

Analysis of Close Proximity Issues in Transactions Reviewed by CFIUS

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A US business' close proximity to facilities or areas considered sensitive by the US Government can raise concerns when the Committee on Foreign Investment in the United States (CFIUS) is evaluating the potential national security risks associated with a transaction. Indeed, close proximity concerns have been particularly relevant in CFIUS reviews involving Chinese investments in the United States. When it comes to close proximity, how close is too close? Is there always a concern when the US business is near a US military base? What are the lessons learned from past close proximity cases? This client alert discusses notable observations regarding close proximity concerns in CFIUS reviews, including key issues and red flags parties should be aware of when considering transactions.

Close proximity concerns raised by CFIUS have received wide media coverage in a number of high-profile transactions. The most publicized example was Chinese-owned Ralls Corporation's acquisition of four Oregon wind-farm projects. CFIUS objected to the transaction, which ultimately led to extensive litigation between Ralls and the US Government and the President taking the rare step of ordering Ralls to divest the acquired assets. CFIUS' concerns—raised by the US Navy—focused on the close proximity of the acquired assets to a US Navy training range. The Ralls litigation, which was ongoing since 2012, settled recently on undisclosed terms. The case underscores the potential ramifications of failing to effectively anticipate and address close proximity concerns. Furthermore, the litigation confirmed the President's authority to block transactions that are deemed to present unresolved national-security concerns.

As the scope of CFIUS reviews evolves to address changing concerns, close proximity issues remain a fundamental component. Of note, in late September, President Obama met with Chinese President Xi Jinping. Following the visit, they released parallel statements addressing national security reviews of foreign direct investment, affirming that both countries "commit to limit the scope of their respective national security reviews of foreign investments (for the United States, the CFIUS process) solely to issues that constitute national security concerns, and not to generalize the scope of such reviews to include other broader public interest or economic issues." While the practical implementation of this mandate remains to be seen, in particular with respect to information technology in the commercial sector, there is little doubt that close proximity concerns squarely fall within the ambit of "issues that constitute national security concerns." Thus, close proximity remains a key issue for foreign investors to consider in deal planning.

Based on our experience representing clients in numerous CFIUS reviews as well as our observations on publicly reported transactions, we have noted the following key trends in cases that have involved close proximity concerns:

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- Many close proximity cases have involved a US target business with physical assets in or near locations devoted to sensitive military activities—in particular those involving open-air training and testing exercises of military equipment (e.g., aircraft). Such areas may or may not be close to an airbase or other ground-based military installation. Indeed, the area of concern in Ralls, known as the Boardman Range, was not near or adjacent to the naval air base whose aircraft used the range.
 - Since the US Department of Defense has Military Warning Areas in the Gulf of Mexico, close proximity issues could arise in transactions that involve leases for oil exploration in the Outer Continental Shelf of the United States.
 - Airspace restrictions around a training or test location often provide a basis for further investigation regarding the existence of potential close proximity concerns associated with that location. However, a target asset need not reside entirely—or even partially—within designated sensitive airspace to raise close proximity concerns. For example, a target uniquely situated to allow unobstructed surveillance of sensitive US Government activities (e.g., aerial testing) may raise close proximity concerns even if the asset is outside of any specially designated airspace.
 - Close proximity concerns for a target located within sensitive airspace might be mitigated by the use or character of the immediate area. For example, a target business located in a densely populated urban area may potentially be less likely to raise actionable close proximity concerns, as nearby US Government activities may have presumably already accounted for the presence of the openly accessible urban area near the installation.
 - Not all military installations associated with open-air test and training ranges are equally sensitive. Knowledge of a particular installation’s activities factors highly in any close proximity analysis.
 - Close proximity concerns that arise in a CFIUS review are usually different than those that are of concern to the Defense Security Service (DSS) when it is assessing a foreign acquisition of a U.S. business with a facility security clearance under its Foreign Ownership, Control, or Influence (FOCI) regulations. DSS closely examines arrangements whereby the foreign buyer will share a building or campus with its cleared soon-to-be affiliate. By contrast, as noted above, CFIUS has tended to focus on assets unrelated to the target business that are situated near open-air test and training facilities (although not exclusively).
 - Close proximity concerns in the CFIUS context appear to be a function of the nature of the target business as well as its location. In particular, close proximity concerns have been frequently raised in cases where the target business is engaged in digging underground or underwater, or operating towers or other elevated structures (e.g., transactions involving mining, oil and gas extraction, and construction of wind turbines). These concerns likely relate to the potential for monitoring afforded by access to underground and elevated areas.
 - CFIUS is likely to view close proximity issues with greater concern if the transaction has a weak business rationale. For example, red flags may be raised if the target business is substantially different from the investor’s other business activities or the buyer appears to be significantly overpaying for the target.
 - Historically, the US Navy appears to have been more proactive in using the CFIUS process to raise close proximity concerns related to its training and test facilities. Nonetheless, close proximity concerns have been raised by other military branches and organizations, and may also be raised by other agencies of the US Government. It is important to note, however, that CFIUS approved the 2013 acquisition of Smithfield Ham by China’s Shuanghui International Holdings without requiring any mitigation despite the close proximity of certain Smithfield properties to sensitive US Government areas in the Commonwealth of Virginia.
 - CFIUS typically tries to focus mitigation measures to its specific concerns. Thus, if a transaction involves the acquisition of multiple facilities and only one is in an area that raises close proximity concerns, the mitigation could likely be tailored to the specific facility (e.g., requiring that it not be included in the acquisition). Accordingly, depending upon the nature of the transaction and with proper due diligence, close proximity issues may be preemptively identified and addressed without jeopardizing the transaction as a whole.

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- Publicly reported transactions that have been rejected on close proximity grounds have to date involved Chinese investors. While this is an issue that Chinese investors should be cognizant of, CFIUS may raise these concerns regarding investors from other countries as well. One could surmise that this would particularly be the case if an investor is from a country viewed as a potential military adversary of the United States, or an ally of such an adversary country. In fact, close proximity concerns were discussed in detail in the Government Accountability Office's (GAO) December 2014 report, "[Risk Assessment Needed to Identify If Foreign Encroachment Threatens Test and Training Ranges](#)." In the report, the GAO recommended that the US Department of Defense develop means of assessing the risk of close proximity of some foreign entities to its ranges, and work with other agencies to obtain additional information on transactions near ranges. The report specifically mentions CFIUS as a potential means of addressing close proximity issues.

Following the visit of President Xi, the White House reaffirmed that the United States welcomes foreign direct investment from China, including Chinese state-owned enterprises. This renewed commitment—together with numerous successful Chinese investments in the US market in recent years—is a positive sign for Chinese investors looking to enter or expand in the US market. While it is always the case that some transactions may not ultimately be workable, having experienced counsel conduct thorough CFIUS-related due diligence can help potential investors fully vet target businesses and be aware of possible issues early in the process. Careful transaction and CFIUS strategy planning can protect investors and help yield the greatest chances for success.

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