

D.C. Circuit Issues Ruling in Important CFIUS Case

I. Introduction

The D.C. Court of Appeals recently issued a landmark decision in *Ralls Corporation v. Committee on Foreign Investment in the United States* (CFIUS), No. 13-5315, slip. op. (D.C. Cir. July 15, 2014), that could have far-reaching implications on how the government reviews transactions in which foreign individuals or entities acquire control of U.S. companies with potential national security implications. In particular, this recent opinion suggests that foreign persons are entitled to access the unclassified evidence that the government relies on during the CFIUS review process, and rebut that evidence, before a potential transaction is blocked.

II. CFIUS Background

CFIUS is the federal inter-agency committee responsible for reviewing transactions that result in a foreign person controlling a U.S. business in order to assess the implications the transaction would have on national security. Pursuant to statute, CFIUS is charged to review “covered” transactions, which are defined to include any merger, acquisition, or takeover by a foreign person that results in control of any U.S. business. Parties to a covered transaction are not required to provide notice to CFIUS prior to closing. But not submitting such a voluntary notice, however, exposes the foreign purchaser to risk because CFIUS can force the foreign purchaser to divest after closing if it later determines that the covered transaction threatens U.S. national security. Indeed, the CFIUS review process has delayed a number of high-profile deals involving foreign purchasers in recent years, including the Wanxiang Group Corp.’s acquisition of A123 Systems Inc. and Shuanghui International Holdings Ltd.’s purchase of Smithfield Foods Inc.

III. Case Background

Ralls Corporation (Ralls) is an American company incorporated in Delaware that is owned by two Chinese nationals. In March 2012, Ralls purchased four American companies previously formed to develop windfarms in Oregon. All of the windfarm sites acquired by Ralls were located close to, or within, a restricted airspace and bombing zone controlled by the United States Navy. Despite the proximity of the windfarms to these areas, Ralls did not submit a joint notice to CFIUS prior to completing the transaction.

Following closing, and despite the fact that the Ralls windfarms were not the only foreign-owned windfarms in or near the restricted airspace, CFIUS took an interest in the transaction. In response to that interest, Ralls submitted a notice related to its acquisition of the four companies to CFIUS. CFIUS thereafter determined that Ralls’s acquisition of the Project Companies threatened national security and issued temporary orders restricting Ralls’s access to, and preventing further construction at, the project companies’ windfarm sites. President Obama later concluded through a Presidential Order that the transaction posed a threat to national security and issued a permanent order prohibiting the transaction. Pursuant to the Presidential Order, Ralls was given 90 days to divest its interest in the four companies and 14 days to remove physical objects and structures from the sites.

Ralls challenged the CFIUS and Presidential Orders in federal district court in Washington, D.C., alleging *inter alia* that the orders resulted in an unconstitutional taking of property that was contrary to the Due Process Clause of the Fifth Amendment. Ralls specifically claimed the fact that neither CFIUS nor the President provided Ralls the opportunity to review and rebut the evidence the government relied upon in reaching their decisions violated its due process rights. The D.C. district court found that Ralls lacked a protected property interest in the four companies because it had acquired the companies knowing that it could be subject to divestiture following a

CFIUS review. And even if Ralls had such an interest, its ability to submit agreements to CFIUS, meet with CFIUS personnel, and respond to CFIUS's inquiries provided Ralls with sufficient due process procedures. Ralls subsequently appealed.

As an initial matter, the D.C. Circuit concluded that it had jurisdiction to review the dismissal of Ralls' due process claim. In reaching this conclusion, the D.C. Circuit rejected CFIUS's arguments that (1) the Defense Production Act of 1950 ("DPA") imposed a statutory bar to judicial review and (2) the challenge to the Presidential Order raised a non-justiciable political question. The DPA states that Presidential Orders "shall not be subject to judicial review." Nevertheless, the D.C. Circuit found that it had jurisdiction because it was not reviewing the final decision made by President Obama with respect to the transaction but rather the process pursuant to which such a decision was made. The D.C. Circuit concluded that the CFIUS's political question argument was inapposite for a similar reason.

After dealing with the jurisdiction issues, the D.C. Circuit analyzed Ralls' substantive due process arguments. The D.C. Circuit reversed the district's decision and held that "Ralls possesses substantial property interests and that the Presidential Order deprives Ralls of its interests without due process of law." The D.C. Circuit explained 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 [government] actor relied and be afforded an opportunity to rebut that evidence." Ralls did not receive these constitutionally mandated procedural protections, even though Ralls suffered approximately \$6 million in losses as a result of having to divest its interest in the companies it acquired. The D.C. Circuit further noted the fact that Ralls had "the opportunity to present evidence to CFIUS and to interact" with government officials during the review process was not sufficient "because Ralls never had the opportunity to tailor its submission to [CFIUS's] concerns or rebut the factual premises underlying the President's action." The D.C. Circuit found that the government's substantial interest in national security supported CFIUS's decision to withhold classified information but did not justify its "failure to provide notice of, and access to, the unclassified information used to prohibit the transaction" that Ralls engaged in. But the D.C. Circuit clarified that its decision that the procedure followed in issuing the Presidential Order violated due process would not require public disclosure of "the President's thinking on sensitive questions" related to national security. It only requires that Ralls must receive the procedural protections before the Presidential Order prohibits the transaction. The court further clarified that "[a]dequate process at the CFIUS stage" would also satisfy the President's due process obligation. The D.C. Circuit also declined to consider whether executive privilege shielded CFIUS from disclosing the non-classified information to Ralls.

The D.C. Circuit remanded the case to district court and instructed that Ralls be provided with sufficient due process, including "access to the unclassified evidence on which the President relied and an opportunity to respond thereto."

IV. Conclusion

The D.C. Circuit's decision could potentially allow foreign persons taking part in acquisitions that result in foreign control of a U.S. business to obtain more information about the CFIUS review process, how covered transactions are reviewed, and the evidentiary basis for why CFIUS or the President declines to approve certain transactions and, importantly, an opportunity to rebut the government's evidence before the CFIUS or Presidential action is taken. But these significant changes to the CFIUS review process are far from inevitable. Given the importance of this case, it is likely that the Department of Justice will seek an *en banc* hearing before the D.C. Circuit or successfully petition the Supreme Court to review the D.C. Circuit's decision. Subsequent events related to this case and the CFIUS review process bear watching closely.