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# China M&A Round-Up

Keeping pace, marking milestones

## What's the Deal?

### The challenge to govern cross-border investments

For the last several decades in the US, among the most debated outcomes of globalization have been the pros and cons of international trade and investment. During periods of heightened public debate, for example around presidential campaigns, trade, and US trade deficits have been a major focus. Now we are increasingly seeing a focus on cross-border investment activities. The rapid ramp up of Chinese investment into the US in 2016, the plateauing US investment in China, and material administrative changes on both sides impacting capital controls, and the scope of national security reviews have raised questions about sector access, rules, taxation, incentives, and approval processes. It is useful to reflect on how cross-border investment is governed, especially in comparison to cross-border trade in goods, and services, because progress toward rule-based investment agreements could be a major contribution to stabilize critical investment relationships.

The WTO represented a major step forward in a consistent framework governing international trade. Officially commenced in January 1995, after eight years of negotiating in the Uruguay Round under the Marrakesh Agreement, the core WTO charter was signed by 123 nations. It very quickly established a multilateral set of trade guidelines and a dispute resolution process that enhanced the reliability and predictability of trade relations globally. One that is rule-based. As of mid-2016, the WTO officially reported a membership of 164 countries.[1]

WTO is a trade-facing organization, and its governing agreements bear in only the most indirect way on cross-border investment, both foreign direct investment (FDI) into greenfield, and refurb facilities, and cross-border M&A. There is no comprehensive multilateral organization or set of agreements that provide for cross-border investments in the way the WTO provides for trade.

Nonetheless, cross-border investment of every type has not only become a more visible subject of policy debate; it has become an increasingly important element in the economic relations between and among nations. The US Treasury reports foreign holdings of US securities exceeded $17 trillion by mid-2016.[2] According to the research firm Rhodium Group, in 2016, Chinese direct investment reached a total of nearly $46 billion in the US, then tapered to $29 billion in 2017.[3]

Absent a multilateral organization and agreement, cross-border investment relies on trustful relationships or bilateral agreements, coupled with normal commercial documentation, and assurances. As global financial linkages strengthened, bilateral investment treaties (BITs) became commonplace, and to a lesser extent Treaties with Investment Provisions (TIPs) also appeared. At present globally there have been 2951 BITs negotiated and 2363 are in force. An additional 310 TIPs are in force, which speak to investment issues but in a more general way than BITs.[4] As of 2015, the US had 41 BITs but China already had 104, over 75 percent of which were with emerging economies.[5] Ultimately though, BITs do not have the enforcement and dispute resolution mechanisms of large multilateral agreements. They have flexibility in conception and implementation.

A tentative plan between China and the US to negotiate a BIT began in 2008 but lasted only a year. In mid 2013, the US, and China jointly announced they had reached agreement to reopen negotiations.[6] In 2014 China concluded a trilateral BIT with South Korea, and Japan. But progress was stalled between the US and China. In actuality, the contents of BITs cover a wide spectrum, from light that are very open, and general to demanding. The US terms are demanding in their coverage of areas like the scope of permissible investments, the proposed review process, other rules governing the ventures, incentives to rely on market forces in the business environment, and protections of investors.[7] In fact US terms for BIT agreements, based on the published US model, are so tough that only two have been signed since the turn of the millennium.[8] Since the beginning of 2016, China has been party to four new agreements, the US to one.[9]

Several US media channels reported progress in negotiations between China and the US in mid 2016 and thus optimism that a deal might be signed.[10] China's Minister of Commerce at the time, Gao Hucheng and former Minster of Commerce Chen Deming, in fact announced that the agreement was basically done before and during one of China's major international conferences in March 2016.[11] A range of business and finance organizations endorsed the value of an agreement, expecting that a BIT agreement would improve some areas of access and regulations that both sides sought. But industry experts close to the negotiations reported that several key areas were not agreed, including IP protection, non-market access barriers (negative list), and independence criteria of Chinese firms investing in the US.

In spite of strong advocacy by major MNCs active in China, Chinese enterprises active in the "going out campaign," and many business associations, the US China BIT process was not concluded and dropped out of sight by the beginning of 2017. There has been little mention of it since. As we enter 2018, the confluence of economic factors, tax law changes, and the lack of an investment agreement have increased the uncertainty over bidirectional investment flows between the US and China.

The passage of the new tax law in the US, with its major corporate tax rate reduction and provisions to encourage repatriating US MNC profits that have been held off-shore, has already prompted a counter measure. In the last year, Chinese leaders have repeatedly indicated a renewed interest in attracting inbound FDI and in MNCs reinvesting Mainland profits in the Mainland. China has indicated that it will allow US companies to retain all earnings, tax free, provided they reinvest them in promoted areas of the Mainland economy.[12] Full details are not yet known, but coupled with intensive capital controls constraining outbound transfer, incentives China offers will get attention, especially if it opens up investment opportunities in China that have heretofore been restricted. An increase in "pull" on the Mainland for foreign investment will likely present opportunities to wedge open previously inaccessible sectors.

On the US side, we have seen considerably more attention paid to the review process for inbound investment from around the world, but it has been most visibly impactful for China. The most recent intervention was the anticipated blocking by CFIUS of Ant Financial's proposed acquisition of Moneygram, collapsing the deal on the second day of the new year.[13] CFIUS's charter from the Department of Treasury prevents it from disclosing its proceedings and reasons for blocking a deal, but this represents an apparent expansion beyond the previous compass of national security issues, focusing on risks in cross-border financial transfers and privacy risks associated with personal, non-anonymized financial data.

In September of last year, CFIUS blocked the sale of Lattice Semiconductor to Chinese fund Canyon Bridge Capital, an acquisition that was judged to have genuine national security implications as well as the transfer of highly proprietary technology.[14] In fact, the official statement accompanying the decision is important to understand, citing among the reasons an acquisition could be blocked, "the potential transfer of intellectual property to the foreign acquirer."[15] This disclosure of the reasoning behind the CFIUS decision deserves more reflection than it has gotten. It would be easy to underestimate the potential impact of limiting IP acquisition in the M&A marketplace, given that IP acquisition historically has been a main driver of M&A.

Whether one agrees or not with these specific decisions, it is evident that a BIT agreement between the US and China would significantly reduce the uncertainty that leads to such outcomes by providing somewhat detailed guidelines about definitions, access, and review processes. Beyond the document itself, there is the reasonable presumption in such a BIT-based relationship that on-going bilateral discussions would constrain unilateral adjustments of review processes and regulations that lead to a sub-optimal investment environment. Relevant processes and regulations are not limited to national security issues, no matter how broadly construed, but include anti-monopoly considerations, concerns over sources of funding, financial viability of the new combined operations, and the like.

And, of course, the investment activities between the two largest economies in the world, the US, and China, impact corporate, financial, and retail investors in every corner of the world. Interest in the stability of that bidirectional activity extends far beyond the national interests of the two parties signing on to the treaty.

## Footnotes

1. https://www.wto.org/english/thewto_e/thewto_e.htm

2. http://ticdata.treasury.gov/Publish/shlhistdat.html

3. http://rhg.com/interactive/china-investment-monitor

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5. https://piie.com/publications/briefings/piieb15-1.pdf

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8. https://www.state.gov/e/eb/ifd/bit/117402.htm

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15. Ibid.

# Trends to watch

China's 2017 GDP growth accelerates for the first time in seven years, Reuters, 1/17/2018
China reports biggest-ever annual trade surplus with US, WSJ, 1/12/2018

# Outbound M&A from China

**Consumer Business**
CITIC acquires New Zealand’s Trilogy International for $175 mln, DealStreetAsia, 12/18/2017

**Energy and Resources**
Brookfield sells Transelec stake to China Southern Power Grid, Private Capital Journal, 12/28/2017
Louis Dreyfus agrees to sell metals business to Chinese fund, Reuters, 12/22/2017
NextView to acquire Lithium X Energy Corp., PR Newswire, 12/18/2017

**Life Sciences & Healthcare**
Shanghai Pharmaceuticals buys out Cardinal Health in China to become top distributor of imported drugs, SCMP, 11/15/2017

**Manufacturing**
Wolong Electric Group to acquire GE's assets related to its small industrial business, Reuters, 12/25/2017
Bohai Piston acquires 75% shares in TRIMET Automotive, Asian Metal, 1/22/2017

**Real Estate**
Hong Kong’s Kingboard buys KPMG London HQ for $533 mln, Mingtiandi, 12/17/2017
Hong Kong’s Cheung Kei buys second Canary Wharf tower for £270 mln, IPE, 12/6/2017

# Inbound M&A into China

**Manufacturing**
Hyster-Yale to buy majority stake in Zhejiang Maximal Forklift for $90 mln, RTTNews, 12/6/2017

# China domestic M&A and industry consolidation

**Aviation, Transportation & Logistics**
CIMC's unit to sell Pteris Global stake for CNY 3 bln, Reuters, 12/4/2017

**Consumer Business**
Alibaba invests $2.9 bln in hypermarket operator Sun Art to continue its offline retail push, TechCrunch, 11/19/2017

**Financial Services**
China's Zhongtian Financial to buy up to $4.7 bln stake in Huaxia Life, Reuters, 11/21/2017

**Life Sciences & Healthcare**
Ping An invests $121 mln in China expansion by Singapore's Fullerton Healthcare, SCMP, 11/28/2017

**Manufacturing**
Qingdao Tianhua Institute plans to buy various assets via share issue, Reuters, 12/7/2017
Aurora intends to acquire Hefei Ruicheng by CNY 718.5 mln, Asian Metal, 11/23/2017

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