

How China's Draft Regulations Will Control Cloud Services

By Timothy Stratford, Grace Chen and Yan Luo, Covington & Burlington LLP

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On Nov. 25, 2016, the Ministry of Industry and Information Technology (MIIT), China's telecom regulator, published a draft Notice on Regulating Cloud Services Market Activities. The MIIT is soliciting comments of the draft until Dec. 24, 2016.

Prompted by the 2015 revision of China's telecommunications catalogue, which for the first time includes cloud computing activities within the scope of value-added telecommunications services (VATS), the provisions of this notice will likely impose more stringent regulations on the way companies may offer cloud services and place restraints on the participation of foreign companies in this sector.

Set forth below is a summary of the highlights of this draft notice, and potential issues of concern to foreign investors in the information industry.

Restrictions on Foreign Investment

Foreign investment in China's telecommunications industry has long been restricted. Foreign investment in VATS is capped at 50 percent, subject to a number of exceptions. However, actual approvals for foreign investments in the VATS industry have been few and far between, and more specifically, approvals for internet data center (IDC) services licenses, which have been restricted to Hong Kong investors pursuant to the Closer Economic Partnership Agreement, have been difficult to obtain.

Prior to the issuance of the 2015 catalogue, cloud services were largely unregulated. In fact, most of the references to cloud computing prior to 2015 have shown up primarily in policy documents that promoted the development of the cloud computing sector. The 2015 catalogue adds a new subcategory under the IDC services category, namely, "internet resource collaboration services", which is defined as "using equipment and resources installed in a data center to provide users with data storage services, development environments for internet applications, and deployment and operations management of internet applications via the Internet or other networks, using sharing of resources to allow users to scale as fast or as much as needed." This definition could



Timothy Stratford



Grace Chen



Yan Luo

conceivably cover any cloud software offering, including "software as a service" (SaaS) products, "platform as a service" (PaaS) products and "infrastructure as a service (IaaS) products. This significantly impacts foreign businesses operating or seeking to operate in this industry sector in China, some of which have sought to achieve regulatory compliance by partnering with domestic IDC service providers.

Restrictions on Partnership Activities

Recognizing that foreign companies are entering the market through foreign-domestic partnership arrangements with domestic IDC operators, the notice places a number of restrictions on technical partnerships entered into by cloud services operators. It stipulates that the operator cannot lease or transfer its VATS license, or provide resources, premises or facilities to its partner. The operator must also enter into contracts directly with the customers, and may not market its services using only its partner's trademark and branding. The operator is also prohibited from illegally providing its partner with any personal information or network data, or act in any way that would be in violation of law. These restrictions essentially call into question most if not all arrangements that technology companies that provide their products in the form of cloud service offerings have entered into with IDC service providers, which will likely need to be restructured if the notice takes effect in its current draft form.

Requirement to Go Through International Gateways

The notice stipulates that IDC operators must build their cloud services platform in China, and if the related servers need to connect with internet sites outside of China, the data must be routed through China's official international Internet gateways, and not via leased lines or VPN. While this is consistent with an old rule from almost two decades ago stipulating that connections to internet sites offshore must go through government-provided international gateways, this requirement may not be practical from a modern technology perspective, particularly in view of the prevalent use of leased lines and VPN services nowadays by both domestic and international companies.

Monitoring Obligations

Operators have monitoring obligations over users (i.e., over the websites that rely on them to provide access or third party developers that rely on them for hosting their applications) with respect to their use of network facilities and resources, compliance with relevant laws, and distribution or transmission of information, and must report any violation (e.g., unauthorized changes to the purpose of use, distribution or transmission of information that is prohibited by law) to the authorities, and cooperate with the authorities by complying with the requirements needed to conduct security examinations.

Data Privacy and Other Issues Relating to Handling of Data

The notice contains standard provisions addressing the protection of personal information that are already applicable to telecommunications and internet service users under laws and regulations that have already been promulgated. However, the notice includes additional restrictions which may present obstacles to operators from a practical perspective, for example, the prohibition against any collection or use of personal information upon termination of services, the requirement that service facilities and network data used for domestic users should be located onshore, and the requirement that three months' notice be provided to the government and a public announcement made to all users upon the cessation of services.

Other Requirements

In addition to the above, the notice also sets out a number of compliance requirements related using qualified telecommunications providers for basic services, achieving safe, reliable and stable operations, and adhering to network security requirements and cloud services standards. The notice also includes a provision prohibiting basic telecommunications operators from providing unlicensed IDC operators with resources for network access, including network infrastructure services, IP address, bandwidth, etc.

Conclusions and Next Steps

The rationale for promulgating such a notice would appear to stem from China's desire to assert its cyberspace sovereignty and address cybersecurity concerns. While these issues are legitimate ones that ought to be addressed, we believe that the requirements may need some fine-tuning to ensure that they do not discourage foreign investment in China's IT industry and thus hinder its development. The objective should be to achieve balance by ensuring that cybersecurity requirements can be met without impeding China's goals to expand its cybereconomy, construct a high-speed information network and develop modern Internet industries (e.g. internet+) and to implement a national big data strategy, as stated in its 13th Five Year plan.

This draft presents an opportunity to provide input to the regulators. Therefore, companies that are already, or thinking of, providing their products via cloud services in China are advised to consider very carefully the provisions of this notice, how its promulgation might impact their current or future operations, and whether to propose changes to the draft that could benefit their own business development as well as development of the sector as a whole.

Timothy Stratford, Grace Chen and Yan Luo are attorneys with Covington & Burlington LLP in Beijing. Stratford is a partner, Chen is of counsel, and Luo is an associate.

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