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Sea Change: How Beijing Officials Outnegotiated AT&T On Marine Cable Plans --- They Reduced the U.S. Giant To a Supporting Role In Trans-Pacific Project --- Unlikely New Player: SBC

By Stephen J. Glain. Wall Street Journal. (Eastern edition). New York: Jul 23, 1997. pg. A1

BEIJING -- For much of this century, a tight fraternity of telecommunications giants led by AT&T Corp. set the rules for running undersea cable systems -- until they tried to sell two Chinese bureaucrats on a billion-dollar project.

Rather than design and set the terms for what could become the world's most important communications line, AT&T and its brethren endured a four-year lesson in humility. China's feisty negotiators, wielding the leverage created by rocketing economic growth, a billion potential customers and the likelihood of major changes in the U.S. telecommunications market, dictated how and where the cable would be built.

Susan Fleming, a spokeswoman at AT&T, says it got what it wanted out of the project. She notes "a lot of competition out there," adding: "And we welcome it."

In fact, the Chinese confined AT&T to a role far less influential than its usual strategic position in such projects. AT&T and cable giants such as Japan's Kokusai Denshin Denwa Co. (KDD) and Britain's Cable & Wireless PLC (C&W) were relegated to supporting roles as Beijing's bureaucrats brought in new players, including AT&T's Baby Bell rival, SBC Communications Inc. The San Antonio company, which recently abandoned merger talks with AT&T, gave the Chinese a powerful bargaining tool and in return got a foothold in what could become the main cable project in AT&T's most critical overseas market.

The companies that competed in a mad scramble for a piece of the action were deftly played off against each other by two hard-nosed Chinese officials who cobbled together exactly the deal China wanted. "We gave them a pedestal to stand on," a C&W official laments, "and that's exactly what they did."

In the early 1990s, the job of choosing which companies would build the new link between China and the U.S. fell to Li Ping, the 42-year-old deputy director of China's Ministry of Post and Telecommunications, and Wang Hongjian, its 52-year-old director. Mr. Li is an elite official who had worked for a year at Nynex Corp., another Baby Bell, and Mr. Wang had spent the early 1970s toiling in the countryside during the Cultural Revolution. Both men speak fluent English and lead the internationalist cadre of the telecommunications ministry. They also embody China's fierce desire for economic self-reliance.

At a dinner in late 1994 in Beijing, Mr. Wang once described for visitors from Canada's Teleglobe Inc. how his servitude under the Red Guards shaped his vision for China's future. "He talked about how important it was for China's youth to think globally and assume control over a strong, modern China, safe from foreign intervention," one executive at the dinner says.

Indeed, China never liked the current telecommunications arrangement. For one thing, it is costly. Worse yet, it gives Japan, China's erstwhile enemy, control over important infrastructure. Most phone calls dialed from China to the U.S. now travel along a cable that dips into the sea, surfaces in Japan, and then plunges back under the Pacific to North America. Many of these networks are controlled by AT&T and Japan's KDD. So, as China's phone traffic surged along with its economic growth, its policy makers pushed for a new system.

From the start, AT&T was the obvious candidate to lead the project. Until recently, it didn't have to worry about competition in Asia. Much of the region is tied to the U.S. by marine cables, with AT&T a major owner and operator. The U.S. had always limited the number of companies that can offer such service, and none had AT&T's experience.

Over the next three years, however, deregulation in the U.S. unleashed a horde of competitors hungry for a role in the China-U.S. project, which may well be the last of its kind for years. By the time the cable consortium was assembled by the Chinese officials, Asia had evolved from a fief controlled by AT&T and its partners into a newly competitive arena in which AT&T is just another player.

Throughout the negotiations, China made it clear that it would have an equal share in the project and not be subordinated to a foreign carrier. "Our general policy," Mr. Li says, "is to not engage in projects that exclude other parties. We want to engage as many companies as possible on an equal basis."

AT&T may not have listened to Beijing until it was too late, people close to the bidding say, because of its past dominance of the cable business. Ever since engineers learned how to bundle telephone wire (and later, optical fibers) into polyethylene, copper and steel jackets and lay them on the ocean floor, AT&T has been the leviathan of trans-Pacific cable. Through various partnerships, AT&T and KDD combined own nearly 40% of all cable capacity in Asia, according to KDD officials. (AT&T says it doesn't comment on its cable ownership by region.) On most of these big cables, AT&T had great influence over which companies could subscribe and how the lines were routed.

AT&T rivals say the company mobilized that clout when it first sensed that some competitors, Teleglobe

and a partnership of Nynex and Cable & Wireless, had offered to link China directly with North America. AT&T responded, people involved in the negotiations say, by announcing it would accommodate China's growing traffic by increasing capacity on an existing cable and thereby avoid the need for a new line. As it turned out, technical limitations permitted only minimal expansion, and some telecommunications executives wondered whether AT&T's announcement was a tactical maneuver designed to scare away rivals. An AT&T spokesman denies any such ploy.

But competitors say the AT&T announcement did undermine rival proposals. It "opened so many potentialities that it effectively killed our plan," says Steve Bayliss, a Teleglobe official.

The only people who didn't react to the AT&T proposal were the Chinese, who continued to talk to various companies about ways to install new capacity that would link China directly to the U.S. "We decided to adopt a wait-and-see attitude," Mr. Wang says.

AT&T also offered to connect China to the U.S. on an existing cable via a switching station in Guam, Mr. Li says. That, too, got a cool response; a Guam landing would have helped AT&T, which has a commitment to Manila to tie in the Philippines to U.S.-bound capacity via the tiny U.S. territory, but there was little in it for Beijing.

"We didn't give [those plans] much detailed consideration," Mr. Li says. "After all, there isn't much traffic between China and Guam." Even KDD, AT&T's partner, wasn't enthusiastic. "From our viewpoint, Guam wasn't that attractive," a KDD official says. "But AT&T persistently pushed it, and AT&T is our intimate friend." (Ultimately, a Guam connection was included in the plan, but only after all the consortium's members approved it.)

Nor did AT&T endear itself to the Chinese with what Mr. Li saw as its aggressive promotion of Submarine Systems Inc., a cable-manufacturing unit that it recently sold to Tyco International Ltd., of Exeter, N.H. At a meeting in Beijing late last year, Mr. Li says, an AT&T-SSI team urged that the unit get the supply contract for the network. According to a memo circulated among SBC officials after the meeting, the Chinese saw that maneuver as "a clear attempt to create a configuration that would allow AT&T/KDD to dominate the project management as well as . . . operation of the system."

The Chinese were having none of it, according to Mr. Li, who describes AT&T's promotion of SSI as "a major dispute in the negotiations." An AT&T spokesman denies its support of SSI was intended to help it control the network and says it backed down when China made its position clear.

Mr. Li says the Chinese were inconvenienced by AT&T's decision to cancel an October meeting

between AT&T Chairman Robert Allen and China's communications minister, Wu Jichuan, at a time when Mr. Allen was preoccupied with the hunt for his successor. Although AT&T says it gave Beijing ample six weeks' advance notice, the cancellation sent a signal that its rivals were quick to exploit. "Everybody was telling the Chinese that AT&T was floundering," an SBC representative says. Mr. Allen declines to comment.

Mr. Li won't say what impact the cancellation had on the ministry's ultimate decision on the deal, but he comments, "It delayed talks with other companies, and it put off progress on the entire project."

Even then, China might have had to accept AT&T's terms -- especially, the Guam landing and SSI role -- except for the emergence of SBC. At the time, SBC was preparing to enter the marine-cable fray in anticipation of the 1996 U.S. Telecom Reform Act, which allowed regional Bell companies to own and operate long-distance systems, including international cable networks. Its entry would add SBC as a major new player that the Chinese could use against AT&T.

By mid-1996, SBC Senior Vice President James S. Kahan had assembled a team to explore the cable business. The group approached Teleglobe, already a cable operator, about jointly proposing a China-U.S. cable. SBC also was mapping out a merger plan with Pacific Telesis Group, another Baby Bell, and hoped to use Pactel's California network as the main U.S. link to Asia.

Mr. Kahan then arranged corporate retreats at which SBC, Pactel and Teleglobe executives listened to engineers and bankers explain every aspect of the cable business: design, financing, deployment, repair -- subjects mastered long ago by AT&T and KDD. At the Camelback Inn in Phoenix last August, for example, about a dozen executives watched a slide show illustrating how a 10-gigabyte cable can be repaired in mid-ocean.

"We wanted this project because it would give us control over our own long-distance destiny," Mr. Kahan says.

Meanwhile, KDD says, the AT&T-KDD team was still trying to sell Beijing on a cable going through Japan and Guam and still ignoring Beijing's desire for a direct connection. SBC, in contrast, proposed a direct link to the U.S.

So heated were the negotiations by late 1996 that meetings were being held almost on top of each other. In late November, Messrs. Li and Wang summoned the AT&T/KDD, C&W/Nynex and SBC teams for separate two-day meetings over a two-week period. Some participants say the Chinese used a series of leaks to manipulate the three groups into adapting their proposals to Beijing's desires. An SBC official recalls that soon after Beijing confidentially endorsed

its proposed route, competitors suddenly adopted the exact same concept.

C&W and Nynex decided to throw in with SBC late last year. People close to the negotiations say the British cable giant and its U.S. partner had by then fallen out of favor, particularly after C&W Chairman Richard Brown hailed a memorandum of understanding signed with Beijing in November as a mandate to pursue new projects in China, including "proposals for a direct fiber-optic submarine cable between China and North America." Peter Eustace, C&W's media-relations manager, says Mr. Brown had chosen his words carefully. But an SBC representative says the statement struck the Chinese as presumptuous.

Nynex's position was even shakier. As a Baby Bell in the U.S. Northeast, it had little to offer Beijing, which viewed the West Coast as its main market.

However, the alliance between SBC and the C&W/Nynex team gave Beijing crucial leverage over AT&T. "The Chinese could now say: 'This will be the structure of the group,'" an SBC representative says. "And you can take it or leave it."

Mr. Wang issued such an ultimatum in January. He called representatives from each competing group and told them that AT&T and KDD would be invited to participate in the project, but only as equal partners. He and Mr. Li also invited in MCI Communications Corp., Sprint Corp., SBC and Nippon Telegraph & Telephone Corp., Japan's giant national phone company, which recently was allowed to compete with KDD for trans-Pacific cable business. The Chinese did this to offset the influence of AT&T and KDD, say people close to the bidding. All these companies joined the consortium.

A few days later, the Chinese invited a slew of other companies; the consortium, now totaling 14 members, also includes China Telecom Ltd., Korea Telecom Authority, Singapore Telecommunications Ltd., Hongkong Telecommunications Ltd., Chung Hwa Telecommunications Corp. of Taiwan, Telekom Malaysia Bhd, PT Indonesian Satellite Corp. and IDC Japan Ltd.

An AT&T news release on the March signing ceremony for the project hailed it as "yet another milestone in AT&T's growing relationship with China."

But industry experts perceive something different. "Things are much more complicated with deregulation," says Jun Byung Sup, managing director of Korea Telecom. "Like AT&T, we used to be the dominant carrier in our country. But now there's more competition, and people are always comparing us with someone else. It's good for the customer, but it's a headache for us. And I think AT&T feels the same way."

AT&T fared better than C&W, which will be represented in the consortium only indirectly by Hongkong Telecom, its affiliate in the former British colony. Only three months later, C&W agreed to sell to Beijing enough of its controlling shares in Hongkong Telecom to leave the two parties with equal 29% stakes. The transaction, the first phase of which was negotiated at a 25% discount to Hongkong Telecom's then-market price, was viewed as inevitable in the runup to Britain's return of Hong Kong to China a few weeks ago.

And Nynex, which swallowed its pride when it agreed to combine forces with archrival SBC, was shut out altogether.