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Smithfield's Chinese Deal Likely To Survive US Scrutiny

By Liz Hoffman

Law360, New York (May 29, 2013, 9:01 PM ET) -- The $7.1 billion acquisition of Smithfield Foods Inc. by China's largest pork producer raises plenty of regulatory questions, but none big enough to stumble what would be a landmark cross-border deal, attorneys say.

Shuanghui International Holdings Ltd. on Wednesday announced plans to buy Smithfield for $4.7 billion in cash plus assumed debt. It's the largest-ever takeover of a U.S. company by a Chinese buyer. And the nature of the target — a well-known company whose products stock refrigerators across America — virtually guarantees extra scrutiny from lawmakers and regulators like the Committee on Foreign Investment in the U.S., which reviews transactions for national security concerns.

“There's no doubt that Chinese-based inbound investment does get CFIUS' attention,” said Farhad Jalinous, who co-chairs Kaye Scholer LLP's national security practice. “This deal is going to get looked at closely.”

But while food safety, trade with China and the cost of America's summer hot dogs are all valid concerns, experts said they could be better handled by ongoing oversight from the relevant agencies — the U.S. Department of Agriculture, Federal Trade Commission and others — than by a knee-jerk reaction from national security regulators.

“It's awfully hard to see a true national security problem lurking here,” said Harry Clark, a partner with Orrick Herrington & Sutcliffe LLP. “The deal is going to get a close look. But not every compliance issue is a national security issue.”

Over the years, CFIUS' domain has grown from simple defense concerns to include “critical infrastructure” — an umbrella that has, at times, covered telecommunications, software, manufacturing, aviation and energy. Last year, the committee **unwound the sale** of four Oregon wind farms to a Chinese buyer because they were located near a military base.

But the foreign takeover of a major food processor is a first-of-its-kind case for the committee, and experts say it raises a novel question of just how big the “national security” umbrella has gotten.

Agriculture and food are among the 17 sectors the Department of Homeland Security has considered "critical infrastructure" since 2011. And the Smithfield sale would put about 40 percent of the U.S. pork industry in foreign hands, up from just about 15 percent currently, according to analysts at BB&T Capital Markets.

Plus, CFIUS includes representatives of a dozen U.S. agencies and regulatory bodies, and it has the power to request input from others. All it takes is for one of them to see a problem, Jalinous said.

“Would we be having this conversation 20 years ago? No," Jalinous said. "But today, it's not crazy to think that the government would be asking questions about a deal like this."

On the other hand, Shuanghui isn't owned by the Chinese government, which has long been a key concern for CFIUS. Smithfield doesn't supply food to the U.S. military, so defense contracts aren't in play. And while a stable food and water supply are key security concerns, “bacon is not critical infrastructure," a source close to the deal said.

Moreover, CFIUS has greenlighted a handful of recent transactions in far more sensitive industries. On Tuesday, it **approved** Sprint Nextel Corp.'s $20.1 billion acquisition by Japan's SoftBank Corp., one of the biggest foreign investments ever in the U.S. telecom space. That follows favorable outcomes for DNA sequencer Complete Genomics Inc. and oil and gas explorer Nexen Corp., which were both sold to Chinese companies earlier this year.

“If CFIUS can let Sprint get purchased by Japanese SoftBank ... we have a hard time seeing a pork deal getting outright blocked,” analysts at JPMorgan said in a note Wednesday.

Smithfield CEO Larry Pope said the parties had made the voluntary filing “out of an abundance of caution.” The merger agreement does not include a breakup fee in case the deal is terminated due to CFIUS problems, suggesting both sides are confident.

Proactively seeking a CFIUS review isn't uncommon, said Ed Rubinoff, a partner with Akin Gump Strauss Hauer & Feld LLP. Buyers might not want to find themselves in the unenviable position of Ralls Corp., which never alerted CFIUS and saw its wind farm deal unwound nearly a year after it closed. Last year, China's Dalian Wanda Group Co. Ltd. sought the committee's blessing for its purchase of the AMC movie theater network — hardly a matter of national security.

“[Filing] can be a reaction to a perceived heightened level of sensitivity,” Rubinoff said. “Even when you think a transaction is unlikely to raise any concerns, you can undergo the review, check that box and move on.”

Even if national security isn't a major cause for concern, Shuanghui might present some food safety worries. Two years ago, the company was forced to recall some of its pork products from store shelves after some of it tested positive for a banned additive. And a series of highly publicized scandals have cast doubts on China's health and safety standards.

But the USDA doesn't review transactions, and experts say those concerns are unlikely to kick up enough dust to widen CFIUS' lens.

“I don't think new corporate ownership is going to cause any major [regulatory] changes, unless there is serious turnover at the individual facility level,” said William Tarantino, an environmental partner and food safety expert with Morrison & Foerster LLP. “These plants are already inspected daily.”

Still, political pressures can snowball quickly, and the aesthetics of a deal can seep into the reguatory review process, attorneys warned.

It was Congress, not CFIUS, that thwarted China's 2005 bid for Unocal Corp., the U.S. oil giant. A year later, lawmakers led the charge against a controversial deal to sell management of some U.S. ports to a Dubai-based company. Lowe's Cos. saw its efforts to buy Rona Inc., Canada's home-grown hardware giant, **derailed** by a streak of economic protectionism and a consumer backlash.

In addition to jobs, the takeover could become a pocketbook issue for consumers. Shuanghui says it plans to export more U.S. pork to China, which may stoke fears of higher prices at home, BB&T analyst Heather Jones said in a research note.

"Some legislators may view this as a zero-sum game," Jones said. "China increasing the security of its food chain arguably reduces the availability of U.S. pork to the U.S. consumer, which would likely result in higher prices."

The parties appear eager to get ahead of the criticism. Shuanghui promised to honor all contracts with Smithfield's workers and keep the company's factories and Virginia headquarters. And Smithfield's CEO on Wednesday said the deal was good for the U.S. trade deficit with China and proof of America's competitiveness in the global market.

As the largest-ever Chinese investment in an American company, the deal's path through Washington will be closely watched by dealmakers in both countries, said Thomas Sauermilch of McDermott Will & Emery LLP.

Inbound Chinese M&A into the U.S. hit an all-time high in 2012 of $6.5 billion, according to the Rhodium Group, which tracks Chinese investments. Interest is surging, but reluctance to embrace the CFIUS process has damped some interest, Sauermilch said.

“If [this deal] goes through without a hitch, I think you'll see more interest from Chinese buyers and more receptive sellers in the U.S.,” Sauermilch said. “This is the kind of transaction that can really open up the market.”

--Editing by Elizabeth Bowen and Chris Yates.