WHITE & CASE

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International Trade

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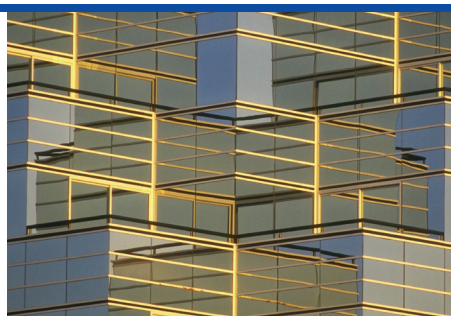
Oral Arguments Held in First-Ever Challenge to CFIUS National Security Review of Foreign Investments in the United States



On May 5, the US Court of Appeals for the District of Columbia (DC Circuit) heard oral arguments in *Ralls Corp. v. CFIUS et al.* The case is the first-ever challenge to the review process conducted by the Committee on Foreign Investment in the United States (CFIUS) within the US federal government that reviews investments by foreign persons in the United States on national security grounds. In 2012, after the acquisition was completed. CFIUS halted and US President Barack Obama subsequently ordered Ralls Corporation, owned by two Chinese nationals, to divest its acquisition of four wind farm project companies in Oregon due to their proximity to a US Navy weapons testing and training facility. Ralls filed a lawsuit challenging the CFIUS and Presidential orders in the US District Court for the District of Columbia (District Court). The District Court ruled against Ralls, citing, inter alia, its failure to file advance notice of the transaction with CFIUS and the non-reviewable nature of the President's actions. On appeal before the DC Circuit, the oral arguments focused on the issue of transparency in the President's decision-making process. The case is important because it weighs the due process foreign investors are entitled to during CFIUS review. It also underscores the importance for potential investors in the United States to carefully consider engaging and filing notice with CFIUS and to remain alert to potential national security considerations in their investments—no matter how innocuous the target—such as proximity to military facilities.

What Is CFIUS?

Pursuant to the Exon-Florio Amendment to the 1950 Defense Production Act, the President, acting through CFIUS, an inter-agency committee in the federal government chaired by the US Department of the Treasury, can suspend, block or otherwise modify investments and acquisitions by *foreign persons* that result in foreign *control* of US entities engaged in inter-state commerce in the United States, if such control threatens US *national security*. This authority may be carried out by conditions or changes prior to the deal's closing or through unwinding or divestment of a transaction that has already been concluded. CFIUS can review transactions upon the filing of a voluntary notice by the parties to a proposed transaction or initiate a review on its own. Upon the filing of a notice with CFIUS, it reviews the transaction over a 30-day period followed by, if need be, a 45-day investigation. At the conclusion, CFIUS may either clear the transaction or refer it to the President, who has 15 days to determine what action to take.

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What Happened With Ralls?

In March 2012, Ralls Corp., a Delaware corporation owned by two Chinese nationals associated with the mega-construction and heavy machinery company, Sany Group, entered into a US$6 million deal to acquire four wind farm project companies in Oregon. Prior to closing the deal, Ralls did not initially file a voluntary notice of the transaction with CFIUS. In June 2012, CFIUS independently learned of the transaction and notified Ralls that if it did not file notice with CFIUS, the Department of Defense, a member of CFIUS, would initiate the review process. On July 25 and August 2, 2012, CFIUS issued orders halting the acquisition; requiring Ralls to cease all construction and remove all items from the relevant properties; and prohibiting Ralls from accessing the properties or selling them until CFIUS was notified and approved of the buyer. On September 28, 2012, President Obama issued a rare and even broader order under Section 721 of the Defense Production Act ordering Ralls to divest all interests acquired in the transaction on national security grounds.[1] A subsequent statement by the US Department of the Treasury on the Presidential order noted that the "wind farm sites are all within or in the vicinity of restricted airspace at Naval Weapons Systems Training Facility Boardman in Oregon."[2] [3]

The District Court's Ruling

On September 12, 2012, Ralls filed an unprecedented lawsuit in the District Court against CFIUS and later President Barack Obama, alleging denial of its due process and equal protection rights. On February 26, 2013, the District Court issued a ruling largely upholding the US government's motion to dismiss the case on the grounds that Section 721 barred judicial review of the President's order yet allowing Ralls to proceed with a limited due process claim regarding the process by which the divestment order was issued. On October 9, 2012, the District Court dismissed Ralls's remaining due process claim. It noted that Ralls possessed no constitutionally protected interests because it "voluntarily acquired those state property rights subject to the known risk of a Presidential veto" and "waived the opportunity... to obtain a determination from CFIUS and the President before it entered in the transaction" by failing to file a notice with CFIUS. The District Court additionally cited the President's "absolute, unreviewable discretion to prohibit a covered transaction."

On Appeal Before the DC Circuit

Following the District Court's dismissal, Ralls filed an appeal with the DC Circuit challenging the District Court's decisions on whether the court can review a Presidential decision under the CFIUS regime and whether Ralls was accorded due process. During oral arguments on May 5, Ralls principally argued that it was entitled to know the "basic gravamen" for the Presidential order. The government's contention regarding proximity to military installations was inadequate, in its view, for example, as only one of the four sets of wind farms was in restricted space. While CFIUS flagged "potential issues" in the transaction, Ralls contended that these issues were never made clear. Ralls further argued that it ought to be able to review the unclassified evidence used by the President in reaching his decision. It cited the risk of transactions being blocked based on factual errors without the investor having the chance to correct the record or implement mitigation measures.

The government conversely argued that Ralls "took a gamble" by not filing with CFIUS, knowing the risk that the President might block the transaction, and that it was not entitled to access materials used as part of the President's deliberative process on a national security matter. Notably, the government suggested that the DC Circuit could remand the case to the District Court to determine whether unclassified information—subject to Presidential communications privilege—could be made available to Ralls to shed some light on the decision-making process.

What Investors Need to Know

Although a degree of transparency in the CFIUS process may emerge from the *Ralls* litigation, the District Court's decision and the statutory regime reflect the deference accorded to the President and CFIUS. Ralls's experience also shows that the onus is on foreign investors to carefully consider the risks of not seeking CFIUS review prior to closing. While filing a notice is voluntary, in many cases prudence demands that investors do so to obtain clearance and safe harbor from further review and to avoid the risk of a costly divestment process after closing. Moreover, given the absence of clear and objective criteria in the CFIUS legal regime for determining national security concerns, it would behoove foreign investors to take as broad as possible a view of what the US government might deem to be of national security concern.

1 See http://www.whitehouse.gov/the-press-office/2012/09/28/order-signed-president-regarding-acquisition-four-us-wind-farm-project-c.

2 See http://www.treasury.gov/press-center/press-releases/Pages/tg1724.aspx.

3 On at least two prior occasions, Chinese investments in the mining sector in Nevada have similarly failed due to the targets' proximity to US military installations.

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