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Will Ralls Decision Really Bring On CFIUS Transparency?

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Law360, New York (August 12, 2014, 10:28 AM ET) -- Since 1988, any foreign or foreign-controlled company seeking to acquire control over a U.S. business has faced the prospect that its investment could be undone or modified by the U.S. president based on concerns for U.S. national security. Under Section 721 of the Defense Product Act of 1950,[1] the president can take such action following a review of such a company's proposed or completed acquisition by the Committee on Foreign Investment in the United States.[2] To date, the basis for the president's decisions and the factors influencing CFIUS in advising the president under Section 721 have been relatively obscure, even to the parties involved in transactions under review. Pursuant to a recent decision of the Court of Appeals for the D.C. Circuit, however, there may be opportunities for increased transparency, at least with respect to CFIUS' considerations.

In *Ralls Corp. v. Committee on Foreign Investment in the United States et al.*,[3] the D.C. Circuit held that entities whose transactions are reviewed under Section 721 are entitled, as a matter of constitutional due process, to have access to unclassified information relied on by the executive branch under Section 721 and to have an opportunity to respond to that information. In so ruling, the court reversed the contrary ruling of the district court below, and remanded the case to the district court for a determination of the contours of the process due, as well as for a decision on the merits of other claims raised in the case.

The decision is a significant victory not only for the plaintiff *Ralls Corp.*, but also for other foreign or foreign-owned companies interested in expanding their presence in the United States. *Ralls*, which is an American corporation owned by two Chinese nationals with connections to the Chinese companies of *Sany Group* and *Sany Electric Co. Ltd.*, brought the case challenging the presidential order to divest its 2012 purchase of four corporations that maintained wind farm sites in Oregon. As part of its business, *Ralls* seeks to identify opportunities in the United States for the use of wind turbines produced by *Sany Electric*. The choice of the corporations purchased in 2012 proved unfortunate, as the acquired wind farm sites are located both in and around a restricted airspace and bombing zone maintained by the United States Navy.

After *Ralls* completed the transaction, the Navy expressed concerns with the purchase and informed *Ralls* that it would notify the transaction to CFIUS if *Ralls* did not. *Ralls* followed up by filing a notice with CFIUS in accordance with Section 721.[4] As required under the statute, CFIUS then commenced a 30-day review of the acquisition and, based on its concerns about the locations of the wind farms, exercised its option to initiate a subsequent "investigation," which, as prescribed in Section 721, could last up to 45 days.

In the course of its review and investigation, CFIUS exercised its authority to "negotiate, enter into or impose, and enforce any agreement or condition" with a party to a notice submitted under Section 721, "in order to mitigate any threat to the national security of the United States that arises as a result of the [notified] transaction." [5] Specifically, based on its view that *Ralls'* acquisition of the companies with the

Oregon wind farms posed a threat to U.S. national security, CFIUS issued orders requiring Ralls to cease its construction on the wind farm sites, to remove all items from the sites, and to abstain from accessing the sites, as well as prohibiting Ralls from selling the four companies without first removing its items from the sites and notifying CFIUS of the sale in advance.

Pursuant to the requirements of Section 721, at the completion of its investigation, CFIUS presented a report and recommendation to the president, and the president then issued a presidential order imposing the same measures ordered by CFIUS and demanding Ralls' divestment in the companies. Ralls brought suit challenging both the CFIUS orders and the presidential order on several grounds, including for violating Ralls' rights under the Fifth Amendment by depriving Ralls of a constitutionally protected property interest without due process of law. In two separate orders, the district court dismissed all of Ralls' claims, and Ralls appealed.

In reversing the district court's orders, the D.C. Circuit made several important findings. First, it determined that, under Section 721, a party can bring a claim for a violation of the party's procedural due process rights, despite the sensitivity of the national security interests involved in executive branch actions under Section 721. Second, it determined that Ralls had been deprived of the process that was due — even though Ralls had, as CFIUS argued, been able “to submit written arguments, meet with CFIUS officials in person, answer follow-up questions and receive advance notice of [CFIUS'] intended action”[6]

Third, it outlined what it considered to be the minimal requirements to satisfy due process: that the affected party (Ralls) “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.”[7] The court emphasized that such a process did not require the disclosure of classified information and did not open the door to review of the executive branch's decision of what constituted a national security interest.

Ralls leaves open a number of questions. For example, it is unclear how much information CFIUS will provide about any particular decision it makes. Although CFIUS often does rely heavily on unclassified information, CFIUS and the president could decide to provide the bare minimum of due process, for example by taking the position that information reflecting their deliberations under Section 721 is classified. This could render the disclosure requirement in the Ralls decision relatively hollow. The manner in which the government deals with its due process responsibilities on remand in Ralls will be telling in this regard.

In addition, although the Ralls decision requires CFIUS to afford parties to Section 721 notices an opportunity to rebut evidence relied on by CFIUS, Section 721 proceedings are subject to strict statutory deadlines, as indicated above. It is uncertain how the ability to rebut evidence within the time periods prescribed by those deadlines will or could occur effectively.

One option that companies have after submitting a notice to CFIUS is to withdraw the notice and subsequently resubmit it — potentially with revisions — after having had an opportunity to meaningfully address what they understand to be CFIUS' principal concerns. But judging when would be the appropriate time to withdraw and resubmit could be difficult, particularly because CFIUS may wait until very late in its review process to articulate its concerns. Moreover, withdrawal and resubmission of a CFIUS notice could prove problematic (if not fatal) to a deal for which closing within a specific time frame is imperative for other reasons.

It also remains to be seen how the district court in Ralls will deal with the claims other than the due process claim addressed on appeal. Ralls' complaint alleges that, with respect to Ralls' investment, (1) CFIUS exceeded its statutory authority, (2) CFIUS violated the Administrative Procedures Act, and (3) CFIUS and the president acted in an ultra vires manner. The district court must now proceed to address the merits of these claims, which challenge not only CFIUS' orders but also aspects of the presidential order. While unlikely, given the president's national security powers, it is possible that the district court could determine that the president has no authority to state the terms under which a corporation must divest itself of property. It could also question the scope of CFIUS' authority to take action short of a presidential order.

Finally, there remains the possibility that the government will seek a rehearing of the D.C. Circuit's decision, either by the original panel of judges or en banc, and/or review by the U.S. Supreme Court.

Ralls plainly establishes that consideration of a transaction under Section 721 must meet due process requirements and that the courts are available to address executive branch failures to meet those requirements. The decision's ramifications as a practical matter in future transactions are much less clear.

[1] Codified as amended at 50 U.S.C. app. § 2170.

[2] The members of CFIUS include the secretaries of commerce, defense, energy, state, treasury and homeland security, as well as the attorney general, the United States trade representative, the director of the Office of Science and Technology Policy and, as nonvoting, ex officio members, the secretary of labor and the director of national intelligence. In addition, the chairman of the Council of Economic Advisors, the director of the Office of Management and Budget, the assistants to the president for national security affairs, economic policy, and homeland security and counterterrorism serve as observers and, where appropriate, participate in and report to the president on the committee's activities.

[3] -- F.3d --, 2014 WL 3407665 (D.C. Cir. July 15, 2014).

[4] Section 721 and its implementing regulations do not require parties to any transaction, including one that will result in foreign control over a major U.S. defense contractor or other U.S. business important to U.S. national security, to submit a notice to CFIUS regarding the transaction. However, such submissions, which trigger CFIUS reviews and recommendations, are the only mechanism through which to obtain assurance that the president will not exercise his Section 721 authority to block or otherwise interfere with a transaction involving the acquisition of foreign control over a U.S. business.

[5] 50 U.S.C. app. § 2170(l)(1)(A).

[6] Ralls, 2014 WL 3407665, at *16.

[7] Id.

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