

CFIUS Shows New Aggressiveness In Ordering Divestiture



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Law360, New York (October 29, 2012, 3:03 PM ET) -- Recent litigation — an extraordinary rarity in practice before the Committee on Foreign Investment in the United States (CFIUS) — has highlighted a new willingness on the part of the U.S. government to restrict parties' activities relating to foreign acquisitions of U.S. companies through measures that go beyond the standard remedies of barring transactions or ordering divestiture.

CFIUS is the interagency executive branch committee that considers the impact on U.S. national security of “any merger, acquisition, or takeover ... by or with a foreign person which could result in foreign control of any person engaged in interstate commerce in the United States.”

Through its review, CFIUS determines whether the transaction poses a threat to national security interests (including law enforcement) and whether to recommend that the president therefore block the transaction on those grounds. The president's decision to block a particular covered transaction is not subject to judicial review under the explicit terms of the governing statute, but the statute confers no authority on the president other than this extraordinary remedy.

In a recent lawsuit, Ralls Corporation — a Chinese-owned purchaser of four Oregon wind energy farms still in development — challenges the issuance of orders by CFIUS and the President directing Ralls to unwind that acquisition. Ralls is arguing that the orders were flatly beyond the scope of authority granted to CFIUS and the president by law, that they were arbitrary and unenforceable even within that authority and that they were an unconstitutional taking of property.

While the litigation is ongoing and bears watching, several things are already clear. First, CFIUS is asserting ever-broader jurisdiction over a variety of transactions traditionally thought remote from national security

concerns. Second, CFIUS has demonstrated a willingness to recommend presidential action to the full limits of statutory authority — and perhaps beyond. Third, these risks for private parties to transactions may be aggravated if transactions close without prior CFIUS review, and CFIUS later determines that such transactions are within its jurisdiction.

Development of the Oregon project at issue in the Ralls Corporation case was begun by a domestic United States company. The developer planned to build the projects with wind turbine equipment from Sany Corporation, a very large Chinese manufacturing firm. During the first half of 2012, Sany formed Ralls to buy the projects and ensure that they were actually built (an effort to vertically integrate with the customer). The parties did not seek CFIUS review before closing.

However, one of the wind farm project sites was located near air space used by the U.S. Navy for flight testing and other sensitive military training. When the U.S. Department of Defense thereafter learned of the deal, it initiated a request for CFIUS review. CFIUS requested a notice describing the particulars of the transactions, and Ralls filed one in June 2012, after the acquisition had closed.

It quickly became clear that CFIUS took a dim view of the transaction, based on concerns that the combination of the sensitive geographic location of the projects and the potential for use of wind turbines as a staging area for electronic equipment might compromise or impair the nearby military operations.

Indeed, in late July 2012, CFIUS issued an "Order Establishing Interim Mitigation Measures." This order barred further construction or operations at the project sites, required removal of the Chinese-manufactured wind turbine equipment then stockpiled at the sites and barred the new owners from access to the sites except for the purposes of removing such materials.

Apparently seeing the handwriting on the wall, Ralls advised CFIUS that it was considering selling the projects to a domestic buyer. Under the circumstances, Ralls seemed to believe that the president might issue a divestiture order anyway and apparently concluded that a preemptive sale would terminate CFIUS' jurisdiction to review the prior transaction as well as the president's authority to act.

It would also allow construction on the site to continue, which was important for earning a year-end tax credit for the wind farm (an element that would no doubt be part of the valuation in the sale by Ralls). But CFIUS responded by issuing a further order — this time prohibiting divestiture by Ralls, except upon prior notice to and approval by CFIUS; prohibiting the sale or transfer of any Sany-manufactured equipments part of the transaction; and barring Ralls from all further access to the project sites except to carry out terms of the order. CFIUS also renewed an assertion it had made in its first order that both sets of directives were enforceable through civil and criminal remedies.

Promptly after CFIUS issued the second order, Ralls took the highly unusual step of initiating litigation against CFIUS. It sought a judgment that the orders exceeded CFIUS' authority in several important respects, particularly including the restrictions on use, access and divestiture. The parties agreed to a form of standstill until the president's Sep. 28 deadline to act.

The president's final order, issued on that deadline, mandated divestiture by Ralls within 90 days; required Ralls to dismantle the infrastructure that had already been constructed at the plant; barred Ralls from access to the property except for the purpose of dismantling the project; and prohibited sale to domestic persons who had assisted in its construction.

Ralls intends to continue the litigation — in fact, it recently added the president as a defendant — but because the president's authority to issue divestiture orders is not subject to judicial review, Ralls is not expected ultimately to own and operate the projects. Rather, Ralls will probably concentrate on arguments that the government's orders to freeze the sale process, to dismantle the projects and to limit the class of

U.S. persons to whom a sale upon divestiture could be made lacked authority and impaired the value of the projects. This case highlights a number of developments that merit careful attention.

First and foremost, this episode demonstrates a new aggressiveness by CFIUS in its review of foreign investment transactions. The divestiture order with respect to wind energy farms in Oregon demonstrates that CFIUS and its constituent agencies may be attentive to national security considerations that are not directly related to the industry in which subject companies participate and that (among other characteristics of the transaction) CFIUS may focus on relative fortuities such as the geographic location of facilities operated by the acquired United States business. (In 2009, Northwest Nonferrous International Investment Company, a Chinese investor, abandoned its proposed 51-percent acquisition of a Nevada-based mining company in the face of CFIUS opposition because of the mine's proximity to a Naval Air Station and "classified security and military assets that cannot be identified.")

Thus, transactions which may appear remote from national security concerns — even after significant diligence — may nonetheless undergo significant government scrutiny. This may be particularly true for buyers from countries that have had a history of being at odds with U.S. national security interests, such as China.

Second, the Ralls case shows that CFIUS is prepared to test the limits of its statutory authority by issuing orders that rely upon expansive assertions of authority. Even though there is no clear provision in the statute for CFIUS itself to issue orders of any kind — let alone "interim" orders — CFIUS did so, twice, in the Ralls case.

It is unclear what statutory authority even the president might rely upon to enforce orders through criminal penalties, but CFIUS embedded a threat to do so in its interim orders against Ralls. And though the law does not refer to authority to require the foreign owner to destroy facilities of the acquired business, or to narrow the class of purely domestic buyers to whom a foreign person might sell — both CFIUS and the president issued orders imposing these requirements in this case.

Third, this case shows that CFIUS' constituent agencies may be particularly aggressive in crafting and enforcing remedies if a transaction closes before notification to CFIUS and/or completion of CFIUS' review process. Some of the harshest aspects of the orders issued in the Ralls case relate not solely to the divestiture order itself, but also to conditions which have the effect of further reducing the value of the U.S. business that the foreign owner has to sell under the inherent pressure of a divestiture order.

The ongoing litigation over the orders issued in Ralls can be expected to address some of these issues, as well as other aspects of the CFIUS review process. Even after this litigation is resolved, questions such as those identified above are likely to engage the attention of CFIUS, its constituent agencies and transaction parties across a broad spectrum of industries.

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