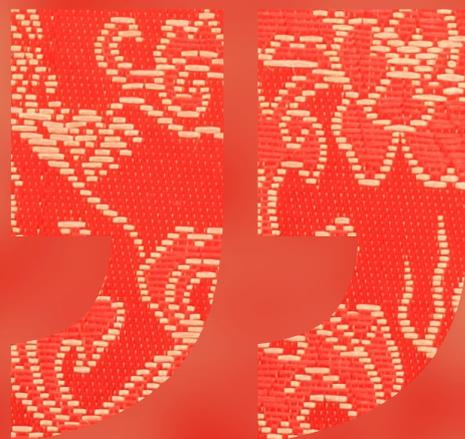


C L I F F O R D

C H A N C E



**EU AND CHINA
COMPREHENSIVE
AGREEMENT ON
INVESTMENT**



— THOUGHT LEADERSHIP

APRIL 2021



EU AND CHINA COMPREHENSIVE AGREEMENT ON INVESTMENT

The European Union (EU) and China (the Parties) concluded in principle the negotiations for a Comprehensive Agreement on Investment (CAI) on December 30, 2020. Although this is only the first step in the process, it sets the framework for the final Agreement text to be submitted to the European Parliament (EP) for adoption setting out commitments in terms of transparency, level playing field, market access and sustainable development affecting both European and Chinese investors in a number of sectors.

CAI NEGOTIATION PROCESS

In October 2013, the European Council adopted a mandate for the European Commission to negotiate a CAI with China on behalf of the EU and the first round of talks took place in January 2014. Following agreement on the CAI's comprehensive scope in January 2016, the Parties moved on to specific text-based negotiations. In April 2019, at the 21st EU-China Summit, the Parties committed to conclude the CAI in 2020. After almost seven years of negotiations, on 30 December 2020, the EU and China agreed on an investment deal, although its official signing is yet to take place. On 22 January 2021, the European Commission published the text of the agreement with some remaining annexes expected to be released later this year.

EU-CHINA INVESTMENT AGREEMENT – KEY ELEMENTS

The CAI is not a free trade agreement, but rather an agreement focusing on investment opportunities aiming to address existing imbalances between the two markets. Nevertheless, there are many aspects not covered by this agreement such as trade in goods and services as well as public procurement. It should be noted that all EU Member States – except for Ireland – already have a bilateral investment treaty with China. The CAI aspires to turn the page on the EU-China trade relationship regarding the market access conditions in specific sectors and aiming to level the playing field for EU companies in China, promoting at the same time sustainable development principles.

Market access commitments by China

The CAI binds China's liberalisation of investments over the last 20 years, making the conditions of market access for EU companies clear. In addition, the EU has negotiated further new market access openings and commitments such as the elimination of quantitative restrictions, equity caps or joint venture requirements in a number of sectors. In particular:

Air transport-related services – China will open up in the key areas of computer reservation systems, ground handling and selling and marketing services.

Automotive sector – China will remove and phase out joint venture requirements providing market access for new energy vehicles.

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

Computer services – China will bind market access for computer services and will include a 'technology neutrality' clause, ensuring that equity caps imposed for value-added telecom services will not be applied to other services such as financial, logistics or medical services, if offered online.

Employees of EU / Chinese investors – Managers and specialists of EU or Chinese companies will be allowed to work up to three years in their

subsidiaries in the other Party, without restrictions such as labour market tests or quotas. Representatives of EU or Chinese investors will be allowed to visit freely prior to making an investment.

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.

Financial services – China had already started the process of gradually liberalising the financial services sector and will commit to grant and keep that opening to EU investors.

Manufacturing – China has made comprehensive commitments with only very limited exclusions (in particular, in sectors with significant overcapacity). Its commitments include cars (traditional and new energy vehicles), production of transport and health equipment, and production of chemicals among others.

Telecommunication/Cloud services – China has agreed to lift the investment ban for cloud services, which will now be open to EU investors subject to a 50% equity cap.

Further, the CAI provides for licensing and qualification requirements and procedures to be publicly available, easily understandable, and reasonable in order not to hinder investment.

On the EU side, the services market is already open and largely committed in GATS. Beyond these commitments, EU

has agreed to grant some additional market access (notably, in the manufacturing sector). However, the EU maintains its policy space in sensitive sectors such as energy infrastructure, agriculture, fisheries, mining and public services. In those areas, the EU reserves the right to alter its policies and adopt possibly stricter measures vis-à-vis foreign investment activities in the future.

Chinese State-Owned Enterprises (SOEs)

The CAI covers a broad definition of SOEs, including the entities controlled by the state through minority ownership or legal title, as well as state-designated monopolies or entities vested with special rights or privileges. The CAI requires Chinese SOEs to behave as any private business would, in accordance with commercial considerations, and not to discriminate against EU companies in their sales and purchases. It also imposes transparency obligations, if the SOEs' behaviour is not compliant with the agreed obligations. Importantly, China 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 CAI obligations.

Subsidies and the WTO reform

The CAI extends the current WTO transparency disciplines for industrial goods to services sectors. Moreover, it establishes a two-stage consultation mechanism between the Parties allowing to collect the necessary information aiming to assess the effects of specific

Key objectives

- Guaranteeing access to EU investors in China.
- Allowing EU companies to buy or establish new companies in key sectors.
- Levelling the playing field for EU companies in China.
- Committing China to rules on state-owned enterprises and transparency in subsidies.

State-to-state Dispute Settlement

- Ad hoc mechanism for engagement at political level in case of serious and urgent issues.
- A two-step approach based on consultations to reach a solution and, if not, the recourse to an arbitration panel procedure.

subsidies on the investment interests of a Party. This settlement procedure shall not be subject to the state-to-state dispute settlement but rather the Parties can resort to a consultation process. The Party arguing for the distortive effects of a subsidy may seek additional information such as the policy objective and / or purpose, the amount of subsidy and any other information facilitating its assessment. This tool may be proven useful to the EU in implementing the currently considered framework for foreign subsidies.

In the WTO, the EU will aim to update the disciplines for industrial goods contained in the Agreement on Subsidies and Countervailing measures. Both processes concerning subsidies (CAI and the WTO reform), are complementary and mutually reinforcing.

These commitments do not affect the adoption of autonomous measures by the EU to address distortions in the European internal market created by foreign subsidies.

Forced Technology Transfers

The CAI prohibits several types of investment requirements that compel transfer of technology, such as requirements to transfer technology to a joint venture partner, as well as interference with contractual freedom in technology licensing. However, such requirements will be permitted if imposed or enforced by a court or administrative tribunal, or even by a competition authority to prevent or remedy a restriction or a distortion of competition. It remains to be seen whether the relevant authorities of the Parties will increasingly impose licensing as a potential remedy to a competition distortion. In addition, it sets out rules on the protection of confidential business information collected by administrative bodies from unauthorised disclosure.

Dispute Resolution and Enforcement Mechanisms

The CAI will provide for a state-to-state dispute settlement mechanism, including an ad hoc mechanism for engagement at political level in case of serious and

urgent issues. In addition, it foresees an institutional framework for monitoring the implementation of the commitments, including regular political oversight. Regular dialogue and stakeholders' involvement (business, civil society and other organisations) will be part of the implementation process.

The CAI also includes a two-step dispute settlement approach based on consultations (and the possibility of mediation) to try to reach a mutually agreed solution and, in the absence of a solution, the recourse to an arbitration panel procedure. With respect to the arbitration panel, the CAI sets out specific rules for its establishment and composition in order to ensure the independence and impartiality of the panel members. It should be noted that the arbitration process could be lengthy, given also the possibility for the complaining Party to request the suspension of the arbitration panel's work at any time for up to 12 months.

Regarding sustainable development, the CAI provides for a specifically designed implementation and enforcement mechanism that will address possible differences, with a high degree of transparency and participation of civil society, while it reaffirms both Parties' commitments under the Paris Agreement. It also designates a distinct dispute settlement mechanism as the state-to-state dispute settlement does not apply to disagreements related to sustainable development investments.

Lastly, China and the EU committed to try to complete the negotiations on investment protection and investment dispute settlement within two years of the signature of CAI, working towards modernised protection standards and a dispute settlement that takes into account the work undertaken in the context of UNCITRAL on a Multilateral Investment Court.

Enforcement

The implementation of the CAI will be monitored by the Investment Committee which will be co-chaired by the Executive Vice President on the side of the EU and Vice Premier on China's side. A specific working group to follow the

implementation of sustainable development related matters, including on labour and climate, has been created.

The implementation mechanism in place enhances information sharing between the Parties, while it provides for the possibility to set up on short notice ad hoc meetings of the co-chairs of the Investment Committee to raise urgent matters related to the CAI implementation.

Transparency obligations

Transparency seems to be one of the key requirements for the implementation of the CAI. To this end, the Agreement imposes certain obligations to the Parties such as the publication of relevant laws that should be easily accessible, while the comments of the other Party should be considered before adopting them.

Moreover, if one of the Parties believes that the commercial activities of an entity of the other Party adversely affect its interests, it is entitled to make a request for information about the operations of such entity such as the percentage of shares and / or voting rights, the organisational structure, the annual revenue and / or total assets, any exemptions or immunities and equivalent measures applicable to that entity. It remains to be seen how the Parties would treat this information, in particular should it be relevant in the context of a merger control review or an antitrust investigation.

Next steps

The conclusion in principle of the negotiations is solely a first step in the process as deliberations for the adoption and ratification of the agreement are yet to take place. Once the final text is agreed and signed by the two Parties, it will have to be sent for approval to the EU Council and the EP, which will decide by a simple majority vote in plenary (i.e., a majority of the votes cast).

Impact on Chinese Investors

Although the EU market is already open to foreign investors with very few restrictions, the CAI will allow access to some manufacturing sectors and the energy sector. At the same time, the CAI would provide a legal protection framework for growing Chinese investment in Europe with detailed dispute settlement procedures in the event of specific disputes falling within the CAI scope.

Lastly, the CAI may result in Chinese SOE's adapting their ways of financing or operating their business in terms of the aforementioned transparency obligations, while it seems to be providing the EU an additional tool in order to review foreign subsidies, in line with the European Commission's proposed policy.



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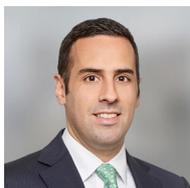
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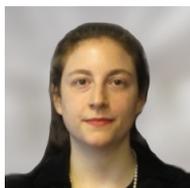
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