

Legal Commentary

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Highlights of the 2022 Amendment to the Provisions on Administration of Foreign-invested Telecommunications Enterprises

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On April 7, 2022, the State Council announced its *Decision on Amending and Annuling Certain Administrative Regulations* (State Council Decree No. 752; the “**Decision**”), which will take effect on May 1, 2022. The Decision primarily aims to promote the separation of operating permits and business licenses, to deepen reforms of “streamlining administration, delegating powers, improving regulation, and strengthening services”, and to stimulate the development vitality of market players. The Decision amends 14 and annuls 6 regulations, of which the first item is the third amendment of the *Provisions on Administration of Foreign-invested Telecommunications Enterprises* (the “**Foreign-funded Telecom Provisions**”; and such third-amended version shall be hereinafter called the “**Foreign-funded Telecom Provisions 2022**”).

Promulgated on December 11, 2001, the Foreign-funded Telecom Provisions were first amended on September 10, 2008 by the State Council’s *Decision on Amending the Provisions on Administration of Foreign-invested Telecommunications Enterprises* (State Council Decree No. 534), which mainly changed department names to conform to the State Council’s institutional reform. The State Council promulgated a second amendment to the Foreign-funded Telecom Provisions on February 6, 2016 (the “**Foreign-funded Telecom Provisions 2016**”) via its *Decision on Amending Certain Administrative Regulations* (State Council Decree No. 666). The second amendment sought to implement the “issuing business license before operating permit” reform, placing in Article 16 the application for a telecom operating permit no longer a prerequisite to applying for a business license. The third amendment was promulgated on April 7, 2022, making breakthroughs in many respects compared to the current 2016 version. For example, the Foreign-funded Telecom Provisions 2022 conform to the current *Foreign Investment Law of the People’s Republic of China* (“**Foreign Investment Law**”), specify an exception where the shareholding limits on foreign investors can be exceeded, relax requirements on foreign investors of having a good track record and operational experience, and simplify the telecom operating permit application procedures and shorten the statutory time limits on review and approval of applications. This commentary gives a summary analysis of relevant changes found in the Foreign-funded Telecom Provisions 2022 and is for reference only. For a comparison between the Foreign-funded Telecom Provisions 2022 and the Foreign-funded Telecom Provisions 2016, please see our commentary dated April 9, 2022.

Comprehensive conformity with the Foreign Investment Law

Compared to the Foreign-funded Telecom Provisions 2016, the 2022 amendment modifies the definition of a foreign-invested telecommunications enterprise to conform to the Foreign Investment Law and removes contents related to the Approval Certificate for Foreign-invested Enterprises, etc. that became obsolete since the Foreign Investment Law entered into force.

On January 1, 2020, the Foreign Investment Law and the *Regulations for the Implementation of the Foreign Investment Law of the People's Republic of China* (collectively, the “**New Foreign Investment Rules**”) officially came into force, which simultaneously repealed the *Law of the People's Republic of China on Joint Ventures with Chinese and Foreign Investment*, the *Law of the People's Republic of China on Foreign-Capital Enterprises*, and the *Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures* (collectively, the “**Old Foreign Investment Laws**”).

Pursuant to the Foreign Investment Law, a foreign-invested/foreign-funded enterprise refers to an enterprise established under PRC law within mainland China and with all or part of its investment from foreign investors. The organizational form, institutional framework, and operating principles of foreign-invested enterprises are regulated by the *Company Law of the People's Republic of China* and the *Law of the People's Republic of China on Partnership Enterprises*, among others. Accordingly, in Article 2 of the Foreign-funded Telecom Provisions 2022, where a foreign-invested telecommunications enterprise is defined, expressions are removed such as “with Chinese investors”, “in the form of a joint venture with Chinese and foreign investment”, and “jointly invest”, and a foreign-invested telecommunications enterprise is defined as “an enterprise lawfully established by foreign investors within the territory of the People's Republic of China to operate telecommunications businesses.” These changes are made to conform the Foreign-funded Telecom Provisions 2022 to its enabling law, and to ensure that both foreign-funded telecom enterprises incorporated under the Old Foreign Investment Laws (i.e., those undergoing the five-year transitional period) and those established under the Foreign Investment Law fall under the umbrella of the Foreign-funded Telecom Provisions 2022.

The Foreign-funded Telecom Provisions 2022 also remove contents related to the Approval Certificate for Foreign-invested Enterprises, in conformity with the Foreign Investment Law, which abolished case-by-case review and approval of foreign investment. These changes achieve comprehensive conformity between the Foreign-funded Telecom Provisions 2022 and the New Foreign Investment Rules.

Exception specified for foreign ownership restrictions on telecom business

The Foreign-funded Telecom Provisions 2022 retain the 49% and 50% mandatory limits set forth in the ratio of capital contributions from foreign investors of telecom enterprises operating basic telecommunications services and value-added telecommunications services, but conclude with the exception “unless otherwise prescribed by the State”.

The above change echoes existing national and local regulations to further relax restrictions on the proportion of foreign ownership in the telecommunications field. For example:

- On January 6, 2014, the Ministry of Industry and Information Technology (“MIIT”) and the Shanghai Municipal People’s Government jointly issued the *Opinions on Further Opening up Value-added Telecommunications Business to Foreign Investments in the China (Shanghai) Pilot Free Trade Zone* (MIIT Lian Tong [2013] No. 410), whereby the foreign investment ratio of certain types of value-added telecommunications business in the China (Shanghai) Pilot Free Trade Zone (“Shanghai Pilot FTZ”) is allowed to exceed 50% on a pilot basis.
- On June 19, 2015, the MIIT issued the *Circular on Lifting Restrictions on the Proportion of Foreign Equity in Online Data Processing and Transaction Processing Business (For-profit E-commerce)* (MIIT Tong [2015] No. 196), a decision to lift nationally restrictions on the proportion of foreign equity in online data processing and transaction processing businesses (for-profit e-commerce), starting from pilot practice in the Shanghai Pilot FTZ, with the maximum ratio being 100%. When applying for an online data processing and transaction processing operating (for-profit e-commerce) permit, the foreign equity proportion requirement imposed on foreign-invested enterprises is in accordance with the circular and other requirements and corresponding approval procedures are subject to the then-effective Foreign-funded Telecom Provisions.
- On June 30, 2016, the MIIT issued the *Notice on Issues Relating to Hong Kong and Macao Service Providers Engaging in Telecommunications Business in Mainland China* (MIIT Tong Xin [2016] No. 222), allowing Hong Kong and Macao service providers to set up joint ventures or wholly-owned enterprises in mainland China to provide six types of value-added telecom services, including online data processing and transactions handling (restricted to for-profit e-commerce), domestic multi-party communication services, and storage-and-forward services, with no limitation on the proportion of Hong Kong and Macao investment.
- In addition, according to the *Special Administrative Measures (Negative List) for the Access of Foreign Investment in Pilot Free Trade Zones (2021)* (Decree of the National Development and Reform Commission and the Ministry of Commerce, No. 48), effective January 1, 2022, with respect to telecommunications companies, the pilot policy schemes for the initial areas of the Shanghai Pilot FTZ (11.1 square miles) have been implemented in all parts of the pilot free trade zone, and e-commerce, domestic multi-party communications, storage-and-forward, and call center services are exempt from the 50% foreign share restriction on value-added telecom services.

Apart from the above regulations, the Hainan Free Trade Port and other areas have also introduced policies to ease foreign share restrictions in specific telecommunications fields. These policies and changes create ample space for continuous stimulation of foreign investment vitality in the telecommunications field and enhance its level of opening-up.

Foreign investors no longer required to have a good track record and operational experience in telecoms business

According to the Foreign-funded Telecom Provisions 2016, the principal foreign investors of foreign-funded telecom enterprises operating basic and value-added telecom businesses should have “a good track record and operational experience” in their corresponding telecom businesses. The Foreign Telecom

Provisions 2022 remove this requirement for the principal foreign investors of foreign-funded enterprises operating value-added telecom businesses, which offers substantial qualification relief to foreign investors in this category. However, while the 2022 amendment lifts this requirement for the principal foreign investors of foreign-funded basic telecom business operators, the removal will have limited substantive effect, given that the Foreign Telecom Provisions 2022 still require foreign investors to obtain a basic telecom operating permit in their country or region of registration. Therefore, the following analysis mainly focuses on principal foreign investors of foreign-funded telecom enterprises operating value-added telecom services.

The MIIT states in the form-filling guidance notes under its current Service Guidelines for Reviewing and Approving Telecom Operating Permit Applications that, to prove telecom business experience, a principal foreign investor should give written details of its (or its first-tier parent/subsidiary's) earlier provision of value-added telecom services, accompanied by documentary evidence; the foreign investor (or its first-tier parent/subsidiary) should also provide written description and screenshots/relevant documents if it has acquired any permit, filing-record, or experience in operating any well-known website or apps prior to making the application. Since there are no further rules to clarify the foregoing requirements, a foreign-invested applicant for a value-added telecom operating permit normally needs to communicate its specific situation with the regulator, who then decides at its discretion whether the principal foreign investor can be deemed as "having a good track record and operational experience in operating value-added telecom business", which lays a certain level of uncertainty on this issue. Moreover, many foreign-funded telecom business operators only have foreign investors who purely engage in financial investments and have no experience in operating non-financial, substantive businesses, let alone any track record or past in value-added telecom business. As a result, in practice, such enterprises are quite likely to fail the test for obtaining a value-added telecom operating permit under the Foreign-funded Telecom Provisions 2016.

The Foreign-funded Telecom Provisions 2022 no longer require principal foreign investors to have "a good track record and experience in operating value-added telecom business", making it easier for foreign-invested enterprises to apply for a value-added telecom operating permit and allowing those enterprises more predictability in being granted the permit. This is materially favorable news for foreign-invested enterprises engaging in value-added telecom business, and for foreign institutions choosing to invest in value-added telecom business operation in China.

In particular, the relaxation of approval requirements may affect enterprises seeking a listing in Hong Kong through a variable interest entity, or VIE structure, in terms of the reasonableness of their use of a VIE structure to avoid foreign ownership limits on the basis that a joint venture "can hardly satisfy the requirement that foreign investors have a good track record and operational experience in value-added telecom business". The Stock Exchange of Hong Kong ("**HKEX**") currently adopts the "narrowly tailored" principle for issuers applying for an IPO in Hong Kong under a VIE structure. Specifically, the VIE structure may be used to address limits on foreign ownership only if the relevant operating entity engages in activities that involve foreign investment restrictions. The issuer must otherwise directly hold the maximum permitted interest in the relevant operating entity. Given that, in practice, applicant issuers and their agent teams normally, through statutory analysis, regulatory interviews and other means, justify their VIE structure (with a wholly PRC-invested operating entity) under the "narrowly tailored" principle by

demonstrating that, in reality, a Sino-foreign joint venture can rarely obtain a value-added telecom operating permit. However, after the Foreign-funded Telecom Provisions 2022 come into force, it will be difficult for an issuer to argue from a statutory perspective that a Sino-foreign structure cannot satisfy the granting conditions of relevant permits; furthermore, it may be unlikely for issuers seeking an IPO in Hong Kong to demonstrate extreme practical difficulty in obtaining relevant value-added telecom operating permits if the MIIT grants a certain number of value-added telecom operating permits to foreign-invested enterprises after the Foreign-funded Telecom Provisions 2022 take effect. As a result, issuers seeking an IPO in Hong Kong may adjust the shareholding structure of their operating entities based on these new circumstances.

Simplified permit application process, shortened statutory time limit for examination

The Foreign-Funded Telecom Provisions 2022 significantly modify Articles 11 to 16 of its 2016 predecessor, mainly in the following two aspects: first, it abolishes the Approval Certificate for Foreign-invested Enterprises and the Decision on Approving Foreign Investment in Telecommunication Business (“**Approval Decision**”), which currently serves as the condition precedent to the application for a telecom operating permit; also, it substantially reduces the statutory time limit for examining telecom operating permit applications.

According to the MIIT’s *Circular on Strengthening Interim and Ex-post Supervision over Foreign-invested Telecommunications Enterprises* (MIIT Tong Xin Han [2020] No.248) issued on October 15, 2020, the MIIT will cease to issue Approval Decisions from the promulgation date of the State Council’s *Decision on Canceling and Devolving a Batch of Items Subject to Administrative Examination and Approval* (Guo Fa [2020] No.13), namely September 21, 2020, and the corresponding foreign investment examination procedure is integrated into the telecom operating permit approval process. Pursuant to the foregoing provisions, after cancellation of the Approval Decision procedure, the MIIT and provincial telecom administrations should take measures to step up interim and ex-post supervision over foreign-invested telecom enterprises. For example, while handling telecom operating permit applications, the relevant authorities should strictly oversee the applicants’ actual compliance with foreign shareholding limits; regulators should intensify monitoring of day-to-day operations of foreign-funded telecom enterprises by urging them to report relevant information as requested; oversight methods such as the “random inspection and public release” model (note: this model comprises inspections of randomly selected entities by randomly selected inspectors and the public release of inspection results) should be adopted to enhance supervision, and illegal activities found during supervision should be investigated and treated in accordance with law, with relevant information disclosed to the public; regulators should carry out credit supervision by truthfully recording illegal and dishonest practices, adopting differential regulatory approaches, etc. The Foreign-funded Telecom Provisions 2022 remove all Approval Decision-related contents in the 2016 version to be consistent with the above provisions.

Furthermore, according to the Foreign-funded Telecom Provisions 2016, in order to apply to the MIIT for a telecom operating permit, foreign-invested enterprises should complete the following steps first: 1) obtain a Decision on Approving Foreign Investment in Telecommunication Business issued by the MIIT; 2) obtain an Approval Certificate for Foreign-invested Enterprises granted by the competent commerce authority;

and 3) complete registration formalities with the administration for industry and commerce. By contrast, in combination with the abovesaid New Foreign Investment Rules, the “issuing business license before operating permit” reform, etc., the Foreign-funded Telecom Provisions 2022 streamline the above procedures down to the following: upon completion of market entity registration formalities with the competent administration for market regulation, a foreign-invested enterprise may apply with the MIIT for a telecom operating permit by submitting materials required in the Foreign-funded Telecom Provisions 2022. The 2022 amendment also merges application for a basic telecom operating permit and a value-added telecom operating permit into one same process, with a mere difference in the examination time limit. The Foreign-funded Telecom Provisions 2016 require the MIIT to make a decision on whether to grant the Approval Decision within 180 days after receiving an application, and the Foreign-funded Telecom Provisions 2022 require the MIIT to make a decision on whether to grant a basic telecom operating permit within 180 days upon receipt of an application. The streamlined process actually shortens the overall statutory time limit for examining a basic telecom operating permit application by cutting off formalities such as the commerce authority’s review process (with a 90-day time limit). On the other hand, the statutory time limit for examining a value-added telecom operating permit application is shortened not only by the above streamlined process but also through an express statutory reduction to “60 days upon receipt of the application” (from 90 days in the 2016 version).

The above changes made by the Foreign-funded Telecom Provisions 2022 will establish a more efficient process for foreign-invested telecom enterprises to apply for a telecom operating permit and would reduce uncertainties imposed on the applicants’ business operations due to a prolonged examination process.

Conclusion

Although the Foreign-funded Telecom Provisions 2022 is freshly released and awaits more specific practice guidelines, this amendment is launched as part of the government’s endeavor to promote the separation of operating permits and business licenses, to deepen reforms to “streamline administration, delegate powers, improve regulation, and strengthen services”, and to stimulate the development vitality of market players. It reveals the affirmative attitude of China towards foreign investments in the telecommunications field, and we are optimistic about how it will work out.

Important Announcement

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