

## **Belt and Road Initiative**

In this article, we introduce the Belt and Road Initiative (**BRI**) and share our insights how this initiative will impact the financing of energy and infrastructure projects and the legal market for M&A.

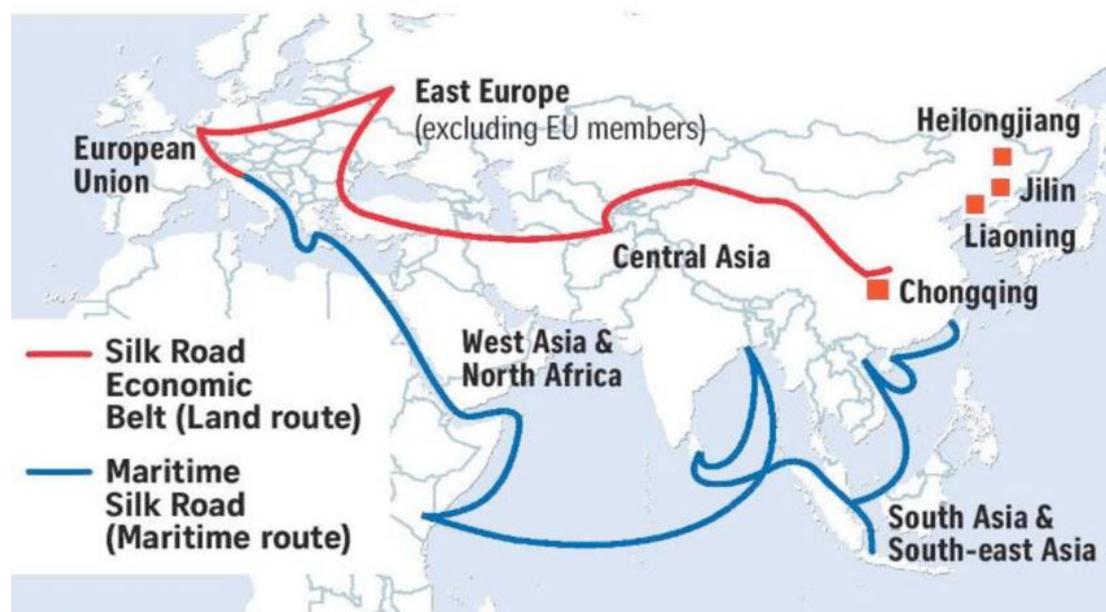
### **1. What is it?**

The Silk Road Economic Belt and the 21st-century Maritime Silk Road is a cross-continental development strategy conceptualized by the Chinese government in 2013. The initiative was then known as the One Belt and One Road Initiative (**OBOR**), and has since been re-framed as the Belt and Road Initiative (**BRI**).

BRI aims to achieve better connectivity and economic cooperation among countries in Eurasia:-

- (a) The Silk Road Economic Belt focuses on bringing together PRC, Central Asia, Russia and Europe (the Baltics); linking PRC with the Persian Gulf and the Mediterranean Sea through Central Asia and West Asia.
- (b) The 21st Century Maritime Silk Road proposes to focus on port construction and multimodal transport and logistics, as well as maritime ecological protection, linking PRC's coastal regions to Europe through the South China Sea and the Indian Ocean in one route, and through the South China Sea to the South Pacific in the other.

## **China's One Belt, One Road initiative**



Source: BLOOMBERG STRAITS TIMES GRAPHICS

### **2. BRI's Impact on the World and Singapore**

BRI is a significant regional cooperation initiative in terms of its geographic reach and expected scale of investment. It may well influence and mould the PRC's economic relations with the rest of the world and supplant multilateral development pacts or initiatives such as the Asia-Europe Meeting (ASEM)<sup>1</sup> and Eurasian Economic Union (EAEU)<sup>2</sup>. For instance, the proposed PRC-Mainland

<sup>1</sup> The Asia-Europe Meeting (ASEM) is an intergovernmental process established in 1996 to foster dialogue and cooperation between Asia and Europe. Presently it comprises 53 partners: [30 European and 21 Asian countries, the European Union and the ASEAN Secretariat](#). ASEM addresses political, economic, social, cultural, and educational issues of common interest, in a spirit of mutual respect and equal partnership. Singapore joined ASEM since 1996.

Southeast Asia economic corridor under BRI extends to the Malay Peninsula, thereby touching several countries that do not share a border with PRC along the way.

Singapore has been an "early and strong supporter" of BRI.<sup>3</sup> **Singapore and the PRC have identified four major areas of cooperation, where both countries have room to share competitive advantages, namely:**

- (i) infrastructure connectivity**
- (ii) financial connectivity**
- (iii) joint collaboration to help other BRI countries**
- (iv) cross-border commercial dispute resolution**

### **3. Energy & Infrastructure**

Energy and infrastructure development is a key tenet of the BRI initiative, as the objective is to link resource rich inland areas to PRC managed ports, through road, rail and pipeline development.

In the Asian region, the BRI establishes a blueprint for Asia's future infrastructure development, with rail being particularly important as the PRC seeks to export the high speed rail technology and production capabilities it has developed when building its own extensive high speed rail network. Southeast Asia is perceived as a strong contender for such development as it is under-served by high speed rail in comparison to other parts of Asia.

It is critical for the legal industry to be cognizant of the new market opportunity for stakeholders along BRI areas. A key roadblock for the execution for the PRC's BRI strategy in Southeast Asia would be the political appetite of the countries in this region to open their markets to investment and capital (which connotes a level of control) from the PRC.

For instance, the possible export of surplus hydro by China to Thailand and Malaysia and the development of ASEAN Power Grid and integration of ASEAN electricity market in a holistic way has been thwarted by energy nationalism (under the badge of national security) within the ASEAN countries, and it remains to be seen whether China's investment in the electricity sector within ASEAN will overcome such restraints.

As the recent 2018 Malaysian election has shown, the terms of financing for rail development funded by PRC sources has also come under scrutiny and renegotiation has been proposed. Such circumstances arise from the domestic political environment, and will likely impact the timeline for rollout of the overall BRI strategy throughout the region.

### **4. M&A**

Total overseas M&A announced by Chinese companies amounted to US\$144.8 billion in 2017<sup>4</sup>. Out of this total amount, US\$48.2 billion went to countries located in the BRI, representing an 81% YoY increase compared to 2016<sup>5</sup>.

Upon analysing PRC's outbound M&A figures, key trends are observed:

1. Outbound Chinese M&A increasingly important to BRI economies
2. Chinese acquisitions are focused on strategically important industries

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<sup>2</sup> The EAEU is an economic bloc and customs union comprising five countries: Russia, Kazakhstan, Kyrgyzstan, Armenia and Belarus. In May 2016, a memorandum of understanding was signed between Singaporean and EAEU to develop cooperation in all spheres, as well as eliminating trade barriers. Countries within the blocs will cooperate in transport and infrastructure, and in ensuring food security.

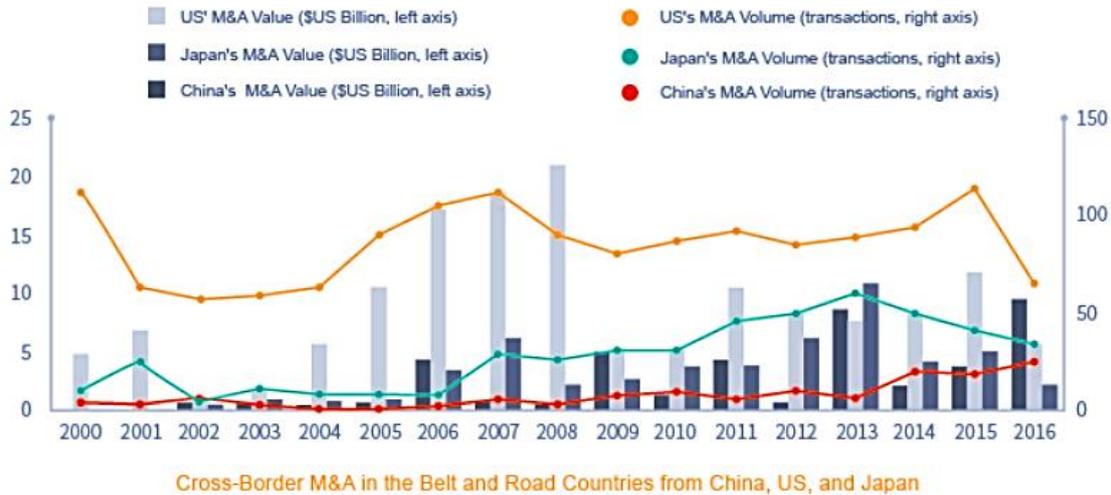
<sup>3</sup> Straits Times feature, 8 April 2018 "Belt and Road Initiative a focal point for Singapore's ties with China."

<sup>4</sup> EY, 11 April 2018 "Overall China outbound investment shows adjustments but B&R gains momentum" <<https://www.ey.com/cn/en/newsroom/news-releases/news-2018-ey-overall-china-outbound-investment-shows-adjustments-but-b-r-gains-momentum>>

<sup>5</sup> China Daily, 12 April 2018 "M&A deals in Belt & Road economies increase by 81%" <<http://www.chinadaily.com.cn/a/201804/12/WS5acebb7ca3105cdcf6517c7d.html>>

3. ASEAN is a major designation for Chinese acquisitions, with Singapore as PRC's largest M&A destination

#### 4.1. Importance of Chinese M&A to BRI economies<sup>6</sup>



Source: Thomson Reuters, in collaboration with Tsinghua University and IWEP Chinese Academy of Social Science

Cross-border M&A activity in BRI economies have typically been dominated by acquisitive US-based corporations seeking to expand and grow their presence in foreign markets. At its peak in 2008, US corporations entered into deals totalling US\$20.9 billion in BRI economies.

Due to the impact of the Great Financial Crisis of 2008, US cross-border M&A retreated somewhat in the immediate years that followed, with Japan stepping up as a source of M&A activity within the BRI although M&A activity was muted overall. The busiest year for acquisitive Japanese companies was 2013, when it was the largest source country for M&A deals in BRI economies in terms of M&A value.

Although the US regained its position as largest source of M&A transactions by value in the BRI in 2014 and 2015, the total quantum of US sourced M&A in the BRI has not returned to the pre-2008 levels.

At the same time, Chinese companies have been steadily growing its share of the pie; and in 2016, Chinese companies were the largest source of M&A transactions in BRI economies in terms of value.

#### 4.2. Strategic Focus of PRC-Sourced M&A

PRC sourced M&A is greatly influenced by cross-border capital controls and the ruling party's economic objectives.

In recent years, high profile investments by Chinese corporations into the US and Australia have faced regulatory and political hurdles that either impeded or outright prevented deal consummation.

Moreover, issues faced by overleveraged and highly acquisitive Chinese companies have also been documented in the business press such as in the case of HNA's reversal of fortunes<sup>7</sup>.

Capital controls have been tightened by the central government as somewhat of a response to the above situation, and in particular to avoid the worst excesses of overleveraging.

<sup>6</sup> Thomson Reuters, in collaboration with Tsinghua University and IWEP Chinese Academy of Social Science, 3 June 2017 "Cross-Border Mergers and Acquisitions in the Belt and Road Regions" see pg 13  
<https://www.thomsonreuters.cn/content/dam/openweb/documents/pdf/china/report/Cross-Border%20Merger%20and%20Acquisitions%20in%20the%20Belt%20and%20Road%20Regions0908.pdf?elqTrackId=0EE8284C449F3E22E92F2A4C21510715&elqaid=2917&elqat=2>

<sup>7</sup> South China Morning Post, 15 June 2018 "China's embattled HNA shuts Hong Kong unit as it struggles to repay debt"  
<http://www.scmp.com/business/article/2150996/chinas-embattled-hna-dissolves-hong-kong-unit-it-struggles-repay-debt>

Consequently, a marked change in the form and structure of outbound M&A deals from the PRC has been observed and this is predicted to be a lasting change.

Essentially, Chinese companies are no longer particularly focused on purchasing trophy assets or stakes in famous companies overseas. Instead, Chinese companies are increasingly focused on making acquisitions with synergistic qualities in respect of its entrepreneurial and growth objectives.

It is therefore predicted that the automotive and transport sector will be a focus of Chinese companies as part of the BRI objective to facilitate connectivity within BRI economies and to the PRC.

Life sciences is another target sector, as analysts have observed a growth in domestic Chinese consumption within this industry. As a result, Chinese companies are seeking to acquire industrial capabilities, technology and supply of pharmaceutical products. In particular, the BRI zone possesses a number of countries with either strong pharmaceutical manufacturing and supply chain capabilities, or innovative technologies, and M&A activity in this area is expected.

Another driver for outbound M&A from the PRC is national strategic objectives. For example, within the central Asian region, Chinese overseas M&A focused on oil and gas is to be expected as the PRC seeks to shore up its supply and control of natural resources in its immediate neighbouring region. Resource-rich South East Asian countries can also expect attention to be directed to companies that possess access and control of key mining regions.

Energy and utilities in the larger BRI region are also expected to be targets of Chinese M&A as part of the national BRI strategy to foster greater connections and leverage Chinese technological advancement in this area, particularly in renewable energy.

As part of efforts to integrate China within the broader flow of capital internationally, outbound M&A into financial industry targets can also not be underestimated.

#### 4.3. Chinese M&A in ASEAN and Singapore

The total deal value of Chinese M&A in ASEAN amounted to US\$34.1 billion in 2017, and represented a quarter of the global Chinese M&A footprint.

As a HQ location of many global companies, including ASEAN companies, Singapore was understandably the biggest destination of Chinese M&A in 2017 given that Chinese M&A in ASEAN (a region which Singapore belongs) was significant that year.

It is expected that Singapore companies continue to play to their strengths in logistics, infrastructure and high-technology; all important strategic focuses of Chinese corporations under the BRI, which put them in a strong position to achieve good valuations and consideration by potential Chinese buyers.

## **5. How law and legislation will evolve**

Laws and the legal systems will likely adjust to accommodate the ambitions of the BRI project, and lawyers (particularly those with a transactional practice) will likely encounter such adjustments in their day-to-day work.

### 5.1. Foreign Investment Legislation in the PRC

In 2016, the PRC ranked third in the world in enticing foreign investment, importing about US\$124 billion of investment, a slight decrease of 1% over the previous year. PRC's overseas investment in 2016 was also US\$183 billion, the second-highest in the world, with its overseas investment growth rate reaching 44.1%.

Consequently, the Ministry of Commerce (MOFCOM) in the PRC introduced a new draft Foreign Investment Law, parts of which have already been adopted by the Standing Committee at the end of 2016.

The overall aim of this new Foreign Investment Law is to streamline the regulatory approval process for foreign companies wishing to enter the Chinese market, and opens the Chinese market more meaningfully to overseas investors. Additionally, foreign investors will be treated the same as local Chinese companies from a regulatory perspective, in the so called a "National Treatment" effect of the new legislation. Restrictions do however remain in place for certain sensitive industries and national security "review" of foreign investment in the PRC is enhanced.<sup>8</sup>

#### 5.2. More negotiations on international treaties will be completed

The PRC has so far entered into bilateral tax treaties with 56 countries, bilateral investment agreements with 60 countries and bilateral aviation agreements with 52 countries.

The establishment in the PRC views these three kinds of international agreements as extremely valuable, and are keen to enter into more such agreements in the coming years to build a strong foundation for trade in the future.

Negotiators from the PRC are also likely to capitalise on the inauguration of Trump as president of the USA to close more international treaties to take advantage of the PRC's enhanced bargaining power now that it seems that the PRC is more politically inclined to pursue free-trade around the world as compared to the USA.

#### 5.3. Endeavour to advance building the institution of the WTO

Many countries along the BRI are yet to join the 164-strong WTO membership.

With the objective of strengthening the existing a multilateral world order, the PRC will likely urge these outlying countries to join the WTO, by enticing such countries to join with the prospect of investment and capital from the PRC.

In addition to being the cheerleader for WTO member, multi-lateral agreements will also be high on the PRC's agenda, with the Regional Comprehensive Economic Partnership (RCEP) likely to be the most important one.

Those taking part in the '10+6' negotiation – including the 10 members of the Association of Southeast Asian Nations plus Australia, China, India, Japan, New Zealand and the Republic of Korea – have committed to completing these negotiations by the end of 2018.

The success of RCEP negotiations could reap benefits for the implementation of the BRI.

#### 5.4. Dispute settlement

Having learnt the mistakes of the first wave of foreign investment outflow from the PRC in the past decade—in particular with regards to disputes with overseas contracting counterparties—the PRC's lawmakers will likely study the 1958 New York Convention and the 1965 Washington Convention with a view to understanding private dispute resolution through arbitration, and greater sophistication of PRC companies when dealing with arbitration as a forum for settlement.

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<sup>8</sup> Meichen Liu, The New Chinese Foreign Investment Law and Its Implication on Foreign Investors, 38 Nw. J. Int'l L. & Bus. (2018). <https://scholarlycommons.law.northwestern.edu/njilb/vol38/iss2/3>

## **6. Conclusion**

BRI will have a significant and lasting impact on international trade and global relations in the coming years, from both a sectoral perspective and in terms of the legal frameworks for foreign investment.

There is significant scope for mutually beneficial collaborations throughout Asia, and the PRC's clout as a global deal-maker will likely grow with the concerted and planned execution of the BRI strategy.

*This article is produced by our Singapore office, Bird & Bird ATMD LLP, and does not constitute legal advice. It is intended to provide general information only. Please contact our lawyers if you have any specific queries.*