CFIUS Review Expanding to Cover Targets Located Near Sensitive Facilities

Two recent investigations suggest that the Committee on Foreign Investment in the United States ("CFIUS") may be broadening the scope of its reviews beyond the activities of the target company itself to include the target's physical proximity to third-party facilities related to national security.[1]

Most recently, CFIUS opened a post-closing investigation into the acquisition of an 88.4% stake in a U.S. mining company still in the start-up phase, Nevada Gold Holdings, Inc. ("NGHI"), by a Chinese company, Far East Golden Resources Investment ("FERGI"). Although it has permits and leases to conduct exploratory mining and a one-person exploratory staff, NGHI's only substantial business operation in 2011 was loaning money to subsidiaries of FERGI's parent corporation.[2] The CFIUS action was apparently based solely on NGHI's proximity to U.S. government facilities near Fallon Naval Air Station ("Fallon NAS"). FERGI has now been forced to divest its interest.[3] This CFIUS review is also noteworthy because it was commenced by an agency notice – i.e., a single CFIUS member agency submitted the transaction for involuntary review, which is very

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1 The Exon-Florio amendments to the Defense Production Act of 1950 (50 U.S.C. App. § 2170) and their implementing regulations (31 C.F.R. part 800) (together, "Exon-Florio") authorize the President to suspend or prohibit foreign acquisitions, mergers, or takeovers of U.S. businesses that threaten to impair the national security of the United States. CFIUS, which conducts reviews under Exon-Florio, is a committee of representatives from various government agencies and offices, including the Departments of Defense, Justice, State, Commerce, Energy, and Homeland Security, and is chaired by Treasury Department. Parties to an acquisition that could raise national security issues can file a voluntary notification of the transaction to CFIUS, thereby triggering a national security review. However, if no notification is made, CFIUS retains the right to review the acquisition in the future, before or after it closes. Following a national security review the Committee may approve the acquisition, require adherence to a security mitigation agreement, or recommend that the President block the acquisition.

To learn more about CFIUS, see our prior alert memorandum, *Recent Revisions to Exon-Florio "National Security" Reviews of Foreign Investment in the United States* (Dec. 22, 2008), http://www.cgsh.com/recent_revisions_to_exon_florio_national_security_reviews_foreign_investment_in_the_us/.

2 FERGI is a wholly owned subsidiary of Hybrid Kinetics Group Ltd., a Chinese-owned Bermuda company.

3 The parties declined to adopt a security mitigation plan that would have required NGHI to dispose of all its leases and claims in Tempo, NV, near Fallon NAS. FERGI and NGHI instead agreed that FERGI would dispose of its interest in NGHI to an approved buyer. Nevada Gold Holdings, Inc., Current Report (Form 8-K) (June 11, 2012).

unusual – and it was not commenced until two years after FERGI's acquisition of NGHI shares closed.

CFIUS's review of NGHI's acquisition by FERGI appears to be the second instance of a transaction being rejected solely because of its location. In an earlier review involving a Chinese acquisition of Firstgold Corp., which also owned a Nevada mine near Fallon NAS, CFIUS cited concerns about the mine's proximity to "sensitive and classified security and military assets that cannot be identified" in blocking the transaction.[4]

The use of location as a dispositive factor for blocking U.S. acquisitions has the potential to seriously complicate efforts to conduct due diligence on potential transactions and assess whether a CFIUS notification is warranted. Following NGHI and Firstgold, it appears that the foreign acquisition of any U.S. business located in the wrong place can lead to adverse CFIUS action, even if the business itself has no national security implications. More troublingly, the parties may have no way of knowing that the target is located in the "wrong place" if the sensitive facilities or operations are not publicly identified and the target has no connection with its neighbor's activities.

Parties contemplating U.S. acquisitions by foreign persons need to take into account the risk that proximity to security assets can lead to CFIUS reviews of transactions that otherwise have no tangible relationship to national security. While it may be very difficult to determine whether sensitive operations are located near the target's facilities or how sensitive those operations may be, foreign acquirers may wish to ask targets with U.S. operations whether they are aware of nearby military or other potentially sensitive facilities as part of their diligence. This is especially the case for acquirors with links to countries that might be considered threats to engage in espionage against the United States. If potential issues are identified, the parties may wish to make a voluntary notification to obtain certainty that the transaction will not be challenged in the future. While post-closing investigations and forced divestiture are likely to remain rare, these recent cases illustrate a new and unpredictable risk to transactions involving businesses far outside the national security sphere.

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[4] Memorandum from Davis Graham & Stubbs LLP and Reed Smith LLP to Firstgold Corp. and Northwest Non-Ferrous Int'l Co. (Dec. 14, 2009) at 3, http://graphics8.nytimes.com/packages/images/nytint/docs/memo-regarding-the-sale-of-firstgold-corp/original.pdf.

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