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China Lowers Market Entry Barriers for Foreign-Invested Telecommunications Businesses Established in Shanghai Free Trade Zone

FEBRUARY 1, 2014

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China has further opened up its value-added telecoms sector, starting with foreign-invested companies established in the new Shanghai Free Trade Zone ("SFTZ").

As reported in our January China Bulletin, the SFTZ offers foreign investors early market access to a range of sectors. All of these opportunities, together with a range of other liberalizing reforms, are set out in the State Council's *General Plan for the Shanghai Free Trade Zone* issued on September 29, 2013.

On January 6, 2014, China's Ministry of Industry and Information Technology and the Shanghai Government jointly introduced market-opening new regulations for the SFTZ entitled, *Opinions Regarding Further Opening up Value-added Telecom Service Sector towards Foreign Investments in the China (Shanghai) Pilot Free Trade Zone* (the "**Opinions**").

Removal of Market Entry Barriers

PRC law divides telecommunications services into basic and value-added services, with the latter being further classified into the following eight categories:

· online data processing & e-commerce processing

· store-and-forward switching services

· voice & video conference call services

· information content provider ("ICP") services

· home internet access services

· virtual private network ("VPN") services

· app stores

· internet data centers

For many years, foreign investment in this sector has been either prohibited or heavily restricted but laws governing value-added services, unlike basic telecom services, do not require foreign investors to joint venture with Chinese state-owned partners.

Under the Opinions, internet data centers remain off-limits to foreign companies but all of the other seven categories are open for foreign investment, within the SFTZ. Among these seven, China was required to lower market entry barriers to three (ICP services, store-and-forward switching services and online data/e-commerce processing) pursuant to its WTO commitments but a decision was made to liberalize market access to all seven.

Limits on Foreign Ownership Abolished for SFTZ-Established Businesses

Most pre-existing caps on foreign ownership have been completely eliminated and the longstanding 50% limit on foreign ownership in online data/ecommerce processing has now been raised to 55%. Only VPN services and ICP services still restrict foreign ownership to no more than 50%.

In other words, foreign investors are now free to establish wholly foreign-owned call centers, conference call businesses, app stores, and entities providing store-and-forward switching operations and home internet installations.

However, to take advantage of these new regulations, investors must establish new businesses in the SFTZ, with service facilities located in the SFTZ. The only type of services that will be restricted to serving only the SFTZ are home internet access - all other services can be offered nationwide through branch offices or other arrangements.

Conclusion

Although the Opinions represent only a basic legal framework and further implementing regulations are needed to fill in critical gaps, foreign investors finally have access to China's value-added telecoms market. This alone is a monumental reform which could be a game-changer for incumbent service providers and consumers alike.

Although the new regulations require foreign companies to establish a base of operations within the SFTZ, nearly all of the affected services can be provided lawfully outside of the SFTZ, and without involving a Chinese partner.

The Opinions are also a welcome signal of progress for foreign investors eyeing market entry in the other industries (eg: credit investigation/reporting, insurance, and engineering, to name a few) earmarked for the SFTZ. So far, Chinese officials have been slow to introduce regulations needed to allow market entry to foreign players in these sectors. Hopefully the Opinions are a sign that this is about to change.

Finally, while it is possible that the treatment now accorded to foreign-invested companies established in the SFTZ will, in time, also be accorded to foreign-invested businesses established elsewhere in China, those that seize the SFTZ opportunity are likely to enjoy early mover advantages.

If you have any questions concerning this topic please do not hesitate to contact Allan Goldner at agoldner@beneschlaw.com or 216.363.4623