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Legal Update
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President Obama Orders Divestiture of Chinese Investment in US Wind Farms; Investor Mounts Unprecedented Legal Challenge

During the past 25 years, the US government, through the interagency Committee on Foreign Investment in the United States ("CFIUS" or the "Committee"), has reviewed hundreds of potential foreign acquisitions of US businesses. By statute, CFIUS has the authority to determine whether the national security of the United States is at risk and, if so, can insist on mitigation measures; CFIUS opposition has sometimes caused parties to abandon their acquisition plans. Although many foreign acquirers have grumbled about CFIUS's reviews, and some foreign governments have expressed concern about possible protectionism, the US government's authority has not been subject to any reported legal challenge.

On September 12, 2012, a foreign acquirer took the unprecedented step of challenging in federal court the application of CFIUS's authority. Ralls Corporation, a Chinese-owned wind-energy developer, brought suit to challenge CFIUS restrictions thwarting its acquisition of four small US wind farm companies.[1]

Barely two weeks later, acting on the recommendation of CFIUS, President Obama formally prohibited the Ralls acquisitions, the first time in 22 years that a president has blocked a foreign acquisition on national security grounds.[2] The presidential order of September 28 not only explicitly ordered the company to divest the acquired interest, but also affirmed all restrictions imposed by CFIUS on the manner of the divesture and conferred new inspection authority on the Committee. On October 1, despite the difficulty of obtaining judicial review of a president's authority to preserve the national security, Ralls persisted in its lawsuit and added the President as an additional defendant.

The *Ralls* lawsuit, and the President's rejection of the Ralls acquisitions, are significant developments. The lawsuit is significant because any success by Ralls in having a federal court subject CFIUS actions to (even limited) judicial review could cause CFIUS to change its practices with respect to reviews and mitigation measures to anticipate possible judicial scrutiny. The President's rejection is significant because the Ralls acquisition is one of a number of recent Chinese acquisitions that have faltered when CFIUS reportedly found the to-be-acquired assets to be near US military facilities.

National Security Reviews by CFIUS

The President of the United States has long possessed the authority to block any "covered transaction," i.e., a transaction that involves a foreign party and could result in foreign control of a US business, which threatens to impair the national security of the United States. Such presidential authority is exercised through national security reviews by CFIUS. CFIUS is an inter-agency committee chaired by the Department of the Treasury; it includes representatives from the Departments of Commerce, Defense, Energy, Homeland

Security, State, and others. In 2007, the CFIUS review process was significantly reformed by the Foreign Investment and National Security Act ("FINSA") and related regulatory changes, expanding the scope of national security reviews and signaling greater scrutiny.

CFIUS review is normally triggered by a joint notice filed voluntarily by the parties to a foreign-person transaction (although the Committee has also requested such notice from the parties or self-initiated a review in prior instances). Where CFIUS has reviewed a transaction and determined that there is no security threat, or that the CFIUS-related statutes do not apply to the transaction, the parties may proceed with the transaction without concern that CFIUS may subsequently require the rescission of that transaction (commonly referred to as a "safe harbor").

Conversely, where CFIUS determines that it has authority over a transaction and that national security risks exist, CFIUS typically requires the parties to enter into "mitigation agreements" with the US government to alleviate national security concerns by altering the transaction or accepting additional obligations. If CFIUS and the parties fail to agree on mitigation measures, or otherwise to address the government's concerns, the Committee has statutory authority to refer the matter to the President, with a recommendation to block the acquisition.

CFIUS Review of the Ralls Acquisitions

Ralls is a Delaware company owned by two executives of China-based Sany Group Co. ("Sany"), a wind-turbine manufacturer. It was established to develop the US market for Sany's products. According to Ralls, earlier this year, the company purchased four small Oregon companies whose assets consisted of wind farm development rights, land rights to construct wind farms, power purchase agreements, and government permits. The projects collectively would produce a total of 40 megawatts of power and allegedly had received an array of state and federal regulatory approvals. Notably, Ralls alleges that the US Navy had given its approval for the acquisitions, once Ralls agreed to re-locate one of the to-be-acquired wind farms, which was considered too close to restricted US military installations. Ralls and the four US target companies did *not* inform CFIUS of the transactions before they closed, and after closing Ralls proceeded to begin construction work at one or more wind farm sites.

After the closing of the transaction, Ralls filed a voluntary CFIUS notice in June seeking the Committee's national security clearance. According to the company, events took a dramatic turn in late July when CFIUS issued an order requiring Ralls to cease construction activities, remove all construction materials, and "immediately cease all access" to the properties. Pursuant to the order, only US citizens were allowed to access the properties and solely for purposes of removing materials in compliance with the order. When Ralls notified CFIUS of its intention to divest its acquired interests, potentially to US buyers, the Committee issued an amended order that, among other things, prohibited the company from selling any item manufactured by Sany for installation at the project site, as well as declaring CFIUS's authority to object to *any* potential buyer of the properties.

The two orders issued by CFIUS in this case are rather unorthodox. Usually, the Committee first suggests a mitigation agreement, even though the proposed terms may be so exacting that the parties have to either unwind the deal or risk rejection by the President. In this case, the Committee effectively ordered an immediate rescission of the deal and the post-transaction actions that Ralls had taken.

The *Ralls* Lawsuit

On September 12, Ralls filed a complaint in the US District Court for the District of Columbia, arguing that the CFIUS orders violated the Administrative Procedure Act ("APA") and constituted an unconstitutional deprivation of

property without due process. Ralls set forth several grounds to support its APA claim, which include that CFIUS exceeded its statutory authority by: (i) arbitrarily rendering determinations absent any evidence or explanation; (ii) imposing an outright *de facto* prohibition of the transaction, without negotiation of mitigation measures; and (iii) prohibiting Ralls from selling Chinese-produced items and, absent CFIUS approval, selling the project properties, even to US buyers.

As a threshold issue, Ralls must litigate whether CFIUS actions are subject to judicial review at all. FINSA expressly shields from judicial review the President's determination to block a covered transaction and the supportive findings. The company essentially argues that CFIUS purported to prohibit the transaction under its own authority and that, because the alleged CFIUS prohibition came before the President's determination, FINSA's exemption does not apply. If the court rules that the lawsuit can proceed, embracing the possibility that CFIUS actions may be subject to some judicial review, CFIUS will have to take that into account in future transaction reviews.

On the merits, Ralls is challenging, among other things, CFIUS's independent statutory authority to block a transaction without a decision by the President, and the Committee's implied determination that the potential sale of Sany's Chinese-made products to US buyers satisfies the jurisdictional requirements that a foreign acquiring party obtain control over a US business. As proof of the grave economic consequences of the sweeping restrictions imposed by the CFIUS orders, Ralls also filed a motion for provisional remedies that would have allowed the company to resume construction of the four wind farms by September 20. If the wind farms are not in service by the end of this year, Ralls alleged, it would forfeit $25 million worth of federal investment tax incentives.

The motion for provisional relief was originally set for expedited briefing and consideration by the court. However, on September 19, Ralls withdrew this motion, citing "an agreement between the parties concerning the resumption of certain preliminary construction activities" at the project site as the reason.[3] In light of the withdrawal, the court canceled a hearing scheduled for the next day, but ordered the two sides to submit a joint status report by October 1.

The Presidential Order and Subsequent Developments

On September 28, President Obama issued an order requiring Ralls to unwind its acquisition of the four Oregon wind farm projects. In addition, the presidential order incorporated all restrictions included in the two interim CFIUS orders, including those on access to the properties and future transfer of project assets. The order went even further, providing that CFIUS shall have the authority to require Ralls, for compliance assessment purposes, to "allow government employees to access their premises to inspect and copy books, accounts, documents; inspect any equipment and technical data, including software; and interview officers, employees, or agents of the [acquired companies], anywhere within the United States."[4]

Ralls, on October 1, amended its court complaint to add new claims against the President. On the statutory front, Ralls sought to challenge the President's reinstatement of restrictions on future transfer of the wind-farm projects, even to US buyers, as well as on the sale of Sany-made products for use on the same project site, as exceeding his authority, arguing that neither falls within the ambit of FINSA. On the constitutional front, the company continued to accuse the US government of engaging in physical and regulatory taking without due process, in violation of the Takings Clause, including through the presidential actions.

Ralls also newly alleged that it had been unconstitutionally denied equal protection, as required by the Constitution. Ralls challenged the reason that reportedly was mentioned by

CFIUS in support of its actions, and that was presumably underlying the President's decision: that the wind-farm projects are within or near a restricted US military area—the Naval Weapons Systems Training Facility in Boardman, Oregon. According to the company's amended complaint, the US government singled out Chinese investors for unfair treatment, because "[n]umerous other windfarms using foreign-made turbines and with foreign ownership are located in or near the Navy's restricted airspace. At least seven foreign-made turbines are located within the restricted airspace, like one of Ralls's planned windfarms."[5]

The *Ralls* litigation is novel and perhaps inevitable, as CFIUS reviews have only increased in importance for foreign-person transactions in recent years. The lawsuit and the presidential determination highlight the Committee's power over US investments by foreign persons, and the significant risks parties incur by closing a transaction without the Committee's approval. In this case, CFIUS not only required the parties to cease all commercial activities associated with the transaction but also asserted authority to dictate the manner in which the acquirer may unwind the acquisitions and dispose of assets subsequently purchased for the projects.

Both foreign and US business communities should monitor the *Ralls* litigation. Parties to a foreign-person transaction are well-advised to file an advance voluntary notice with CFIUS, as it is the only way to receive a "safe harbor" from the possibility of a divestiture ordered by the US government.

For more information about the Ralls *litigation or any other CFIUS matter raised in this Legal Update, please contact any of the following lawyers.*

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Endnotes

1 Complaint in *Ralls Corp. v. Committee on Foreign Investment in the United States*, case no. 1-12-cv-01513 (D.D.C. Sept. 12, 2012).

2 *See* Order of September 28, 2012, *Regarding the Acquisition of Four U.S. Wind Farm Projec*t *Companies by Ralls Corporation*, 77 Fed. Reg. 60281 (Oct. 3, 2012). The only other instance also involved a Chinese investment. In 1990, President George H.W. Bush blocked for national security reasons the proposed acquisition of MAMCO Manufacturing Inc., a maker of motors and generators, by China National Aero-Technology and Export Corp.

3 Notice of Withdrawal of Motion for Temporary Restraining Order and Preliminary Injunction (Sept. 19, 2012).

4 Amended Complaint at 32 (Oct. 1, 2012).

5 Amended Complaint at 37 (Oct. 1, 2012). There have been two other publicly reported instances in recent years where CFIUS rejected a transaction because of proximity of the US business's property —in both cases, mining facilities — to US military installations. In December 2009, CFIUS rejected the plans of a Chinese government-controlled company, Northwest Ferrous International Investment Company, to acquire a 51 percent interest in a Nevada gold mining business, Firstgold Corp. Also, in May 2012, CFIUS forced Far East Golden Resources Group Ltd. ("Far East"), a subsidiary of Chinese firm Hybrid Kinetic, to divest its majority interest in US mining company Nevada Gold Holdings, Inc. The interest was acquired in October 2010 without a voluntary CFIUS filing, but the Committee subsequently proceeded to initiate a review on its own in March 2012 and ultimately compelled the rescission of the acquisition 18 months after its completion. (CFIUS can formally request that parties file a notice of a transaction, and a CFIUS member agency can also submit a notice of a transaction to the full Committee based on information available, even in the absence of cooperation by the parties.)