

CONNECTED TRANSACTIONS



World Bank Loan

In 1994, the Ministry of Finance obtained a loan from the World Bank (the “World Bank Loan”), of which, after a series of novations, China Telecommunications Corporation became the borrower. A portion of the World Bank Loan was advanced by China Telecommunications Corporation to the Company for general corporate use. The Company also bears the cost of servicing that portion of the World Bank Loan. As at 31 December 2002, the outstanding amount of the World Bank Loan owed by the Company was US\$46.61 million. The Company has fully repaid such outstanding portion of the World Bank Loan in March 2003.

Guarantees

In 1993 and 1994, the former Shanghai, Guangdong, Jiangsu and Zhejiang Posts and Telecommunications Administrations entered into various loan agreements with China Import and Export Bank for an aggregate loan amount of 38,436 million Japanese yen to finance the development of telecommunications networks, including the development of inter-provincial transmission optic fibers. These loans were novated to the four provincial subsidiaries of the Company and were guaranteed by China Telecommunications Corporation.

As the Company has assumed the guarantees in place of China Telecommunications Corporation immediately after its listing, such guarantees no longer constitute connected transactions.

Terms of Other Connected Transactions Agreements

On 10 September 2002, the Company and China Telecommunications Corporation entered into certain connected transactions agreements set out below. The term of the agreements will expire on 31 December 2004, automatically renewable for further periods of three years unless the Company provides three months’ written notification to China Telecommunications Corporation of its intention not to renew the agreements upon expiry of their current term.

Trademark Licence Agreement

Pursuant to the Trademark Licence Agreement, China Telecommunications Corporation has granted to the Company the right, on a royalty-free basis, to use the trademark bearing the China Telecom logo which is in the process of being registered at the State Trademark Office under the PRC State General Administration for Industry and Commerce, as well as the right to use certain other registered trademarks and trademarks in the process of being registered.

Centralised Services Agreement

Centralised Services include:

- the provision of management services in relation to certain large enterprise customers of the headquarters of China Telecommunications Corporation and the operation of business support centre and network management centre; and

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- the use of the international telecommunications transmission facilities.

The settlement of any net amount due to or due from the Company is made once a year.

The provision of management services relating to certain large enterprise customers of the headquarters of China Telecommunications Corporation, and the operation of the business support centre and the network management centre

Under the Centralised Services Agreement, the Group and China Telecommunications Corporation share certain overhead costs and the Group has agreed to provide human resources relating to administrative functions of China Telecom Group. Assets relating to the Centralised Services are used by both the Group and China Telecom Group. The Group has also agreed to provide the necessary human resources responsible for the upkeep and maintenance with respect to these assets, in addition to providing maintenance services in relation to the international transmission facilities. The aggregate costs incurred by the Group and China Telecommunications Corporation for the provision of the Centralised Services (which include salaries and benefits of employees of the Group, depreciation of equipment and properties, maintenance fees and research and development fees) are apportioned pro rata between the Group and China Telecommunications Corporation according to the revenues generated by each of the Group and China Telecom Group.

For the year ended 31 December 2002, the Group's portion of the costs in respect of the provision of such services was RMB69 million.

The use of the international telecommunications facilities

China Telecommunications Corporation has retained the assets associated with international telecommunications facilities, such as international gateways, undersea cables and satellite facilities, and has granted a licence to the Group to use such facilities. The Group has agreed to provide the necessary human resources responsible for the upkeep and maintenance with respect to the international telecommunications facilities. The Group and China Telecommunications Corporation agreed to apportion the costs associated with operating such assets pro rata according to the aggregate volume of the inbound international calls terminated by and outbound international calls originating from, the Group and China Telecom Group, respectively.

For the year ended 31 December 2002, the Group's portion of the costs in respect of the use of international telecommunications facilities was RMB414 million.

Interconnection Agreement

In order to facilitate interconnection between subscribers within the Group's service regions and subscribers outside the service regions which are serviced by China Telecom Group, China Telecommunications Corporation and the Company entered into an interconnection settlement agreement (the "Interconnection Agreement"). The Interconnection Agreement does not provide for early termination or non-renewal by China Telecom Group.

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Pursuant to the Interconnection Agreement, the telephone operator terminating a telephone call made to its local network shall be entitled to receive from the operator from which the telephone call originated a fee prescribed by the MII, which is currently RMB0.06 per minute. The formula for settlement is based on the net volume of telephone calls originating from the Group to China Telecom Group or originating from China Telecom Group to the Group multiplied by the MII prescribed settlement fee.

The settlement is made between the Group and China Telecom Group on a monthly basis, with the operator who has originated more calls paying the net amount to the operator who has terminated more calls.

For the year ended 31 December 2002, the net settlement payment made by the Group to China Telecom Group pursuant to the Interconnection Agreement was RMB385 million.

Optic Fibers Leasing Agreement

Pursuant to the Optic Fibers Leasing Agreement, the Company agreed to lease the relevant parts of the inter-provincial transmission optic fibers within the Group's service regions from China Telecom Group.

The amount payable by the Group to China Telecommunications Corporation for the leasing of the inter-provincial transmission optic fibers is based on the depreciation charge for the optic fibers. In addition, the Group agreed to be responsible for the maintenance of these optic fibers within the Group's service regions.

For the year ended 31 December 2002, the total amount paid by the Group to China Telecommunications Corporation with respect to optic fibers leasing was RMB102 million.

Engineering Agreements

The Group and the provincial subsidiaries of China Telecom Group in each of the Group's service regions (the "Provincial Subsisting Companies") entered into engineering framework agreements (the "Engineering Framework Agreements") to govern the tendering for the right to provide the Group with construction, design, equipment installation and testing services and/or to act as general contractors in relation to construction and supervision of engineering projects commissioned by the Group.

The charges payable for engineering related services rendered under the Engineering Framework Agreements shall be determined by reference to market rates as reflected by prices obtained through a tendering process. The Group does not accord any priority to any of the Provincial Subsisting Companies to provide such services, and the tender may be awarded to an independent third party. However, if the terms of an offer from a Provincial Subsisting Company are at least as favourable as those offered by another tenderer, it is expected that the Group would award the tender to the relevant Provincial Subsisting Company.

For the year ended 31 December 2002, the Group's expenditure for engineering services was RMB3,243 million.

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Property Leasing Agreements

Mutual leasing of properties

Under the Property Leasing Framework Agreements between the Group and the Provincial Subsisting Companies, the Group leases properties from the Provincial Subsisting Companies for use as its business premises, offices, equipment storage facilities and sites for network equipment. Under the Property Leasing Framework Agreements, the Group also leases certain properties to the Provincial Subsisting Companies.

The rental charges in respect of each property are based on market rates, with reference to amounts stipulated by local price bureaus. Rental charges are payable monthly in arrears and subject to review every three years.

For the year ended 31 December 2002, the Group's expenditure for the property leasing was RMB266 million. For the same period, the Provincial Subsisting Companies' expenditure for the property leasing was RMB3 million.

Third Party Properties Sub-Leasing Agreements

The Provincial Subsisting Companies sub-let to the Group certain properties owned by and leased from independent third parties for use as offices, retail outlets, spare parts storage facilities and sites for network equipment (the "Third Party Properties"). China Telecom Group has agreed to give the Group an indemnity with respect to any claims or costs incurred by the Group in connection with any defect in the titles to any such Third Party Properties.

The amounts payable by the Group to the Provincial Subsisting Companies under the Third Party Properties Sub-Leasing Agreements are the same as the amounts payable by China Telecom Group to the relevant third parties. The rental charges for the Third Party Properties are based on market rates negotiated between the Provincial Subsisting Companies and the relevant third party on an arm's length basis.

For the year ended 31 December 2002, the Group's expenditure in relation to third party properties sub-leasing was RMB321 million.

IT Services Agreements

The Group entered into framework agreements with the Provincial Subsisting Companies pursuant to which the Provincial Subsisting Companies agreed to provide the Group with certain information technology services such as office automation and software adjustment (the "IT Services Framework Agreements").

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The Provincial Subsisting Companies are entitled to tender for the right to provide the Group with information technology services. The charges payable for such information technology services under the IT Services Framework Agreements shall be determined by reference to market rates as reflected by prices obtained through a tendering process. The Group does not accord any priority to the Provincial Subsisting Companies to provide such services, and the tender may be awarded to an independent third party. However, if the terms of an offer from a Provincial Subsisting Company are at least as favourable as those offered by another tenderer, the Group may award the tender to the relevant Provincial Subsisting Company.

For the year ended 31 December 2002, the Group's expenditure for information technology services was RMB151 million.

Equipment Procurement Services Agreements

Pursuant to the equipment procurement framework agreements entered into between the Group and the Provincial Subsisting Companies (the "Equipment Procurement Framework Agreements"), the Provincial Subsisting Companies agreed to provide comprehensive procurement services, including the management of tenders, verification of technical specifications and installation services.

Pursuant to the Equipment Procurement Framework Agreements, the Group may request that the Provincial Subsisting Companies act as their agents in procuring foreign and domestic telecommunications equipment and other domestic non-telecommunications materials. The Group may give priority to the Provincial Subsisting Companies if the terms and conditions of the services provided by them are at least as favourable as those offered by independent third parties.

Commission charges for these services are calculated at the maximum rate of:

- (1) 1% of the contract value, in the case of imported telecommunications equipment; or
- (2) 1.8% of the contract value, in the case of domestic telecommunications equipment and other domestic non-telecommunications materials.

For the year ended 31 December 2002, the Group's expenditure for equipment procurement services was RMB78 million.

Community Services Agreements

China Telecom Group, through the Provincial Subsisting Companies, provides certain cultural, educational, property management, vehicles, health and medical services, hotel and conference, community and sanitary services to the Group. The arrangements are set out in the community services framework agreements between the Group and the Provincial Subsisting Companies (the "Community Services Framework Agreements"). If the Group cannot, without incurring significant additional costs and expenses, obtain these services from a third party after such termination, the Provincial Subsisting Companies cannot terminate the provision of such services.

Although the Community Services Framework Agreements are on a non-exclusive basis, the following conditions are to apply:

- (1) the Group may give priority to the Provincial Subsisting Companies in using the services, provided that the terms and conditions offered by independent third parties to the Group are no more favourable than those offered by the Provincial Subsisting Companies for the same services;

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- (2) in return, the Provincial Subsisting Companies have undertaken to the Group that the Provincial Subsisting Companies shall not provide services to the Group on terms which are less favourable than those offered by them to third parties;
- (3) the Provincial Subsisting Companies are only entitled to provide the relevant services to third parties provided that it would not affect the provision of services to the Group under the Community Services Framework Agreements; and
- (4) if the Provincial Subsisting Companies cannot satisfy the needs of the Group for the services to be provided under the Community Services Framework Agreements or the terms offered by independent third parties are more favourable, the Group may obtain such services from independent third parties.

The Community Services Framework Agreements stipulate that the above community services be provided at:

- (1) the government prescribed price;
- (2) where there is no government-prescribed price but where there is a government-guided price, the government-guided price applies;
- (3) where there is neither a government prescribed price nor a government-guided price, the market price applies. The market price is defined as the price at which the same type of services are provided by independent third parties in the ordinary course of business; or

- (4) where none of the above is applicable, the price is to be agreed between the relevant parties for the provision of the above services, which shall be the reasonable cost incurred in providing the same plus a reasonable marginal profit (for this purpose, “reasonable costs” means the costs confirmed by both parties after negotiations).

For the year ended 31 December 2002, the Group’s expenditure for community services was RMB1,291 million.

Ancillary Telecommunications Services Agreements

The Provincial Subsisting Companies provide certain repair services to the Group, such as the repair of certain telecommunications equipment, the maintenance of the fire prevention equipment and telephone booths and other customers services (the “Ancillary Telecommunications Services”) on a non-exclusive basis.

Under the framework agreements between the Group and the Provincial Subsisting Companies for the provision of Ancillary Telecommunications Services (the “Ancillary Telecommunications Services Framework Agreements”), the Provincial Subsisting Companies agreed to provide Ancillary Telecommunications Services to the Group. However, if the Group cannot, without incurring significant additional costs and expenses, obtain these services from a third party, the Provincial Subsisting Companies cannot terminate the provision of such services.

The Ancillary Telecommunications Services Framework Agreements contain the same conditions as set out in (1) to (4) in the second paragraph under the heading “Community Services Agreements” above.

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The Ancillary Telecommunications Services under the Ancillary Telecommunications Services Framework Agreements are provided in accordance with the same pricing policy as that of the Community Services Framework Agreements.

For the year ended 31 December 2002, the Group's expenditure for Ancillary Telecommunications Services was RMB1,219 million.

Special Communications Services Agreements

The Provincial Subsisting Companies continue to be responsible for providing emergency network services and network services dedicated to the Chinese government (the "Special Communications Services").

The Provincial Subsisting Companies agreed to lease the infrastructure in connection with the Special Communications Services from the Group at a fee prescribed by the MII.

On the other hand, the Group agreed to provide the necessary human resources to maintain and operate the Special Communications Services within the Service Regions in return for China Telecom Group reimbursing the Group its actual costs, including the costs for network operations and support, general and administrative expenses and certain other operating expenses.

For the year ended 31 December 2002, the Group was paid RMB28 million for Special Communications Services by China Telecom Group.