

Regulation of Foreign Direct Investment in the Chinese Telecom Industry

CHEN ZHANG

If you spent New Year's Eve 2003 in China, it was hard to miss a newly released movie called *Cell Phone*. The film focused on the clever host of a television program who was juggling his relationship with his wife and his relationship with his mistress, only to find the effort futile because of cell phones—too much communication by everybody, everywhere, and at any time. The movie was a big hit, garnering box office receipts of 93 million RMB yuan (approximately U.S. \$13 million dollars at the exchange rate at the time).¹ The real winners from the movie, however, were the Chinese telecom carriers, which sent messages to over 100 million cell phone subscribers to advertise the film.²

Measured by mobile phone subscribers, China is the largest telecom market in the world. By March 2007, there were 480 million mobile phone subscribers and 370 million fixed-line or landline users in China. Every month, another 6.5 million mobile users and 1.06 million landline users are added. The largest mobile carrier in the world measured by number of users is China Mobile, which boasted 392 million users as of March 2008. In 2007, China Mobile's profit jumped 24.4 percent, to U.S. \$12.43 billion.³

In addition, China's telecom companies also are making great leaps forward in the services they provide. China hopes to offer high-quality broadband Web access on cell phones for visitors to the 2008 Olympics and is likely to roll out 3G cellular technology later in 2008. As of the writing of this article, China Mobile is negotiating with Apple Inc. to introduce the iPhone into China.⁴

The wireless boom presents just a small snapshot into China's vibrant telecom landscape. Late last year,

Chinese Huawei teamed up with Bain Capital Partners in an attempted \$2.2 billion takeover bid for U.S. networking pioneer 3Com Corp., a Marlborough, Massachusetts, company whose products include systems to protect against computer hackers. However, in February 2008, the Committee on Foreign Investment in the United States blocked the deal, citing national security.⁵ This landscape raises particularly interesting questions about what international telecommunications companies have been doing in China and what regulations govern foreign investment in the Chinese telecom industry.

Foreign Telecom Investment

Western telecom companies have been making inroads into China for a number of years, and several now have a significant presence. British Telecom (BT) claimed to be the first to enter the Chinese market after China joined the World Trade Organization (WTO) in 2001 when it joined with a privately owned Chinese telecom service provider, 21 ViaNet (China) Inc., in a cooperative relationship.⁶ In fact, however, BT began operations in China in 1995 and now has three offices in Beijing and Shanghai, employing about forty people. Its business caters to multinational operations that need globally networked services such as virtual private networks (VPNs). BT also has partnered with China Netcom, one of the top four Chinese telecom operators, to provide multiprotocol label switching (MPLS), an important technology used for the provision of fixed and mobile services on a converged network. Within three years, BT expects annual revenues from China to hit U.S. \$250 million.⁷

In 2000, U.S. telecom operator AT&T launched Shanghai Symphony Telecom, a joint venture with Shanghai Telecom and Shanghai Information Investment. Now called Unisiti, the company offers VPNs, Broadband IP, collocation, and other services. Although AT&T's revenue in China

grew by approximately 20 percent as recently as 2005, company executives have characterized overall performance as disappointing and blamed regulatory limitations on the scope of its business.⁸

Other international telecoms also have taken steps to enter the Chinese market. Vodafone Group PLC, a British company, has an equity stake in China Mobile; and Spanish telecommunications operator Telefónica, S.A., has bought into China Netcom. South Korea's SK Telecom (SKT) signed a deal with China Unicom under which Unicom will issue U.S. \$1 billion in convertible bonds to SKT. China Telecom is now left as the only Chinese telecom operator that has yet to partner with a foreign operator.

Smaller and more specialized U.S. companies also are diving in to China. Intervoice, Inc., which provides converged voice and information solutions, has been selling and supporting its converged communications products in the Chinese market since 2001. "The company [originally] developed its business in China by selectively partnering with local and regional sales and distribution leaders such as Alliance Digital and IT Apps. As a result, Intervoice currently supports customers across a variety of sectors in the region, including insurance, logistics, manufacturing, telecommunications and government." More recently, Intervoice has been "increasing investment in China by establishing dedicated sales and support personnel through its [existing] partnership with Alliance Digital."⁹

Finally, U.S. companies also are finding their way into China through a more traditional, capitalist approach—acquisition. In 2006, Nevada-based Crawford Lake Mining purchased Jinan Yinquan Technology Co., Ltd., a telecommunications technology company located in the Shandong Province of the People's Republic of China. Crawford Lake Mining, formerly an exploration stage company, then renamed itself China VoIP & Digital Telecom to "better reflect its new business strategy."¹⁰

Chen Zhang (czhang@washtradelaw.com) is an associate in the Washington, D.C., office of Washington Trade Counsel LLC, where he specializes in international investment law and immigration law.

According to its SEC filings, China VoIP & Digital Telecom has a cooperative relationship with China Tie Tong, one of China's largest six carriers licensed to provide basic telecommunications services.¹¹ Moreover, China VoIP & Digital Telecom's client base includes Zhejiang Geely Group, the only private enterprise among the top ten Chinese automobile producers.¹² China VoIP & Digital helped Geely install its Voice over Internet Protocol (VoIP) communication network.

Similarly, U.S. private-equity firms Silver Lake Partners and TPG, Inc., recently snapped up and took private New Jersey-based Avaya, Inc. Avaya is a prominent player in the arena of VoIP and sells VoIP installation and system integration to various Chinese industries through approximately two dozen reseller partners in China.¹³

Regulation of Foreign Direct Investment

China officially joined the WTO on December 11, 2001. Within six years of entry, or as of December 11, 2007, China eliminated all geographical limitation on foreign investment in basic telecommunications services.¹⁴ Geographical limitations that had existed were phased out over time, over five years for cellular and data services and over two years for paging and value-added (the approximate equivalent of "enhanced") services.¹⁵ However, there are, and always will be, limitations on the equity stake for foreign investment, which currently stand at 49 percent for basic services, except wireless paging services, and 50 percent for value-added services and wireless paging services.¹⁶ A foreign enterprise therefore must form a joint venture with a Chinese business partner to do business in China.

A foreign company's investment in telecommunications services in China is affected by a multitude of Chinese laws and regulations. A few important ones are the Joint Venture Corporate Law, Ordinance of Implementing the Joint Venture Corporate Law, Guiding Provisions on Foreign Investment and Guiding Catalogue of Foreign-Invested Industries, Regulations of Proportion of Registered Capital to Total Investment in the Joint Ventures, Regulations of Foreign Investors Investing in China and Regulations of Foreign Investor's

M&A of Domestic Companies, Telecommunications Regulations, Rules on Foreign-Invested Telecommunication Companies, and Measures for Managing Internet Information Services. Although the detailed requirements of all of these laws and regulations are beyond the scope of this article, the vast majority focus on regulating the foreign investment; there are few specific regulations that apply to both the Chinese and foreign telecom service providers.

In addition, a foreign telecom investor seeking to provide basic or cross-province enhanced services must obtain approval from the Ministry of Information Industry (MII), the Chinese cabinet level regulatory body that effectively serves as the equivalent of the Federal Communications Commission (FCC).¹⁷ Approval may be obtained from the local telecommunications bureau of the province, autonomous region, or municipality to provide value-added services within that area.¹⁸ A prerequisite to approval includes meeting certain capital requirements, which are 2 billion RMB yuan (approximately U.S. \$285,918,513 at today's exchange rates) for national basic services, 200 million RMB yuan (approximately U.S. \$28,591,851) for provincial basic services, 10 million RMB yuan (approximately U.S. \$1,429,593) for national value-added services, and 1 million RMB yuan (approximately U.S. \$142,959) for provincial value-added services.¹⁹ The capital requirements also can be met by acquiring a portion of the local telecommunications company in China.²⁰

There are four phases involved in obtaining approval from MII, as set forth in the regulations adopted to implement the Regulatory Provisions of Foreign Investment in Telecommunications Enterprises issued by the State Council.²¹ First, the Chinese investors must submit a project proposal and/or feasibility study, with supporting documents, to MII or appropriate provincial authorities.²² Assuming there are no issues to be addressed, the investors will then receive an Evaluation Letter for Foreign Investment in Telecom Service Operations. At that point, the applicants must submit to the relevant authorities of foreign economy and trade (the provincial or municipal foreign economy and trade commission) the articles of incorporation for the joint venture, its by-laws, and other documentation.²³ If all documentation is in order,

the foreign economy and trade authorities then issue a Permit of Formation of Foreign-Invested Telecom Companies.²⁴ As the third step, the applicants return to MII or the provincial telecom bureau to apply for the Operation License of Telecom Services.²⁵ Lastly, the applicants register the joint venture with the Industry and Commerce Administration,²⁶ at which point they may begin to do business.

As of April 2005, MII had received at least twenty-two formal applications for foreign investment in the Chinese telecom market. All of these applications were for value-added services.²⁷ This number has presumably been increasing, but reliable data is not publicly available for more recent years. U.S. businesses that have had their applications granted include ESPN, Microsoft, and eBay International. Microsoft, for example, partners with a Chinese entity to operate msn.com.cn, MSN Messenger, Hotmail, and MSN Mobile in China.

These companies were granted licenses to provide enhanced telecommunications services, but not basic services. The lack of foreign investment in basic telecommunications services may result from the high investment threshold for entering the basic services market and the partnership requirement, but at this time the motivation behind the lack of entry is not entirely clear. If cost is the primary barrier to entry, other options would seem to be available.

For example, what about becoming a reseller rather than an initial provider of basic services? There is no Chinese equivalent of the Open Access doctrine embodied in the United States' 1990 Telecommunications Act,²⁸ which raises the question: Why would China Telecom or China Netcom lease their public switched telephone network (PSTN) to resellers? On the other hand, a deal may be negotiated with these companies to lease their networks if it benefits both parties.

Another option would be to attempt to do in China what Vonage is doing in the United States. MII classifies VoIP as basic services. Therefore, arguably, a company with a license to provide basic telecommunications services could offer VoIP to Chinese consumers.

Regulations Relating to Specific Services

Enterprise Qualification Certification

One of the more interesting open questions at this time is whether a company seeking to provide VoIP installation for one enterprise, rather than to individual consumers, must obtain the basic telecommunications service license that requires a 2 billion RMB yuan capital investment? Technically, if VoIP installation enables the enterprise to engage in external communications, the service provider is providing basic telecom services and therefore needs to obtain the basic license. However, if the service to be provided merely involves installing a VPN or VoIP network for an enterprise and the network is used only internally, then the service should not be considered telecommunications services requiring a basic license. Just as in the United States, equipment installation for internal uses is considered system integration or network consolidation in China as long as the call carried on the IP telephony network is not terminated on a PSTN.

Nevertheless, enterprises engaged in system integration may wish to obtain telecommunications information network system integration enterprise qualification certification. Although the certification is not a threshold license to conduct system integration, it is an extremely helpful credential for a company to have when preparing to bid for telecom projects.

There are three classes of enterprises each with slightly different requirements for certification. Approval from the telecommunications administration at the provincial level is required for second- or third-class certification; authority to issue first-class certification is reserved by MII. All certificate applicants must meet four criteria. First, applicants must be legally established, independent corporate people that have obtained an operating license or preregistration document issued by the Industrial and Commercial Administration. Second, the applicant must be a specialist in conducting businesses of telecommunications information network system integration. Third, the applicant must have a permanent place of business of a size commensurate with its staffing level. And, finally, the applicant must meet a class-specific requirement. Among the requirements for Class A applicants are registered capital of 10 million RMB yuan and

completion, within the last two years, of two projects valued at 30 million RMB yuan each or four projects valued at 15 million RMB yuan each.²⁹ There is no entry-level certification for conducting system integration.

International Telecom Gateways

A company seeking to install a switch in China that connects to the Internet and terminates in another country most likely will be subject to at least one additional regulation: Examination and Approval of Establishment and Adjustment of International Telecom Gateway. This regulation provides specific conditions that must be met prior to setting up an international telecom gateway. Only state-owned telecommunications service providers are allowed to establish international gateways under the regulation. Therefore, a foreign entity will have to begin by leasing the gateway from a state-owned provider.

Telecommunication Service Norms and Standards

In March 2005, MII issued Telecommunication Service Operation Norms and Standards (Telecom Operating Standards), setting forth various standards governing the provision of all telecom services.³⁰ The Telecom Operating Standards provide minimum standards for both customer service and quality.³¹ Local telecom bureaus supervise the implementation of these standards within their jurisdictions.³² Of course, an individual service provider may develop its own, higher standards.³³ Similar to the tariff requirement in the United States,³⁴ Chinese telecom service providers also must publish the service categories, terms of service, fees, and service scope and file those items with the local service authority. In addition, any service provider must notify customers thirty days in advance of ceasing to offer any particular service.³⁵ Penalties for failing to comply with the Telecom Operating Standards can range from 10,000 to 30,000 RMB yuan (approximately U.S. \$3,500 to U.S. \$10,500).³⁶

Entering China's Telecom Market

Opportunities to enter the Chinese telecom market are endless, as are the potential strategies that different players may employ. For equipment manufacturers, 3G licenses remain an

area of potential entry into the marketplace.³⁷ Call center installation in China also presents a feasible model in the relatively unregulated area of system integration. In addition, acquiring a promising Chinese telecom equipment company is a worthwhile strategy.

For mobile virtual network operators or cell phone operators, a mere reselling or roaming agreement with a Chinese partner without physical presence in China does not trigger the MII regulatory regime. According to China's Accession Protocol of Services to the WTO, there are no restrictions on providing offshore telecommunications services.³⁸ As a result, a reseller agreement could be negotiated with China Mobile (if the U.S. market penetration demands that level of attention) or other carriers.

Another avenue of opportunity could be partnering with China Netcom or China Telecom, the only two entities operating PSTNs, to provide private-line services to Chinese businesses having multiple offices in China. Although this business model faces challenges, including that it would be subject to the regulatory regime discussed above, it also provides significant opportunities. Alternatively, installing a PSTN is not prohibited in China, although you must team up with a Chinese company while retaining minority equity.

VoIP also is an extremely promising area in China if you can cross the \$2 billion hurdle and be happy with a minority equity stake. To avoid the investment amount and equity hurdle, value-added services remain an option.

Comparing the operating margins of various companies explains investor interest in China: those of China Telecom (22.05 percent, 2006 quarterly), China Netcom (22.14 percent, 2007), and China Mobile (30.79 percent, 2007 quarterly) are significantly higher than those of Verizon (16.67 percent, 2007), AT&T (17.16 percent, 2007), and Qwest (12.56 percent, 2007). For this reason, even with the presumably heavy regulations, international telecom investment in China seems to be headed in only one direction—up. 

Endnotes

1. Feng Xiao Gang xiang shen fang bu hui tou lu "Shou Ji ju er piao fang [Director Feng Xiao Gang Shows Up at Press Conference and Revealed Box Office Figure for

“Cell Phone”] (2004), at <http://ent.qianlong.com/4543/2004/03/16/999@1944302.htm>.

2. *Id.*

3. FINANCIAL HIGHLIGHTS OF CHINA MOBILE LIMITED (Apr. 25, 2008), at www.chinamobiletd.com/.

4. Gregg Keizer, *China Mobil Fights iPhone's Revenue Sharing*, COMPUTERWORLD, Apr. 15, 2008, available at www.pcworld.com/businesscenter/article/144576/china_mobile_fights_iphones_revenue_sharing.html.

5. See Hiawatha Bray, *3Com Corporation's New CEO Signals Change in Focus to the Chinese Market*, TECH ONLINE EDITION, May 2, 2008, available at <http://www-tech.mit.edu/V128/N23/3com.html>.

6. *British Telecom Becomes First Foreign Firm on Chinese Market*, CHINA DAILY, Mar. 8, 2002, available at <http://french.hanban.edu.cn/english/BAT/28362.htm>.

7. *BT Expects China Revenues to Hit US\$250 Mln*, CHINA DAILY, Sept. 7, 2006, available at http://english.china.com/zh_cn/business/telecom/11024502/20060907/13609658.html.

8. *AT&T's China Revenue Set to Grow 20%*, SHENZHEN DAILY, Oct. 17, 2005, available at www.china.org.cn/english/BAT/145604.htm.

9. Clients of the Intervice—IT Apps partnership include Industrial and Commercial Bank of China, Bank of China, China Construction Bank, Agricultural Bank of China, Hua Xia Bank, Shenzhen Development Bank, and China Everbright Bank. See *Intervice Increases Investment in China*, BUS. WIRE, Oct. 24, 2006, at www.thefreelibrary.com/Intervice+Increases+Investment+in+China-a0153993601.

10. See *Crawford Lake Mining Acquires Chinese Voice over Internet Protocol Company*, BUS. WIRE, Nov. 13, 2006, at http://findarticles.com/p/articles/mi_m0EIN/is_2006_Nov_13/ai_n16838195.

11. 10KSB SEC Filing, China VoIP Digital Telecom Inc. (Apr. 16, 2007), available at <http://sec.edgar-online.com/2007/04/16/0001137171-07-000519/Section3.asp>.

12. *Chinese Automaker Geely Goes VoIP*, MARKETWIRE, Oct. 2007, at http://snapvoip.blogspot.com/2007_10_01_archive.html.

13. Huashen Tiancheng huo Avaya

zhongguo shou ge bai jin he zuo huo ban renzheng [Huashen Tiancheng Awarded the First Platinum Partner Certificate] (Apr. 4, 2007), at www.avaya.com.cn/corporate/pressroom/2007/P070404.asp.

14. WORLD TRADE ORGANIZATION, REPORT OF THE WORKING PARTY ON THE ACCESSION OF CHINA, ADDENDUM, SCHEDULE CLII—THE PEOPLE'S REPUBLIC OF CHINA, PART II—SCHEDULE OF SPECIFIC COMMITMENTS ON SERVICES LIST OF ARTICLE II MFN EXEMPTIONS.

15. *Value-added services* refers to the services provided by third parties, other than end users and basic service providers, through application-based platforms.

16. See *supra* note 14.

17. Premier Zhu Rongji, *Waishang touzi dianxin qiye guanli guiding* [Regulatory Provisions of Foreign Investment in Telecommunications Enterprises] (State Council Order Dec. 11, 2001) art. 11 (P.R.C.), available at www.mii.gov.cn/col/col521/index.html.

18. *Id.* art. 13, available at www.mii.gov.cn/col/col521/index.html. There are five autonomous regions and four municipalities directly under the central government in China. For example, Tibet is an autonomous region, and Beijing is a municipality directly under the central government.

19. *Id.* art. 5(1), (2).

20. Qian Tingshuo (Deputy Director-General), Department of Planning, MII, *Foreign Investment in China's Telecom Market*, CHINA COMM'NS 16 (June 2005).

21. State Council is the administrative body of the Chinese central government. It is chaired by the president and includes the heads of each governmental department and agency. Ministry of Information Industry, *Waishang touzi dianxin qiye cheli shenpi* [Establishment and Approval of Foreign Investment in Telecommunications Enterprises], available at <http://xzsk.mii.gov.cn/site>.

22. *Id.*

23. *Id.*

24. *Id.*

25. *Id.*

26. Qian Tingshuo, *supra* note 20.

27. See 47 U.S.C. § 251(c)(3); see also § 251(a)(1) (a requesting carrier can obtain shared access by purchasing telecommunications services at wholesale rates for resale to end users, by leasing unbundled elements of incumbents' networks, and by interconnecting its own facilities with the incumbents' network (referred to collectively as the "open access requirements")).

28. Ministry of Information Technology, *Tongxin xinxi wangluo xitong jicheng qiye zizhi rending* [Qualification Certification of Telecommunications Information Network System Integration Enterprise], available at www.mii.gov.cn/art/2005/12/15/art_523_1322.html.

29. Minister Wang Xu Dong, *Dianxin fuwu guifan* [Telecommunications Service Operation Norms and Standards] (Order of Ministry of Information Industry Mar. 13, 2005) art. 4 (P.R.C.), available at www.mii.gov.cn/art/2005/12/17/art_524_1656.html.

30. *Id.* art. 3.

31. *Id.* art. 4.

32. *Id.* art. 5.

33. See 47 U.S.C. § 203(a). The FCC has adopted a policy of excusing nondominant providers of long-distance telephone service from the § 203 filing requirement. See November 25 Report and Order, 7 F. C. C. Rcd 8072 (1992).

34. *Id.* art. 8.

35. *Id.* art. 19.

36. Gongshang shibao: *Dalu mingque biaotai fafang 3G xuke* [Industrial & Commercial Times: Mainland Expressly Indicating Issuance of 3G License] (May 26, 2008), available at www.c-fol.net/news/content/9/200805/20080527053532.html (indicating that one license will likely be issued to each of TDSCDMA, WCDMA/HSPA, and cdma2000 EV-DO technologies).

37. WORLD TRADE ORGANIZATION, *supra* note 14.

38. GOOGLE FINANCE, available at <http://finance.google.com>.