



# U.S. report dashes China telecoms' expansion hopes

By

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WASHINGTON – The U.S. ambitions of two Chinese telecom equipment makers were stopped in their tracks on Monday as a congressional report urged American companies to stop doing business with the firms, raising fears of retaliation from China.

Huawei, the world's second-largest maker of routers and other telecom gear, and ZTE, the fifth-largest, for years have been stymied in their efforts to make big inroads into the United States due to national security concerns, but Monday's report escalated the dispute.

The U.S. House of Representatives' Intelligence Committee warned industry that Beijing could use equipment made by the two companies to spy on certain communications and threaten vital systems through computerized links.

The panel urged network providers and others to seek other vendors for their projects.

"It's absolutely devastating," said Roger Entner, a telecoms analyst at Recon Analytics. "While Huawei had its hands tied already, it's one thing having restrictions that aren't voiced publicly, but it's another thing entirely when the government comes out publicly and says not to use Huawei."

The report also advised the Committee on Foreign Investments in the United States (CFIUS), an inter-agency government panel that vets foreign deals for security concerns, to block any future business tie-ups involving Huawei or ZTE and U.S. companies.

The demands come at a very sensitive time for U.S.-China relations, ahead of the U.S. presidential and congressional elections and a transition of power to a new leadership in China.

Tensions have recently been ratcheting higher thanks to a series of trade actions against China by President Barack Obama, including his blocking of a privately owned Chinese company from building wind turbines close to a U.S. military site, and his challenge of Chinese auto and auto-parts subsidies in a World Trade Organization case. His Republican opponent, Mitt Romney, says if elected he will label China a currency manipulator from day one.

Ed Snyder, an analyst at Charter Equity Research, said the committee's report could lead to retaliation against U.S. companies that sell products in China in the telecommunications industry and beyond. He mentioned Cisco, Google, Qualcomm, Apple as examples but said non-tech U.S. companies could also be hit.

"By calling them out like this they're almost certain to get retribution," Snyder said. "There's a lot of ripe targets."

The report capped an 11-month investigation that Huawei itself had urged in early 2011. Huawei, which already has a U.S. presence with its handset sales, had hoped that such a probe would remove suspicions that had killed its bid for U.S. communications company 3Com and U.S. server technology firm 3Leaf.

The move apparently backfired.

Committee Chairman Mike Rogers, a Michigan Republican who is a former FBI agent, said at a press conference on Monday that American companies must protect themselves against the national security risks posed by Huawei and ZTE.

"My argument is that if this helps the Chinese government get out of the business of cyberespionage, then that's great," Rogers said.

Huawei unequivocally denies the allegations in the report, said William Plummer, a company spokesman in Washington.

He said the panel's recommendations would set a "monstrous, market-distorting, trade-distorting policy precedent that could be used in other markets against American companies."

ZTE, in a newly released copy of a letter to the committee, said it "profoundly disagrees" with allegations that it is directed or controlled by the Chinese government.

"ZTE should not be a focus of this investigation to the exclusion of the much larger Western vendors," it said.

#### POSSIBLE DOJ PROBE

The committee's document was long on suspicion and short on evidence. A classified annex provides "significantly more information adding to the committee's concerns," it said.

Rogers said that some anonymous U.S. users of Huawei routers had told the committee of what he described as unauthorized shipments of large amounts of data to China late at night.

Asked why the report did not detail those accusations, he cited what he called "proprietary" concerns involving confidential disclosures to the committee's investigators.

The panel also said it had referred to the Justice Department and Department of Homeland Security credible allegations suggesting Huawei may be guilty of bribery and corruption, discriminatory behavior and copyright infringement.

DOJ spokeswoman Rebekah Carmichael said, "We take all credible allegations of foreign bribery seriously, and will review the materials when we receive them."

Rogers said lawmakers' concerns had been heightened by what he and the panel's top Democrat, C.A. Ruppertsberger of Maryland, described as the companies' lack of full cooperation with the investigation.

Chris Johnson, an analyst at the Center for Strategic and International Studies, said Huawei is not doing itself any favors by not being more forthcoming about sensitive aspects of its business, such as founder Ren Zhengfei's history as an officer in the Chinese army.

"They've taken a lot of steps, they've gone out and hired lobby firms and people like Bill Plummer to try to address the situation but it clearly it isn't working, based on the report and the general sentiment people have," Johnson said.

#### MOBILE PHONES SPARED

Employee-owned Huawei has made greater strides expanding in Europe and India, becoming the world's second-biggest maker of routers, switches and other telecommunications equipment after Sweden's Ericsson.

The committee's warning comes as Huawei weighs a possible initial public offering, sources said, as part of an effort to overcome suspicions that have all but blocked its U.S. efforts, including business tie-ins.

Huawei's U.S. sales totaled \$1.3 billion last year, a small fraction of its worldwide sales of \$32.4 billion. Handheld devices accounted for about three-fourths of the U.S. sales in the United States last year, including via T-Mobile, AT&T and Sprint.

ZTE's U.S. telecom infrastructure equipment sales last year were less than \$30 million. In contrast, two of the larger Western vendors alone had combined U.S. sales that topped \$14 billion, ZTE has said, alluding to Espoo, Finland-based Nokia Siemens Networks and Paris-based Alcatel Lucent.

Rogers, responding to a question at the press conference, stopped short of urging a U.S. boycott of mobile phones and other handheld devices made by Huawei and ZTE.

The panel's warning pertains to devices that involve processing of data on a large scale, he said, not Huawei- and ZTE-made mobile phones.

While the biggest U.S. wireless providers do not use Huawei equipment in their networks, some smaller companies including Clearwire Corp use the Chinese vendor.

Clearwire announced in 2009 that Huawei would supply it with equipment for its wireless network. It declined to say on Monday whether it will do any more business with Huawei in the future.

'A BAD MIX'

Huawei and ZTE may not be the only companies that present a risk to U.S. infrastructure, the committee's report said, but they are the two largest Chinese-founded, Chinese-owned companies seeking to market critical network equipment in the United States.

The report underscores how little return Huawei in particular has gotten from its significant investment in lobbying in Washington after suffering the setbacks with 3Leaf and 3Com. Private equity firm Bain Capital had partnered with Huawei for the latter deal.

Huawei has brought on seven firms registered to lobby U.S. lawmakers, including APCO, Doyce Boesch and Fleishman-Hillard, according to forms filed under the lobbying disclosure act. That is up from four firms in 2011, two in 2010 and one in 2009.

But China trade analyst Derek Scissors of the Heritage Foundation said Huawei can only do so much to overcome its a fundamental image problem.

"A company that's in a sensitive sector that has both theft and the possibility of espionage? That's a bad mix," Scissors said. "No one will be surprised if Huawei and ZTE continue to be locked out."

(Additional reporting by Chyen Yee Lee, Diane Bartz, Sinead Carew, Nicola Leske, Aruna Viswanatha and Paul Eckert; Editing by Karey Wutkowski, John Wallace, Leslie Adler and Bernard Orr)

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