

National security concerns can block or unwind your real estate deal

By Ashley Gault and Tod Northman

CFIUS is a federal committee that has the authority to review foreign investments in U.S. businesses to determine if the transactions pose national security risks. For example, CFIUS historically considered foreign control of U.S. businesses that were involved in weapons activity, aerospace or that hold substantial sensitive data about U.S. persons.

Growing foreign investment in the U.S. spurred Congress to expand CFIUS's reach. Before the new law — Foreign Investment Risk Review Modernization Act ("FIRRMA") — was signed by President Trump, CFIUS previously only had jurisdiction to review transactions that could result in "control" of U.S. business by a foreign person.

Under the new law, CFIUS has the power to scrutinize any foreign investment in a real estate transaction that involves a purchase, lease, or concession of U.S. real estate that is located within or functions as part of an airport or maritime port or is in close proximity to a U.S. military facility or other sensitive governmental operation.

This means that CFIUS's authority now extends to developed and undeveloped parcels, leasing and acquisitions meeting the above criteria. Presumably, CFIUS will prescribe forthcoming regulations that define "close proximity." Single-family units and property in urban areas are excluded.

Impacts on Deal Activity

The effect of these changes will be to impact real estate transactions that involve foreign interests. Whether the new law slows deal activity remains to be seen, and future regulations will help define what teeth this new law has.

Foreign companies that invest in U.S. real estate, U.S. companies that have foreign



investors, and sellers and landlords who receive offers from either of those categories, need to understand the impacts of FIRRMA in order to manage their foreign investment risk. Lenders should also have heightened awareness to CFIUS review as CFIUS involvement may occur after financing has been put in place.

The broadening of the types of transactions that fall within CFIUS's review indicates an intent to review any real estate transaction that could potentially pose a threat to national security activities. As part of the due diligence review, companies need to consider whether proactively seeking CFIUS approval is worthwhile. Filing a pre-close voluntary notice can act as a safe harbor and protect against post-closing investigations that could ultimately require a divestiture or unwinding of the transaction.

How CFIUS Works

CFIUS's role is to evaluate whether and to what extent a covered transaction could impact U.S. national security. It is chaired by the Secretary of the Treasury and typically operates by consensus. Submissions, deliberations

and decisions are confidential. CFIUS makes recommendations to the president of the United States about any covered transaction by or with any foreign person which could result in foreign control of a U.S. business. If the president determines that a covered transaction could pose a risk to U.S. national security, the president may suspend or prohibit the transaction, or impose conditions on it.

If a covered transaction is potentially within CFIUS's jurisdiction, the transaction parties should notify CFIUS of the transaction. If the transaction is submitted and cleared by CFIUS, it is cleared forever which eliminates CFIUS risk. However, if a transaction is not cleared by CFIUS prior to closing, it can be reviewed at any time.

Formerly, preparing a filing was a substantial undertaking that required intrusive personal disclosure, including information about financial holdings of the investor and the investor's officers, directors and owners holding more than a 5% interest in the investor.

In reality, companies routinely file an informal draft notice. Then, after receiving

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guidance from CFIUS staff, companies file a formal notice. In practice, CFIUS staff frequently treats a formal notice as a draft and suggests changes.

Under the new law, once CFIUS formally accepts a filing, it reviews the transaction and decides whether to clear it or commence an investigation instead. If CFIUS still has not resolved any potential national security concerns at the end of the investigation period, CFIUS is responsible for making a formal recommendation to the president as to whether to clear or block the transaction. The president then has to decide whether to suspend, prohibit or impose conditions on the deal. The new law also permits, but does not require, CFIUS to adopt a brand-new filing fee of 1% of the transaction value, capped at \$300,000.

Few transactions have been rejected outright through the CFIUS process – more typically parties withdraw the transaction from review and terminate the transaction if staff suggests that approval is unlikely. Alternatively, CFIUS will frequently impose mitigation measures to restructure the transaction to address U.S. security concerns. Examples of mitigation measures that CFIUS has required include creation of a corporate security committee with security policies, annual reports, and independent audits; advance notice to customers of changes in control; and a mandate that only U.S. citizens handle certain products and services.

Example: Unwinding Wind Farms

Even though it occurred before this summer's reform, an Obama-era CFIUS case involving four wind farms in Oregon illustrates well how CFIUS operates.

Ralls Corp., a Delaware corporation

owned by two Chinese citizens, purchased four Oregon wind farm companies without seeking clearance from CFIUS. One of the farms was within or in the vicinity of restricted air space at a Naval weapons system training facility. CFIUS received notice of the deal after closing and notified Ralls that it was reviewing the transaction, leading Ralls to make a voluntary filing. Following review, CFIUS ordered Ralls to stop construction on the projects and ordered Ralls to divest all of its interests in the project within 90 days.

CFIUS provided no further justification for its decision, and wind farms in the area were operated by Danish and German companies. Ralls filed suit, alleging that it had been unconstitutionally deprived of its property without due process of law, since had not been able to participate meaningfully in CFIUS's deliberations. The D.C. Court of Appeals agreed with Ralls' due process arguments, ordered CFIUS to disclose all non-confidential information, and remanded the case to the District Court for further deliberation. The Court of Appeals did not address a last-minute claim of executive privilege, leaving it to the lower court to decide whether executive privilege applied.

Despite "winning" at the Court of Appeals, Ralls eventually abandoned the transaction after CFIUS again affirmed its finding that national security interests were implicated by Ralls pursuing the wind farms. By law, the CFIUS decision is non-appealable.

Lessons from Windfarms Example

- If CFIUS elects to challenge a transaction, the parties nearly always abandon the deal if CFIUS will not agree to mitigation steps.
- Mitigation is not always available. Of note, it

was reported that only one of the four wind farms were within the restricted space, yet CFIUS challenged the entire transaction and there is no indication mitigation was ever discussed. The failure to voluntarily file first may have played a part in CFIUS's approach.

- Nationality matters. Transactions by Chinese investors are subject to particular scrutiny, even if there is no obvious ties between the investor and the Chinese government.
- Because of the facts described in the lawsuit, the amount of information we have about Ralls is extraordinary. All submissions to the Committee are confidential, as are its deliberations and decisions. Indeed, Ralls' suit was based on the secrecy of CFIUS's proceedings. Typically, the only information available about a CFIUS proceeding is provided by the investor.
- The president has nearly unfettered authority under the statute and need not justify his or her decision. Whether executive privilege would provide further protection has not been resolved.
- CFIUS monitors deal flow to discover unreported transactions.



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