July 28, 2014

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DC Circuit Decision Could Increase Transparency in CFIUS Reviews of M&A

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On July 15, 2014, the D.C. Circuit issued a significant decision that has the potential to inject greater transparency into reviews by the Committee on Foreign Investment in the United States (CFIUS) of the national security implications of acquisitions of U.S. companies by non-U.S. persons. In *Ralls Corp. v. Committee on Foreign Investment in the United States*, the D.C. Circuit held, for the first time, that the Constitution's due process clause requires CFIUS, and eventually the President of the United States, to provide to a foreign company the unclassified information on which a decision prohibiting an investment by the company may be based, and to give that company an opportunity to rebut adverse findings derived from such information before a decision is made.[1] Although the D.C. Circuit decision does not itself directly limit CFIUS's or the President's authority to review and block transactions that are believed to pose a threat to national security, it may well be a harbinger of change in the CFIUS review process.

CFIUS Review of Foreign Acquisitions of U.S. Companies

CFIUS is an executive branch, inter-agency committee chaired by the Secretary of the Treasury. By a combination of statute and executive order, its membership includes 15 additional departments and agencies (several of which have non-voting or observer status). CFIUS's mandate to conduct national security reviews of foreign acquisitions of U.S. companies comes from a 1988 amendment (the Exon-Florio Amendment) to the Defense Production Act of 1950 (codified as Section 721 of that Act).[2] Under that provision, CFIUS is authorized to review any merger or acquisition that could result in foreign control of a U.S. business to determine the effects of the transaction on U.S. national security. Typically, the parties to a transaction that could implicate national security submit a notice to CFIUS and wait for CFIUS "clearance" before closing the deal. While such notices are not mandatory, they often are seen as advantageous inasmuch as clearance by CFIUS operates as a safe harbor against a future order requiring an unwinding of the deal on national security grounds.[3]

If CFIUS finds no threat to national security, it informs the parties to the transaction that it has concluded its review and decided to take no action. If CFIUS finds that a transaction could threaten to impair national security, it usually works with the parties to put in place measures to mitigate the perceived threat, and then closes the matter subject to the parties' agreement to abide by those measures. In extremely rare cases, where the transaction parties are unwilling to agree to mitigation measures deemed necessary by

CFIUS and also unwilling to abandon (or voluntarily unwind) the transaction, CFIUS may refer the matter to the President.

If the President finds that (i) "there is credible evidence that leads the President to believe that the foreign interest exercising control [of a U.S. company] might take action that threatens to impair the national security," and (ii) other provisions of law (excluding the International Emergency Economic Powers Act) are inadequate to the task of protecting the national security, then the President may order the transaction to be suspended or prohibited. If the transaction already has been consummated, the President may order divestment.[4] As relevant to the *Ralls* case, the Exon-Florio Amendment provides that "[t]he actions of the President … and the findings of the President … shall not be subject to judicial review."[5]

CFIUS and Presidential Action Prohibiting Ralls's Acquisition

In *Ralls*, a Georgia-based, Delaware-incorporated company (Ralls) owned by Chinese nationals acquired several other companies (also established under U.S. law) that had been formed to develop wind farms in Oregon. One of Ralls's owners was the chief financial officer of a Chinese company, known as Sany Group, an affiliate of which manufactures wind turbines that it hoped to use in wind farms developed by Ralls.

Ralls had not notified CFIUS before acquiring the project companies in March 2012, but after closing, the deal came to CFIUS's attention. The D.C. Circuit decision suggests that CFIUS's interest may have related to the wind farms' proximity to restricted airspace maintained by the U.S. Navy.[6] At the request of CFIUS, Ralls submitted a notice describing the transaction in June 2012.

After review, CFIUS determined that Ralls's acquisition of the project companies posed a national security threat. Pending final action, CFIUS imposed mitigation measures requiring Ralls to cease all construction at, and all access to, the wind farm sites and to remove all stockpiled and stored items from the sites within a matter of days. CFIUS later amended its order to prohibit Ralls from selling the project companies or their assets without first giving CFIUS the opportunity to object to such a sale. Ralls's lawsuit challenged not only the President's eventual order of divestment based on CFIUS's recommendation (the "Presidential Order"), but also the CFIUS Order that preceded it (and that by its own terms expired upon issuance of the Presidential Order).

CFIUS recommended that the President prohibit Ralls's acquisition of the project companies, and in September 2012, the President issued an order following that recommendation. The Presidential Order required an unwinding of the acquisition, as well as compliance with the various mitigation measures that had been contained in the earlier CFIUS Order, including those pertaining to the sale of the project companies and their assets. (The Presidential Order also prohibited the sale or transfer of any Sany Group products for use or installation at the project sites.)

Consistent with CFIUS practice, neither CFIUS nor the President gave Ralls notice of the evidence on which they had relied, let alone provide an opportunity for Ralls to rebut that evidence.

Ralls's Complaint

Even before the President issued his order prohibiting Ralls's acquisition, Ralls filed suit in the U.S. District Court for the District of Columbia challenging the CFIUS Order. In an amended complaint, Ralls later added a challenge to the Presidential Order. In an October 2013 judgment, the district court dismissed the claims pertaining to the CFIUS Order as moot on the grounds that it had been superseded by the Presidential Order. It dismissed most of Ralls's other claims on the grounds that they were precluded by the Exon-Florio Amendment's bar to judicial review of presidential action. Although it found Ralls's constitutional due process claim not to be precluded, it dismissed that claim on the grounds that Ralls had not been deprived of a constitutionally protected interest, because it acquired its interest in the project companies knowing that its acquisition could be subject to presidential review for national security reasons. (Alternatively, the court found that Ralls's

opportunity to make a submission to CFIUS accorded with the requirements of constitutional due process.)

Ralls appealed, and in its July 15, 2014 decision, the D.C. Circuit reversed and remanded the case to the district court.

The D.C. Circuit Decision

The first question before the D.C. Circuit was whether the Exon-Florio Amendment's bar to judicial review of the actions and findings of the President precluded jurisdiction over Ralls's due process claim. It answered that question in the negative. The court relied on precedents requiring clear and convincing evidence of congressional intent to bar constitutional claims. It found a lack of clear and convincing evidence in the text or history of the Exon-Florio Amendment that Congress intended to preclude claims such as Ralls's due process challenge to the Presidential Order. In this regard, the court drew a distinction between the statute's bar to judicial review of presidential action and its silence as to "the *process* preceding such presidential action."[7]

Having found that it had jurisdiction to hear Ralls's due process claim, the court next considered the government's contention that that claim raised a non-justiciable political question. It rejected that argument, too, explaining that "we do not automatically decline to adjudicate legal questions if they may implicate foreign policy or national security."[8] Again, the court drew a distinction between presidential action and the process leading to presidential action. It found that Ralls's complaint concerned the process – that is, the absence of "notice of, and access to, the evidence on which the President relied and an opportunity to rebut that evidence before [the President] reaches his non-justiciable (and statutorily unreviewable) determinations."[9] It rejected the government's contention that the process itself raised a non-justiciable political question.

On the merits, the D.C. Circuit held that the government's failure to give notice of its evidence – at least unclassified evidence – and to provide Ralls an opportunity to rebut it, did not comport with due process. In getting to that conclusion, the Court held that, contrary to the government's submissions and the lower court's decision, Ralls had a property interest protected by the due process clause, even though the company acquired that property (*i.e.*, land and other rights related to the wind farm sites) knowing that its acquisition could be subject to CFIUS review. In particular, the Court found that Ralls's failure to submit a notice to CFIUS before making its acquisition did not constitute a waiver of its property interest given the voluntary nature of the CFIUS review process and the possibility, expressly provided for in the CFIUS regulations, of seeking a review even after a transaction is completed.[10]

Having found that Ralls had a protected property interest, the Court next considered what process was due Ralls before depriving it of its property interest. It 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."[11] Since the Presidential Order purported to deprive Ralls of its property without even this minimum level of due process, the Court held the deprivation to be unconstitutional and remanded the case to the district court.

Of potential importance to the long-term significance of the *Ralls* decision is the fact that, in reversing and remanding, the D.C. Circuit indicated that it was not reaching an argument raised belatedly by the government concerning "whether the executive privilege shields the ordered disclosure" of the unclassified information on which CFIUS and the President relied.[12] It may be that upon fuller briefing the district court finds even the unclassified information on which CFIUS and the President relied to be shielded by executive privilege. The theory (presumably) would be that disclosing even the unclassified information would reveal the deliberative process that lead to CFIUS's and the President's decisions, and that this would encroach unduly on executive branch decision making. If the district court, and eventually the D.C. Circuit, agree with that argument, then the long-term impact of the *Ralls* decision is likely to be minimal or non-existent.

Finally, the D.C. Circuit found that the district court erred in dismissing Ralls's separate challenge to the

CFIUS Order as moot on the grounds that it was superseded by the Presidential Order. The Court agreed with Ralls that its challenge to the CFIUS Order was subject to the capable-of-repetition-yet-evading-review exception to mootness. That is, given the relatively brief period for which the CFIUS Order was in effect and the likelihood that Ralls will engage in similar future transactions that could be subject to similar treatment by CFIUS, it was appropriate in this case to make an exception to the ordinary jurisdictional bar due to mootness.[13]

In light of the D.C. Circuit's decision, the government has several options. It may seek *en banc* review by the full D.C. Circuit (which it would have to do by August 29, 2014). It may ask the Supreme Court to review the decision (which it would have to do by October 14, 2014). Or, it may take its chances on remand that the district court will dismiss Ralls's claims on grounds not addressed in that court's earlier decision – *e.g.*, executive privilege.

However, if the decision in Ralls's favor survives, and if executive privilege and other defenses the government could assert on remand are rejected, then the decision may have an impact on future CFIUS reviews, even if it does not itself limit CFIUS or the President's powers or ultimate decisions.

Possible Impact on Future CFIUS Reviews

The CFIUS review process frequently has come under criticism for its lack of transparency. CFIUS does not give reasons for its findings or actions. Neither the Exon-Florio Amendment nor the CFIUS regulations define "national security." In guidance issued in December 2008, following a substantial revision of the Exon-Florio Amendment in 2007, the Treasury Department (as chair of CFIUS) explained that

> CFIUS identifies all national security considerations (*i.e.*, facts and circumstances that have potential national security implications) in order to assess whether the transaction poses national security risk (*i.e.*, whether the foreign person that exercises control over the U.S. business as a result of the transaction might take action that threatens to impair U.S. national security). In conducting its analysis of whether the transaction poses national security risk, CFIUS assesses whether a foreign person has the capability or intention to exploit or cause harm (*i.e.*, whether there is a threat) and whether the nature of the U.S. business, or its relationship to a weakness or shortcoming in a system, entity, or structure, creates susceptibility to impairment of U.S. national security (*i.e.*, whether there is a vulnerability).[14]

In the same document, CFIUS referred to the illustrative list of 11 national security-related factors set forth in section 721(f) of the Defense Production Act. While that list gives some indication of how CFIUS thinks about national security, it also concludes with a catch-all reference to "such other factors as the President or [CFIUS] may determine to be appropriate, generally or in connection with a specific review or investigation."[15]

The 2008 guidance notes that CFIUS's "national security risk assessment is concluded based on information provided by the parties, public sources, and government sources, including a classified National Security Threat Assessment [prepared by the Director of National Intelligence]."[16] (Thus, in principle, if the *Ralls* decision stands, and if the government is unsuccessful in invoking executive privilege as a shield, there should be some unclassified information that CFIUS will have to produce to transaction parties before taking action that could deprive them of protected property interests.)

In addition to providing no information about the reasons for its findings related to national security, CFIUS provides no information about the rationale behind measures it proposes to mitigate perceived threats to national security. Parties may have some ability to negotiate with CFIUS over threat mitigation measures, but in doing so they necessarily see only half of the picture. Thus, a company may be able to demonstrate to CFIUS that a particular measure will have a burdensome impact on its business operations, but since the company will not know CFIUS's basis for demanding that measure,

it probably will not be able to demonstrate that the burden is disproportionate compared to the degree of threat mitigation anticipated to be achieved.

Given the extreme obscurity that currently shrouds CFIUS decision making, even the modest due process protections that *Ralls* could engender are likely to be welcome, especially to companies that are repeat players before CFIUS. At a minimum, the D.C. Circuit decision should serve as a reminder to Treasury and to the other CFIUS members that even in the realm of national security, constitutional protections still apply, and their actions are not entirely beyond judicial review. Even if *Ralls* does not result in particular changes to CFIUS practices and procedures, it could have an impact on the way CFIUS decision makers go about their work.

It is important, however, not to overstate the significance of the *Ralls* decision, even if it does stand. Whatever unclassified information the government ultimately may be required to produce to parties is likely to be limited and reveal little, if anything, about CFIUS's analysis. Moreover, it is unclear whether the D.C. Circuit's reasoning would extend to the normal case of a CFIUS review conducted before a transaction closes (and, therefore, before a constitutionally protected property interest is acquired). CFIUS could well decide to limit any change in practice to its actions with respect to transactions that come to its attention after closing. In that case, the question of whether there are any due process limitations on CFIUS action prior to a transaction's closing would have to be answered in a future case.

1. *Ralls Corp. v. Comm. on Foreign Inv. in the U.S.*, No. 13-5315 (D.C. Cir. July 15, 2014).
2. 50 U.S.C. App. § 2170.
3. *See* 31 C.F.R. § 800.601 ("finality of actions under section 721").
4. 50 U.S.C. App. § 2170(d)(4).
5. 50 U.S.C. App. § 2170(e).
6. *Ralls* at 8.
7. *Ralls* at 21.
8. *Ralls* at 25.
9. *Ralls* at 26-27.
10. *Ralls* at 30-32.
11. *Ralls* at 36.
12. *Ralls* at 38.
13. *Ralls* at 42-43, 46-47.
14. 73 Fed. Reg. 74567, 74569 (Dec. 8, 2008).
15. 50 U.S.C. App. § 2170(f)(11).
16. 73 Fed. Reg. at 74569.

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