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UPDATE ON CFIUS DEVELOPMENTS:

PRESIDENTIAL ORDER IN WIND FARM CASE

We are writing to provide our perspective on the Executive Order (the "Order") issued by President Obama last Friday, September 28, directing the divestiture of a Chinese acquisition in the United States — only the second time in history that a sitting President has exercised his authorities under Section 721 of the U.S. Defense Production Act (also known as "Exon-Florio") to prohibit a foreign merger, acquisition or takeover on national security grounds. In connection with the Order, the Department of Treasury, as chair of the Committee on Foreign Investment in the United States ("CFIUS"), also issued a statement addressing the decision to recommend to the President that he prohibit the transaction.

SUMMARY

The Order formally prohibits Ralls Corporation ("Ralls"), a U.S. company owned by two Chinese nationals and affiliated with China's Sany Group, from owning four wind farm project companies in Oregon that are within or near the vicinity of restricted airspace at the Naval Weapons Systems Training Facility in Boardman, Oregon. Press reports have noted that the U.S. military flies unmanned drones and conducts low-level military aircraft training from the Navy base. Ralls initially acquired the interests in the four wind farm projects in March 2012, but did not notify CFIUS of the transaction at the time. Instead, Ralls formally filed the transaction with CFIUS in June 2012 after it had consummated the acquisition of the wind farm project companies.

The President's decision follows the unanimous conclusion by CFIUS, based on "credible evidence" that it obtained, that the transaction threatened to impair U.S. national security and that threat could not be mitigated. The Order also follows extraordinary interim protections that CFIUS ordered during its review of the transaction. Those protections included a demand that Ralls immediately cease construction and operations at the wind farm sites, remove all stockpiled or stored items from the sites, and cease all access to the sites. In addition, CFIUS imposed conditions on any sale of the assets.

The Order largely codifies — but also amplifies — the initial protections required by CFIUS. Specifically, the Order:

- prohibits Ralls from owning the wind farm project companies and orders their divestment, including all assets, intellectual property, technology, personnel and customer contracts, within 90 days, unless CFIUS otherwise agrees to extend the timeframe for divestment for an additional period not to exceed three months;
- requires within 14 calendar days the removal of all items, structures, or other physical objects or installations, including concrete foundations, that Ralls has stockpiled, stored, deposited, installed or affixed on the wind farm properties, and requires that Ralls defer its divestment until it completes the removal;
- prohibits Ralls and any employee of Ralls from accessing the properties effective immediately, provided that U.S. citizens who are contracted by Ralls and approved by CFIUS can access the properties to effect the removal of all items as required under the Order;

- prohibits the sale or transfer to a third party any items that were produced by the Sany Group for use or installation on the wind farm sites; and
- requires Ralls to notify CFIUS of any buyer and affords CFIUS ten business days to raise any objection. (The Order notes that CFIUS may consider whether the intended buyer is a U.S. citizen or owned by a U.S. citizen — an implicit acknowledgment of the legal fact that CFIUS would not have jurisdiction over such a transaction.)

In addition to these requirements, the Order authorizes CFIUS to take measures to verify compliance with the Order, with such verification measures to be completed within 90 days of divestment. The Attorney General of the United States is authorized to enforce the Order, which supersedes and revokes the prior interim protections issued by CFIUS.

Earlier this month — prior to the President's Order — Ralls had filed suit in U.S. federal court against CFIUS alleging that CFIUS's actions, including its interim protections, violated a federal statute, the Administrative Procedure Act, and constituted a deprivation of property without due process of law in violation of the Constitution. Ralls dropped its initial request for a restraining order and preliminary injunction when CFIUS agreed to allow Ralls to continue certain pre-construction work, but did not drop the suit, and Ralls reportedly initiated litigation against the President today for his Order.

ANALYSIS AND LESSONS

We think that it is important that our clients and contacts who are interested in cross-border investment in the United States and the CFIUS process understand what the Ralls case means and, equally important, what it does not mean.

While the case is notable because of the extraordinary nature of the Presidential Order — the only prior exercise of the President's authorities under Exon-Florio occurred in 1990 when President George H.W. Bush ordered the state-owned China National Aero-Technology Import & Export Corporation to divest Mamco Manufacturing Company, a Seattle-based aerospace parts manufacturer — it does not portend any sea change in CFIUS practice or the United States' approach to foreign investment. Rather, the Ralls decision is perhaps the most public example of two trends that have become more prominent in the CFIUS process over the last several years, but that are not new.

First, the Ralls case is an example of the concerns that proximity — or what the government has called "persistent co-location" — to U.S. military bases and other sensitive facilities can present, especially in cases involving China. Proximity issues are among the most challenging to mitigate because they combine a persistent threat (the threat of espionage or other clandestine action) with a fixed vulnerability (the physical location of the assets). In the last several years, CFIUS also has determined that proximity issues presented irreconcilable national security risks in two mining-related cases in Nevada in which the assets were proximately located to another U.S. military testing range, and in a technology transaction in New Mexico in which the business was located in an industrial complex with other contractors that performed on sensitive programs for the U.S. government. Thus, Ralls is not the first — nor is it likely to be the last — case to present very challenging concerns based on the location of the U.S. assets.

Second, Ralls exemplifies the difficulties that "non-notified" transactions can present to CFIUS, especially when the transaction has closed. Many of the most challenging CFIUS cases — including many cases involving investors from countries other than China — have arisen from transactions that were consummated before filing with CFIUS. Such cases are especially challenging because closing a transaction locks in a certain set of facts before CFIUS has reviewed the terms. In turn, if

the underlying facts of a transaction present a material national security risk, it becomes much harder for CFIUS to address that risk retrospectively and still satisfy its statutory burden to certify to the U.S. Congress that the transaction presents "no unresolved national security concerns."

Importantly, however, these risks can be avoided through (i) appropriate vetting of potential national security issues during the transaction planning stage; and (ii) appropriate engagement with CFIUS prior to closing a transaction that involves an acquisition of control by a foreign person over a U.S. business. In particular, Chinese investors should pay careful attention to proximity issues and consult knowledgeable advisors when seeking to acquire ownership interests that include real property in order to fully assess the risks of any such acquisition.

The Ralls case also should not be viewed as a change in U.S. policy or an overall tightening of the CFIUS process. As the Treasury Department has stated regarding the Ralls case: "The President's decision is specific to this transaction and is not a precedent with regard to any other foreign direct investment from China or any other country."

Our belief, based on our long experience before CFIUS, including on several Chinese deals within the last few years, is that this statement is not simply a rhetorical response from the chair of CFIUS, but rather a still-valid reflection of U.S. policy and the CFIUS process. Notwithstanding the very public nature of certain failed transactions like Ralls, CFIUS has consistently demonstrated a clear ability to review and approve a wide range of Chinese transactions in a timely manner. Indeed, because of the profile of certain failed transactions, there is considerable policy interest within the U.S. government in receiving well-planned investments from China that can readily be approved.

Thus, properly understood, Ralls is an interesting case because of its extraordinary result and facts and because it is symbolic of the risks inherent in non-notified transactions that involve proximity concerns. But it does not portend greater restrictions for Chinese investment in the United States or any tightening of the CFIUS process.

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