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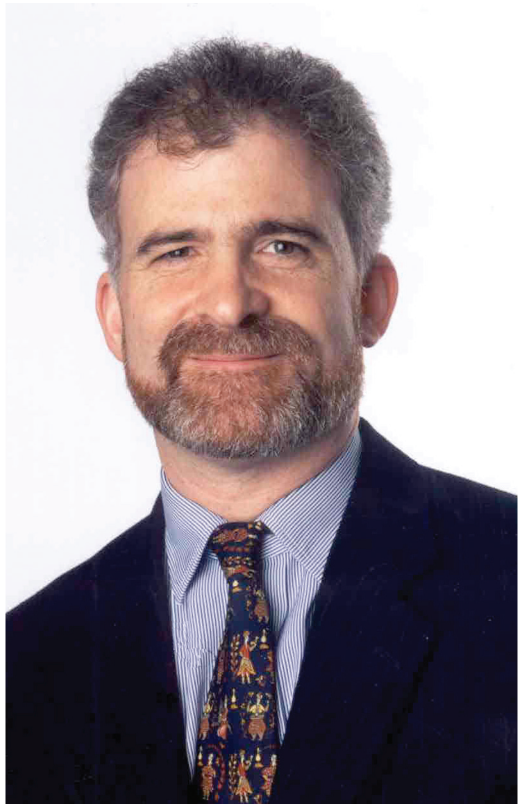
The Deal

CHINA BOUND

A CONVERSATION WITH MILBANK TWEED'S ANTHONY ROOT

BY SUE-CHING JEAN CHEN IN HONG KONG



MILBANK, TWEED, HADLEY & MCCLOY LLP HAS RECENTLY BEGUN TO GET SOME BIG RETURNS ON A LONG-TERM BET ON CHINA. Recently, the Wall Street law firm advised China's second-largest bank, China Construction Bank, or CCB, on two investments totaling $4 billion from Bank of America Corp. and Temasek Holdings Ltd. BofA's $2.5 billion contribution in June was corporate China's biggest-ever foreign direct investment and the first in one of China's big four state banks.

The deal also represented a milestone in China by being negotiated in and contracted in English.

China's big four state-owned lenders are courting foreign strategic investors and planning initial public offerings to help revamp operations long tainted by politics and corruption ahead of the start of financial markets liberalization in December 2006.

That's becoming a big payday for Milbank, which says it has also been enlisted to assist a foreign investor preparing to plunk down several billions of dollars into other top Chinese banks.

Milbank also recently advised on what would have been China's biggest overseas investment: the $18.5 billion bid by CNOOC Ltd. for El Segundo, Calif., energy company Unocal Corp. State-owned CNOOC last month dropped the bid amid political opposition in Washington. Milbank's role was adviser to CNOOC's two financial advisers, Goldman, Sachs & Co. and J.P. Morgan on financing the deal.

Milbank's Asia team, which includes 35 attorneys in Hong Kong, Singapore, and Tokyo, has a strong corporate focus. It advises some of the region's most active investors, including J.P. Morgan Partners and Farallon Capital Management LLC of San Francisco. Milbank has gained a strong reputation in Asia in general, but less so in China—until now.

In 1977, Milbank was the first major Wall Street law firm to set up shop in Hong Kong and Tokyo; yet, only toward the end of this year will it finally open an office on mainland China, in Beijing, matching rivals Shearman & Sterling LLP, Skadden, Arps, Slate, Meagher & Flom LLP and Sullivan & Cromwell LLP, which have in recent years descended upon the capital, the nerve center of China's state-dominated business establishment.

The firm's Asian corporate finance chief, Anthony Root, and Ed Sun will head Milbank's Beijing office. Root, 52, moved to Asia in 1993 with his wife, Pamela Root, now a general counsel at Goldman Sachs in New York. Root counsels on a wide range of industries including banking, technology, infrastructure, natural resources, power and telecommunications.

The China Construction Bank deal built on his experience 10 years ago when as a lawyer at Davis Polk & Wardwell he negotiated with the Chinese bank on behalf of Morgan Stanley in setting up China's first investment banking joint venture with Beijing-based China International Capital Corp., or CICC. Root plans to buy a residence in Beijing and commute between Beijing and Hong Kong when the new Beijing office opens. The Deal recently spoke to him.

The Deal: Why do you feel the need to set up an operation inside China?

Root: All the major companies have gone to China in the past two years. Deal execution is moving to China. The major investment banks are moving to China. Our Hong Kong office will still have a Korean and a regional focus. In the next two to five years, the main business in China will be executed out of Beijing and Shanghai. Future growth will come from China. We are setting up an office in Beijing. There will be five professionals and future hires in Beijing. We will primarily focus on acquisitions and corporate finance. If you focus on venture capital and inbound multinational investment you would end up in Shanghai. People think Shanghai is China's New York. I think it's the Chicago of China. There's a lot of business trading in Shanghai. But when it comes to corporate finance, Beijing has the best of the deals.

What was Milbank's role on the CNOOC bid and what were the notable aspects of the financing process?

We represented Goldman Sachs and J.P. Morgan. They were providing a large portion of financing, about 40% of the total $18.5 billion, to CNOOC. It is not uncommon for investment banks to provide risk financing for an acquisition but it is less common in Asia. This would have been the largest acquisition loan ever made in China. Our role was to structure the loan. Halfway through the transaction, there was a discussion about a $500 million breakup fee for CNOOC to pay Unocal shareholders to compensate the political risks. CNOOC agreed to the payment but everything happened so quickly it needed to obtain a special approval from China's SAFE [State Administration of Foreign Exchange].

In the end, they obtained the approval at the last moment. Nothing is easy in China. But the real issue was not with the breakup fee but with politicians in the U.S. who wanted to block CNOOC's bid.

Incidentally, we are advising a Chinese investor on a big real estate investment in Europe. One of the first questions they asked was whether there were political risks. They are becoming aware of political risks involved in overseas investment. The U.S. used to be a safe haven. Now it's risky for them to invest there.

What were the particular challenges of the China Construction Bank transaction?

To make business deals fit into the regulatory frameworks of both countries. In particular, the U.S. has the Bank Holding Company Act. It limits the kind of investment an American bank can make, the amount of investment, how you characterize the investment, the manner they invest, a very complex set of rules. There's a cottage industry of lawyers making money from it.

BofA has to be aware of the amount of money they can invest in another entity without consequences.

Likewise in China, there are foreign ownership restrictions and other rules. We brought our regulatory partner from Washington, Winthrop Brown, in for two-and-a-half weeks. Milbank has had a strong regulatory practice for decades.

How did the CCB transaction come about?

CCB considered many different partners, not just Bank of America. When they had an understanding there would be a deal, they brought us in.

Through China International Capital Corp., I was familiar with the challenges working with a Chinese bank. Bank of America's chairman and vice chairman were here. They hired Cleary, Gottlieb, Steen & Hamilton [LLP] to do diligence and negotiations for two or three weeks. Everything came together very quickly. The whole transaction took actually six weeks of active involvement.

What changes have you seen in CCB since working with them 10 years ago as an adviser to Morgan Stanley in negotiating to become its partner?

It's a complete makeover. CCB's management has changed a good deal. There's been lots of turnover. CCB is looking for technology transfers on wealth management, credit cards and a full-range of financial services.The level of sophistication and confidence on the China side resulted in a much faster execution in the CCB deal. It took CCB only six weeks to complete the deal with Bank of America. By contrast, it took a year and a half to create CICC. Their executions, the structure of the company, across the board, are more institutionalized today. The documentation used in the CCB deal is more in line with international standards. Top management at CCB was able to negotiate in English. We provided Chinese translation but the negotiations were in the English, not the Chinese version. In the CICC deal, you could not move the negotiation further without a Chinese draft. It was a very slow process.

Why are the Chinese banks looking for foreign strategic investment?

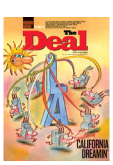
CCB, for one, is concerned about the impact of foreign competition. Even after China liberalizes in December 2006, it will still be behind India. The Chinese banks are huge. In five to seven years, they will have international standards installed throughout their systems. The IPOs will help them to achieve international standards of disclosure.

What's your overall strategy for Asia?

Our strategy in Asia has been to focus on the high-end premium practices on a Pan-Asian basis. We bring a broad understanding of business, not a particular country system. We apply the same executions technique from country to country. We are strong in the private-equity financing and private-equity acquisitions, IPOs, exits. We have 70% of our work in corporate, and 30% in finance. All these things feed each other. We know no other firm in Asia with our private equity focus. No other firms are strong in all three aspects.

On a country basis, there is always a national market that would represent the biggest book of business. Is it China this year?

In the first six months of the year, we had 45% of work hours dedicated to China deals, a level absolutely higher than before. The other 55% was Korea, India and Indonesia. Ten years ago people thought Indonesia was the biggest market in Asia. And the Philippines No. 2. China was very slow. In the late 1990s it was South Korea's M&A and restructuring. Since 2003, China has dominated the deal flow and remained strong in 2004 and 2005. This year, India is doing well. Many private equity investors have begun to target India. China is very active but we have a strong advantage to do equally well across southeast Asia. ■



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