

COMMUNICATION FROM THE UNITED STATES

The following communication, dated 3 October 2007, is being circulated at the request of the Delegation of the United States.

**TRANSITIONAL REVIEW MECHANISM PURSUANT TO PARAGRAPH 18
OF THE PROTOCOL ON THE ACCESSION OF THE PEOPLE'S
REPUBLIC OF CHINA ("CHINA")**

Questions from the United States to China
Concerning Trade-Related Investment Measures

I. M&A REGULATIONS

1. Shortly before last year's transitional review before this Committee, in August 2006, new regulations on mergers and acquisitions (M&A regulations) were jointly issued by China's Ministry of Commerce (MOFCOM), the State-owned Assets Supervision and Administration Commission, the State Administration of Taxation, the State Administration of Industry and Commerce, the China Securities Regulatory Commission and the State Administration of Foreign Exchange. The regulations strengthen MOFCOM's supervisory role over foreign investment, in part by requiring MOFCOM's approval of M&A transactions that it believes impact state economic security or involve famous Chinese brands. The regulations also place MOFCOM in the role of determining if the domestic acquisition target has been appropriately valued.

2. In the interest of transparency, and so that the United States and other WTO Members can better understand how China's M&A regulations may or may not be relevant to the TRIMS Agreement or commitments that China made in its WTO accession agreement, the United States seeks the following clarifications from China:

- (a) Article 12 of the M&A regulations calls for MOFCOM's approval of any deal involving a "major industry", having "impact on the state economic security" or concerning "famous trademarks or traditional Chinese brands". This language is very broad and appears to require MOFCOM approval on most foreign investment transactions. Please explain what the quoted terms mean. Does China intend to define these terms in the implementing rules?
- (b) Article 14 of the M&A regulations requires that MOFCOM approve the valuation of any merger or acquisition. What qualifications and experience will be required of

those who determine the appropriate valuation? On what basis will they determine the value?

- (c) Chapter 5 of the M&A regulations requires reporting of any M&A transaction that meets specific criteria or involves "very large market share" or "other important factors" that affect competition. Will the recently enacted Anti-Monopoly Law (AML) supersede these reporting requirements and the anti-monopoly examination of foreign M&A transactions under these regulations? If not, what will be the relationship between the anti-monopoly reviews under Chapter 5 and the AML?
- (d) Will any anti-monopoly review of mergers be carried out separately from the national economic security review under Article 12 of the M&A Regulations? Please explain.
- (e) What plans do the relevant Chinese agencies have for issuing implementing rules for the M&A regulations, in addition to the guidelines issued in March 2007 on the requirements for filing reports under Article 51? Will opportunities be provided for public comment on drafts of these implementing rules?

II. AUTOMOBILE INDUSTRIAL POLICY

3. In connection with prior transitional reviews before this Committee, the United States addressed Article 47 of China's automobile industrial policy, published on 1 June 2004, and entitled "Development Policy of the Automobile Industry", which states that a new automobile production plant requires a minimum investment of RMB 2 billion, of which owned capital should not be less than RMB 800 million. According to Article 47, the new plant should also include an R&D facility, investment in which should not be less than RMB 500 million. Article 47 additionally requires the establishment of an R&D facility in connection with new automobile engine manufacturing.

4. The United States previously explained that, in its WTO accession agreement, China committed not to condition the right of investment on the conduct of research and development. The United States cited paragraph 7.3 of China's Protocol of Accession ("China shall, upon accession, comply with the TRIMs Agreement, without recourse to the provisions of Article 5 of the TRIMs Agreement. ... Without prejudice to the relevant provisions of this Protocol, China shall ensure that the distribution of import licences, quotas, tariff-rate quotas, or any other means of approval for importation, the right of importation or investment by national and sub-national authorities, is not conditioned on: whether competing domestic suppliers of such products exist; or performance requirements of any kind, such as local content, offsets, the transfer of technology, export performance or *the conduct of research and development in China*") and paragraph 203 of the accompanying Working Party Report ("The allocation, permission or rights for investment will not be conditional upon performance requirements set by national or sub-national authorities or subject to secondary conditions covering, for example, *the conduct of research*, the provision of offsets or other forms of industrial compensation including specified types or volumes of business opportunities, the use of local inputs or the transfer of technology").

5. In response to the United States' request that China explain whether Article 47 was consistent with China's commitments in paragraph 7.3 of China's Protocol of Accession and paragraph 203 of China's Working Party Report not to condition the right of investment by mandating the conduct of research and development in China, the representative from China stated at last year's transitional review before this Committee that, "[a]ccording to his knowledge, so far, the Chinese government has not enacted any follow-up rules on administration of the investment in the auto manufacturing sector to implement the policy".

- (a) In the past year, has China issued any measures or taken any other actions to implement the requirement in Article 47 that new automobile production plants include an R&D facility? Please explain.
- (b) In the past year, has China issued any measures or taken any other actions to implement the requirement in Article 47 that new automobile engine manufacturing plants include an R&D facility? Please explain.

III. STEEL POLICY

6. In connection with prior transitional reviews before this Committee, the United States addressed China's steel industrial policy, released by the National Development and Reform Commission on 8 July 2005, which mandates certain requirements as conditions for investments. One of these requirements, set forth in Article 22, is that foreign steel enterprises possess proprietary technology/intellectual property in the processing of steel if they are to invest in a Chinese steel enterprise. Given that foreign investors are not allowed to have a controlling share in steel and iron enterprises, it is the United States' view that this requirement would seem to constitute a *de facto* technology transfer requirement.

7. In response to the United States' request that China explain how this requirement is consistent with the commitments made by China in paragraph 7.3 of its Protocol of Accession and paragraph 203 of its Working Party Report, the representative from China stated at last year's transitional review before this Committee that "this was a qualification criterion on the investor, which was different in nature from a compulsory technology transfer requirement".

- (a) Please explain how a "qualification criterion" is different from a "requirement". For example, is it possible for a foreign steel enterprise to invest in a Chinese steel enterprise without possessing proprietary technology/intellectual property in the processing of steel?
- (b) Assuming that the foreign steel enterprise is required to possess proprietary technology/intellectual property in the processing of steel, is it China's position that the foreign steel enterprise nevertheless does not have to share its proprietary technology/intellectual property with the Chinese steel enterprise in which it is investing? Please explain.
- (c) Has China issued any measures or taken any other actions to implement the requirement in Article 22 that foreign steel enterprises possess proprietary technology/intellectual property in the processing of steel if they are to invest in a Chinese steel enterprise? Please explain.

IV. FOREIGN INVESTMENT CATALOGUE

8. The National Development and Reform Commission (NDRC) and the Ministry of Commerce issued the *Catalogue for the Guidance of Foreign Investment Industries* in November 2004, and it became effective in January 2005. The United States understands that this catalogue is currently undergoing another revision. Will an opportunity be provided for public comment on a draft of the revised catalogue?
