Administration of Commercial Encryption¹¹ provides that:

The encryption products and the equipment with encryption technology regulated by the *Regulations for the Administration of Commercial Encryption* are those special hardware and software products with core

functions of encryption and decryption operations only, Mobil phones, windows software and browser software are not within this scope.

According to Article 13 of the RACE, the importation of encryption products and equipment with encryption technology can only occur with approval from the state encryption administration authorities. It expressly states that no entity or individual shall be allowed to sell encryption products manufactured overseas.¹²

Article 9 of the *Regulations for the Administration on the Use of Commercial Encryption Products* provides that foreign investment enterprises, including Sino-foreign equity joint ventures, Sino-foreign contractual joint ventures, foreign-funded enterprises, and so on, may import encryption products manufactured abroad for their own business use.¹³

In addition, Announcement 18 states that the products listed in the first Management Catalog and those products where an importer knows (or should know) contain encryption technology can be imported upon having obtained import licenses.

In summary, the products which require import licenses are:

1. Those listed in Announcement 18¹⁴ which include: (1) electrostatic sensitive light type integrated multi-function encryption fax machines and other integrated multi-function encryption fax machines; (2) cordless encrypted telephones and other encrypted phones; (3) optical communication encryption routers; (4) non-optical communication encryption ethernet switches; (5) non-optical communication encryption routers; and (6) cipher machines (include phone cipher machines and fax cipher machines).

2. Special hardware and software products which importers know (or should have known) would include encryption and decryption operations as the core functions.

However, the next step is to look at exemptions. Three exemptions are offered by the various encryption regulations. First, foreign diplomatic representatives or consular offices can obtain certain exemptions for obvious reasons.¹⁵ Second, those encryption products listed in the first Management Catalog can be exempted if:

1. They are part of a processing trade program and are imported for mere processing and then re-exported;
2. Under monitoring and management by Customs, they are temporarily imported before being re-exported; and
3. They are imported into a bonded zone area, or similar area monitored and managed by Customs and handled under Customs supervision.¹⁶

Third, mobile phones, Windows software, and browser software are excluded according to the *Issues Relevant to Regulations for the Administration of Commercial Encryption*.¹⁷

Interestingly, the SEAB has a policy which is essentially another exception based on intellectual property issues. This is potentially a very useful exemption for many hi-tech organizations. Currently, the SEAB claims that it will allow the import and use of a product with encryption technology if its main purpose is for protecting the intellectual property in a product. This policy does not have legislative support in China, however we have seen it applied to various software and communication products that are brought into China.

The Process for Obtaining Relevant Import Licenses

Firstly, importers are required to submit applications to local encryption administration authorities if the imported products are those listed in the first Management Catalog or they know or might know that their imported products include some kind of encryption technology.

The application is then reviewed under Article 13 of the RACE, Article 9 of the *Regulations for the Administration on the Use of Commercial Encryption Products*, Article 6 of the *Regulations for the Administration on the Use of Commercial Encryption Products by Foreign Organizations and Individuals in China*, and Announcement 18.

During the reviewing process, the administrators generally verify whether the products will be imported for self use and communication with entities abroad, and whether the importers and ultimate users of the imported encryption products are foreign investment enterprises.

The materials required to be submitted are a formal application form, a copy of a sealed Customs agent contract if the applicant is without import and export operation rights, and other documentation as directed by Customs for each individual case. A sample of the code or encryption product/software is not required as part of the application, but a relevant description of the code or encryption product/software will generally be required. It normally takes 20 working days from the date of filing of an application to get the relevant approval or rejection. No filing fees are currently payable.

Penalties

The RACE sets out relevant penalties for violations. For example, if an individual is found guilty of importing encryption products without a permit or approval for sale in China, the imported encryption products and the illegal income will be confiscated,

and a fine of one to three times of the amount of any illegal income obtained can be imposed.¹⁸

Occasionally, importers may breach Customs laws and regulations by failing to use the correct tariff numbers in the Customs declaration forms in order to avoid obtaining a license. If Customs deem the intention behind misclassifying the goods to be for the avoidance of the licensing requirements, it could treat the violation as an administrative offense or even a criminal smuggling offense. The penalties for those offenses are fines, confiscation of profits and goods, and imprisonment. In addition, those offenses can result in a downgrade of the importer's enterprise Customs grade which would have an impact on its Customs clearance and contract manufacturing operations.

Decided Cases

As mentioned above, reported cases of enforcement of these encryption regulations are not common. One case that received significant press was the 2005 Hewlett Packard laptop case.¹⁹ In 2005, HP sold a kind of laptop called "Extreme Security" laptop which included a TPM internal safety chip—a tool for disk encryption in China. According to the RACE, internal encryption of products which include a TPM safety chip must be developed, produced and sold by authorized domestic companies. HP tried to evade the law—it disabled the chip's encryption management function before selling the products in China, and told customers to download the function online for personal use. This created the impression that HP was not selling products with encryption technology developed abroad in breach of the regulations. However, the SEAB found that the encryption in the TPM chip was a commercial encryption which must be approved by them prior to selling in China. Consequently, HP was ordered to remove the encryption technology from these products prior to selling them in China.

Conclusion

China continues to treat encryption technology developed locally and abroad with suspicion. In the past, the encryption regulations have not been enforced consistently across China, however, indications are that China Customs are starting to pay more attention to these regulations. Importers and users of encryption products should seek approval or exemption advice from the SEAB officers when looking to import and/or use foreign developed encryption products.

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¹ From <http://finance.qq.com/a/20090820/000767.htm> (last visited January 17, 2011).

² They are the top five companies which have the most registered commercial encryption products according to the information shown on http://www.oscca.gov.cn/Doc/21/News_1162.htm (last visited January 17, 2011).

³ See http://www.oscca.gov.cn/Doc/21/News_1162.htm (last visited January 17, 2011).

⁴ Wassenaar Arrangement Introduction, available at <http://www.wassenaar.org/introduction/index.html> (last visited January 5, 2011).

⁵ The Management Catalog is available on both the SEAB and CCGA websites. See: http://www.oscca.gov.cn/Doc/2/News_1175.htm and

<http://www.customs.gov.cn/publish/portal0/tab515/info201678.htm> (last visited January 11, 2011).

⁶ All mentioned regulations are available on the SEAB website. See

http://www.oscca.gov.cn/Html/Column_2_1.htm (last visited January 11, 2011).

⁷ Article 3 of the *Regulations for the Administration on the Use of Commercial Encryption Products*.

⁸ Article 3(3) of the *Regulations for the Administration on the Use of Commercial Encryption Products by Foreign Organizations and Individuals in China*.

⁹ Article 2 of the RACE.

¹⁰ <http://www.bjgm.gov.cn/news/detail.asp?classid=3&id=317> (last visited January 5, 2011).

¹¹ Issued by the State Encryption Management Commission as an interpretation of the RACE in 2000. The author contacted a SEAB staff member who confirmed the regulation is still valid on October 20, 2010.

¹² Article 13 of the *Regulations for the Administration on the Sale of Commercial Encryption Products* states a similar rule.

¹³ *Regulations for the Administration on the Use of Commercial Encryption Products by Foreign Organizations and Individuals in China* provides the same in Article 6.

¹⁴ This list is updated from time to time.

¹⁵ Article 15 of the RACE.

¹⁶ Article 2 of Announcement No. 18 by the SEAB and CCGA.

¹⁷ After the RACE was issued, the public was unclear as to whether mobile phone, Windows software and browser software constituted commercial encryption products. The confusion was clarified in *Issues Relevant to Regulations for the Administration of Commercial Encryption*, which classified those products as non-commercial encryption products.

¹⁸ Article 20(3) of the RACE.

¹⁹ 联想vs.惠普：遭遇"TPM"事件，
<http://tech.sina.com.cn/it/2005-05-11/1459604569.shtml> (last visited January 11, 2011).