

## 'Ralls' Decision Doesn't Alter CFIUS Voluntary Reporting Analysis for Foreign Investment in U.S.

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July 31, 2014

A lot of attention has been given to a recent decision by the U.S. Court of Appeals for the District of Columbia (D.C. Court of Appeals) unanimously ruling against President Barack Obama relating to his order stopping Chinese investors from proceeding with their acquisition of four wind farm companies.

But importantly, this decision does not change the process or the need for foreign investors to continue to comply with CFIUS and to carefully assess the need for applying for clearance when acquiring businesses in the U.S.

On July 15, 2014, the D.C. Court of Appeals reversed a District Court ruling and held that Ralls Corporation, a Delaware company owned by two Chinese nationals (Ralls) had been deprived of its protected property interest without due process of law when the President, at the recommendation of the Committee on Foreign Investment in the United States (CFIUS), ordered Ralls to divest itself of wind farm companies that it had previously acquired from a U.S. citizen.

At first blush, this decision may seem like a significant victory for Ralls, but a close reading of the opinion reveals something slightly different. In fact, parties to a covered transaction should keep in mind that, while this narrow holding has potential to provide some clarity to parties that are ordered to divest their interest in a U.S. business as to why they were so ordered, this decision does not significantly impact the analysis that should be undertaken when deciding whether to voluntarily notify CFIUS of a transaction subject to CFIUS review.

### Background

The purchase of the wind farm companies by Ralls (the "Transaction") was subject to CFIUS review, because the Transaction would result in control of a U.S. business by a foreign person. Ralls proceeded with the Transaction without first seeking clearance of the Transaction from CFIUS. After the Transaction closed, CFIUS informed Ralls that the Transaction was under its review and shortly thereafter, Ralls made a voluntary notification with CFIUS. Citing national security concerns, CFIUS issued an order prohibiting Ralls from accessing or furthering constructing at the wind farm sites. After determining that mitigation measures could not adequately address the national security concerns, CFIUS referred the matter to the President, who ultimately determined that the Transaction posed a threat to national security and issued a permanent order prohibiting the Transaction and ordering Ralls to divest itself of the companies.

Neither CFIUS nor the President provided Ralls with any notice of details relating to why they reached their determination that the Transaction posed a national security concern. So Ralls was not provided with an opportunity to rebut. Consequently, Ralls filed a complaint in the U.S. District Court for the District of Columbia against CFIUS and the President alleging, among other things, that Ralls was unconstitutionally deprived of its property without due process of law.

In response, CFIUS and the President argued that (1) Ralls's property interests were too contingent to merit constitutional protection, and (2) Ralls effectively forfeited those interests by not seeking pre-approval of the Transaction. Siding with CFIUS and the President, the District Court concluded that even though Ralls's interests in the wind farm companies and their assets constituted "property," they were not constitutionally protected because Ralls

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“voluntarily acquired those state property rights subject to the known risk of a Presidential veto” and “waived the opportunity... to obtain a determination from CFUIUS and the President before it entered into the transaction.” The District Court went on to conclude that even if Ralls had a constitutionally protected property interest, Ralls was provided with due process.

### The Appeal

On appeal, the D.C. Court of Appeals agreed with the District Court that Ralls’s interests in the wind farm companies and their assets constitute “property.” The D.C. Court of Appeals found, however, that Ralls did not waive its property interest by failing to seek pre-approval of the Transaction. Important for its decision was the fact that the CFUIUS notification process is voluntary and allows parties to provide the notice either before or after a transaction is completed. The D.C. Court of Appeals also stated that the federal government cannot evade due process protections afforded to state property by simply “announcing that future deprivations of property may be forthcoming.”

After analyzing the facts and circumstances of the Ralls case using the three-factor balancing test established by *Mathews v. Eldridge*, the D.C. Court of Appeals concluded that in a situation like Ralls’s, due process requires, at the least, that an affected party be informed of the official action, be given the unclassified evidence on which the official actor relied and be afforded an opportunity to rebut the evidence. The D.C. Court of Appeals made it clear that classified information is still within the privilege and prerogative of the executive branch. The D.C. Court of Appeals clarified that just because it concluded that the procedure that was used in issuing the Presidential and CFUIUS orders violates due process, it does not mean that the President must, in the future, disclose his thinking on sensitive questions related to national security in reviewing a covered transaction.

CFUIUS and the President made a late assertion of executive privilege, which was not raised in their brief. Instead of deciding the issue of executive privilege, the D.C. Court of Appeals remanded the Ralls case to the District Court with instructions that Ralls be provided the requisite process, which should include access to the unclassified evidence on which the President relied and an opportunity for Ralls to respond thereto. The D.C. Court of Appeals also stated that should disputes arise on remand, such as an executive privilege claim, the District Court is well-positioned to resolve them.

### Practical Implication

We will continue to closely follow the Ralls case as it develops. In the meantime, we highlight a few aspects of the decision that should be kept in mind, especially when trying to understand what this decision really means and more importantly, what this decision doesn’t mean.

First, the D.C. Court of Appeals’ decision is not final and can be appealed to the U.S. Supreme Court, and since the outcome of the case has constitutional implications, the U.S. Supreme Court may be inclined to hear the case. Similarly, on remand, the District Court may find that even if the process outlined by the D.C. Court of Appeals is due, disclosure of the unclassified information is nonetheless shielded by executive privilege.

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Assuming the D.C. Court of Appeals' decision is not appealed to the U.S. Supreme Court and the District Court does not find that the unclassified information is protected under executive immunity, it is still important to keep in mind that the D.C. Court of Appeals' decision only addresses a narrow procedural due process question and does not impact the President's authority to block a transaction for national security concerns. In Ralls's case, for example, even if Ralls receives access to unclassified information that was used by CFIUS or the President in reaching their determination, Ralls may not be able to rebut the information in any meaningful way that will change the President's ultimate decision. And, since the President's decision will still be non-justiciable and statutorily unreviewable, the final outcome in the case may not change.

In a similar vein, the decision makes it clear that parties to a covered transaction do not have any right to receive any classified information used by CFIUS or the President in reaching their decision. If the unclassified information that will be shared with Ralls is of the type that is released to the public in CFIUS's unclassified version of its Annual Report to Congress, then as those of us who carefully review those reports know, the information may not be specific enough to be acted upon.

Another thing to keep in mind is that a party will have right to unclassified information only after "protected property rights" are created. In Ralls's case, property rights were created only after Ralls acquired the ownership of the Oregon companies and the wind farm assets. While the D.C. Court of Appeals did mention that a CFIUS mitigation measure would affect protected property rights, it is not clear from the decision whether entering into a letter of intent or even an agreement to purchase a company would be sufficient to create "protected property rights."

Given the various aspects of the D.C. Court of Appeals' opinion highlighted above, our experience helping our clients through the CFIUS notification process, and the fact that obtaining CFIUS clearance is the only certain way to know that a covered transaction will not later be blocked or unwound by the President, it is in the best interest of the parties of a covered transaction to make an assessment early on, before spending too much time and money evaluating a transaction, as to whether a transaction would trigger CFIUS review and if so, whether the parties want to make a voluntary notification with CFIUS or make a business decision to assume the risk that the transaction may later be blocked or unwound if the President finds that national security concerns are implicated.

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