



June 17, 2019

PUBLIC DOCUMENT

Joseph Barloon
General Counsel
Office of the United States Trade Representative
600 17th St. NW
Washington, DC 20508

Re: Comments Regarding Proposed Modification of Action Pursuant to Section 301, Docket No. USTR-2019-0004

Dear Mr. Barloon:

Microsoft Corporation (“Microsoft”), Nintendo of America Inc. (“Nintendo”), and Sony Interactive Entertainment LLC (“SIE”) respectfully submit these joint written comments in response to the Office of the U.S. Trade Representative’s (“USTR”) request for public comments regarding products imported from China that could be subject to tariffs pursuant to USTR’s Section 301 investigation of China’s acts, policies, and practices related to technology transfer, intellectual property (“IP”), and innovation.¹

At the outset, we note that we support the Entertainment Software Association’s (“ESA”) submission requesting removal of a broader range of videogaming-related Harmonized Tariff Schedule of the United States (“HTSUS”) subheadings from the final tariff list. As leading video game console manufacturers, we submit this separate submission to highlight the enormous impact and undue economic harm that proposed tariffs on video game consoles would have on the entire video game ecosystem.

In particular, tariffs on video game consoles would:

- Injure consumers, video game developers, retailers and console manufacturers;
- Put thousands of high-value, rewarding U.S. jobs at risk; and
- Stifle innovation in our industry and beyond.

While we appreciate the Administration’s efforts to protect U.S. intellectual property and preserve U.S. high-tech leadership, the disproportionate harm caused by these tariffs to U.S. consumers and businesses will undermine—not advance—these goals. Accordingly, we respectfully request that the Administration remove HTSUS subheading 9504.50.00, covering video game consoles, from the final list of tariffs, and thus refrain from applying tariffs on these products.

¹ *Request for Comments Concerning Proposed Modification of Action Pursuant to Section 301: China’s Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation*, 84 Fed. Reg. 22564 (May 17, 2019).

I. Our Companies and the Video Game Industry Drive U.S. Economic Growth and Technological Innovation

The video game industry makes groundbreaking, high-technology video game consoles that entertain and engage consumers of all ages and support businesses of all sizes across the United States. As makers of virtually all video game consoles in America, Microsoft, Nintendo, and SIE lead the growth of this dynamic and highly innovative segment of the gaming market.

Economically, the video game industry contributes substantially to the U.S. economy, and its year-on-year growth is impressive. The U.S. video game industry generated total revenue of \$36 billion in 2017² and \$43.4 billion in 2018,³ reflecting over 20% in growth. This industry directly and indirectly employs more than 220,000 people.⁴ Ninety-nine point seven percent (99.7%) of video game companies qualify as small businesses and can be found in each of the fifty states;⁵ many develop software for video games across the range of platforms, from PCs to mobile, including the video game consoles that we manufacture, and are an integral part of the booming app economy.⁶

In a single year (2018), our three companies collectively sold more than 15 million video game consoles in the United States alone.⁷ Together, we currently employ nearly 8,000 people across the United States,⁸ including high-value, high-tech research and development roles and creative design and coding jobs in game development studios.

- Founded in 1975, Microsoft is a leader in the technology industry. Microsoft has developed a wide range of services, software, and hardware products, including the Office suite of productivity applications, the flagship Windows operating system, the Bing search engine, the Surface tablet computer, Azure Cloud Services, and the Xbox gaming products and services. Microsoft manufactures the Xbox line of gaming consoles and accessories, platform software and development tools that enable software developers to create games and applications that run on Xbox consoles and in the cloud, and operates the Xbox Live service, a digital storefront for games, a live game streaming service called “Mixer,” and 15 individual game studios, including studios located in Washington, California, and Louisiana. Microsoft partners with over 1000 game developers in the United States to provide games and content for its gaming platform.

² Entertainment Software Association, *Impact of the Video Game Industry: State by State*, <https://www.arenweinyourstate.org/>.

³ Entertainment Software Association, *2019 Essential Facts About the Computer and Video Game Industry*, at 3, available at https://www.theesa.com/wp-content/uploads/2019/05/ESA_Essential_facts_2019_final.pdf.

⁴ Stephen E. Siwek, *Video Games in the 21st Century* (2017), available at <https://www.theesa.com/wp-content/uploads/2019/03/2017-EIR-National-Report.pdf>.

⁵ Entertainment Software Association, *Impact of the Video Game Industry: State by State*, <https://www.arenweinyourstate.org/>.

⁶ ACT (The App Association), *State of the App Economy*, <http://actonline.org/2018/04/16/state-of-the-app-economy-report-highlights-american-leadership-in-the-950-billion-app-economy/>.

⁷ The NPD Group, Inc / Retail Tracking Service. / Combined sales of Nintendo Switch, Sony PlayStation 4, and Microsoft Xbox One / Annual 2018.

⁸ This figure includes only Microsoft employees dedicated to gaming; in total, Microsoft has approximately 80,000 employees in the United States.

- Nintendo of America Inc. is headquartered in Redmond, Washington. One of Nintendo’s high-tech research and development teams is based in Redmond, focused on identifying and developing technology for use in Nintendo’s future video game consoles, systems, and services. Nintendo also has video game development studios in both Redmond and Austin, Texas. Nintendo became known as a video game company more than 30 years ago and has been offering the world unique and original entertainment products ever since, including but not limited to the Nintendo Entertainment System, the Game Boy family of handheld systems, the Wii console and, most recently, the Nintendo Switch gaming system.
- SIE is a leading innovator of interactive digital entertainment and the company responsible globally for the PlayStation brand and family of products and services, including the PlayStation video game console and the immensely popular PlayStation Network, a community of online digital entertainment consumers numbering nearly a hundred million active users worldwide, and the PlayStation Store, where SIE sells all forms of digital entertainment to consumers. Among SIE’s most visionary offerings in the last five years are its virtual reality headset, PlayStation VR, and its first-to-market over-the-top (internet-based) live streaming television service, PlayStation Vue. In 2016, Sony Corporation moved the global headquarters of Sony Interactive Entertainment from Tokyo to San Mateo, California, due to a deep commitment to invest in the United States. All aspects of the business are represented in California, including engineering, research and development, operations, sales and marketing and corporate support functions. The company has six game development studios in Washington, Oregon and California, which are focused on developing world-class games for the PlayStation consoles and which employ designers, artists, developers, producers and support staff.

II. Video Game Consoles Are Highly Specialized Products With Complex Supply Chains

Unlike PCs, each of our consoles has a custom hardware configuration and design and offers unique and differentiating features that run on proprietary software operating systems connected to each company’s unique platform and services. Games and services designed for one console must be re-engineered—through a labor intensive process known as “porting”—to operate on another console or on a PC, at significant cost to the video game publisher.

In 2018, over 96% of video game consoles imported into the United States were made in China.⁹ The video game console supply chain has developed in China over many years of investment by our companies and our partners. It would cause significant supply chain disruption to shift sourcing entirely to the United States or a third country, and it would increase costs—even beyond the cost of the proposed tariffs—on products that are already manufactured under tight margin conditions. Each video game console comprises dozens of complex components sourced from multiple countries. A change in even a single supplier must be vetted carefully to mitigate risks of product quality, unreliability and consumer safety issues. Tariffs would significantly disrupt our companies’ businesses and add significant costs that would depress sales of video game consoles and the games and services that drive the profitability of this market segment.

⁹ Trade Partnership Worldwide, *Estimated Impacts of Proposed Tariffs on Imports from China: Cellphones, Laptops and Tablets, Video Game Consoles and Toy Drones* (June 17, 2019) at 3.

III. Beyond Video Game Console Makers, U.S. Consumers, and U.S. Retailers, the Proposed Tariffs Would Asymmetrically Harm Small and Medium-Sized Software Developers Across America

Although our video game consoles provide a critical foundation for our businesses by driving demand for games and services, we sell them under very tight margin situations, meaning that we price video game consoles at—or slightly above—cost to make them as affordable as possible, and look to the sale of video games and services, which are much lower priced, to drive economic returns. Console purchasers are extremely price sensitive.¹⁰ In 2018, approximately 110 million console gamers in the United States spent around \$15 billion on video game software and services, equating to over \$130 in annual software and services spend per gamer.¹¹

Video games are a core part of the fabric of American entertainment culture. Two out of three households have at least one video game player¹² and 60% of Americans play video games daily.¹³ A price increase of 25% will likely put a new video game console out of reach for many American families who we expect to be in the market for a console this holiday season. For those purchases that do go forward despite tariffs, consumers would pay \$840 million more than they otherwise would have, according to a recent study prepared for the Consumer Technology Association by the independent economic group, Trade Partnership.¹⁴ That study also noted that “[e]ven after accounting for new tariff revenue, the result is a net \$350 million loss for the U.S. economy for each year the tariffs remain in effect, with the burden carried by U.S. consumers.”¹⁵

Given that the main purpose of video game consoles is to play games, as significant as the impact of tariffs would be for video game console makers and consumers, the harm to the thousands of U.S.-based game and accessory developers who depend on console sales to generate demand for their products would be equally profound. The ripple effect of harm could be dramatic. Our consoles have generated a vast ecosystem of small and medium-sized game developers. A significant number of the games played on Microsoft, Nintendo, and SIE video game consoles are not developed by our companies in-house.

¹⁰ See, e.g., Entertainment Software Association, *2019 Essential Facts about the Computer and Video Game Industry*, at 21, available at https://www.theesa.com/wp-content/uploads/2019/05/ESA_Essential_facts_2019_final.pdf (noting that 66% of survey respondents indicated that price was among the top five factors influencing a game purchase). According to some analyses, consoles have even been sold at losses. See, e.g., Ravi Srikant, *The Economics of Gaming Consoles (SNE, MSFT)*, Investopedia (Oct. 23, 2018), <https://www.investopedia.com/articles/investing/080515/economics-gaming-consoles.asp> (“In 2006, at the time of PS3’s launch, each console was sold at a loss of around US \$240 per console, while the Xbox 360 lost around US \$125 per console when it launched in 2005.”).

¹¹ Newzoo.

¹² Entertainment Software Association, *2018 Essential Facts About the Computer and Video Game Industry*, at 5, available at https://www.theesa.com/wp-content/uploads/2019/03/ESA_EssentialFacts_2018.pdf (“64% of US households own a device that they use to play video games.”).

¹³ *Id.*

¹⁴ Trade Partnership Worldwide, *Estimated Impacts of Proposed Tariffs on Imports from China: Cellphones, Laptops and Tablets, Video Game Consoles and Toy Drones* (June 17, 2019) at 4.

¹⁵ *Id.* at 4.

Rather, the games are created by independent developers and purchased separately by consumers; this system expands options for consumers by promoting a rich diversity of game offerings.

The U.S. is a world leader in creating video games. As of 2018, there were over 65,000 workers employed at over 2,700 video game software publisher and developer companies across the U.S.¹⁶ These are high-skilled and well-compensated jobs that are not in any way immunized from the ramifications to software sales of stalling growth or shrinkage in video game console sales. Console game development is already a highly competitive space; when game sales are depressed or games are canceled, major layoffs routinely result.¹⁷ Because console makers are publishers of independent games as well, providing manufacturing, marketing, sales and/or distribution assistance for the games made by these small developers, declining revenues for console makers could translate into reduced support for developers. The effects on communities could be compounded by necessary relocations to other states or countries of high wage earners. Reduced video game console sales unquestionably will lead to reduced sales of games, which is highly likely to have a deleterious effect on the small and medium-sized businesses that make these games, and on the workers whom they employ.

Retailers that distribute our video game consoles would also feel the effects of this significant tariff. Video game consoles are primarily sold at brick-and-mortar retailers such as GameStop, Best Buy and Wal-Mart. Given that retail margins on video game consoles are generally very tight, we see no possible reasonable scenario for retailers other than passing tariff costs down to consumers. Any imposition of tariffs leading into the winter holidays—the strongest sales season for consoles—would have a significant negative impact on U.S.-based retailers and their employees, in particular because promotional offers on consoles are important to driving sales volume. Tariffs would make it especially difficult for both console makers and retailers to support the types of promotional offers typical of the holiday season.

Because of the deep interdependence of video game consoles and game software, and due to the price sensitivity of video game console purchasers, tariffs on video game consoles would not only harm our companies, consumers, and retailers, but will also disproportionately harm the thousands of small and medium-sized software and accessory developers in the United States. Thus, these tariffs would have a ripple effect of harm that extends throughout the video game ecosystem.

IV. Tariffs Could Hinder or Delay Technological Innovation in a Broad Range of Applications Beyond Gaming

The proposed tariffs on consoles could also impair our companies' and game developers' ability to innovate further, materially undermining this investigation's goal of protecting "American intellectual property rights, innovation, [and] technology development."¹⁸ There would be ripple effects extending far beyond the video game industry, because the video game industry has historically and persistently

¹⁶ Entertainment Software Association, *2018 Essential Facts About the Computer and Video Game Industry*, at 14, available at https://www.theesa.com/wp-content/uploads/2019/03/ESA_EssentialFacts_2018.pdf.

¹⁷ See, e.g., Kevin Webb, *Activision-Blizzard, the Major Video Game Company Behind 'Call of Duty' and 'Overwatch,' Is Laying Off About 800 Employees*, Business Insider (Feb. 12, 2019), <https://www.businessinsider.com/blizzard-layoffs-2019-2>.

¹⁸ Office of the U.S. Trade Representative, *Findings of the Investigation into China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation Under Section 301 of the Trade Act of 1974* (Mar. 22, 2018), at 4, available at <https://ustr.gov/sites/default/files/Section%20301%20FINAL.PDF> ("The President instructed USTR to determine under Section 301 whether to investigate China's law, policies, practices, or actions that may be unreasonable or discriminatory and that may be harming American intellectual property rights, innovation, or technology development.").

been a leader in U.S. technology innovation in both the hardware and software spaces and beyond the game industry.

Microsoft, Nintendo, and SIE collectively invest billions of dollars in research and development in the U.S. to develop and deliver inventive consoles and next-generation technology to our customers. Microsoft, for instance, has over 2,000 issued and pending U.S. patents for innovations originally created for gaming. Instituting tariffs would lead to reduced R&D investment, as console makers scale back on revolutionary new technologies.

Importantly, many innovations originating in gaming have been deployed to the benefit of other industries and sectors of society. For example, Microsoft originally developed its award-winning motion sensing input device known as “Kinect” as a gaming accessory device for Xbox consoles and Windows PCs. Microsoft’s investments in motion and depth sensing technology can now be experienced in its HoloLens mixed reality head-mounted device, and its recently announced Azure Kinect device. These devices are being deployed globally in a variety of healthcare, retail, industrial, manufacturing, education, and research scenarios by commercial enterprises, academic institutions, and government agencies.¹⁹

In 2018, Microsoft launched the Xbox Adaptive Controller, which was named one of the 50 most innovative products for 2018 by Time Magazine. This innovative controller enables players with limited mobility to engage in gaming using specialized external devices including buttons, switches, and joysticks.²⁰ Recognizing the multiple therapeutic benefits of gaming for injured veterans, including fostering social connections, strengthening motor skills, and promoting cognitive processing, the U.S. Department of Veterans Affairs and Microsoft recently launched a partnership to bring the controller to twenty-two VA rehabilitation centers across the U.S.²¹

Similarly, Nintendo, creator of the Wii console, has helped expanded audiences play video games with its motion controls that even today keep people active and social, enhancing their quality of life through fitness and fun. Outside of entertainment, Nintendo is often credited with making the front-facing camera a ubiquitous feature on today’s smart devices through its Game Boy camera accessory.

SIE’s PlayStation®3 console employed an innovative processor architecture known as the Cell Broadband Engine, a chip that approached “supercomputer” levels of processing power. The Cell was used for Stanford University’s Folding@Home™ project which is the most powerful supercomputer cluster in the world for disease research by simulating protein folding. Hundreds of scientific research papers came out of the Folding@Home project. In 2016, SIE launched PlayStation VR, a virtual reality headset that has been widely praised for its physical design, ease of use and accessible price point. SIE has been instrumental in pushing the VR industry forward by creating a much greater installed base of systems that incentivize game developers to make more and better games.

¹⁹ As another example of a game applied in an academic setting, Microsoft’s Minecraft: Education Edition is a game that promotes creativity, collaboration, and problem-solving in an immersive environment. Educators are using the game to teach a range of subjects, from history and chemistry to sustainability and foreign languages, and can map lessons directly to specific learning outcomes and curriculum standards.

²⁰ Deborah Bach, *How the Xbox Adaptive Controller Is Helping VA Medical Centers Support Veterans*, Vantage Point (Apr. 30, 2019), <https://www.blogs.va.gov/VAntage/59625/xbox-adaptive-controller-helping-va-medical-centers-support-veterans/> (Official Blog of the U.S. Dep’t of Veterans Affairs).

²¹ *Id.* (“For active duty military members, playing video games can help release stress, build camaraderie and offer comforting familiarity in foreign environments. For Veterans returning from combat, gaming can reduce isolation, renew connections with fellow service members and provide therapeutic benefits.”).

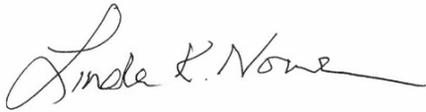
V. Imposing Tariffs on Video Game Consoles Would Not Be “Practicable or Effective to Obtain the Elimination” of China’s Problematic IP Practices

Although we appreciate the Administration’s goal of strengthening the protection of IP in China, video game consoles are not the focus of the Chinese practices targeted by this investigation. Video game consoles are not priorities in any Chinese industrial policies, *e.g.* Made in China 2025. Indeed, Chinese-developed and branded video game consoles are virtually non-existent; one video game console that launched in 2016 has not been well received by the market.²² Moreover, because margins are tight due to the nature of our business model (as explained above), incentives to steal IP to make counterfeit consoles are exceptionally weak. Video game consoles are also relatively complex types of equipment, so the amount of effort and cost required to manufacture infringing or illegitimate products would not be justified by potential returns.

* * *

We appreciate the Administration’s consideration of this request that tariffs not be applied on HTSUS subheading 9504.50.00, covering video game consoles, and therefore that this subheading not be included in the final fourth list of products subject to Section 301 tariffs.

Sincerely,



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Devon Pritchard
General Counsel and Executive Vice President of Business Affairs
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Jennifer Liu
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²² *Detailed Review of the First Chinese Game Console Zhanfu F1*, Sohu (June 17, 2016), http://www.sohu.com/a/84039579_429272.