

U.S. Government Blocks Chinese Acquisition of Wind Farms: Lessons Learned

October 22, 2012

On September 28, 2012, President Barack Obama signed an Executive Order prohibiting the acquisition of four wind farm companies in Oregon by Ralls Corporation, a Delaware corporation, the Sany Group, a Chinese company, and two Chinese citizens who wholly own Ralls and hold senior executive positions at Sany. The Order also prohibited the ownership, whether directly or indirectly, of any interest in the wind farms or assets by Ralls, Sany Group or either of the two Chinese Nationals.

Background

The transaction was referred to the President for review by the Committee on Foreign Investment in the United States (CFIUS), which is the inter-agency committee of the U.S. Government that has authority to review any acquisition that could result in foreign control of a U.S. business. If CFIUS finds that an acquisition poses national security concerns, it can require parties to the transaction to take mitigation measures to address the concerns; or, if the concerns cannot be adequately addressed by such measures, CFIUS may then refer the matter to the President. If the President then determines that the transaction is a threat to national security that cannot otherwise be addressed, the President may block the transaction or take other action to protect the country's national security. Parties to a transaction can request prior clearance of the transaction from CFIUS, which will ensure that the transaction will not be blocked later on.

In this case, Ralls had acquired the wind farm companies in March 2012 without first seeking approval of the transaction from CFIUS. At that time, the only assets of the wind farm companies included the rights and permits necessary to build the wind farms. Some time thereafter, the United States Navy expressed national security concern because of the proximity of one of the properties where the companies proposed to build the wind farms to restricted airspace of the Navy Weapons System Training Facility where the military flies unmanned drones and conducts aircraft training.

In June 2012, Ralls and the seller made a joint voluntary notification filing with CFIUS. Approximately two months later, instead of approving the transaction, CFIUS declared that national security risks had arisen as a result of the transaction. Without identifying any evidence or providing any explanation as to why CFIUS was concerned, CFIUS issued a mitigation order requiring Ralls to immediately cease all construction and remove all items from the properties and then CFIUS forwarded the matter to the President for his determination.

President's Executive Order

The President decided to block the transaction because "credible evidence" led him to believe that the companies and the two Chinese nationals, in exercising control over the wind farm companies, "might take action that threatens to impair the national security of the United States." The President also did not disclose the evidence that led him to issue the Order nor did he specify how the national security of the United States could be impaired by the project.

To implement the Order, among other things, the President ordered Ralls to divest, within 90 days of the Order, all interest in the wind farm companies and their assets, intellectual property, technology, personnel, and customer contracts, and any operations developed, held, or controlled, whether directly or indirectly, by the wind farm companies at the time of, or since, their acquisition. In addition, the President ordered Ralls and the Sany Group to remove, within 14 days of the Order, any and all items that any of them had stored or placed in any other way on the properties and

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cease access to the properties. The President also restricted Ralls from selling or transferring the wind farm companies or their assets to any third party until various conditions are met, including having the intended recipient or buyer cleared by CFIUS.

Ralls' Complaint

In response to the Order, Ralls filed complaint in the U.S. District Court for the District of Columbia against CFIUS and President Obama. The complaint alleges, among other things, that Ralls was unconstitutionally deprived of its property without due process of law and that its right to equal protection of law was violated since Ralls was treated differently than similarly situated parties. Ralls also alleged that CFIUS and the President exceeded their statutory authority by arbitrarily and capriciously issuing their orders and decrees. It will be interesting to see how the Ralls case develops over the next few months and how the constitutional law questions raised in the case are resolved.

Lessons Learned

This case provides important lessons for parties contemplating selling a U.S. business to foreign parties. First, if Ralls had voluntarily notified CFIUS of the transaction prior to acquiring the wind farm companies, Ralls could have been apprised of the rejection prior to closing on the transaction.

Second, this case also shows that in addition to carefully analyzing the business of the target company, especially where the business involves "critical infrastructure" or "critical technologies," and the background of the foreign purchaser, especially where the purchaser is from China, Russia, the Middle East or another country with which the U.S. government scrutinizes more carefully, parties should also pay attention to the physical location of a proposed investment. In the Ralls case, an otherwise innocuous transaction seems to have been deemed to have national security implications simply because of its proximity to a naval base. This proximity factor is not novel; in fact, CFIUS has on past occasions reviewed transactions that were close to a naval base and recommended that the parties withdraw from proposed transactions.

Importantly, however, the Ralls case should not be interpreted too broadly against Chinese investments. CFIUS analyzes each transaction on a case by case basis. Indeed, the vast majority of Chinese investments, including all the ones that Miller Canfield has been involved with, that have made voluntary notification filings with the CFIUS have successfully obtained prior clearance of their contemplated transactions from CFIUS.

If parties are contemplating entering into a transaction that might be subject to CFIUS review, the parties should consider whether a joint voluntary notification should be filed with CFIUS as a closing condition and if so, what the consequences will be if clearance is not obtained. For example, if CFIUS required the parties to undertake mitigation measures, this type of contingency should be addressed in the agreement between the parties.

This analysis should be undertaken as early as possible in the transaction process. Waiting too long could prevent a transaction from closing on time, because of the length of the CFIUS review process. The initial CFIUS review process takes 30 days from when a notification filing is deemed *complete*. If the CFIUS review goes into a CFIUS investigation stage, the process is extended for an additional 45 days. This process could be even further extended if the matter is forwarded to the President for final review and determination.

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As the Ralls case shows, and through our experience in advising domestic and foreign parties to covered transactions, it is generally good practice for such parties to seek clearance from CFIUS prior to effecting the transaction. An added benefit of making the voluntary notification filing is that it can help a foreign purchaser develop some experience in dealing with CFIUS for other transactions.