A NEW CHAPTER FOR RELATIONS BETWEEN THE EUROPEAN UNION AND CHINA?

An investment agreement between the European Union ("EU") and China has been the subject of discussions since 2013, with over 35 rounds of negotiations. A decisive step was taken on 30 December 2020, with the announcement of an "agreement in principle" on a Comprehensive Investment Agreement ("CAI") between the Parties. Even if negotiations are still ongoing, the provisory text was published recently, on 22 January 2021. The released draft covers the preamble, six sections, and three annexes, the remaining parts expected to be published in February.

The CAI covers commitments on market access, level playing field and sustainable development. It also provides a State-to-State dispute settlement mechanism. The chapter on investment protection and improvements to the dispute settlement mechanism are to be agreed upon between the Parties within the next two years.

The agreement has been presented by the European Commission as pioneering and very ambitious. Indeed, the text confirmed expectations: it aims to improve the Chinese business environment for European investors, thanks to disciplines that forbid forced transfers of technology, that intend to establish a level playing field granting European companies national treatment, and to promote greater transparency and regulation of subsidies and licences. Several obstacles to establish a company within the Chinese territory will also be removed, such as the obligation to form joint ventures in some sectors, the limitation of the number of companies or of foreign capital in operation.

However, even if these concessions may look like an important win to the EU, most of them have already been granted by China in its recent Foreign Investment Law ("FIL") and in the US-China Phase One Trade Deal, both of which entered into force in 2020. Hence, the benefits to the EU might not be that ground-breaking.

Even if we consider otherwise, another relevant point is how to enforce Chinese compliance with the far-reaching commitments of the CAI. Disputes on subsidies regulations and sustainable development, for instance, are not subject to the dispute settlement mechanism set forth by the agreement, and can only be solved through consultations between the Parties.

NOT THAT INNOVATIVE CONCESSIONS ON MARKET ACCESS

The agreement aims to promote trade relations by facilitating investments, improving the rules and conditions for investment.

Among the important provisions on market access are that, in sectors where market access commitments have been agreed upon, Parties cannot impose limitations on the number of enterprises that may carry economic activities, the total value of transactions, the total number of operations or the total number of people to be employed. Parties also cannot restrict or require the constitution of a joint venture or a specific legal entity as a condition to operate within the territory (Section II, Article 2), as China used to request. Moreover, there is a prohibition to force transfers of technology (Section II, Article 3).

To ensure the level playing field, the CAI also establishes non-discriminatory treatment for foreign invested enterprises, granting national (Section II, Article 4) and most-favoured nation treatment (Section II, Article 5). State-owned enterprises should act according to commercial considerations (Section II, Article 3bis).

Most of these concessions, however, had already been granted indistinctly by the recent Chinese FIL. It replaces the three previous laws governing foreign investment in China - Chinese-Foreign Equity Joint Venture Law, Chinese-Foreign Cooperative Joint Venture Law and Wholly Foreign Owned Enterprise Law - providing greater protection for foreign investment and enhancing regulatory transparency.

When analysing the FIL that currently regulates all foreign investment in China, we realise that the country did not make that many concessions to the EU through the CAI. To promote a transparent and level playing environment, the FIL already prohibited forced transfers of technology (Article 22) and granted national treatment for foreign invested enterprises (Article 4), ensuring equal rights of participation in bidding for government procurement for foreign investors (Article 16).

Moreover, on the progressive opening of market access to foreign ownership, the FIL also represented a major step forward. Since the establishment of a Foreign Investment Catalogue, first published by the Chinese Ministry of Commerce ("**MOFCOM**") in 1995, China has classified industries into "encouraged", "restricted" or "prohibited" for purposes of access to foreign investments. The Catalogue was later replaced by the Negative List, listing 190 "restricted" or "prohibited" industries. When last updated in 2020, it had only 34 sectors. Even if some remain inaccessible for foreign investment under the FIL (Article 28), the law marks a Chinese commitment to continue to reduce the industries under the list, particularly in the financial sector. In that respect, one may note that some of the market opening commitments made by China under the CAI are already covered by existing regulations or policies applicable to all foreign investors (automotive sector, private hospitals, cloud services).

Chinese market access concessions regarding full foreign ownership have also been made with regard to the United States. US-China Phase One Trade Deal includes commitments to remove the foreign equity cap in several sectors, such as life, pension, health insurance and fund management (Article 4.6). China also allowed US companies to acquire the majority stake in their existing joint ventures with Chinese companies.

Thus, the biggest concessions of the CAI in terms of market access had already been assured by the FIL. One possible step further would be to remove the foreign equity cap in more sectors under the CAI than in previous or existing Chinese commitments. However, that cannot be affirmed so far, since the annex listing sectors and subsectors in which market access commitments have been undertaken is not available yet. The final text should be released in February.

REGULATION AND TRANSPARENCY OF SUBSIDIES

Section III of the CAI addresses regulatory framework, and Article 8 of Sub-section 2 specifically addresses the transparency of subsidies. The agreement adopts the Agreement on Subsidies and Countervailing Measures ("**ASCM**") definition of subsidies, and does not apply to subsidies for fish and fisheries, or for audio-visual services.

This Article establishes that Parties should, until 31 December of the year subsequent to the one in which a subsidy was granted, publish information on the objectives, legal basis, form, amount and recipient of every subsidy. These transparency commitments should be put into practice no later than two years after the entry into force of the agreement.

If a Party considers that a particular subsidy can have a negative effect on its investment interests under the CAI, it can request consultations with the other Party, which has 90 days to respond. Disputes over subsidies cannot be a matter for the dispute settlement procedure set forth by the agreement. This raises questions regarding the strength of the enforcement mechanisms available on the CAI in terms of regulation of subsidies.

An annex clarifies the sectors to which the commitments on transparency of subsidies apply: business services, communication services, construction and related engineering services, distribution services, environmental services, financial services, health-related services, tourism- and travel-related services and transport services. The provisions in Article 8 do not undermine World Trade Organization ("**WTO**") rights and obligations expressed under Article XV of the General Agreement on Trade in Services ("**GATS**"), Article VI of the General Agreement on Trade in Goods 1994 ("**GATT**"), the ASCM Agreement and the WTO Agreement on Agriculture.

WEAK COMMITMENTS ON SUSTAINABLE DEVELOPMENT

A big issue during the negotiations that preceded the CAI was the fight against forced labour and the need to engage China into committing to ILO Conventions and environmental protection instruments.

The CAI establishes a commitment to continue to improve a high level of environment and labour protection (Section IV). Parties shall not weaken protection as a way to attract more foreign investment, and environmental or labour protection shall not constitute a disguised restriction to foreign investment (Section IV, Sub-Sections 2 and 3, Article 2).

More specifically, China commits to effectively implementing the United Nations Framework Convention on Climate Change and the Paris Agreement (Section IV, Sub-Section 2, Article 6). The Party also agrees to effectively implement ILO Conventions that it has already ratified, and to work towards ratifying other ILO fundamental conventions, specifically Conventions no. 29 and 105 (Section IV, Sub-Section 3, Article 4).

While Chinese commitments on climate and labour on this Section are unprecedented, the mechanisms to secure enforcement raise doubts over the efficacy of these provisions. Disputes raised under the sustainable development section cannot be settled by the dispute settlement mechanism established by the CAI.

Disputes should at first be settled through consultations with the other Party. If the Parties fail to agree on a solution, a Party may request the establishment of an ad hoc Panel of Experts of three Members that should be chosen in concert with the Parties. The Panel shall examine the matter in accordance with the Section and the Vienna Convention of the Law of Treaties. A final report shall be issued within 180 days from the date of composition of the Panel (Section IV, Sub-section 4).

DISPUTE SETTLEMENT MECHANISM

Section V of the CAI establishes a State-to-State dispute settlement mechanism to solve disputes relating to the agreement, except for those related to transparency of subsidies and sustainable development.

It first encourages Parties to solve disputes by entering into consultations (Article 3). Parties can also opt for mediation (Article 4). If Parties cannot achieve a mutually agreed solution, the requesting Party may demand the establishment of an arbitration panel (Article 7). Panellists

would be selected by both Parties, to be chosen from a list prepared by the Investment Committee (Article 8).

The arbitration should be held under the rules of the Vienna Convention of the Law of Treaties. Panellists may also take into account relevant case-law of the WTO Dispute Settlement Body (Article 11). An interim report shall be delivered within 120 days, and the final report no later than 180 days after the composition of the Panel (Article 12). Decisions are to be unconditionally accepted by the Parties, but shall not create rights or obligations to natural or legal persons.

After the final report is released, the Party complained against shall deliver a notification to the complaining Party explaining its intentions and measures to comply with the arbitral award, unless a compensation or other mutually satisfactory solution is agreed upon between the parties (Article 13). If immediate compliance is not possible, it should not exceed 15 months from issuance of the Panel's final report (Article 14).

If there is a disagreement regarding the fulfilment of an obligation established by the award, a Compliance Review Panel may be requested. The Compliance Review report should be delivered within 50 days (Article 15). Section V also sets forth the possibility for Parties to impose temporary remedies as a reaction to failure to comply with the arbitral award (Article 16). Among those, there is the possibility for cross-retaliation - violation in one sector, suspension of rights/obligations in another. Suspension of obligations shall be temporary and removed as soon as the Party complained against notifies measures that prove conformity with the Panel's award.

The text also contains provisions on the choice of forum for the settlement of the disputes. When a particular measure has allegedly breached an obligation under the CAI and an equivalent one under another international agreement to which both Parties are party, including the WTO Agreement, the Party seeking redress shall select the forum (Article 21). The forum selected shall be used to the exclusion of other fora. The WTO Agreement or any other international agreement shall not be invoked to preclude a Party from suspending obligations set out in the covered provisions pursuant to this Section.

Despite this first draft, final provisions of the CAI (Section VI) establish Parties' commitment to negotiate an agreement on investment protection and pursue negotiations on the investment dispute settlement mechanism within two years from the signature of the agreement (Section VI, Sub-Section 2, Article 3).

INSTITUTIONAL AND FINAL PROVISIONS

Section VI establishes institutional committees and working groups to ensure the proper functioning of the CAI. The Investment Committee (Article 1), co-chaired by co-chairs of the EU-China High Level Economic and Trade Dialogue established between EU and China, should meet once a year and supervise the functioning of the agreement, considering amendments if necessary. The Working Group on Investment (Article 3), co-chaired by the Director-General of the European Commission for Trade and investment and the Vice-Minister of the MOFCOM, shall meet every six months. They shall prepare the meetings of the investment committee and undertake their assigned tasks. The Working Group on Sustainable Development (Article 4) should meet once a year, and facilitate and monitor effective implementation of the sustainable development obligations.

Among the final provisions detailed under Section VI, Sub-section 2, some exceptions to the provisions of the CAI are measures necessary to protect public morals or to maintain public order, to protect human, animal or plant health or safety, to secure compliance with laws and regulations and other exceptions of GATT Article XX.

Previous agreements between Members States or the EU and China are not superseded by the CAI (Article 15).

CONCLUDING REMARKS

The full text of the agreement between the EU and China has not been published yet, and still needs to be finalised on a technical level before being submitted for ratification by the Council of the EU and the European Parliament. Therefore, many of the provisions hereby assessed may undergo changes.

Ratification by the European institutions is not expected before the second half of 2021, and will most likely be a tough battle. Some consider that the deal was reached with last-minute compromises, without sufficient mechanisms to guarantee implementation of the commitments made. Criticisms have also been made regarding access to the Chinese market, which remains limited within the scope of this agreement.

In February, when the full text of the agreement is expected to be released, our team will reassess the matter. So far, considering that the concessions on market access (the most attractive part of the deal for the EU) had for the most part already been granted by Chinese law, what remains to be seen is whether the dispute settlement mechanisms will be strongly enforced to guarantee the commitments agreed upon. As for the commitments on transparency of subsidies and on sustainable development, the CAI appears to have a high political cost for few benefits for Europe, as the Agreement excluded such matters from the dispute settlement mechanism (they can only be dealt with through a non-binding consultation procedure) . One should also remember that the announcement of this deal was not well-received by the United States, which had expressed its wish to coordinate efforts with the EU when dealing with China.

Sources:

- EU-China Comprehensive Agreement on Investment
- Chinese Foreign Investment Law
- US-China Phase One Trade Deal

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