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The EU-China Investment Agreement 2020

On 30 December 2020, after seven years of negotiations, an investment agreement between the European Union and China was concluded, called the Comprehensive Agreement on Investment (CAI). The CAI is a political agreement that seeks to establish the most favourable conditions for investors on both sides, prioritising fair conditions for competition.

This text seeks to explain the four main areas of this agreement. The first of these refers to new forms of market access in areas such as manufacturing, the automotive sector, financial services, health services, telecommunications, and others. The second category called "Legal playing field", lays down rules concerning the State-owned enterprises, transparency in subsidies and forced technology transfer. The third section deals with the conditions for "Investment and Sustainable Development" and the commitments of the parties on environmental and labour issues, as well as a final section called "Dispute Settlement", which refers to the process itself.

In addition, particularities of the agreement and some important criticisms of it are addressed.

Market Access

The agreement highlights the following investment commitments by China, which are set out below:

Manufacturing

China made significant concessions in favour of the EU, with this sector accounting for almost half of European foreign direct investment, namely transport and telecommunication equipment, chemicals, health equipment and more (details to be set out in the February Annexes in 2021). Some notable exceptions relate to overcapacity in particular sectors that could represent benefits for the Chinese industry.

ALLIURIS A.S.B.L.
ALLIANCE OF INTERNATIONAL BUSINESS LAWYERS

MANAGEMENT
D-30159 HANNOVER
LUISENSTR. 5
FON +49-511-307 56-50 505056-20
FAX +49-511-307 56-60

INTERNET
WWW.ALLIURIS.ORG
INFO@ALLIURIS.ORG

LEGAL SEAT
B-1000 BRUSSELS
AVE. DES ARTS 56

alliuris.law

Automotive sector

A major commitment was to remove and phase out joint venture requirements. This is expressed in the agreement itself (s.2 art. 2.1) stating that the Parties shall not require companies to necessarily have to incorporate a specific type of company to carry out their economic activities. There is also a commitment to ensure access for new energy vehicles, as every fifth car in China has German origins.

Financial services

There have already been international commitments by China to liberalise certain services, which was seen in advance with the agreements concluded between them and the United States. The treaty states in the negative that the Parties shall not adopt or continue to implement measures which, in the establishment, acquisition or maintenance of an enterprise by an investor of one of the Parties, whether in its territory or regional subdivision, impose limitations on the number of enterprises that may carry on an activity, or operations or the value of transactions (s. 2, art. 2.1).

An important paragraph concerning the performance of enterprises was included (art. 3), which refers to the fact that companies incorporated in any of the territories of the Parties should not be imposed or conditioned to fulfil commitments that have to do with achieving specific economic objectives, i.e., achieving a specific target of exporting goods or services of the enterprise itself or with domestic content. There should also be no influence on which local suppliers producing goods or providing services are to be purchased. Nor should there be an obligation to transfer not only technologies, but also production processes or know-how that have already been patented (with specific exceptions), or for a Party to direct an enterprise as to which market it should supply its goods or services that it has to offer, among various other things.

On the other hand, this section for the release of investments does not apply in the case of audio-visual services, and air transport (with certain particularities), as well as for the government procurement for purchasing goods or services, among others (s.2 art. 1.2).

However, China will open in the key areas of computer reservation systems, ground handling and selling and marketing services. As far as the Joint venture requirements and foreign equity caps are concerned, these were removed for banking, trading in securities and insurance (including reinsurance), as well as asset management.

Health (private hospitals)

The so-called joint venture requirements will be no longer applied for private hospitals in key Chinese cities, including Beijing, Shanghai, Tianjin, Guangzhou and Shenzhen. It is considered that Germany and France could specially profit from it.

R&D (biological resources)

In relation to this sector there is a commitment only not to create new barriers and restrictions towards the EU now and for the future.

Telecommunication/Cloud and Computer services

A particular achievement from the EU is that China has agreed to lift the investment ban for cloud services. They will now be open to EU investors subject to a 50% equity cap, which is in line with what the US already agreed in negotiations with China, which will be confirmed when the European Commission releases the corresponding Annexes. Also, the inclusion of a 'technology neutrality' clause, would ensure that equity caps imposed for value-added telecom services will not be applied to other services such as financial, logistics, medical etc. if offered online.

International maritime transport

China will allow investment in the relevant land-based auxiliary activities, enabling EU companies to invest without restriction in cargo-handling, container depots and stations, maritime agencies, etc. This will allow EU companies to organise a full range of multi-modal door-to-door transport, including the domestic leg of international maritime transport.

Business services

China will eliminate joint venture requirements in real estate services, rental and leasing services, repair and maintenance for transport, advertising, market research, management consulting and translation services, etc.

Environmental services

China will remove joint venture requirements in environmental services such as sewage, noise abatement, solid waste disposal, cleaning of exhaust gases, nature and landscape protection, sanitations, and other environmental services.

Construction services

China will eliminate the project limitations currently reserved in their GATS commitments.

Employees of EU investors

The agreement regulates the entry and temporary stay of persons for business purposes in general between the Parties. To this end, two categories of visitors are established:

(a) business visitors for establishment purposes: those who enjoy a senior position for the sole purpose of establishing a business, without offering various services or remuneration. The permissible length of stay shall be for a period of up to ninety days in any twelve-month period.

(b) intra-corporate transferees: those who are employees of the company or partners for at least one year, who could be:

- Managers: Those who are primarily responsible for the management of the company or other related activities, including the supervision and control of personnel.
- Specialists: Those who have specialised knowledge of production, techniques, processes, among other characteristics, will be allowed to work up to three years in Chinese

subsidiaries, without restrictions such as labour market tests or quotas. Same applies to Managers.

Representatives of EU investors will be allowed to visit freely prior to making an investment.

Level playing field

One of the aims of this agreement was to establish fair conditions for investors from both contracting parties. To this end, China's commitments are summarised as follows:

State owned enterprises (SOEs)

Chinese SOEs contribute to around 30 percent of the country's GDP. For this reason, there is a section specifying the behaviour to be observed by the Parties towards these enterprises. They are called "Covered entities" (s.2 art. 3 bis), companies in which one of the parties owns more than 50% of the share capital, or controls more than 50% of the voting rights, or has extensive powers of appointment of members of any organ or its decisions, where the Parties should observe a non-discriminatory treatment, commercial considerations, transparency requirements and the possibility of an independent decision-making body. The agreement mainly covers the rights known as National Treatment, Most-Favoured-Nation Treatment, Senior Management and Board of Directors, which are listed as stability for investors, although there are exceptions. Importantly, China also undertakes the obligation to provide, upon request, specific information to allow for the assessment of whether the behaviour of a specific enterprise complies with the agreed the CAI obligations. If the problem goes unresolved, we can resort to dispute resolution under the CAI.

Transparency in subsidies

Also, the CAI obliges China to engage in consultations to provide additional information on subsidies that could have a negative effect on the investment interests of the EU.
China is also obliged to engage in consultations with a view to seek to address such negative effects. It is stated (Annex to Art. 8, s.III, Sub. II) that the subsidies provided by the Parties shall be transparent, including, but not limited to, the following: business services, such as professional- (underlying medical and dental services only privately funded), real estate-, Leasing-, telecommunication-, retailing-, all insurance and insurance-related and Banking and other financial services, franchising, hotels and restaurants (incl. catering), Maritime Transport Services and more.

Forced technology transfers

As described above, there are provisions that consist on the prohibition of several types of investment requirements that compel transfer of technology, such as requirements to transfer technology to a joint venture partner, as well as prohibitions to interfere in contractual freedom in technology licensing. Regarding the information collected by administrative bodies, there will be control from unauthorized disclosure.

Investment and sustainable development

The signatories commit themselves to the promotion of investment that fosters sustainable development, with each party reserving the right to establish its own policies, priorities, and levels of labour and environmental protection. (S. IV Subsection 2. Art. 1).

It also establishes the importance of the United Nations Framework Convention on Climate Change (UNFCCC) and the Paris Agreement as mere aspirations to be considered. (S.IV, Sub. 2 art. 6). In the same way, the parties reserve the right to regulate the labour sphere and its social protection (S.IV, Sub. 3. Art. 1).

Dispute Settlement

The EU and China will use a state-to-state dispute settlement to solve controverses. It starts with what is known as monitoring mechanism at a political level, if the parties do not agree on any of the above issues (S.IV. Sub. 4, Art.1). It begins with a prelitigation process starting with a written consultation, indicating reasons and sufficient information, where the other party shall enter these consultations within a period not exceeding 30 days. In the event of a possible disagreement within 120 days of the consultation or as agreed by the parties, a Panel will be established, consisting of three members appointed by the parties. (Art. 3). A list of experts of a total of twelve persons, knowledgeable in international labour law or international environmental law and similar subjects, divided into three sub-categories with at least four persons each, the last one being composed of individuals who are not nationals of the Parties, with the possibility of their review prior to the protest of their position, shall be drawn up. The expert panel shall issue its interim report within 150 days of the panel's establishment in consensus form and confidentially, with an opportunity for the parties to comment on its contents (S. IV. Sub4, art. 4). A final report is issued no later than 15 days after the issuance to the Parties, with the utmost transparency in its publication but protecting confidential information.

On the other hand, the standard dispute settlement procedure includes the opportunity for mediation and the process as such is identical, with the difference that the experts must have expertise in law and international trade or investment, as well as the Panel must take into consideration the customary rules on interpretation of public international law (s.V, art. 11) and the final report must be executed within a reasonable period of time, understood as within 15 months after the date of issuance of the report. For this there must be an agreement for mutually acceptable compensation, which if not achieved, obligations may be suspended in accordance with the decision of the arbitration panel.

Finally, an Investment Committee will be functioning in a political level to observe the implementation of the CAI to respect to Sustainable Development.

Particularities of the CAI

This agreement has an indefinite duration and shall enter into force on the first day of the second month following the notification of the conclusion of the formal requirements and procedures of its countries (s.VI.Sub.2 Art. 18-19).

Some of the next steps are a formal exchange of market access offers between the EU and China in February, after the translation and legal review is expected to be submitted to the Council and the European Parliament for approval in Autumn 2021 and in fact, it is considered that the agreement will enter into force no earlier than 2022.

Collision with other international agreements

It is important to note that this agreement will have repercussions for the treaties and rules previously in force for both contracting parties. On the EU side, there have been at least 25 bilateral treaties signed by member states unilaterally with China, before the EU took over such authority. Some believe that upon the entry into force of this agreement, each of these treaties will be replaced by this agreement. Others consider that these previous agreements will not be superseded or terminated by this treaty, i.e. they might coexist (s. VI Art.15). However, the obligations under the WTO agreements will take precedence over those set out in the CAI (s.VI.15.3).

On the other side, China created in 2019 the Law for Foreign Investment (FIL) which entered into force in January 2020, replacing laws on wholly foreign owned enterprises. Throughout its 42 articles, it establishes the promotion and protection of investments, as well as attitudes to be observed by foreign investors. In the event of a possible collision between the FIL and the CAI, art. 41 of the FIL could be considered in an analogue way, which refers to provisions on the part of the State concerning financial industries as banking, securities, or insurance, or of their making investments in such financial markets as securities market or foreign exchange market, in which the CAI will have supremacy over the FIL.

There is another interesting point to consider and the role that might play for the relationship with China itself. In Germany there is a debate for the draft of the so-called *Supply chain law*. It has to do with the responsibility of companies for violations of human rights upstream in their own supply chains. Even though it is slowly advancing in the debates, the EU could overtake them. The Legal Affairs Committee of the EU Parliament presented an own-initiative report at the end of January. In March, it will be voted on in the plenary of the EU Parliament. In June, the EU Commission will present the legislative proposal. The sticking points here are also liability, scope, and practical implementation: meaning adequate processes to identify risks. The consequences with other countries with deficient regulations in Labour law might be affected thought it.

Negative Lists

At the same time, it is important to note that for foreign investors in China there are several regulations to consider when entering this market. There are norms that apply to all companies, both domestic and international, as well as some specific ones for foreign investors, so-called: the *Special Administrative Measures on Access to Foreign Investment (Negative List 2020) and the Free Trade Zone Special Administrative Measures on Access to Foreign Investment (FTZ Negative List 2020)*. They establish the so-called Negative Lists, announced by the "Financial Stability and Development Committee" (financial regulatory body) which establish prohibitions or restrictions on certain industries in China. This practice is carried out periodically, with the most recent revision on 30 June 2020, reducing the first regulation from 40 to 33 items *(Negative List 2020)* and from 37 to 30 items for the second regulation *(FTZ Negative List 2020)*.

The key point is that for trade in services and development of investments, even though there are the Market Access- and National Treatment Commitments, there are normally also exceptions, limitations or reservations for certain activities, contained in what it is known as Schedules in the agreement, which are the negative lists. It is worth mentioning that the use of negative lists (as well as positive ones such as GATS or hybrid ones such as TiSA) is a relatively common international practice. Even the European Union used it in the CETA agreement on water issues.

In the case of the CAI, there is an Annex that has not yet been published, which states the China's schedule and their non-conforming measures of activities of sectors and subsectors, in which foreign investment is prohibited [Entry 9 (paragraph 1), 21, 22, 23, 24, 25 and 26], which would indicate that only those activities would be restricted, subject to further clarification of the agreement itself. Such an explanation on the part of the Annexes is important, because, to name one example, on the issue of automobile manufacturing, the negative list applicable to them in 2020, except for special purpose vehicles, new energy vehicles and commercial vehicles, is that the Chinese party in complete automobile manufacturing shall hold not less than 50% of the shares, where the CAI eliminates foreign share-holding restrictions.

Geographical Indications

An important role in the effective implementation of the regulatory framework for investors will be played by the agreement celebrated back in 2020 between the EU and China for the promotion and protection of geographical indications. This bilateral agreement will protect 100 European Geographical Indications (GIs) in China and 100 Chinese GIs in the European Union, which will give certainty against imitation.

It is important to highlight that this agreement has not yet entered into force, according to the Official Journal of the European Union, which possible date will be the 1st March 2021. In addition, within four years of the entry into force of this agreement, the geographical protection will be increased to 175 GI for both parties, following a similar process to that already established for this agreement of GI.

Critics

There are basically three major criticisms of this agreement. On the one part, there is a strong social resistance due to the capitulations concerning Labour and Environmental Law. It is considered to have missed a unique opportunity to seek China's ratification of international agreements dealing with forced labour and to leave it up to the parties to consider the Paris Agreement and the UNFCCC, without concrete and enforceable commitments for both.

On the other part, the agreement lacks a chapter on investment protection. It is established that the parties shall negotiate an agreement on investment protection and investment dispute settlement within two years of signing the agreement. (s.VI. Sub. 2. Art. 3). Given that priority was then given to securing an agreement while leaving this negotiation in parallel, some sceptics consider that there are no longer significant leverages for the EU to push its own agenda.

Finally, there is a certain aversion on the part of investors to the Dispute Settlement system. The reasons, which are somewhat subjective, are that, although it is true that using it in practice is not entirely common, there is also a significant risk for those involved of suffering reprisals in current or future processes to continue investing in the Chinese country, above all due to the reservation of certain discretionary powers for both parties, which could lead to uncertain results.

Conclusion

The CAI sets out important parameters and guidelines to consider for investors forming or considering forming part of the business opportunities between the European Union and its allies.

As a result of Brexit, the EU's domestic market has shrunk by a seventh due. This is precisely why, given this situation and the trade wars between the United States and China, and of course the current pandemic, the EU is seeking to participate neutrally in the global geopolitical game. Significant achievements play in its favour, such as China's market commitments in particular areas of business transparency and its year-on-year international opening of key sectors for the EU, such as manufacturing and the automotive sector, especially in terms of clean energy. It is also foreseen that SEOs will play a less preponderant role in making the market more competitive and with clearer rules for participants, which is already evident in the reduction of elements of China's negative lists, which the EU will have to take into account in order to have better margins for manoeuvre in future negotiations.

Likewise, the non-binding commitments on labour and environmental matters represent a great step forward in the fulfilment of supranational objectives such as the reduction of CO2 and various pollutants, among others, which is not witnessed in its magnitude by other agreements signed by China. While it is evident that the labour area lacks some clarity in terms of effective oversight to avoid issues of worker exploitation, it is also the case that it promotes even more political and media pressure, especially in the private sector, which will inevitably suffer significant scrutiny in the handling of its business dealings with its international competitors.

On the other side, the rush to conclude this agreement before the current US president Joe Biden takes office also means that China has managed to divide the EU and the US politically for the time being. There is also a risk that by setting aside the investment protection chapter for the moment, it would imply that the EU would be willing to accept any agreement for the CAI to enter into force at all costs. At the end of the day, while it is true that international agreements do not necessarily have to fully regulate labour issues, human rights, etc., in order to conduct trade activities, it is also true that such instruments reflect the core values of the participants. Nevertheless, the CAI represents the foundation on which a solid regulatory framework that encourages investment and its effective international protection will continue to be built.

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ALLIANCE OF INTERNATIONAL
BUSINESS LAWYERS
Avenue des Arts 56,
B-1000 Brussels / Belgium

Editors:
Chief editor (responsible): Ulrich Herfurth

Management :

ALLIURIS A.S.B.L.
Luisenstr. 5
D-30159 Hannover
Fon ++49 511 30756-0
Fax ++49 511 30756-10
Mail info@alliuris.org
Web www.alliuris.org