

International Trade Alert

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Court Orders CFIUS to Increase Transparency but Rejects Review of Presidential Determination

A recent decision by the D.C. Circuit has prompted much speculation about possible changes to the traditionally opaque and secretive national security review process administered by the Committee on Foreign Investment in the United States (CFIUS or the “Committee”). On July 15, 2014, a three-judge panel of the D.C. Court of Appeals determined that a presidential order requiring Ralls Corporation (“Ralls”)—a U.S. company owned by two Chinese investors—to divest its interest in four Oregon wind farms based on national security concerns, deprived Ralls of due process of law. The case has now been remanded to the D.C. District Court for further review. While many believe that the decision will result in greater transparency in the CFIUS process, the ultimate effects of the decision still remain unclear.

Ralls CFIUS Process

Under the Exon-Florio Amendment to the Defense Production Act (the “Exon-Florio law”), the President has the authority to review, investigate, restrict or reverse foreign direct investment in the United States resulting in foreign control of a U.S. business that is determined to pose a threat to U.S. national security.¹ The President’s authority under the Exon-Florio law is implemented by CFIUS, an interagency committee chaired by the U.S. Department of Treasury. CFIUS is responsible for reviewing and investigating foreign investment transactions, determining whether the transactions pose a threat to national security and making recommendations to the President.

In March 2012, Ralls acquired four U.S. wind farm companies in Oregon and began installing Chinese-origin wind turbines on the land. Based on concerns from the U.S. Navy, which maintained restricted airspace and bombing zones on or near each of the wind farms, CFIUS informed the parties to the wind-farm transaction that the Department of Defense intended to file a notice triggering CFIUS review. Consequently, Ralls submitted a voluntary notice to the Committee on June 28, 2012, regarding the already completed acquisition.

CFIUS undertook a 30-day review of the transaction, followed by a 45-day investigation, to assess the national security concerns surrounding the transaction. During the review and investigation periods, the parties responded to questions from, and made presentations to, CFIUS. CFIUS ultimately determined that the transaction posed a national security threat, issued a mitigation order and amended order requiring that Ralls take actions—including limitations on its use and sale of the property—to ameliorate the national security concerns, and provided a report and recommendation to the President.

¹ 50 U.S.C. App. 2170 (d)(1).

On September 28, 2012, the President issued an order instructing Ralls, among other actions, to divest its interest in the Oregon wind farms. At no point during the CFIUS proceeding did the Committee or the President provide the parties with notice of the evidence used by the Committee and the President to make the national security determination. Moreover, the parties did not have an opportunity to rebut that evidence.

Judicial Challenge by Ralls

Ralls challenged both the CFIUS amended order and the presidential order in U.S. District Court for the District of Columbia, claiming, among other things, that the orders deprived Ralls of its constitutional right to due process of law. The District Court dismissed all of Ralls' arguments, finding that it lacked judicial authority to review the presidential order and that the CFIUS review process was sufficient to satisfy due process requirements. The District Court also refused to review the due process challenge to the CFIUS order, claiming that it had been rendered moot by the superseding presidential order.

Ralls appealed, and, on July 15, 2014, the D.C. Circuit Court of Appeals reversed the findings of the District Court and remanded the case. Specifically, the Court found that (1) while it does not have authority to review the President's final national security determination, it does have judicial authority to review constitutional challenges to the process employed by the President in undertaking the national security review; and (2) due process requires that the affected parties have certain rights prior to the issuance of a presidential order, including the right to view, and the opportunity to rebut, unclassified evidence. The Court also instructed the District Court to reopen and review the constitutional due process challenge to the CFIUS order.

Impact on the CFIUS Process

Although some observers consider this initial decision to be a victory for proponents of greater transparency in the CFIUS process, the actual implications of the decision, at least at this stage, remain unclear. The decision itself is narrow and limited solely to the due process requirements for a presidential order, which is an extraordinarily rare occurrence in CFIUS proceedings. Nevertheless, the case, and the questions left to the District Court, create the possibility of expansive changes to the underlying CFIUS process. We analyze below the aspects of the CFIUS process that remain the same and the significant issues left open by the decision that could eventually lead to changes.

What Remains the Same

Certain aspects of the CFIUS process clearly are not impacted by the Court's decision. Specifically, the Court's decision does not change the President's overall authority under the Exon-Florio law. The President still maintains authority to block or reverse transactions based on CFIUS recommendations. The President also can still block transactions based on classified information without providing a rationale, and there is no requirement that the President explain what the Court of Appeals referred to as his "thinking on sensitive questions related to national security" for blocking a transaction. Finally, and most importantly, the decision does not provide a process for judicial review of the rationale for the presidential determination. To the contrary, the decision explicitly states that the courts have no authority

(either constitutionally or statutorily) to review the President's final determination regarding the national security implications of a transaction.

Significant Issues Left Open by the Decision

At this point, due to a number of questions that remain unsettled, the full impact of the Ralls decision on the CFIUS process remains unclear. Indeed, the following issues are still open:

- **Appeal of the Case** – The government has yet to announce whether it will appeal, or seek an en-banc rehearing, of the appellate court decision. This decision and the issues to be determined on remand at the District Court will dictate how CFIUS implements the decision, including any changes to the CFIUS regulations and/or its practice in the review, investigation and presidential phases that would result in more information regarding the basis of the government's decision.
- **Executive Privilege** – In its opinion, the D.C. Circuit refused to opine on an executive-privilege argument raised by the U.S. government for the first time during oral arguments. This issue will likely be raised again in the District Court and could have implications on any requirement to share the rationale regarding the national security determination.
- **Additional Challenges to the CFIUS Process** – In the past, parties have been reluctant to challenge CFIUS actions. This decision could encourage parties to fight CFIUS decisions in court.
- **Incentives for CFIUS to Rely on Classified Information** – Irrespective of the outcome at the District-Court level, this decision appears to create the incentive for CFIUS to rely more heavily on classified information in making its determinations. While unclassified information must be released to the affected party prior to a presidential order, this rule does not apply to classified information. Therefore, to the extent that CFIUS does not want to disclose information to the affected parties, it can rely to a greater degree on classified information in its determination.
- **Incentives for Parties to Create Property Interests in Advance of CFIUS Filings** – Currently, many parties evaluate whether to file a CFIUS notice in advance of signing or closing a transaction to minimize the risk of CFIUS unwinding a deal or, more likely, imposing burdensome mitigation on the parties after the execution of a transaction. This decision may have a countervailing effect on that typical approach by incentivizing parties to create "property interests" in advance of a CFIUS filing to shroud the deal in the constitutional protection of due process.

To the extent that the decision stands, it will require the U.S. government, at a minimum, to take three steps to ensure that a party with a property interest affected by a CFIUS proceeding is not unconstitutionally deprived of due process: (1) inform the party of the official action, (2) give the party access to unclassified data information on which the presidential order is based and (3) provide the party with the opportunity to rebut that evidence. These requirements apply only prior to the issuance of a presidential order, which has occurred only one other time in CFIUS's history. The vast majority of transactions are resolved prior to this stage through engagement with CFIUS and not the President. Thus,

the current impact of this decision is very limited—while the open questions and possibilities for further changes remain significant depending on the procedural path the case takes from here.

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