Chinese Deals Under the Microscope: Looking at the Evolving CFIUS Process

Chinese corporations filed only six notices with the Committee on Foreign Investment in the United States (CFIUS) during 2010. However, in 2012 the number of filings by Chinese entities had risen to 23, representing a nearly four-fold increase, and the value of the proposed acquisitions had leapt to US$11.5 billion. Out of a total of 114 filings in 2012, 20% were filed by Chinese companies. This meant that Chinese entities were, for the first time in history, the number one CFIUS filers. They had significantly increased their share of filings over the 2009-11 period, when they accounted for just 7% of filings and ranked behind the United Kingdom, France and Canada in total filings.

It is abundantly clear that Chinese companies have a strong desire to continue investing in the U.S. But at the same time, there is a strong feeling among Chinese businesses that their investment is not entirely welcome and there is little doubt that the CFIUS process has contributed to this belief.

CFUIS – a federal inter-agency committee empowered to review inbound foreign investments for national security concerns – plays a pivotal role in determining the outcome of proposed transactions in the U.S. Under CFIUS's broad authority, it has the ability to require deal parties to mitigate concerns, and if this is not possible, a proposed transaction can be blocked. As such, it has a profound influence on transactions and on the major shifts that are taking place in global markets.

That said, CFIUS' relationship with Chinese companies has never been more critical. Evidence abounds that China's meteoric economic rise over the past few decades has significantly impacted the global economy – initially through trade and in more recent years increasingly via direct investment. Since China's ascendency to the World Trade Organisation ("WTO") in 2001, when it was the world's sixth largest economy with an annual GDP of US$1.3 trillion, it has rapidly grown and today ranks as the second largest economy.

Today China is looking to reshape its economy and the acquisition of enhanced capabilities will be necessary to facilitate this transition. International cross-border mergers and acquisitions will be a significant factor in China's next phase of global integration.

This agenda has been supported by the Chinese government. Over the years it has directed investment policy to convert its massive trade surpluses into hard assets and has diversified the end targets of its outbound M&A strategy. This investment diversification has had both an industry or sector dimension and a geographic dimension. In the initial phase of China's global integration, investment was heavily focused on natural resources and principally targeted within the Asian region. Today, China frequently seeks investments in the technology, consumer and financial services sectors, amongst others, and the investment now reaches all corners of the globe.

While pre-transaction CFIUS clearance is not mandatory to a transaction filing in the U.S., disregarding the process can result in complicated roadblocks as recent contentious cases involving Chinese investments have shown. Examples include:

- President Obama's controversial order requiring Ralls Corporation, a Chinese operated wind turbine company, to divest certain Oregon-based wind farms due to being located near U.S. military installations
- Huawei Technologies repeatedly being denied permission to make U.S. investments

Despite this, it is anticipated that the frequency and size of inbound deals driven by Chinese companies will increase given growing confidence by these entities have shown in executing complex cross-border M&A projects.

Following the Third Plenary Session of the 18th Communist Party of China Central Committee in Beijing during November 2013, regulatory reform was proposed in connection with outbound investment. The proposed changes can be expected to facilitate acceleration of Chinese investment into the U.S. and elsewhere. Formerly, companies seeking to undertake outbound foreign investment required numerous government approvals. However, going forward and under the sponsorship of Premier Li Keqiang, only transactions valued in excess of US$1 billion will require approval from China's economic planning agency, the National Development and Reform Commission. Even so, the high level of scrutiny by the U.S., and other host countries of China's targets, will remain a constant.

The most recent report that CFIUS delivered to the U.S. Congress showed that the number of 45-day investigations undertaken held steady, but also tracked a record number of filings that were withdrawn and/or abandoned. Some see this as a barometer of the U.S.'s openness. However, there are multiple commercial reasons for a party to withdraw and/or abandon a deal particularly following deal restructuring and/or mitigation. In light of this, it is important to remember that the focus of CFIUS is national security and also that most Chinese transactions do ultimately receive approval. This offers clear evidence that the review process is not an insurmountable hurdle and its reputation as a major obstacle is undeserved.

The increased willingness that Chinese companies have shown to engage with CFIUS and the greater sophistication demonstrated in dealing with U.S. concerns illustrates a rising maturity of Chinese acquirers. A number of transactions over the course of 2013 have underlined this trend:

- Smithfield Foods US$7.1 billion acquisition by Shuanghui International – corporate China's largest acquisition of a U.S. target
- Sinopec's US$1 billion investment in Chesapeake Energy's Mississippi Lime shale assets in Oklahoma
- Sinochem's US$1.7 billion purchase of a 40% share in Pioneer Natural Resources' Wolfcamp development in Texas

The increased interest of Chinese investors in acquiring U.S. real estate is also noteworthy. The transactions in this area include:

- Fosun's US$725 million purchase of Chase Manhattan Plaza
- The Sungate Trust/Zhang Xin family's acquisition of a US$700 million stake in the General Motors building
- Greenland Group's joint venture agreement to develop Atlantic Yards in New York – a US$5 billion project

Some takeaways from these and other recent CFIUS reviews indicate certain trends are being established, which include:

- A broadening of the reach of CFIUS's jurisdiction
- An increase in the time reviews are now taking to complete
- The impact private Chinese firms are having on China-U.S. capital flows

Shuanghui's bid for Smithfield is illustrative of all these trends.

Many market, regulatory and political observers struggled to recognise the "national security" dimension associated with the proposed deal, given it involved a hog producer and pork processor. Nevertheless, the deal was subject to extensive review and investigation based on concerns including the safety of U.S. food supplies. The CFIUS review covered the maximum 75 days permitted by statute under the 30-day initial review period, and subsequent second phase 45-day investigation. The increasingly extended timetable for reviews has seen the proportion of deals subject to an investigation rise from approximately 4% of filed cases in 2007 to 39% in 2012.

Despite CFIUS being designed as a non-political process and bound in confidentiality, there are concerns that its opaque proceedings in fact contribute to the sense of distrust felt by parties driving U.S. in-bound investment. However, the bottom line is that the CFIUS process, though considered with suspicion by certain investors, appears to achieve its twin purposes of thoroughly screening foreign acquisitions from a national security perspective, whilst also ensuring the U.S. continues to be viewed as open to foreign investors.

With all of this said, the key question for Chinese parties looking to invest in the U.S. is how to navigate the CFIUS process?

At the outset it is important to recognise that there will be challenges, many linked to widespread misunderstandings and misperceptions – particularly in the case of China's large State Owned Enterprises. Companies are best placed to secure regulatory approval by assessing the deal risks and proactively addressing the likely concerns and robustly articulating the benefits of the transaction for all stakeholders. Furthermore, in combination with legal and banking actions, a well-crafted public affairs and strategic communications programme can meaningfully contribute to understanding and subtly influencing the political thinking and policy framework that make up CFIUS review proceedings.

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