



New EU-China Investment Agreement (CAI) - Implications for German Companies Doing Business in China

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In 2020, China has replaced the US as the EU's largest trading partner. This makes it all the more important for all parties involved to have fair regulations that favor trade relations. The investment agreement concluded between China and the EU on December 30, 2020, represents a very central basis for this. The Agreement goes by the abbreviation CAI (Comprehensive Agreement on Investment).

So far, only the principles of the agreement are known, but not the text of the treaty. The agreement has also not yet been signed and subsequently requires ratification by the bodies of both contracting parties - in the EU, the European Parliament and Council. The CAI contains regulations on mutual market access and fair competitive conditions.

The CAI is not a free trade agreement. It therefore regulates neither free trade in economic goods nor free trade in services. Thus, among other aspects, the CAI does not contain any regulations on the participation of foreign companies in tenders in China.

For Germany the CAI will co-exist with the bilateral investment agreement with China which entered into force in 2005. This Agreement addresses the promotion, the protection and the fair treatment of capital investments (in the English text reference is made to ‚investments‘ only). Such investments may also occur in a business context (e.g. purchase of a building for business use).

In the following, the relevant contents of the CAI from the point of view of German and European companies will be presented. In order to understand the scope of the improvements intended by the agreement for European investors in China, we will first briefly outline the economic and legal background (item 1). We will then analyze the regulations on improved market access for European companies in China (item 2). Depending on the sector, in the past Chinese market access for European companies had in some cases been completely prohibited or made considerably more difficult, for example due to upper limits on shareholdings or joint ventures. In this respect, China's domestic law on foreign investment from 2020 had already brought about an opening. Substantial facilitations were introduced thereafter. In addition, the CAI contains commitments by China in the area of creating fair competitive conditions (item 3). After that and remarks about the further procedures on the way to ratification of the CAI (item 4) we will address control of foreign direct investments by many EU Member States which are not affected by the CAI and will continue to be applied irrespective of the provisions of the CAI (item 5). Then the Agreement between the EU and China on geographic indications regarding agricultural products which was signed in September 2020 will be discussed (item 6) not putting last the very important aspect of investment protection (investment dispute resolution, item 7). In concluding we will give recommendations how to make best use of the far-reaching provisions of the CAI in business practice (item 8).

1. Economic and legal background for EU Investments in China

According to official data from the EU Commission, direct investment by European companies in China has totaled over EUR 140 billion in the last 20 years. In view of the growth and size of the Chinese economy, there is still potential in this respect. In order to promote foreign investment, China has indeed reduced the number

of industries banned or restricted in the so-called negative lists with effect from Jan. 27, 2021, compared to previous years. Nevertheless, the bans and restrictions contained therein still pose significant hurdles for European investors in some cases. These hurdles are to be further removed by the regulations on improved market access in the agreement (see point 2. below). In addition, European investors in China complain that - once they have obtained market access - the conditions of competition in China are not always fair. This applies in particular to competition with state-subsidized and state-owned enterprises. In this respect, too, the agreement is intended to bring about improvements (see point 3 below).

2. Improved market access for European companies in China

The enhanced market access schemes for European companies in China cover manufacturing (e.g., transportation equipment, telecommunication equipment, chemicals, and healthcare technology), automotive including alternatively powered vehicles, financial services, healthcare (private hospitals), biological resources research and development, telecommunications/cloud services, IT services, investments in land-based international maritime transport (cargo handling, container depots and terminals, maritime agencies, etc.), in air transport, investment in computerized booking systems, ground handling, and sales and marketing services, business services (e.g., real estate services, rental and leasing services, repair and maintenance for transport, advertising, market research, management consulting, and translation services), environmental services (e.g., wastewater, noise abatement, solid waste disposal, exhaust gas treatment, nature and landscape conservation, sanitation), construction services. China's market access commitment also includes residence and work permits for employees in EU companies to work in Chinese subsidiaries for up to three years, as well as free entry for representatives of EU investors for visit purposes prior to investment.

About one half of EU investments into China relate to manufacturing of goods and basic materials. In that respect the provisions regarding market access are of big importance. Market access should be understood broadly relating both to access to manufacturing and distribution of products in China.

3. China's commitments in the area of fair competition

China's fair competition commitments address the issues outlined below:

3.1. State-owned enterprises

With regard to state-owned enterprises, the CAI provides for China's obligation to ensure that decisions are solely based on economic criteria. This includes the obligation not to discriminate against European companies in the purchase and sale of goods or services. In order to assess whether the conduct of a particular state-owned enterprise meets these obligations undertaken by the Chinese side, the CAI provides for the obligation to provide specific information upon request.

3.2. Transparency in subsidies

The CAI introduces transparency obligations with regard to subsidies in the services sector. This also includes an obligation on China to exchange information and consult on subsidies that could adversely affect EU investment interests.

3.3. Prevention of forced technology transfer

To prevent forced technology transfer, the CAI includes a corresponding ban on various types of investment requirements that in the past had led to such transfer. In addition, the agreement provides rules for the protection of trade secrets against unauthorized disclosure by administrative bodies (e.g. in the context of a certification procedure relating to a good or service).

3.4. Standardization, approvals, transparency

Finally, China is committed to granting EU companies equal access to standard-setting bodies. In the area of approvals, China is committed to greater transparency, predictability and fairness. With regard to regulatory and administrative measures, China has made a commitment to ensure greater legal certainty.

4. Signature and ratification still pending

The CAI has yet to be signed. Its ratification is then also likely to take an estimated one year, because the text still has to be legally reviewed and translated into the official languages of the EU before it can be submitted to the European Parliament and the Council for approval. Some parties in the European Parliament have already announced that they will oppose its ratification because of allegedly insufficient commitments by China on labor and environmental standards.

5. Control of Foreign Direct Investments

Existing measures in the EU to control foreign direct investment are not affected by CAI. They therefore continue to exist, although politically they mainly concern investments from China. But China does, after all, maintain controls on foreign investment itself with the negative list, which has been shortened but remains authoritative. In response to U.S. sanctions, in December 2020 the National Development and Reform Commission (NDRC) issued a ban on investments in the 'military' area and prohibited the acquisition of majority stakes in companies in the energy, natural resources, agriculture, internet technology and financial services sectors. It still needs to be clarified whether these restrictions also apply under CAI.

6. Other measures: Agreement on geographical indications (GIs)

China is the EU's third-largest export destination for agricultural products produced in the EU. To ensure the recognition of the quality of such products and consumer confidence the agreement on the protection of geographical indications is important for the trade relationships between the EU and China. It was signed in September, 2020, and is scheduled to enter into force during the early part of 2021. It initially protects 100 geographical indications of each party in the field of trade in agricultural products. Another 175 products are expected to follow within the next four years. In comparison, a total of 1,250 foreign geographical indications are protected in the EU out of a total of 3,300 registered EU domestic geographical indications.

7. Investment Protection - Dispute Settlement

Regulations on investment protection are to be agreed between the EU and China within the next two years as a supplement to the regulations stipulated in the CAI. These essentially concern the measures that a company which considers an investment unjustly endangered by state intervention is entitled to initiate arbitration procedures against the Chinese state. A typical example is if legal norms are changed that call the long-term viability of the investment into question. For dispute resolution, China prefers investment arbitration under the UNCITRAL (the World Trade Organization of the United Nations) Rules on Transparency in Treaty-based investor-State Arbitration. These came into force on April 1, 2014. Alternatively, the procedure under the ICSID (International Center for the Settlement of Investment Disputes, an organization of the World Bank) Convention Arbitration Rules is also available for dispute resolution in investment arbitration. China has been a party to the ICSID Convention since 1993. Arbitral awards under the ICSID Convention are, in principle, automatically recognized and enforced in the defendant recipient country of an investment (in our context, China). The UNCITRAL Transparency Rules, for their part, provide for greater public awareness of state arbitration.

By way of background, prior to 2020 only four proceedings had been initiated against China for violations of investment protection. Three more claims were filed in 2020 alone. No arbitral award has yet been issued against the country in such proceedings. The bilateral agreement between Germany and China from 2005 basically invokes the arbitration rules under the ICSID Convention. One of the four investment arbitration proceedings initiated against China prior to 2020 concerns the alleged expropriation of the right of use granted by the Chinese state to the subsidiary of a German company in respect of an industrial site on which buildings had been erected.

In its current form the CAI does, however, not allow to institute any formal dispute resolution procedures in case a violation of its provisions shall be raised.

8. Conclusions and Outlook

In contrast to classic investment protection agreements, which regulate the post-investment phase, the agreement initially concerns the phase preparing and initiating the business investment, in other words the market access phase. The protection of investments in the post-investment phase (see item 7 above) is reserved for a supplemental agreement yet to be negotiated. From the point of view of European companies, issues such as product piracy, public procurement and state subsidies are not or only partially covered by the current agreement.

From the point of view of European companies, the planned regulations on market access can rightly be described as far-reaching in terms of their content. In terms of their legally binding character, they are more like trade policy guidelines. With respect to enforcing the claims under the CAI an agreement still needs to be reached regarding the protection of investor's rights against the host country of the investment.

Since the text of the CAI is not yet available, any assessment of the CAI is currently only preliminary. Until the CAI is signed and subsequently ratified by both parties, it is not binding. This will certainly take at least another year.

In any case, Europe gains a lot having agreed to the CAI: The CAI offers considerable concessions by the Chinese side. The market opening provided for in the CAI had already been available to Chinese companies in Europe. In practice, until an agreement is reached on a settlement of differences related to the agreement (investment protection, see above item 7), the monitoring mechanism takes place at the political level.

From the point of view of European companies, it may also be important to consider how their trade with China may affect their U.S. business: After all, business deals with Chinese companies can violate U.S. sanctions against China. As the case of the Nord Stream 2 gas pipeline shows, U.S. authorities may enforce trade restrictions – although they are primarily imposed upon U.S. companies – against foreign companies as well, in the form of a so-called extraterritorial application.

At the present stage the far reaching and fundamental provisions of the CAI can be best applied in practice by the political institutions, the trade and business associations and the individual business enterprises relying and invoking the really far reaching provisions in their business dealings and other forms of exchange with their counterparts in China. The CAI sets forth fundamental principles of doing business under fair conditions and should be applied accordingly.

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- [Business Guide to the Trade and Cooperation Agreement between the EU and the UK and shortly also our comprehensive and at the same time concise and coming soon our](#)
- [Investment Guide to Germany](#)