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E-ALERT | Cross-Border Investment

July 18, 2014

UPDATE ON CFIUS DEVELOPMENTS:

PERSPECTIVES ON THE U.S. COURT OF APPEALS DECISION IN *RALLS*

Summary

We are writing to share our perspectives on the decision this week of the U.S. Court of Appeals for the District of Columbia Circuit ("DC Circuit") in *Ralls Corporation v. Committee on Foreign Investment in the United States* ["CFIUS"] — the first ruling by a federal circuit court on a CFIUS case. We have written previously about President Obama's Executive Order (the "Presidential Order") prohibiting Ralls Corporation ("Ralls") from owning certain Oregon wind farm project companies located in the vicinity of restricted airspace associated with a U.S. Navy facility. We also wrote about the earlier decision of the U.S. District Court for the District of Columbia, which dismissed Ralls' claims that CFIUS's actions preceding the Presidential Order violated a federal statute, the Administrative Procedure Act, and amounted to an unconstitutional deprivation of property without due process of law.

A three-judge panel of the DC Circuit, reversing the district court, held that the Presidential Order deprived Ralls of a constitutionally protected property interest without due process of law. The DC Circuit further found that due process entitled Ralls to review an unclassified version of the evidence on which the President relied in making his determination and to have an opportunity to rebut that evidence.

In light of the extensive commentary on the *Ralls* case over the past several days, we believe that it is important to bear in mind what the decision means — and, just as importantly, what it does not. Perhaps the most significant policy implication of the decision is its affirmation of the integrity of the U.S. legal framework for foreign direct investment: not only is the U.S. system open to foreign investment, but it also offers strong protections for investors — even when the authorities of the Executive Branch are at their zenith, as is the case with national security decisions. In this regard, the *Ralls* decision sends a powerful positive message both to foreign investors contemplating investment in the United States, *and* to other countries regarding the basic protections that should be afforded to *their* inbound investment (including investment from the United States).

More fundamentally, the DC Circuit decision carries two principal regulatory implications.

First, the decision affirms the importance of transparency and fairness in regulatory processes. That this is true even for the CFIUS process — a process predicated on protecting U.S. national security and that inherently is based on classified information — illustrates the overwhelming primacy of due process interests in the American legal system. As a practical matter, this principle can be realized through a CFIUS process that is more transparent and involves more iterative engagement with transaction parties — process points that, as described below, CFIUS can implement readily if it so chooses.

Second, the DC Circuit decision re-opens a lingering question as to whether CFIUS may permissibly impose interim mitigation measures to protect national security during the pendency of an ongoing CFIUS review. This will be an important issue for the district court to consider on remand.

At the same time, we would caution against viewing the DC Circuit decision in *Ralls* as a rebuke of the Presidential Order, or as a decision requiring radical changes to the CFIUS process. Indeed, to the contrary, the DC Circuit did not limit *in any respect whatsoever* the President's authority to suspend or prohibit transactions that present unresolvable risks to national security, nor did it limit CFIUS's underlying authority to determine the impact of a transaction on national security. Likewise, the court never questioned the President's substantive national security determination in *Ralls*.

It will not be difficult for CFIUS to comply with the DC Circuit's decision and to continue to prohibit Ralls' acquisition of the wind farm project companies. As described below, CFIUS can readily provide more "due process" (*i.e.*, greater transparency) through relatively modest modifications to its process. There also is reason to believe that the district court ultimately will affirm CFIUS's ability to take interim measures to protect national security in certain extraordinary circumstances like to those presented in *Ralls*.

Seen in this light, the *Ralls* decision is perhaps best understood as a positive decision for foreign investors — and one with positive process-related implications — but not as signaling a sea change in the CFIUS process or in the President's authority to protect U.S. national security.

Discussion

THE DECISION

As noted, the DC Circuit's decision focuses carefully on the *processes* that CFIUS employs — which processes the court deemed inadequate — and not on the substance of CFIUS's or the President's authorities. It remains to be seen whether the government will seek a rehearing *en banc* (*i.e.*, by the entire 11-judge bench of the DC Circuit) or appeal the ruling to the U.S. Supreme Court. In the meantime, however, the DC Circuit reached a number of conclusions that bear on the administration of the CFIUS process:

- **No statutory bar to judicial review of CFIUS's processes.** Section 721 of the Defense Production Act of 1950 ("Section 721"), which empowers CFIUS to review and the President to block foreign acquisitions of U.S. businesses, provides that "the actions of the President . . . shall not be subject to judicial review." Noting that the Supreme Court has long held that a statutory bar to judicial review precludes review of constitutional claims only if there is "clear and convincing" evidence that Congress so intended, the DC Circuit concluded that while Congress may have intended a Presidential decision to "suspend or prohibit" a transaction to be immune from judicial review, Congress did not intend to immunize from judicial scrutiny the *process* that leads to such a decision. Accordingly, it is appropriate for the judiciary to examine CFIUS processes to ensure that they pass constitutional muster, even if the ultimate decision on the merits to permit or block a transaction remains committed to the President's sole discretion.[1]
- **Ralls acquired a constitutionally protected property interest.** The district court previously had concluded that while Ralls acquired legally cognizable property interests as a matter of state law, those interests were not constitutionally protected because Ralls (1) acquired the interests

[1] Because the due process claim did not require the DC Circuit to review the merits of the Presidential Order, the court concluded that its consideration was not barred by the political question doctrine — a separation of powers doctrine that precludes courts from reviewing decisions that are inherently political in their nature and, therefore, committed solely to the political branches of government.

"subject to the known risk of a Presidential veto" and (2) "waived the opportunity . . . to obtain a determination from CFIUS and the President before it entered into the transaction." The DC Circuit rejected this analysis. It concluded that there was nothing "contingent" about the property interests that Ralls obtained and that Ralls did not waive its property interest by choosing not to make a voluntary filing with CFIUS.

- Constitutional due process requires access to *unclassified* information and an opportunity to rebut that information. In one of the most important holdings in the case, the DC Circuit determined that the "specific dictates of due process" in the CFIUS context requires "at the least, that the affected party be informed of the official action, be given access to the unclassified information on which the official actor relied and be afforded an opportunity to rebut that evidence."
- However, parties before CFIUS have *no* right to *classified* information or information protected by executive privilege. The court was careful to note that due process does not require that parties have access to classified information. The court also noted that the Executive Branch could seek to assert executive privilege with respect to certain information related to the President's decision and withhold such information from the parties.
- District court to consider scope of CFIUS's authority to impose interim orders. Even before President Obama's issuance of the Presidential Order, CFIUS separately had issued an interim order prohibiting Ralls from accessing the wind farm locations and imposing certain other requirements and restrictions. Ralls challenged CFIUS's interim order as beyond CFIUS's authority and as a violation of the Administrative Procedure Act. The district court concluded that Ralls' challenge of CFIUS's order was mooted by the President's subsequent order and declined to consider that question. The appeals court disagreed, applying the "capable of repetition yet evading review" exception to the mootness doctrine. Importantly, the court's decision in this regard puts the question of whether CFIUS's interim order exceeded the Committee's authority squarely before the district court on remand.

RALLS' UNIQUE CIRCUMSTANCES AND THE IMPLICATIONS FOR REMAND

To understand the impact of the *Ralls* decision, it is essential to bear in mind the unusual circumstances of the case. Most importantly, Ralls did not notify the transaction to CFIUS until *after* the transaction had been consummated. As a consequence, Ralls already had acquired the relevant property rights before it ever entered the CFIUS process. By contrast, the vast majority of parties that voluntarily seek CFIUS review do not acquire an interest in the relevant property until *after* the CFIUS review is completed. These unusual circumstances led to an equally unusual and extreme outcome: an interim CFIUS order and a Presidential Order compelling divestiture of the U.S. business.

In part because of these unusual circumstances, the DC Circuit decision is unlikely to have a meaningful practical impact on Ralls' position vis-à-vis CFIUS. As noted, the court was very careful to make clear that it did not question the President's authority to block a transaction or force a divestiture. And there is little reason to believe that the President would have reached a different conclusion had Ralls been afforded enhanced procedural protections that the DC Circuit now has required. We note in this regard that a statement by the Department of the Treasury that accompanied the Presidential Order already contains a cursory explanation of the reasons for the President's decision:

> Ralls Corporation is owned by Chinese nationals, and is affiliated with a Chinese construction equipment company that manufactures wind turbines. The wind farm sites are all within or in the vicinity of restricted air space at Naval Weapons Systems Training Facility Boardman in Oregon.

Given the extreme actions taken by CFIUS and the breathtaking sweep of the Presidential Order — not only was a divestiture directed, but the President ordered the removal of all installations, *including concrete foundations*, that had been laid by Ralls — it is abundantly clear that the U.S. government had grave national security concerns regarding the Ralls transaction, and those concerns likely were heavily informed by classified analysis. Thus, even if Ralls is presented with unclassified information in greater detail about the nature of the government's concerns, it is quite unlikely to be able to rebut and mitigate those concerns in a manner sufficient to change the existing outcome of the CFIUS review.

If the DC Circuit decision is not appealed (and granted a writ of certiorari — *i.e.*, review by the U.S. Supreme Court), a potentially more interesting and impactful issue on remand will be the district court's reconsideration of whether CFIUS's interim order — which effectively froze work at the wind farms and prohibited Ralls from accessing them — exceeded the Committee's authority under Section 721. This is particularly important because it goes squarely to the policy balance that underlies the CFIUS statute and process. Thus, as affirmed by successive Presidential administrations dating back to the 1970s, the United States has an open investment policy, welcoming all investors and subject only to very narrowly tailored actions to protect national security. For this reason, the law governing CFIUS established the Department of the Treasury — the executive agency most responsible for the economic vitality of the United States — as the Chair of CFIUS, rather than an agency with more traditional security responsibilities, such as the Department of Defense: in other words — and contrary to the belief of some who view CFIUS as concerned rigidly and solely with national security, as if it operated in a vacuum — the CFIUS process is by statutory design intended to be consistent with and to promote the U.S. policy of open investment, while ensuring that agencies with national security responsibility also can review transactions and take appropriately tailored action to protect national security in the context of an open investment environment. Had Congress intended otherwise, a security agency — not the Department of the Treasury — would chair the Committee.

For these same reasons, Section 721 did not establish CFIUS to be a screening mechanism for all foreign M&A activity in the United States; to the contrary, the Committee screens only about 10-15 percent of potentially covered transactions in any given year. The law and the associated implementing regulations, in turn, help ensure that the CFIUS process is narrowly scoped by providing for a "voluntary" notification process. While this approach guards against CFIUS overextending its jurisdiction to transactions that have no bearing on national security, it also places a responsibility on transaction parties to make informed and prudent judgments as to when they should bring transactions to CFIUS's attention before consummating them.

Against this backdrop, it would be surprising if the district court concludes on remand that CFIUS lacks authority to impose interim mitigation to protect national security in cases where transaction parties close a transaction without filing with CFIUS and the resulting transaction in turn threatens the national security. Whether the district court also concludes that CFIUS's particular interim protection order in *Ralls* was consistent with this authority remains to be seen, but we expect that the court will find CFIUS does have authority to take action in such extreme cases — provided that it also complies with the due process requirements.

WHAT "DUE PROCESS" MEANS IN THE CFIUS CONTEXT

For most transaction parties that are subject to CFIUS review, the principal significance of the *Ralls* decision will be what "due process" means going forward. To that end, it is important to note that the DC Circuit decision should not be understood to afford due process only to parties that close

transactions and, therefore, have acquired property. Rather, properly understood, the decision appears to affirm that all parties appearing before CFIUS must receive due process before CFIUS takes action that impacts their rights. For example, the court appeared to conclude that CFIUS's procedures had not satisfied the requirements of constitutional due process, regardless of whether those procedures were afforded before or after the completion of the transaction; thus:

> There is no indication that the process Ralls received after the transaction was completed is different from the process it would have received had it sought pre-approval — and, as discussed *infra*, that process was inadequate.

In addition, the court treated CFIUS's interim order as implicating the same constitutionally protected property interest as the Presidential Order.

Indeed, to interpret the DC Circuit's decision to apply only to cases filed after transactions close would create bizarre incentives — i.e., in order to receive the benefits of constitutional due process, the parties would need to close the transaction before CFIUS's review is completed. This result would be directly at odds with the structure and purpose of Section 721, as explained above.

As a practical matter, it should not be difficult for CFIUS to effectuate a review and investigation in a manner that provides the required due process to the transaction parties. Indeed, many transaction parties will attest that this has happened, even in challenging cases. Nevertheless, CFIUS could enhance its regular process with a few minor adjustments that would be entirely consistent with the statute, regulations, and governing Executive Order.

- **Enhanced Communication with Co-Lead Agencies.** After a transaction has been notified to CFIUS, one or more agencies are designated as "lead agencies" and will be responsible for managing engagement with the parties and negotiating a mitigation agreement, if necessary. Typically the CFIUS agencies with the greatest equities in a particular transaction — and substantive expertise in the particular industry — will be designated as co-lead agencies.

  The Executive Order governing the CFIUS process (which implemented the most recent amendment to Section 721) provides that "communication with the parties to a transaction shall occur through or in the presence of the lead agency or the [Department of the Treasury] if no lead agency has been designated." This rule is designed to help define and organize the CFIUS process. However, as a practical matter, the rule has been implemented in a manner that limits CFIUS's communication with the parties. It is not unusual even for lead agencies to defer all questions and communications to the Treasury Department, and parties have very limited, if any, ability to communicate with agencies that are not formally designated as the "lead," even if those agencies may have concerns or questions about the transaction.

  From the perspective of transaction parties, this channeling of communications through the Treasury Department and the corresponding barrier to dealing with other member agencies of CFIUS can obfuscate the review process. It adds a layer between the transaction parties, which have the best understanding of the transaction and the business at issue, and those elements of the government that might have the greatest interest or greatest concerns about the transaction. In addition, as chair, the Treasury Department is naturally protective of the review process and the deliberations of the Committee. These are admirable qualities for an administrator of an inter-agency process, and the Treasury Department deserves credit for its fidelity to its role as chair. But these very same qualities that make it an effective chair, when combined with the fact that the Treasury Department often does not have the substantive equities or expertise that may underlie a particular concern, mean that the Treasury Department may feel constrained in its communications to parties and those communications, in turn, will appear more equivocal to

transaction parties. This dynamic limits the ability of the transaction parties to address directly and clearly particular interests or concerns of the CFIUS member agencies — and it may contribute to feelings of the parties that they are not receiving a "process" even when the Committee is working very hard to provide a thorough and fair process in its deliberations.

Resolving this problem would require only modest tweaks to the CFIUS process. Specifically, when CFIUS designates those agencies with the greatest equities in a particular transaction as "co-lead" agencies, it could permit those agencies to engage directly with the parties together with the Treasury Department. This will ensure that the Treasury Department, as the Chair, remains firmly involved and chiefly responsible for administering reviews and guiding the process — consistent with the statute, regulations and governing Executive Order (and greatly in the parties' interest) — while also providing the sort of direct communication that may help address the process concerns of the DC Circuit. And, the direct engagement with the co-lead agencies that have substantive expertise and equities in the transaction can help provide the CFIUS agencies with greater information about the transaction and the parties, leading to a more informed and fair process.

- **Earlier Interactive Engagement with Parties.** There is another aspect of the CFIUS process that has limited engagement with the parties and that could be resolved with a minor adjustment to the process. Section 7(b) of Executive Order 13456 governing the CFIUS process requires the Committee to agree to and approve any risk mitigation measure before it is proposed and negotiated with the parties. This procedure was designed to prevent mitigation agreements that reflect the interests of only one CFIUS agency and may not be directly related to a national security risk. Yet this rule, when combined with the limitation on communication with the parties described above, has the practical effect of substantially delaying substantive communication with the parties. In some cases in which CFIUS identifies a national security risk, the Committee may be unable to come to consensus until the very end of a 75-day review period, after which CFIUS is required by Section 721 to approve the transaction or submit it to the President for his action. In those instances, there can be little or no substantive interaction with the parties until the very end of the statutory review period, if at all — and thus, little opportunity for the sort of engagement that the DC Circuit's decision requires.

  Once again, the solution requires only a modest tweak of CFIUS's practices. If the co-lead agencies and the Treasury Department could engage with transactions parties more freely about *unclassified* potential concerns and mitigation considerations earlier in the CFIUS process — subject to a clear understanding that any concerns and mitigation ultimately must reflect a consensus of the Committee — this would help provide a process for transaction parties to address those concerns. Such engagement could occur after CFIUS receives the initial National Security Threat Assessment that, by statute, the Director of National Intelligence must produce for every CFIUS review, or even earlier in cases that foreseeably present challenging national security issues (such as with repeat investors that have multiple national security agreements and that are active in sectors that are very likely to implicate national security interests). This early engagement and discussion around potential mitigation would not undercut the important requirement that any mitigation decision be based on the consensus of the Committee, nor would it dictate any outcome — including a conclusion that national security concerns are unresolvable. It would, however, provide parties more opportunity to "rebut" any of the unclassified information that would inform a decision that national security concerns are unresolvable, consistent with the requirements of the DC Circuit's decision.

Importantly, neither of these changes would require any amendment of Section 721, the regulations, or the Executive Order governing CFIUS. In addition to addressing the concerns about the CFIUS process apparent in the DC Circuit's decision, they could decrease the amount of time necessary to

complete CFIUS reviews, a result that is consistent with the United States' longstanding policy of openness to foreign investment.

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