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A Look Behind the Curtain: D.C. Circuit Orders Obama Administration to Provide Chinese Company with Explanation for CFIUS Challenge to Wind Farm Investment

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On July 15, 2014, the U.S. Court of Appeals for the District of Columbia Circuit, reversing a lower court decision, unanimously held that the Committee on Foreign Investment in the United States ("CFIUS") and the President violated constitutional due process guarantees by ordering Chinese-owned Ralls Corporation to unwind a purchase of wind farm properties on the basis of undisclosed national security concerns.[1] While the grounds of the court's reversal are narrow—that CFIUS and the President failed to provide Ralls with unclassified evidence supporting the decision and an opportunity to respond to that evidence—it represents a sharp rebuke to the often opaque procedures used to conduct national security review of foreign investment in the United States.

CFIUS's Review of the Ralls Deal

In March 2012, Ralls purchased controlling interests in four U.S. companies that held property and permits for the development of wind farms in Oregon. Ralls is owned by two Chinese nationals, both of whom were affiliated with the Sany Group, a Chinese manufacturer of wind turbines. Ralls was in the business of identifying opportunities in the United States for the construction of wind farms that could demonstrate the quality and reliability of Sany's wind turbines. Because Ralls was owned by Chinese nationals, the purchase fell under section 721 of the Defense Production Act of 1950[2] (the "Exon-Florio Amendment"), which gives the President, acting through CFIUS, the authority to review a foreign person's acquisition of a U.S. business to "determine its effects on the national security of the United States."[3] The wind farm projects were located near a U.S. military facility in Oregon, and the Department of Defense indicated that it intended to initiate CFIUS review of the transaction. Upon receiving notice of that intent, Ralls "voluntarily" submitted the deal for CFIUS's review.[4]

The initial CFIUS review period is 30 days, which in some cases is followed by a 45-day investigation period. If, at the end of the investigation period, CFIUS has identified an unresolved national security risk, it can recommend to the President that the transaction be suspended or prohibited. The President then has 15 days to make a final determination.[5] Critically, the statute provides that the actions of the President to suspend or prohibit any covered transaction (or to decline to do so), and the findings of the President underlying a decision to suspend or prohibit a transaction "shall not be subject to judicial review."[6]

During its initial 30-day review period, CFIUS determined that the Ralls acquisition posed a threat to national security and issued an interim mitigation order requiring Ralls to cease construction and operations at one of its project sites, remove all stockpiled or stored items from the sites within 5 days, and cease all access to the sites. CFIUS then initiated a 45-day investigation and issued an amended order further restricting Ralls from completing any sale of the project sites without prior notification to CFIUS. Neither order disclosed the nature of the asserted national security threat nor the evidence on which the Committee relied. Upon conclusion of its investigation, CFIUS submitted a recommendation and report to the President. On September 28, 2012, the President issued an order finding "credible evidence" that Ralls might take action that threatens to impair the national security of the United States. Accordingly, the President directed Ralls to divest itself of all interests in the project companies and their assets within 90 days, remove all items from the project sites, cease access to the sites, and refrain from further dealings to erect wind farms on the sites.[7] Neither CFIUS nor the President gave Ralls notice of the evidence on which they relied in issuing their orders, nor any opportunity to rebut that evidence.

Ralls' Challenge to the Presidential Order

Ralls filed suit against CFIUS and the President, arguing among other things that they violated the Constitution's Due Process Clause by failing to provide Ralls with an opportunity to address any concerns identified by CFIUS or to rebut the factual premises underlying the President's action. The U.S. District Court for the District of Columbia dismissed Ralls' claims against CFIUS as moot and rejected the due process challenge on the ground that Ralls did not have a constitutionally protected property interest, having voluntarily acquired the project company interests subject to the known risk of a Presidential veto under the Exon-Florio Amendment and having waived the opportunity to obtain a determination from CFIUS and the President prior to completing the transaction. The district court also found that the CFIUS review process provided Ralls adequate notice and an opportunity to be heard prior to issuance of the divestment orders.

The D.C. Circuit reversed. The court first held that the statute's bar on judicial review of the President's actions and determinations did not preclude a constitutional challenge to the *process* used to reach those actions and determinations, and then found that process wanting. While the President and the Committee were authorized to withhold from Ralls any classified information on which they relied, the D.C. Circuit unanimously held that "due process requires, at the least, that an affected party be informed of the official action, be given access to the unclassified evidence on which the official actor relied and be afforded an opportunity to rebut that evidence."[8] The court remanded the case to the district court with instructions that the government provide that access and opportunity to respond.[9]

Ralls' victory might well be a Pyrrhic one if its aim was to reverse the President's decision. After all, its due process claim did not challenge the President's finding that the transaction threatened national security or his decision to prohibit the transaction as a means to mitigate that threat. (Indeed, the D.C. Circuit suggested that reviewing those determinations could require it to trespass impermissibly on the Executive's foreign policy and national security powers.)[10] Instead, the court stated, Ralls' claim was only that "the Due Process Clause entitles it to have notice of, and access to, the evidence on which the President relied and an opportunity to rebut that evidence before he reaches his non-justiciable (and statutorily unreviewable) determinations."[11] While Ralls, after receiving the unclassified basis for the original decision, conceivably could convince CFIUS and the President to reach a different result, it is more likely that the outcome will be the same, but now insulated from further judicial review. Moreover, there is no guarantee that the President will provide even

unclassified information to Ralls on remand, as the D.C. Circuit expressly left open the possibility that the President could invoke Executive Privilege to shield this information from disclosure.[12]

The real impact of the *Ralls* decision might be on the level of transparency provided by CFIUS in future reviews, and the willingness of the Committee to challenge deals, when doing so might require that the deal parties be granted access to non-classified sources of information underlying such an action. Even if the Government could continue to shield such information from disclosure relying on the Executive Privilege, invocation of that privilege would invariably involve litigation and be subject to case-by-case decisions by the courts. The potentially chilling effect of shining a light on the underpinnings of the CFIUS process might be enough to prompt the Administration to seek *en banc* review by the full D.C. Circuit or to petition the U.S. Supreme Court to review the decision on certiorari.

CFIUS Review Often Poses Difficult Hurdles for Foreign Investors

Foreign investors—and Chinese investors in particular—are no strangers to the CFIUS review process. While many such deals are ultimately approved, even the prospect of CFIUS review often exerts a powerful influence over the decision by foreign investors to make a play for U.S. targets, particularly those that bear any connection to national security.

The fact that the Ralls properties were adjacent to U.S. military facilities and that the wind towers to be erected on the sites could abut or penetrate restricted airspace underscored the issue of proximity as a potential basis for CFIUS intervention (as the Defense Department's intention to trigger CFIUS review in this case demonstrates) and dramatically expanded the universe of transactions that could potentially be blocked under the auspices of national security. It also signaled a warning to the investment community that unknown and unstated factors could cause a deal to fail to win CFIUS clearance.

Last year, Paul Hastings represented Shuanghui International Holdings (now WH Group) in its $7 billion acquisition of Smithfield Foods Inc. Unlike Ralls, the parties voluntarily submitted a notification to CFIUS before consummating the transaction and ultimately received clearance, but in the interim the transaction was subjected to a veritable firestorm of political criticism, including claims from some members of Congress that the purchase might pose risks to U.S. food supply. Had this argument been accepted, it could have resulted in another expansion of the growing list of factors subjected to CFIUS scrutiny.

Other large Chinese investors have not fared as well, including recent reports that Lenovo's pending acquisition of IBM's server business has stalled in the CFIUS process. The ultimate legacy of the *Ralls* decision might be to encourage CFIUS to be more forthcoming with concerns during the course of its review and to provide parties with greater opportunity to address those concerns prior to the issuance of any order seeking to restrict or block a transaction. If not, the Administration might find itself on the receiving end of more judicial challenges to the process, if not the substance, of CFIUS reviews.

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[1] *Ralls Corporation v. Committee on Foreign Investment in the United States*, No. 1:12-cv-01513 (D.C. Cir., July 15, 2014) ("Slip Opinion")
[2] 50 U.S.C.. § 2170.
[3] *Id.* § 2170(b)(1)(A).
[4] CFIUS has the authority to review transactions voluntarily noticed to the Committee, *see* 50 U.S.C. § 2170(b)(1)(C)(i), or to initiate review *sua sponte*, *see id.* § 2170(b)(1)(D)**.**While submission of a notice to CFIUS is voluntary, companies often elect to submit a notice prior to completing a potentially-covered transaction to avoid a post-closing determination by CFIUS that the transaction is prohibited—and, critically, to avoid an order to unwind the transaction.
[5] *See* 31 C.F.R § 800.506.
[6] 50 U.S.C. § 2170(e).
[7] Order Regarding the Acquisition of Four U.S. Wind Farm Project Companies by Ralls Corporation, September 28, 2012.
[8] Slip Opinion at 36.
[9] *Id.* at 47.
[10] *Id.* at 26.
[11] *Id.* at 27.
[12] *Id.* at 38, 47.