

# CFIUS post-Ralls: Ramifications for Sovereign Wealth Funds

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## ABSTRACT

Global capital is on the move and sovereign wealth funds, with significant assets, are uniquely positioned to take advantage of the increase in mergers and acquisitions activity, especially in the United States. At the same time, major acquisitions in the US by foreign investors, including sovereign wealth funds, face a key challenge in the Committee on Foreign Investment in the United States (CFIUS or the Committee). CFIUS vets foreign acquisitions of US businesses for national security concerns, and “national security” is a term that is not defined by CFIUS statute or regulation. With increased sovereign wealth fund investments in the US, it is important for policymakers and investors alike to understand the potential roadblock that the Committee presents to foreign investment and for investors and potential US targets to develop an appropriate strategy to approach CFIUS when contemplating an acquisition.

In a recent appellate court decision, *Ralls v. Committee on Foreign Investment in the United States*, the US Court of Appeals for the District of Columbia Circuit held that the Ralls Corporation (a Chinese-owned and controlled company) had been deprived of its property without due process when the President (at the recommendation of CFIUS) ordered Ralls to divest its interests in certain US wind farm projects on national security grounds. The court held that under the Fifth Amendment Due Process Clause of the US Constitution, Ralls was entitled to receive both the unclassified evidence that was the basis for the government’s decision and an opportunity to respond to this evidence. The case is still ongoing at the time of this writing; thus, the full impact of the decision remains to be seen. It is noteworthy, however, as the first legal case ever brought against CFIUS, and because the court’s holding is relatively unusual in an area – national security – in which US courts traditionally defer to the executive branch.

Part I of this article provides the history of CFIUS’s statutory and regulatory authority; how CFIUS determines jurisdiction over a particular transaction; and the review and investigation process, with special emphasis on the treatment of sovereign wealth fund transactions. Part II examines the recent D.C. Circuit Court decision in *Ralls v. Committee on Foreign Investment in the United States* and analyzes the decision’s implications for foreign investors, including sovereign wealth funds. It concludes by emphasizing that although the *Ralls* litigation is ongoing at the district court level, the proceedings should, at minimum, result in an opportunity for foreign investors to have increased engagement with CFIUS, which may lead to more informed decision-making by CFIUS. At the same time, as Part III discusses, the decision does not at present change the importance of certain strategies for sovereign wealth funds navigating the CFIUS process to maximize the opportunity for success.

**Keywords:** Committee on Foreign Investment in the United States, CFIUS, Sovereign Wealth Funds, *Ralls v. Committee on Foreign Investment in the United States*, Due Process Clause of the US Constitution, national security

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# لجنة الاستثمار الأجنبي في الولايات المتحدة بعد «Ralls»: نتائج صناديق الثروة السيادية

## ملخص

لا شك أن رأس المال العالمي كثير التحرك، وصناديق الثروة السيادية بما تمتلكه من أصول ضخمة، لها وضعها الفريد الذي يسمح لها بالاستفادة من الزيادة في أنشطة الاندماج والاستحواذ، خصوصاً في الولايات المتحدة. وفي الوقت ذاته، تواجه عمليات الاستحواذ الكبرى في الولايات المتحدة من قبل مستثمرين أجانب، بما في ذلك صناديق الثروة السيادية، تحدياً رئيسياً في لجنة الاستثمار الأجنبي في الولايات المتحدة (يشار إليها في المقال أيضاً باسم «اللجنة»). تعوق لجنة الاستثمار الأجنبي في الولايات المتحدة الاستحواذ الأجنبي للشركات الأمريكية بسبب مخاوف الأمن القومي، و«الأمن القومي» هو مصطلح لم يتم تعريفه في النظام الأساسي للجنة الاستثمار الأجنبي في الولايات المتحدة أو لوائحها. ومع زيادة استثمارات صناديق الثروة السيادية في الولايات المتحدة، من المهم لوضع السياسات والمستثمرين على السواء، أن يفهموا الحاجز المحتمل الذي تمثله اللجنة على الاستثمار الأجنبي والمستثمرين والأهداف الأمريكية المحتملة لوضع إستراتيجية مناسبة للتعامل مع لجنة الاستثمار الأجنبي في الولايات المتحدة عند التفكير في الاستحواذ.

في قرار صدر مؤخراً عن محكمة الاستئناف، في قضية كان طرفها شركة «Ralls» و«لجنة الاستثمار الأجنبي في الولايات المتحدة»، قضت محكمة الاستئناف الأمريكية لدائرة مقاطعة كولومبيا بأن شركة «Ralls» (وهي شركة تملكها الصين وتتحكم فيها) قد حرمت من ممتلكاتها من دون اتباع الإجراءات القانونية الواجبة، عندما أمر الرئيس (بناءً على توصية من لجنة الاستثمار الأجنبي في الولايات المتحدة) شركة «Ralls» بتصفية حصصها في بعض مشروعات مزرعة الرياح الأمريكية، لأسباب تخص الأمن القومي. ورأت المحكمة أنه بموجب التعديل الخامس لبنود الإجراءات الواجبة في دستور الولايات المتحدة، كان يحق لشركة «Ralls» الحصول على الأدلة غير المصنفة التي كانت أساس قرار الحكومة، وكذلك الحصول على فرصة للرد على هذه الأدلة. ولا تزال القضية جارية حتى وقت كتابة هذه السطور؛ وبالتالي فإن الأثر الكامل للقرار لا يزال قيد الانتظار. وجدير بالذكر أن القضية تُعد هي القضية القانونية الأولى التي تُرفع ضد لجنة الاستثمار الأجنبي في الولايات المتحدة، وأن انعقاد المحكمة يُعد أمراً غير عادي نسبياً في مجال الأمن القومي، حيث عادةً ما تحيله المحاكم الأمريكية إلى السلطة التنفيذية.

يعرض الجزء الأول من هذه المقالة تاريخ النظام الأساسي واللائحة للجنة الاستثمار الأجنبي في الولايات المتحدة، وكيف تحدد لجنة الاستثمار الأجنبي في الولايات المتحدة الولاية على صفقة معينة، وعملية المراجعة والتحقيق، مع التركيز بشكل خاص على التعامل مع صفقات صناديق الثروة السيادية. ويتناول الجزء الثاني قرار محكمة دائرة مقاطعة كولومبيا مؤخراً في قضية شركة «Ralls» ضد «لجنة الاستثمار الأجنبي في الولايات المتحدة»، ويحلل الآثار المترتبة على القرار بالنسبة للمستثمرين الأجانب، بما في ذلك صناديق الثروة السيادية. ويخلص إلى التأكيد على أنه على الرغم من استمرار قضية شركة «Ralls» على مستوى محاكم المقاطعة، فإنه ينبغي أن تكون وقائع القضية، على أقل تقدير، فرصة للمستثمرين الأجانب لزيادة الانخراط مع لجنة الاستثمار الأجنبي في الولايات المتحدة، وهو الأمر الذي قد يؤدي إلى اتخاذ قرارات أكثر استنارة من جانب لجنة الاستثمار الأجنبي في الولايات المتحدة. وفي الوقت نفسه، وكما يناقش الجزء الثالث، فإن القرار لا يغير في الوقت الحاضر أهمية إستراتيجيات معينة لصناديق الثروة السيادية التي تقود عملية لجنة الاستثمار الأجنبي في الولايات المتحدة لزيادة فرصة النجاح.

## INTRODUCTION

Global capital is on the move again. According to Mergermarket reports, global mergers and acquisitions reached nearly \$2.5 trillion in the first three quarters of 2014, up from approximately \$1.6 trillion for the same period a year ago.<sup>1</sup> Sovereign wealth funds had a milestone year in 2013 for acquisitions – a record \$174.7 billion in direct transactions.<sup>2</sup> Sovereign wealth fund investment continued to increase in 2014: As of September 2014, there were \$51.13 billion in direct transactions, a 20.6 percent increase that can largely be attributed to increased real estate deals.<sup>3</sup> Sovereign wealth fund assets are predicted to grow substantially, and are well on their way to hit forecasts of \$8.6 trillion by 2016.<sup>4</sup> Given record assets, sovereign wealth funds are uniquely positioned to take advantage of the increase in mergers and acquisitions activity, either directly or through partnerships with other investors.<sup>5</sup>

Against this backdrop, sovereign wealth funds have shown particular interest in investing in the United States.<sup>6</sup> Scarcely a day goes by that we do not hear about another major acquisition by a sovereign wealth fund in the United States.<sup>7</sup> The Abu Dhabi and Norwegian-based sovereign wealth funds have taken stakes in iconic New York City addresses such as the Time Warner Center at Columbus Circle and Times Square.<sup>8</sup> A large cultural center and office building in downtown Washington, D.C. has opened with funds provided by a Qatar-based sovereign wealth fund.<sup>9</sup>

<sup>1</sup>Mergermarket Global M&A Trend Report: Global and Regional M&A: Third quarter 2014, (October 2014) at 5, available at, <http://www.mergermarket.com/pdf/MergermarketTrendReport.Q32014.FinancialAdvisorLeagueTables.pdf>; see also Avik Das, *Global M&A Deals Cross \$3 Trillion for First Time Since 2007*, REUTERS (Nov. 21, 2014), available at <http://www.reuters.com/article/2014/11/21/us-globalm-a-deals-idUSKCN0j51TU20141121>.

<sup>2</sup>Sovereign Wealth Fund Institute, *The Most Active Sovereign Wealth Fund Investors of 2013* (March 2014), <http://www.swfinstitute.org/swf-article/the-most-active-sovereign-wealth-fund-investors-of-2013-12310/> (last visited August 5, 2014).

<sup>3</sup>Sovereign Wealth Fund Institute, *2014 Looks to Beat 2013 in Sovereign Wealth Fund Transactions* (Sept. 23, 2014), <http://www.swfinstitute.org/swf-article/2014-looks-to-beat-2013-in-sovereign-wealth-fund-transactions-889333/>; see also Sovereign Wealth Fund Institute, *Real Estate Investments More Attractive for Sovereign Wealth Funds* (Nov. 4, 2014), <http://www.swfinstitute.org/swf-article/real-estate-investments-more-attractive-for-sovereign-wealth-funds/>; Sovereign Wealth Fund Institute, *Real Estate: A Powerful Sovereign Wealth Fund Investment Trend* (Oct. 6, 2014), <http://www.swfinstitute.org/swf-article/real-estate-a-powerful-sovereign-wealth-fund-investment-trend-999222/>.

<sup>4</sup>See Klaus Wille, *Sovereign Funds' Assets to Gain 60% by 2016, UBS' Castelli Says*, BLOOMBERG (Mar. 13, 2013), <http://www.bloomberg.com/news/2013-03-13/sovereign-funds-assets-to-gain-60-by-2016-ubs-s-castelli-says.html>.

<sup>5</sup>For examples of recent SWF partnerships with other investors, see Klaus Wille, *Abu Dhabi Fund Said to Buy Time Warner Building with GIC*, BLOOMBERG (Jan. 15, 2014), <http://www.bloomberg.com/news/2014-01-15/abu-dhabi-fund-said-to-invest-with-gic-in-time-warner-building.html>; Brian Spegele, *Qatar's Sovereign Wealth Fund to Invest at Least \$15 Billion in Asia*, WALL STREET JOURNAL (Nov. 4, 2014), available at <http://online.wsj.com/articles/qatars-sovereign-wealth-fund-to-invest-at-least-15-billion-in-asia-1415080679> (reporting partnership between Qatar SWF and China's CITIC Group to “pursue[] infrastructure and other investment”); Carolyn Cummins, *Goodman Group and Singapore's Sovereign Wealth Fund, GIC Invest in Auckland's Viaduct District*, SYDNEY MORNING HERALD (Nov. 7, 2014), <http://www.smh.com.au/business/property/goodman-group-and-singapores-sovereign-wealth-fund-gic-invest-in-aucklands-viaduct-precinct-20141106-11hd17.html>.

<sup>6</sup>See BLOOMBERG, *supra* note 1, at 2.

<sup>7</sup>Other prominent foreign companies have also recently purchased everything from movie theatres, (Zachary R. Mider, *China's Wanda to Buy AMC Cinema Chain for \$2.6 Billion*, BLOOMBERG (May 21, 2012, 3:33 PM), <http://www.bloomberg.com/news/2012-05-21/china-s-wanda-group-to-buy-amc-cinema-chain-for-2-6-billion.html>), to a US pork producer in the United States, including the \$4.7 billion purchase last year by Shuanghui International Holding of Smithfield Foods, Inc., the American pork producer – the largest Chinese acquisition of a US company to date. Nathalie Tadena, *Smithfield Shareholders Approve Shuanghui Deal*, WALL STREET JOURNAL (Sept. 24, 2013, 11:16 AM), <http://online.wsj.com/news/articles/SB10001424052702304213904579095061880118346>. Deals of note currently in the US market include the purchase by Lenovo, a Chinese company, of the low-end server business of IBM and the Motorola handset business. Juro Osawa, *Lenovo Still Expects IBM Server Deal to Close This Year*, WALL STREET JOURNAL (July 2, 2014, 12:57 AM), <http://online.wsj.com/articles/lenovo-still-expects-ibm-low-end-server-deal-to-close-this-year-1404271733>.

<sup>8</sup>Wille, *Abu Dhabi Fund Said to Buy Time Warner Building with GIC*, *supra* note 5; Eliot Brown, *Time Warner Nears Deal to Sell Headquarters*, WALL STREET JOURNAL (Jan. 15, 2014, 1:15 PM), <http://online.wsj.com/news/articles/SB10001424052702303819704579320902316499722>.

<sup>9</sup>Steven Pearlstein, *Can a Texas Developer and Qatar Investment Make D.C.'s CityCenter a Success?*, WASHINGTON POST (Oct. 22, 2011), [http://www.washingtonpost.com/can-a-texas-developer-and-qatar-investment-make-dcs-citycenter-a-success/2011/10/17/gIQAePMi6L\\_story.html](http://www.washingtonpost.com/can-a-texas-developer-and-qatar-investment-make-dcs-citycenter-a-success/2011/10/17/gIQAePMi6L_story.html) (noting project was on “life support” and “what saved CityCenter was an investment of \$622 million by the government of Qatar, whose sovereign wealth fund likes the visibility and perceived stability of investing in downtown Washington.”).

All indications are that allocations by sovereign wealth funds to the US, particularly to US infrastructure and real estate, will increase substantially.

Investments by sovereign wealth funds have been an important source of cross-border flows, which, in turn, further integrate financial markets and promote financial stability.<sup>10</sup> At the same time, the activities of sovereign wealth funds can raise national security concerns because they are controlled by foreign governments.<sup>11</sup> Given the increase in politically sensitive investments by sovereign wealth funds, the question of how countries ought to strike a balance between an open investment policy – being “open for business,” as is the US policy – and protecting national security is an important one.

Major acquisitions in the US, including those by sovereign wealth funds, have placed the Committee on Foreign Investment in the United States (CFIUS or the Committee) squarely in the spotlight. CFIUS is the US government inter-agency committee that reviews foreign inbound investments to assess their potential impact on US national security. Under this regime, the President of the United States has the authority to block deals (or to have them unwound after the fact) if they are found to threaten national security. The annual report released by CFIUS at the end of 2013 shows heightened scrutiny across the board and an unprecedented increase in transactions by Chinese acquirers.<sup>12</sup>

Moreover, a recent decision from a US federal appellate court, *Ralls v. Committee on Foreign Investment in the United States*, has invited even more focus on CFIUS and its process for vetting deals for national security reasons.<sup>13</sup> The case is the first legal challenge to a presidential veto in the history of CFIUS. In a landmark decision, the appellate court ruled that, before blocking a transaction under review, CFIUS must provide the buyer and seller with the unclassified information that is the basis for their decision, and an opportunity for rebuttal. Notably, it does not affect either the authority of the President to prohibit a covered transaction or CFIUS's authority to conduct national security reviews. However, the decision clearly has implications for the CFIUS process and for foreign investors, including sovereign wealth funds.

## I. THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES

### A. History of statutory and regulatory authority

CFIUS is a federal inter-agency committee established in 1975 by President Gerald Ford, via Executive Order 11858, which provided CFIUS with “primary continuing responsibility within the Executive Branch for monitoring the impact of foreign investment in the United States, both direct and portfolio, and for coordinating the implementation of United States policy on such investment.”<sup>14</sup> In 1988, in response to the growth of Japanese investment, Congress enacted the Exon-Florio Amendment at Section 721 of the Defense Production Act of 1950, to give the President statutory authority to review and investigate transactions with foreign persons that may affect national security, and to prohibit foreign takeovers that the President finds present a threat to national security.<sup>15</sup>

<sup>10</sup>See Government Accountability Office, *Sovereign Wealth Funds: Publicly Available Data on Sizes and Investments for Some Funds Are Limited*, GAO-08-946 (Sept. 2008), available at <http://www.gao.gov/assets/290/280267.pdf> (noting that for the funds identified, “officially reported data and researcher estimates” indicated that SWF funds’ total assets was between \$2.7 trillion and \$3.2 trillion and that “[s]ome researchers expect these assets to grow significantly,” and stating that “GAO analysis of a private financial research database identified SWF investments in US companies totaling over \$43 billion from January 2007 through June 2008, including SWF investments in US financial institutions needing capital as a result of the 2007 subprime mortgage crisis.”).

<sup>11</sup>See Robert M. Kimmitt, *Public Footprints in Private Markets: Sovereign Wealth Funds and the World Economy*, Foreign Affairs, Jan.-Feb. 2008, available at <http://www.foreignaffairs.com/articles/63053/robert-m-kimmitt/public-footprints-in-private-markets?nocache=1> (last visited Aug. 5, 2014).

<sup>12</sup>See COMMITTEE ON FOREIGN INV. IN THE UNITED STATES ANN. REP. TO CONGRESS, (December 2013), available at <http://www.treasury.gov/resource-center/international/foreign-investment/Documents/2013%20CFIUS%20Annual%20Report%20PUBLIC.pdf>.

<sup>13</sup>*Ralls Corp. v. Committee on Foreign Investment in the United States*, 758 F.3d 294 (D.C. Cir. 2014).

<sup>14</sup>Exec. Order No. 11,858, 3 C.F.R. 990 (1971–1975).

<sup>15</sup>Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100–418, § 5021, 102 Stat. 1107, 1425 (1988), codified as amended at 50 U.S.C. app. § 2170.

Following the Unocal controversy in 2005<sup>16</sup> and the Dubai Ports controversy<sup>17</sup> in 2006, Congress amended Exon-Florio with the Foreign Investment and National Security Act of 2007 (FINSAs) (Section 721 of the Defense Production Act of 1950, as amended) (“Section 721”).<sup>18</sup> Although FINSAs left Section 721 largely intact, it made clear, among other things, that as part of its national security analysis, CFIUS could consider whether a transaction affects US “critical infrastructure.”<sup>19</sup> It also established a presumption that CFIUS fully investigates not only foreign government-controlled transactions, but also whether a transaction would “result in control of any critical infrastructure . . . by or on behalf of any foreign person, if the Committee determines that the transaction could impair national security, and that such impairment to national security has not been mitigated by assurances provided or renewed with the approval of the Committee.”<sup>20</sup>

FINSAs also enhanced congressional oversight (and thereby imposed greater political accountability) by, among other things, mandating that CFIUS provide Congress with reports following its investigations.<sup>21</sup> Although codifying CFIUS’s existence has bolstered the Committee’s authority in some respects, it has also decreased some of the flexibility it had prior to FINSAs by imposing greater congressional oversight.

On November 21, 2008, pursuant to notice-and-comment rulemaking, the US Department of the Treasury (hereinafter the Treasury) issued regulations implementing the changes imposed by FINSAs.<sup>22</sup> The agency received approximately two hundred written and oral comments from law firms and finance professionals’ organizations, many of them concerned with the need to specify the definition of “control” under the statute.<sup>23</sup> In response to these comments, the final Treasury rules purport to “maintain[] the longstanding approach of defining ‘control’ in functional terms as the ability to exercise certain powers over important matters affecting an entity.”<sup>24</sup> The CFIUS regulations are available at 31 C.F.R. part 800; this article addresses “control” and other key aspects of CFIUS’s authority in more detail below.

Although CFIUS can review and investigate foreign investment transactions, the President retains the sole authority to “suspend or prohibit” a transaction where there is “credible evidence” that the foreign acquirer “might take action that threatens . . . national security” and there is no other legal authority to address an identified national security concern.<sup>25</sup> The President has vetoed transactions only twice. In 1990, President George H.W. Bush required China National Aero Tech (CATIC), which was owned by a close affiliate of the People’s Liberation Army, to divest MAMCO Manufacturing, an aerospace company based in the state of Washington.<sup>26</sup> Most recently, in 2012, President Barack

<sup>16</sup>In the Unocal controversy, the state-owned China National Offshore Oil Corporation (CNOOC) announced in June of 2005 its intent to bid \$18.5 billion for the US-based company Unocal. Numerous members of Congress publicly attacked the transaction, holding hearings and proposing legislation designed to prevent it from occurring. Then-President George W. Bush’s administration did not respond to requests from members of Congress to review the transaction under CFIUS, but ultimately congressional pressure forced CNOOC to withdraw its bid. See EDWARD M. GRAHAM & DAVID M. MARCHICK, U.S. NATIONAL SECURITY AND FOREIGN DIRECT INVESTMENT 3–4 (2006).

<sup>17</sup>The Dubai Ports controversy arose in 2006, after CFIUS had conducted its initial 30-day review under Exon-Florio of the United Arab Emirates firm DP World’s acquisition of P&O, a British firm that owned a US subsidiary managing operations at six US ports. After CFIUS approved the acquisition, however, the Associated Press ran an article on the deal, noting that several of the 9/11 hijackers had been from the UAE, and that the maritime industry was considered “vulnerable to terrorism.” Ted Bridis, *U.A.E. Co. Poised to Oversee U.S. Ports; Administration Not Blocking Deal*, Associated Press, Feb. 11, 2006. The Bush administration defended its decision not to undertake the additional 45-day CFIUS review of and report to Congress on the transaction prior to approving it, but eventually political pressure forced DP World to announce its intention to sell its US operations, as Congressional Republican leaders warned the President that they would be unable to garner sufficient votes to sustain his threatened veto of any legislation blocking the deal. Greg Hitt and Neil King Jr., *Dubai Firm Bows to Public Outcry—Under Pressure, DP World to Shed US Holdings; Fears of Political Fallout—Putting off Foreign Investors?*, WALL STREET JOURNAL, March 10, 2006, at A1. The impact of the Dubai Ports controversy is discussed in further detail below.

<sup>18</sup>Pub. L. No. 110-49, 121 Stat. 246 (2007), codified at 50 U.S.C. App. § 2061 note, §§ 2170, 2170 note; 31 U.S.C.A. § 301; 5 U.S.C.A. § 5315, 5315 note.

<sup>19</sup>§ 2, 121 Stat. at 247, codified at 50 U.S.C. App. § 2170(a)(6).

<sup>20</sup>*Id.*, 121 Stat. at 249, codified at 50 U.S.C. App. § 2170(b)(2)(B)(i)(III).

<sup>21</sup>*Id.* 121 Stat. at 249-50, codified at 50 U.S.C. App. § 2170(b)(3).

<sup>22</sup>Regulations Pertaining to Mergers, Acquisitions and Takeovers by Foreign Persons; Final Rule, 73 Fed. Reg. 70,702 (Nov. 21, 2008) (to be codified at 31 C.F.R. pt. 800).

<sup>23</sup>See, e.g., Letter from Lawrence R. Uhlick, CEO, Institute of International Bankers (June 9, 2008); Letter from Stephen J. Canner, Vice President, Investment Policy, United States Council for International Business (June 9, 2008).

<sup>24</sup>73 Fed. Reg. at 70,704; 31 C.F.R. § 800.204(a).

<sup>25</sup>50 U.S.C. § 2170(d)(1), (4)(A).

<sup>26</sup>See generally Jim Mendenhall, *United States: Executive Authority to Divest Acquisitions Under the Exon-Florio*



Obama unwound the purchase by the Ralls Corporation (a Chinese-owned and controlled company) of interests in wind farm projects located in Oregon near a US military installation.<sup>27</sup>

## B. Structure

CFIUS is composed of nine voting members of the Executive Branch: the Secretaries of Treasury, State, Defense, Commerce, Homeland Security, and Energy, and the Attorney General; the Office of the US Trade Representative, and the Office of Science and Technology Policy.<sup>28</sup> In addition, there are two non-voting members (the Director of National Intelligence and the Secretary of Labor), and five observer White House offices.<sup>29</sup> The Secretary of the Treasury is the chairperson of CFIUS. The President may also appoint “heads of any other executive department, agency, or office, as the President determines appropriate[.]”<sup>30</sup>

## C. Threshold factors for jurisdiction

CFIUS has jurisdiction over any transaction by or with a foreign person that could result in foreign control of a US business.<sup>31</sup> Such a transaction is termed a “covered transaction.”<sup>32</sup> The Committee does not have jurisdiction over so-called “greenfield” investments,<sup>33</sup> although some have recommended that the law be amended to grant it such jurisdiction.<sup>34</sup> The concept of foreign control is quite broad, and the jurisdictional analysis is very fact-specific, which allows CFIUS much discretion. Four key concepts determine whether CFIUS has jurisdiction: the concepts of “transaction,” “foreign person,” “control” and “US business.”

- “Transactions” can include purchases of shares, assets, certain convertible instruments, joint ventures and some types of long-term leases.<sup>35</sup> Loans by foreign lenders are typically not covered, but could be if default is imminent or if there otherwise exists “a significant possibility that the foreign person may obtain control of a US business as a result of the default or other condition.”<sup>36</sup>

*Footnote continued*

Amendment—The MAMCO Divestiture, HARV. INT’L L.J. 286 (1991); see also W. Robert Shearer, Comment, *The Exon-Florio Amendment: Protectionist Legislation Susceptible to Abuse*, 30 Hous. L. Rev. 1729, 1757-58 (1993) (noting that the divestiture “reveals two apparent deficiencies in Exon-Florio’s approach to protecting the national security. First, although the original order required CATIC to divest within three months, over a year passed before a new purchaser acquired MAMCO. Secondly, CFIUS had no means of protecting the outflow of critical technology to CATIC before the completion of the forty-five day investigation.”).

<sup>27</sup>As discussed in more detail below, however, the D.C. Circuit recently affirmed Ralls’ challenge to this unwinding in court, not in terms of the substance of the President’s decision but in finding that the Due Process Clause of the Fifth Amendment to the US Constitution required the executive branch to provide Ralls with the reasons for the unwinding. *Ralls*, 758 F.3d 296 (D.C. Cir. 2014).

<sup>28</sup>50 U.S.C. App. § 2170(k)(2).

<sup>29</sup>*Id.* § 2170(k)(2)(H), (I). The observer White House offices are the Office of Management and Budget, Council of Economic Advisors, National Security Council, National Economic Council, and Homeland Security Council. Exec. Order 13,456, 3 C.F.R. 13,456 (2008).

<sup>30</sup>50 U.S.C. App. § 2170(k)(2)(I).

<sup>31</sup>31 C.F.R. § 800.501(a).

<sup>32</sup>*Id.* § 800.207.

<sup>33</sup>The term “greenfield” investment has been defined in different ways, but generally refers to the establishment of new enterprises by direct investors, versus transfer of ownership of existing enterprises. See Organisation for Economic Co-operation and Development, *Benchmark Definition of Foreign Direct Investment* at 87 (4th ed. 2008) (“While M&A transactions imply the purchase or sale of existing equity, greenfield investments refer to altogether new investments (*ex nihilo* investments).”), available at <http://www.oecd.org/daf/inv/investmentstatisticsandanalysis/40193734.pdf>; Ayse Bertrand, *Int’l Monetary Fund Committee on Balance of Payments Statistics and OECD Workshop on International Investment Statistics, Direct Investment Technical Expert Group, Issue Papers #4, #28, #29: Mergers and Acquisitions (M&As), Greenfield Investments and Extension of Capacity* (Nov. 2004), at 2 (defining greenfield investment as “creation of a subsidiary from scratch by one of [sic] more non-resident investors”), available at <http://www.imf.org/external/np/sta/bop/pdf/diteg42829.pdf>. See also 31 C.F.R. § 800.301, Example 3 (describing a greenfield investment as not a covered transaction within CFIUS jurisdiction, where such investment “involves such activities as separately arranging for the financing of and the construction of a plant to make a new product, buying supplies and inputs, hiring personnel, and purchasing the necessary technology. The investment may involve the acquisition of shares in a newly incorporated subsidiary.”).

<sup>34</sup>See JAMES K. JACKSON, CONG. RESEARCH SERV., RL33388, THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES 12–13, 28 (Mar. 6, 2014) (discussing recommendations in 2012 REP. TO CONG. OF THE U.S.-CHINA ECON. & SECURITY REV. COMMISSION (Nov. 2012) to extend CFIUS review to include greenfield investments).

<sup>35</sup>31 C.F.R. § 800.224.

<sup>36</sup>*Id.* § 800.203(a)(1).

- “Foreign persons” are natural persons as well as entities organized and headquartered outside the United States; a foreign-controlled US entity will also be deemed a foreign person.<sup>37</sup>
- “Control” is the ability – whether or not exercised – to “determine, direct, or decide” important business matters affecting an entity.<sup>38</sup> Control is not a bright-line test; it does not hinge on any one factor, such as the ownership of a majority of shares in a company. As noted above, the definition of control under the CFIUS regime is a functional one. To determine whether a transaction would result in foreign control of a US business, the Committee looks at a range of facts, including ownership of voting securities, the ability to make or block (i.e., veto) important business decisions, proxy voting, contractual arrangements and other means of obtaining control.<sup>39</sup> Therefore, ownership of ten percent of the voting securities of an entity accompanied by significant governance rights could equal “control.”
- A “US business” is any entity that, regardless of the nationality of its ownership, is engaged in interstate commerce; the definition of “entity” used in the US business definition encompasses not only legal entities (including a branch, partnership, group or subgroup, association, estate, trust, corporation, or organization), but also assets that are operated as a business undertaking – even if they are not separately incorporated. A collection of assets or a division of a US company could, if engaged in interstate commerce, constitute a “US business.”<sup>40</sup>

CFIUS also has jurisdiction over the purchase by one foreign acquirer of another *foreign* entity, if such a purchase could confer control over that foreign entity and thereby confer control over a US business.<sup>41</sup> Although CFIUS reviews are confidential and officially non-public, news reports and securities filings provide a window into many reviews.<sup>42</sup> For example, in 2013, CFIUS, as well as Canadian regulators, reportedly reviewed and approved CNOOC’s acquisition of Nexen Inc.— a Canadian company that has significant operations in the Gulf of Mexico.<sup>43</sup> CFIUS also reportedly reviewed the acquisition of Canada-based Lincoln Mining Corporation (Lincoln) by another Canadian company, Procon Mining and Tunnelling, Ltd. (Procon), and Procon’s affiliates, including China National Machinery Industry Corporation, a Chinese state-owned enterprise. Lincoln’s core mining operations are in the United States, reportedly prompting CFIUS review of the transaction. Ultimately, Procon had to divest itself of Lincoln.<sup>44</sup> CFIUS was not required to specify the national security concerns that were the basis for its determination; however, Lincoln’s properties’ proximity to a US naval air station in Nevada reportedly was a significant concern.<sup>45</sup>

## D. The CFIUS process

### 1. Filing before CFIUS

Notifying CFIUS of a particular transaction is ostensibly voluntary, but the Committee has the authority to request a filing even if it is not notified.<sup>46</sup> Member agencies also can file on their own if they believe that a transaction presents national security considerations.<sup>47</sup> Determining whether to file is a matter of risk assessment and risk tolerance. In some cases, however (such as the purchase by a foreign person of a government contractor doing classified work), filing is essentially mandatory. Consideration should also be given to certain other factors relating to the

<sup>37</sup>*Id.* § 800.216.

<sup>38</sup>*Id.* § 800.204.

<sup>39</sup>*Id.* § 800.204(a).

<sup>40</sup>*Id.* §§ 800.211; 800.226.

<sup>41</sup>*See id.* § 800.226.

<sup>42</sup>*Id.* § 800.702.

<sup>43</sup>Euan Rocha, *CNOOC Closes \$15.1 Billion Acquisition of Canada’s Nexen*, REUTERS (Feb. 25, 2013), <http://www.reuters.com/article/2013/02/25/us-nexen-cnooc-idUSBRE9101A420130225>.

<sup>44</sup>*See* <http://www.lincolnmining.com/> (noting “Lincoln’s three core projects are located in the United States”) (last visited Jan. 8, 2015); “Divestment of Procon Investment in Lincoln Mining Required as a Result of US Regulatory Review” (June 18, 2013), [http://www.lincolnmining.com/news/index.php?&content\\_id=255](http://www.lincolnmining.com/news/index.php?&content_id=255).

<sup>45</sup>*See* Thilo Hanemann, *Chinese FDI in the United States: Q2 Update*, RHODIUM GROUP (July 19, 2013), <http://rhg.com/notes/chinese-fdi-in-the-united-states-q2-2013-update>.

<sup>46</sup>31 C.F.R. § 800.401(b).

<sup>47</sup>*Id.* § 800.401(c).

transaction, such as whether the US business is engaged in sensitive business areas or whether the foreign acquirer is from a country that has sponsored industrial espionage or is not closely allied with the United States. The risk of not filing is that CFIUS may still review the transaction. In such circumstances, the failure to file voluntarily may taint the review process. Furthermore, transactions that are not reviewed are open to review in perpetuity. If a review occurs after closing, parties may be required to put in place costly mitigation measures (including restructuring) or risk having the transaction referred to the President for divestiture.

Notification requires that the parties marshal a significant amount of information with respect to the transaction, the parties and their activities, and personal identifier information for officers and directors, which may in some cases pose some difficulty in the case of sovereign wealth funds due to their structure and the necessity of providing information that may not be easily accessible.<sup>48</sup> After an initial “pre-filing,” which the parties submit about five to seven days prior to the filing and during which period CFIUS may identify specific questions or issues for the parties to address in the formal review, the notice may be filed formally for acceptance by the Committee. A pre-filing is not required, but it is often helpful in enabling a dialogue between CFIUS and the parties so that the Committee has some advance notice of the transaction and the parties have the opportunity to amend or supplement their filing to address particular concerns.

## 2. CFIUS review and investigation of covered transactions

Once CFIUS accepts the notice, agencies with special interest in the transaction are appointed to lead the review in addition to the Treasury, and the initial review period begins. It typically lasts 30 days and can sometimes be followed by an additional 45-day investigation.<sup>49</sup> It is not uncommon, however, for a complex transaction to be withdrawn and re-filed by the parties, starting the initial 30-day period over, which can result in an overall review period of longer than 75 days. Re-filings may occur in complicated transactions where CFIUS has identified national security risks and is trying to address those risks with the parties through mitigation, as discussed below. In the rare case that the transaction is referred by CFIUS to the President upon completion of the investigation, the President has 15 days to make a decision to veto the transaction or allow it to proceed.<sup>50</sup>

Although the law sets forth an illustrative list of factors<sup>51</sup> the Committee may examine in assessing whether a transaction presents a “national security risk,” the term is not explicitly defined by the statute. Legislative history supports a broad interpretation of the term “national security,” however, and CFIUS has broad discretion in applying the term to a particular transaction.<sup>52</sup>

As an analytical matter, national security risk is a function of the interaction of three factors: (i) the *threat* posed by the foreign acquirer (informed by a National Security Threat Assessment

<sup>48</sup>31 C.F.R. § 800.402; see also 31 C.F.R. § 800.702 (providing that “[a]ny information or documentary material filed with the Committee pursuant to this part” is exempt from disclosure under the Freedom of Information Act, 5 U.S.C. § 552).

<sup>49</sup>31 C.F.R. §§ 800.502, 800.505.

<sup>50</sup>§ 6, 121 Stat. 255, codified at 50 U.S.C. App. § 2170(d).

<sup>51</sup>In addition to whether a transaction is a foreign-government-controlled transaction, such factors include: the domestic production needed for projected national defense requirements; the capability and capacity of domestic industries to meet national defense requirements; the potential effects of the proposed or pending transaction on sales of military goods, equipment or technology to countries that support terrorism or weapons proliferation; and the potential effects of the proposed or pending transaction on US “critical infrastructure,” “critical technologies,” or US “international technological leadership in areas affecting United States national security.” 50 U.S.C. App. § 2170(f) (1), (2), (4)–(8). These factors also include “... such other factors as the President or [CFIUS] may determine to be appropriate, generally or in connection with a specific review or investigation.” *Id.* at § 2170(f)(11).

<sup>52</sup>See Jose E. Alvarez, *Political Protectionism and United States International Investment Obligations in Conflict*, VA. J. INT’L L. 71–72 (1989) (quoting Representative Florio’s statement in Foreign Takeovers and National Security: Hearings on § 905 of H.R. 3 Before the Subcomm. on Commerce, Consumer Protection, and Competitiveness of the House Comm. on Energy and Commerce, 100th Cong., 1st Sess. 1987 (Oct. 20, 1987), advocating for “our Government . . . [to] be able to review and take appropriate action involving investments that do impact [sic] in ways that are not in the interest of the country national security wise, as well as national security wise from a broader base, and that is the economic base.”); 77 n.407 (quoting S. Rep. No. 80, 100th Cong., 1st Sess. 25 (1987) (“The term ‘national security’ is intended to be interpreted broadly without limitation to particular industries . . . [N]othing in this section is meant to imply that past interpretations of the extraordinary breadth of the Defense Production Act or its grant of authority to the President is incorrect.”)).



and performed by the Director of National Intelligence, along with other factors, including track record on export controls and non-proliferation, and other matters of interest to US national security);<sup>53</sup> (ii) the *vulnerability* posed by the US business;<sup>54</sup> and (iii) the consequences of the interaction of those two factors for US national security. What follows are just a few examples of questions that could be asked by the Committee in assessing the threat: Does the foreign acquirer's home country have a history of cooperating on important US national security priorities such as non-proliferation and counter-terrorism?<sup>55</sup> What are the home country's cybersecurity policies?<sup>56</sup> Are there ties between the acquirer's management and military or intelligence agencies?<sup>57</sup> Is the home country reputed to engage in commercial or state espionage?<sup>58</sup> Does the acquirer do business in countries subject to US sanctions?<sup>59</sup> The answers to these, and other, questions will have a significant effect on the review process.

Traditionally, CFIUS looked primarily at assets comprising the military industrial base. In 2006, however, the purchase by Dubai Ports World, (a state-owned firm in the United Arab Emirates), of the Peninsular and Oriental Navigation Company, which operated several US port facilities, sparked significant controversy. As noted above, FINSA was enacted in the wake of this case; one of its most significant changes was the addition of a provision that the term "national security" would be construed to include issues relating to "homeland security," and the impact of a transaction on "critical infrastructure."<sup>60</sup>

What constitutes "critical infrastructure" is determined by CFIUS on a case-by-case basis.<sup>61</sup> Not every investment in a sector that might be viewed as critical infrastructure, such as telecommunications, will be viewed as critical infrastructure for purposes of Section 721. It will depend, rather, on the nature of the asset and its importance to the United States. Typically, major energy (particularly if the assets connect to the energy grid), transportation, telecommunications, and financial industry assets fall into this category.<sup>62</sup>

The Committee has broad authority to ask questions. It will likely want to know, for example, whether the operations of the US business involve information technology, telecommunications, energy, natural resources, or other goods and services vulnerable to sabotage, espionage or cybersecurity risk.<sup>63</sup> It will also want to know whether the US business provides products or services to federal, state, or local government agencies; whether it has classified or sensitive government contracts; and whether the target is involved in highly sensitive areas such as weapons, munitions, or aerospace.<sup>64</sup> Is the US business an important part of US critical infrastructure, such as energy pipelines, transportation, ports, and financial systems?<sup>65</sup> Is the US business subject to US export controls?<sup>66</sup> In the current environment, CFIUS regularly assesses

<sup>53</sup>Office of Investment Security; Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States, 73 Fed. Reg. 74,567, 74,571 (Dec. 8, 2008). The "threat assessment" considers whether the foreign acquirer has the capability or intention to cause harm. *Id.* at 74,569.

<sup>54</sup>Whether there is vulnerability depends on whether the nature of the US business or its relationship to a weakness or short-coming in a system, or structure creates susceptibility to impairment of US national security. *Id.* at 74, 569.

<sup>55</sup>See 50 U.S.C. App. § 2170(f)(4), (9); Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States, 73 Fed. Reg. at 74,569, 74,570.

<sup>56</sup>See COMMITTEE ON FOREIGN INV. IN THE UNITED STATES ANN. REP. TO CONGRESS, *supra* note 12, at 22; Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States, 73 Fed. Reg. at 74,572.

<sup>57</sup>See COMMITTEE ON FOREIGN INV. IN THE UNITED STATES ANN. REP. TO CONGRESS, *supra* note 12, at 36.

<sup>58</sup>See 50 U.S.C. App. § 2170(m)(3)(ii); COMMITTEE ON FOREIGN INV. IN THE UNITED STATES ANN. REP. TO CONGRESS, *supra* note 12, at 29 (noting that the US intelligence company "judges that foreign governments are extremely likely to continue to use a range of collection methods to obtain critical U.S. technologies").

<sup>59</sup>See COMMITTEE ON FOREIGN INV. IN THE UNITED STATES ANN. REP. TO CONGRESS, *supra* note 12.

<sup>60</sup>§§ 2, 4, 121 Stat. at 247, 253, codified at 50 U.S.C. App. § 2170(f)(6)-(7).

<sup>61</sup>The CFIUS definition of critical infrastructure essentially adopts the definition of the same term in the USA PATRIOT Act, 42 U.S.C. § 5195c(e). The CFIUS definition is "systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security." 50 U.S.C. App. § 2170(a)(6).

<sup>62</sup>See 50 U.S.C. App. § 2170(f)(6); Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States, 73 Fed. Reg. at 74,570.

<sup>63</sup>See Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States, 73 Fed. Reg. at 74,572.

<sup>64</sup>See *id.* at 74,570.

<sup>65</sup>See *id.* at 74,569, 74,570.

<sup>66</sup>See *id.*

cybersecurity threats to national security or critical infrastructure in order to prevent insertion of malicious code in technology that may be involved in sensitive tasks.<sup>67</sup>

A relatively new factor in assessing national security risk (one that is critical for sovereign wealth fund acquirers), is whether the assets, even if otherwise of little interest, are located near sensitive government facilities. In at least two recent cases, as discussed below in connection with the *Ralls* case, CFIUS found that a transaction should be prohibited for national security reasons because the acquisition targets had property located near US military facilities.<sup>68</sup>

If the Committee is satisfied that there are “no unresolved national security concerns,” it will conclude action; the reviewed transaction benefits from a “safe harbor” and cannot be reopened by CFIUS absent fraud, misrepresentation or certain breaches of a mitigation agreement.<sup>69</sup> If national security risks are identified during the review, however, the Committee will likely propose mitigation measures that will help it reach conclusion. These measures can be put in place with or without the consent of the parties and are generally part of a national security agreement.

Typical mitigation measures may require a security committee, appointment of an independent security officer, independent third party compliance audits (reported to the government), compliance measures, and corporate governance requirements that, in some cases, can greatly diminish the value of the deal to the foreign buyer. This is especially true when the acquirer expects to take a hands-on role in management of the business, a factor that may be less of a concern for sovereign wealth funds. In a 2012 report (the latest date for which information is available at the time of this writing), CFIUS required businesses to take additional “specific and verifiable actions,” such as:

- (i) Restricting access to certain technology and information to specific authorized persons;
- (ii) Requiring security committees to appoint a U.S. government-approved security officer or member of the board of directors;
- (iii) Establishing policies for handling existing or future U.S. government contractors, U.S. government customer information, “and other sensitive information”;
- (iv) Ensuring that only U.S. citizens handle certain products and services;
- (v) Ensuring that certain activities and products are located in the United States;
- (vi) Obtaining approval from security officers or relevant U.S. government parties prior to visits from foreign nations;
- (vii) Notifying the U.S. government “of any awareness of any vulnerability or security incidents”; and even
- (viii) Terminating certain activities of the U.S. business.<sup>70</sup>

In 2012, CFIUS imposed mitigation measures for eight covered transactions (seven percent of the total transactions it reviewed that year), relating to acquisitions of US companies engaged in the software, information, mining, energy, and technology industries.<sup>71</sup>

In each case involving a mitigation agreement, the Treasury designates a US government signatory as lead agency for monitoring the parties’ compliance with this agreement.<sup>72</sup> The lead agency may accomplish this task in a variety of ways, including: (i) requiring periodic reports from the parties; (ii) conducting on-site compliance reviews; (iii) requiring the parties to submit to external (third party) audits; and (iv) initiating investigations and requiring remedial actions “if anomalies or breaches are discovered or suspected.”<sup>73</sup> In addition, FINSAs authorize the

<sup>67</sup>See COMMITTEE ON FOREIGN INV. IN THE UNITED STATES ANN. REP. TO CONGRESS, *supra* note 12, at 22; Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States, 73 Fed. Reg. at 74,572.

<sup>68</sup>See *Ralls*, 758 F.3d at 304; Thilo Hanemann, *Chinese FDI in the United States: Q2 Update*, RHODIUM GROUP (July 19, 2013), <http://rhg.com/notes/chinese-fdi-in-the-united-states-q2-2013-update> (discussing unwinding of Lincoln Mining acquisition); Presidential Order Regarding the Acquisition of Four US Wind Farm Project Companies by Ralls Corporation, 77 Fed. Reg. 60,281 (Oct. 3, 2012).

<sup>69</sup>§ 2, 121 Stat. at 248, codified at 50 U.S.C. App. § 2170(b)(1)(D).

<sup>70</sup>COMMITTEE ON FOREIGN INV. IN THE UNITED STATES ANN. REP. TO CONGRESS, *supra* note 12, at 20.

<sup>71</sup>*Id.*

<sup>72</sup>*Id.*

<sup>73</sup>*Id.* Note also that, depending on the US target’s activities, other US government agencies may impose their own mitigation requirements as well under their separate authorities. For example, where the target is a cleared US contractor and a foreign acquirer would have the ability “to direct or decide matters affecting the management or operations of that company in a manner which may result in unauthorized access to classified information or may

President or CFIUS to initiate a review unilaterally if the lead agency certifies to CFIUS that a party has intentionally and materially breached the mitigation measures and CFIUS concludes that “there are no other remedies or enforcement tools available to address such breach.”<sup>74</sup>

If the Committee determines that there are national security risks that cannot be mitigated or otherwise addressed, it may inform the parties that it will refer the transaction to the President for decision. Under these circumstances, given the high likelihood of presidential veto, the parties typically withdraw their filing and abandon or unwind the transaction. In the rare circumstance that the parties refuse to withdraw and the matter is referred to the President, the President has broad authority to take action, including the power to suspend or prohibit the transaction.

### 3. Sovereign wealth fund transactions

A transaction by a sovereign wealth fund will generally be treated as a “foreign government-controlled transaction” under Section 721, because it is generally owned and/or controlled by a foreign government. CFIUS looks at the same question it considers when assessing control within the context of a covered transaction in determining whether a foreign government controls the foreign acquirer in a covered transaction (and therefore, whether that transaction constitutes a “foreign government-controlled transaction” for purposes of Section 721). As discussed above, this question is whether the foreign government has the authority to “determine, direct or decide” important matters affecting the foreign acquirer (whether or not exercised), and thereby, the US business.<sup>75</sup> Thus, the Committee will look at the range of facts discussed above under “Threshold factors for jurisdiction.”<sup>76</sup> Because the purpose of the CFIUS review process is to assess national security risk, the definition of “control” is much broader than it is in other areas of law.

In some cases, though not necessarily applicable in the sovereign wealth fund context, a foreign government may own what is commonly referred to as a “golden share” or “special share” in a foreign acquirer. Such shares are generally addressed in a company’s Articles of Association, which specify rights that belong to the special share, as well as matters that are variations on the rights of the special share and would therefore require the consent of the special shareholder to be effective. Such matters may include the sale of the company’s property or particular uses of the property, a change in board leadership, or the ability of an entity or group of entities acting in concert to gain a controlling share in the company.

A golden or special share could therefore, depending on the rights of the government and other factors, provide the basis for a determination by CFIUS of foreign government control.<sup>77</sup> Foreign government-controlled transactions can include those resulting in control of a US business by, among others, foreign government agencies, state-owned enterprises, government pension funds, and sovereign wealth funds.<sup>78</sup> In a sovereign wealth fund transaction, because a finding of foreign government control has implications for the CFIUS process, it is particularly important to assess which factors indicating foreign government control are (or are not) present, and address these carefully in a filing.

By law, “foreign government-controlled transactions,” which may include sovereign wealth fund transactions, presumptively receive the additional 45-day investigation, although the investigation can be waived if senior officials determine that the transaction “will not impair” national security.<sup>79</sup>

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#### *Footnote continued*

adversely affect the performance of classified contracts,” the US government will consider the target under foreign ownership, control, or influence (FOCI) and will require both the contractor and acquirer to take measures to mitigate or negate the FOCI. For additional information on FOCI mitigation, see DoD 5220.22-M, “National Industrial Security Program Operating Manual” at 2-300.

<sup>74</sup>§ 2, 121 Stat. at 248, codified at 50 U.S.C. App. § 2170(b)(1)(D).

<sup>75</sup>31 C.F.R. § 800.204(a). A “foreign government-controlled transaction” is “any covered transaction that could result in control of a US business by a foreign government or a person controlled by or acting on behalf of a foreign government.” *Id.* § 800.214. Notably, the fact that a government has never exercised its authority is instructive, but in no sense dispositive on the question of government control. As long as the authority exists, “control” likely will be deemed to exist.

<sup>76</sup>The regulations also list a number of factual examples of situations that would or would not qualify as “control” of a US business. See 31 C.F.R. § 800.204.

<sup>77</sup>*Id.* § 800.402(c)(6)(iv)(D).

<sup>78</sup>See Office of Investment Security; Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States, 73 Fed. Reg. at 74,571.

<sup>79</sup>*Id.* §§ 800.503(b); 800.504.

Although it is not uncommon for such a finding to be made, it is nevertheless wise for sovereign wealth funds to expect at least the full 75-day period for CFIUS review.<sup>80</sup>

With respect to the review itself, guidance issued by the Treasury notes that, although foreign government control is “clearly a national security factor to be considered, the fact that a transaction is a foreign government-controlled transaction does not, in itself, mean that it poses national security risk.”<sup>81</sup> CFIUS has in fact reviewed and concluded action favorably on many foreign government-controlled transactions.

Foreign government control is one of the specific factors listed in Section 721 that CFIUS may consider in assessing national security risk; as such, it will be an important consideration in assessing a sovereign wealth fund transaction.<sup>82</sup> The Section 721 factors also highlight certain areas that are particularly relevant in assessing national security risk when examining a foreign government-controlled transaction. Among all other relevant facts and circumstances, CFIUS will consider the following:

- The extent to which the basic investment management policies of the investor require investment decisions to be based solely on commercial grounds;
- The degree to which, in practice, the investor’s management and investment decisions are exercised independently from the controlling government, including whether governance structures are in place to ensure independence;
- The degree of transparency and disclosure of the purpose, investment objectives, institutional arrangements, and financial information of the investor;
- The degree to which the investor complies with applicable regulatory and disclosure requirements of countries in which they invest;
- The record of the country of the foreign acquirer on adherence to non-proliferation regimes, and the relationship of the country with the United States, specifically on its record in cooperating in counter-terrorism efforts; and
- The potential for transshipment or diversion of technologies with military applications, including export control laws and regulations.<sup>83</sup>

#### **4. Typical sovereign wealth fund transaction – Real estate**

Large sovereign wealth funds, including those from China and the Middle East, are increasing their investments in real estate in the United States. For the first three quarters of 2014, sovereign wealth funds invested a total of \$17.5 billion in direct real estate, an increase of roughly 35 percent over the first three quarters of 2013. Competition for core real estate assets in New York, London, Paris and San Francisco, is mounting.<sup>84</sup>

Given this activity, it is important to understand how Section 721 can apply to foreign acquisitions of real estate in the United States. CFIUS clearly has jurisdiction over real estate transactions that constitute the acquisition by a foreign person of control of a “US business,” including purchases of certain assets and acquisitions of control of entities that operate real estate, and purchases made through other vehicles, including private equity. Certain real estate investments akin to “greenfield” investments are unlikely to warrant review. These include the acquisition of unimproved land (without any other assets and assuming no other relevant facts),<sup>85</sup> and purchases of unused buildings (assuming customer lists, intellectual property, or other proprietary information or personnel used to operate the building, are not included).<sup>86</sup>

<sup>80</sup>*Id.*, 121 Stat. at 250, codified at 50 U.S.C. App. § 2170(b)(3)(C).

<sup>81</sup>73 Fed. Reg. at 74,571.

<sup>82</sup>50 U.S.C. App. § 2170(f)(6); see also *supra* note 45, for listing of other factors in § 2170(f).

<sup>83</sup>50 U.S.C. App. § 2170(9)(A-C).

<sup>84</sup>Sovereign Wealth Fund Institute, *Real Estate Investments More Attractive for Sovereign Wealth Funds*, *supra* note 3.

<sup>85</sup>Depending upon the type of land and the state in which it is located, however, certain federal or state laws may apply. For a more detailed discussion of these limitations on land use, See GAO-09-608, *Sovereign Wealth Funds: Laws Limiting Foreign Investment Affect Certain U.S. Assets and Agencies Have Various Enforcement Processes* (May 2009), available at <http://www.gao.gov/new.items/d09608.pdf>. Even where US federal or state laws do not prohibit foreign ownership of US land, or require advance notice before a real estate purchase or lease, foreign owners of US property may still be subject to additional reporting requirements under the International Investment Survey Act of 1976 and the Agricultural Foreign Investment Disclosure Act of 1978.

<sup>86</sup>31 C.F.R. § 800.301(c), Examples 6 and 7. For additional guidance from the Treasury on the acquisition of

The key issue in many real estate transactions involving a collection of assets is whether the assets constitute a “US business.” To the extent that a purchase involves the assets necessary to operate a particular business, for example, including customer lists, intellectual property, and other key assets, the acquisition could be deemed a covered transaction under Section 721. Purchases of hotels and other occupied buildings, such as office buildings with tenant leases, contracts, customer lists, management personnel, and other tangible assets, therefore, could be covered, as could other types of properties. Apart from acquisitions of an asset or collection of assets, CFIUS also could have jurisdiction over the purchase by a foreign acquirer, or by an entity such as a joint venture that is controlled by a foreign acquirer, of a controlling interest in an entity that operates commercial real estate. Under these circumstances, it is wise to consider the second question – whether the transaction could present national security considerations – as part of assessing whether to file with CFIUS.

Although real estate has not traditionally raised national security issues, recent heightened scrutiny of all foreign acquisitions by the Committee—and the fact that sovereign wealth funds will generally constitute foreign government-controlled entities—mean that certain real estate transactions will merit a CFIUS filing.<sup>87</sup> In particular, proximity to military and other sensitive US government facilities – so-called “persistent co-location” by the US government – should be weighed when assessing possible national security considerations in real estate deals.<sup>88</sup> Consideration should also be given to a range of questions, including whether the assets consist of “critical infrastructure,”; house the manufacture or storage of “critical technologies,” or are in close proximity to either of those things; or (ii) the tenants include sensitive US government agencies. The acquisition of a hotel that frequently houses foreign heads of state, as in the case of the purchase by Anbang Insurance Group Co., Ltd. (from China) of the Waldorf Astoria hotel in New York City, recently approved by CFIUS, is an example of a real estate transaction that clearly would merit a CFIUS filing. Appropriate due diligence that focuses on the nature and use of the assets in these types of transactions is critical.

Where a sovereign wealth fund may lack in-depth knowledge of the US real estate market, some have considered partnering with US real estate companies through structures that might include real estate investment trusts or limited partnerships. To mitigate concerns, sovereign wealth funds may also consider ways to limit their control of the asset or company, such as minimizing the investor’s governance rights or retaining a US property manager who is answerable to US overseers.

## II. THE D.C. CIRCUIT DECISION IN *RALLS*

In *Ralls*, a three-judge panel of the US Court of Appeals for the District of Columbia Circuit (“DC Circuit”) reversed a district court decision and unanimously ruled that the process that led to President Obama’s order (presidential order) unwinding a Chinese-controlled acquisition had essentially deprived the buyer, Ralls Corporation (Ralls), of a constitutionally protected property interest without due process of law.<sup>89</sup> The case itself is unprecedented: the first legal challenge to a presidential veto in the long history of CFIUS. Although the decision does not affect either the authority of the President to prohibit a covered transaction or CFIUS’s authority to conduct

*Footnote continued*

warehouses, *compare* 31 C.F.R. §§ 800.301, Example 6 (where foreign Corporation X seeks to acquire from US Corporation A an empty warehouse facility in the US, the acquisition would not be a covered transaction where “the acquisition would be limited to the physical facility and would not include customer lists, intellectual property, or other proprietary information, or other intangible assets or the transfer of personnel”), *with* Example 7 (where the same proposed warehouse acquisition would also involve Corporation X’s acquiring “personnel, customer list, equipment, and inventory management software used to operate the facility,” such acquisition would be a covered transaction).

<sup>87</sup>The CFIUS Annual Report issued in December 2013 listed, for the first time, the fact that CFIUS reviewed four real estate transactions. See COMMITTEE ON FOREIGN INV. IN THE UNITED STATES ANN. REP. TO CONGRESS, *supra* note 12, at 8.

<sup>88</sup>According to publicly available information, several recent transactions have foundered on proximity concerns. As noted in Part I, the Chinese controlled entity, Procon, was required to divest its investment in Lincoln, a Canadian company. Lincoln’s US operations were reportedly near the Marine Corps Air Station Yuma (in California) and the Fallon Naval Station (in Nevada). See *supra* note 43. The most famous example of “persistent co-location,” however, is the Ralls transaction discussed in Part II of this article.

<sup>89</sup>The panel consisted of three appellate judges: Circuit Judge, Robert L. Wilkins, nominated by President Barack Obama and appointed in June of 2013; Circuit Judge Janice Rogers Brown, nominated by President George W. Bush in 2003 and appointed on June 8, 2005; and Circuit Judge Karen L. Henderson, nominated by President George H. W. Bush and appointed in July of 1990.



national security reviews, the decision could have implications for the CFIUS process and for foreign investors, including sovereign wealth funds.

### A. Background of the *Ralls* case and the D.C. Circuit's opinion

The *Ralls* litigation arose from President Obama's veto of the acquisition of four limited liability companies (project companies) operating wind farm projects in Oregon. The buyer was the Ralls Corporation, an American company owned and controlled by two senior officials of the Sany Group, a Chinese corporation. Although the wind farms are located near a highly sensitive US military installation, Ralls did not submit the transaction for CFIUS review until after the deal closed, and then only because CFIUS requested the review. CFIUS subsequently issued an Order Establishing Interim Mitigation Measures, which was later amended (CFIUS order), requiring, among other things, that Ralls cease all activities at the wind farms.<sup>90</sup> Following CFIUS review, the transaction was vetoed by President Obama on September 28, 2012, on grounds that the acquisition threatened US national security.<sup>91</sup>

The blocking order was only the second presidential veto in history—the last dating back to 1990. Ralls sued the government in federal district court even before the presidential order was issued, alleging that the CFIUS order violated several provisions of US law, including the Due Process Clause of the Fifth Amendment to the US Constitution, which provides that no person may “be deprived of life, liberty or property, without due process of law,”<sup>92</sup> and the Administrative Procedure Act. After the veto, Ralls amended the complaint to include the President as a party, along with claims that the presidential order, *inter alia*, violated the Fifth Amendment Due Process Clause. The district court granted in part the government's motion to dismiss for lack of subject matter jurisdiction, holding that Section 721 barred judicial review of all but Ralls's due process claims against the presidential order.<sup>93</sup> The court also dismissed Ralls' claims against the CFIUS order on the grounds that the presidential order had superseded the CFIUS order and therefore claims against the CFIUS order were moot.<sup>94</sup>

In subsequent proceedings before the district court, Ralls argued that, because it was not apprised of the factual basis for the veto or given an opportunity to present evidence rebutting those facts, it had been denied its property without due process in violation of the Fifth Amendment. In October 2013, the court dismissed the complaint on the grounds that the President had not deprived Ralls of a constitutionally protected property interest because Ralls “voluntarily acquired those state property rights subject to the known risk of a Presidential veto” and “waived the opportunity . . . to obtain a determination from CFIUS and the President before it entered into the transaction.”<sup>95</sup> The court also found that even if there had been a constitutionally protected property interest, Ralls had received sufficient due process because it had been given notice (in the form of receiving CFIUS's request for review and CFIUS notification to Ralls' counsel to voluntarily divest or CFIUS would recommend divestiture to the President) and had provided its views to CFIUS (by filing its notice before CFIUS, and attending meetings with the Committee prior to CFIUS's decision).<sup>96</sup>

Ralls appealed the decision, and in July 2014, the D.C. Circuit reversed the district court's decision. The government advanced two arguments for precluding judicial review of due process claims. The first argument was that the express language of Section 721 (which bars judicial review of the “actions” and “findings” of the President)<sup>97</sup> prevented review of presidential action; the second argument was that a due process claim was a non-justiciable political claim. The D.C. Circuit rejected these arguments and concluded that Section 721 only reached the authority of the President to suspend a transaction and only precluded judicial review of the President's determination that the foreign interest might take action that threatens to impair the national security.<sup>98</sup> The three-judge

<sup>90</sup>*Ralls*, 758 F.3d at 305.

<sup>91</sup>*Id.* at 304-06. (The presidential order revoked the CFIUS order.)

<sup>92</sup>U.S. CONST. Amend. V.

<sup>93</sup>*Ralls Corp. v. Comm. on Foreign Inv. in the United States*, 926 F. Supp. 2d 71 (D.D.C. 2013).

<sup>94</sup>*Id.* at 95-99.

<sup>95</sup>*Ralls Corp. v. Comm. on Foreign Inv. in the United States*, 987 F. Supp. 2d 18, 32-37 (D.D.C. Oct. 9, 2013, as amended on Oct. 10, 2013).

<sup>96</sup>*Id.* at 19.

<sup>97</sup>50 U.S.C. App. § 2170(e).

<sup>98</sup>Although Ralls had raised the argument that the President's determination on this score (as well as CFIUS's) was nonreviewable under Section 721, the district court squarely rejected the argument and Ralls did not appeal that portion of the decision. *See Ralls*, 987 F. Supp. 2d at 30 (“In addition, Ralls's argument that it had an interest in

panel concluded that Congress had not intended to preclude judicial review of *all* claims under Section 721.<sup>99</sup> Thus, although final action by the President prohibiting the transaction was immune from judicial review, due process claims relating to the CFIUS determination that led to presidential action could be heard.

The court also rejected the government's second argument that the claims presented a non-justiciable political question. Rather, the court held that Ralls's due process claim did not require review of the presidential determination (i.e., the political question), and that a review of the *process* leading up to that determination was permissible. In reaching its determination, the court first looked to prior Supreme Court decisions on justiciability, particularly the seminal case *Baker v. Carr*, which held that courts may not decide a case when any of the following are "prominent on the surface":

- (1) a "textually demonstrable constitutional commitment of the issue to a coordinate political department";
- (2) "a lack of judicially discoverable and manageable standards for resolving it";
- (3) "the impossibility of deciding without an initial policy determination of a kind clearly for nonjudicial discretion";
- (4) "the impossibility of a court's undertaking independent resolution without expressing lack of the respect due coordinate branches of the government";
- (5) "an unusual need for unquestioning adherence to a political decision already made"; or
- (6) the potential for "embarrassment from multifarious pronouncements by various departments on one question."<sup>100</sup>

The Supreme Court cited a number of contexts that had presented justiciability issues under the political question doctrine, including foreign relations; dates of durations of hostilities; validity of enactments; and the status of Indian tribes.<sup>101</sup> The *Ralls* court considered that the case presented issues that might implicate "foreign policy and national security," but cited the Supreme Court's holding in *Baker* that "it is error to suppose that every case or controversy which touches foreign relations lies beyond judicial cognizance."<sup>102</sup>

Following the *Baker* factors as a guidepost, and absent any Supreme Court opinions that presented similar factual scenarios to the facts presented in *Ralls*, the D.C. Circuit proceeded to rely extensively on its previous decisions in the *People's Mojahedin Organization of Iran (PMOI)/ National Council of Resistance of Iran (NCRI)* line of cases, which involved an Iranian organization's challenge to its designation as a Foreign Terrorist Organization (FTO) by the US State Department under the Antiterrorism and Effective Death Penalty Act of 1996 (AEDPA).<sup>103</sup> Under this line of cases, organizations with a sufficient "constitutional presence" in the United States are entitled to due process,<sup>104</sup> but the merits of a determination by the State Department as to whether an organization's activities threaten US national security are nonjusticiable.<sup>105</sup> Applying these decisions, the court found that Ralls only "asks us to decide whether the Due Process Clause entitles it to have notice of, and access to, the evidence on which the President relied and an opportunity to rebut that evidence before he reaches his nonjusticiable (and statutorily unreviewable) determinations."<sup>106</sup>

Turning to the merits, the court found that Ralls had a constitutionally protected state property interest in the project companies that had fully vested upon acquisition and was entitled to the protections of the Due Process Clause. The court relied on Supreme Court precedent holding that, so long as Ralls possessed property interests under state law when it acquired the project

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*Footnote continued*

acquiring the property fails because the President's determination about whether to prohibit the transaction is entirely discretionary. Section 721 vests broad, unreviewable authority in the President to prohibit a transaction.").

<sup>99</sup>*Ralls*, 758 F.3d at 307-12. The court declined to address (but remanded to the district court for further determination) whether the doctrine of "executive privilege" would otherwise bar disclosure, as the argument was raised for the first time in oral argument. *Id.* at 318, 320-21, 325.

<sup>100</sup>369 U.S. 186, 217 (1962) (quoted in *Ralls*, 758 F.3d at 313).

<sup>101</sup>*Baker*, 369 U.S. at 211-17.

<sup>102</sup>*Ralls*, 758 F.3d at 313 (citing *Haig v. Agee*, 453 U.S. 280, 292 (1981); *Baker*, 369 U.S. at 211).

<sup>103</sup>See *Ralls*, 758 F.3d at 313-14.

<sup>104</sup>*National Council of Resistance of Iran v. Dep't of State*, 251 F.3d 192, 202 (D.C. Cir. 2001) (NCRI).

<sup>105</sup>*People's Mojahedin Org. of Iran v. Dep't of State*, 182 F.3d 17, 23 (D.C. Cir. 1999) (PMOI I).

<sup>106</sup>*Ralls*, 758 F.3d at 314.

companies, “due process protections necessarily attached.”<sup>107</sup> It also distinguished Ralls’ case from the Supreme Court decision in *Dames & Moore v. Regan*, in which the court held that attachment of Iranian property did not entitle the owner to compensation under the Takings Clause of the Fifth Amendment, because regulations promulgated by the Treasury Department’s Office of Foreign Assets Control (OFAC) provided that attachments of Iranian property were nullified absent a license.<sup>108</sup> The *Ralls* court found that, unlike the right to attach property, which, in *Dames & Moore*, was conditioned upon obtaining a license from the government that could be revoked at any time, Ralls’ state property interests were “fully vested . . . to which interests due process protections traditionally apply.”<sup>109</sup>

In deciding what level of due process Ralls was entitled to under the Constitution, the court first cited the test the Supreme Court articulated in *Mathews v. Eldridge* to assess what procedural protections are required by the Due Process Clause under the circumstances.<sup>110</sup> The test in *Mathews* requires courts to consider three facts: (1) “the private interest that will be affected by the official action”; (2) “the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards”; and (3) the government’s interest, which includes “the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail.”<sup>111</sup> The *Ralls* court also looked to the Supreme Court’s holding in *Mathews* that due process requires “the opportunity to be heard in a meaningful manner.”<sup>112</sup>

In applying these factors to the facts at hand, the court again looked primarily to the precedent in the *PMOI/NCRI* cases—this time to *NCRI*—which held that the NCRI could not be deprived of its interest in a small bank account in the US without receiving notice of the proposed designation; access to unclassified evidence undergirding the designation; and opportunity for rebuttal, notwithstanding the government’s compelling interest in national security.<sup>113</sup> The court also briefly considered the Supreme Court decision in *Greene v. McElroy*,<sup>114</sup> in which the Supreme Court found that the Secretary of the Armed Forces’ revocation of a government contractor’s security clearance violated the contractor’s due process rights. In *Greene*, the contractor received a hearing, but had no opportunity to confront or cross-examine adverse witnesses, and it was “obvious . . . from the questions posed to petitioner and his witnesses, that the [adjudicators] relied on confidential reports which were never made available to petitioner.”<sup>115</sup> The *Greene* case does not appear to be exactly on point: In contrast to the CFIUS regulations, which were promulgated with explicit authorization by the President (and by Congress through the enactment of FINSA), the revocation in *Greene* occurred under regulations that the Secretary of the Armed Forces had promulgated without explicit authorization by either the executive or legislative branch.<sup>116</sup> Although the lack of a clear executive or legislative delegation of authority was a cornerstone of the Court’s analysis in *Greene*, the D.C. Circuit still found the opinion’s holding applicable: “Where governmental action seriously injures an individual, and the reasonableness of the action depends on fact findings, the evidence used to prove the Government’s case must be disclosed to the individual so that he has an opportunity to show that it is untrue.”<sup>117</sup> The court found that Ralls’s transaction should be entitled to similar protections as those afforded to the NCRI’s interest in *NCRI* and the contractor’s security clearance in *Greene*.<sup>118</sup>

<sup>107</sup>*Id.* at 315 (quoting *Phillips v. Wash. Legal Found.*, 524 U.S. 156, 164 (1998) (“Because the Constitution protects rather than creates property interests, the existence of a property interest is determined by reference to ‘existing rules or understandings that stem from an independent source such as state law’”; *Paul v. Davis*, 424 U.S. 693, 710 (1976) (holding that property interests “attain . . . constitutional status by virtue of the fact that they have been initially recognized and protected by state law.”)) (other citations omitted).

<sup>108</sup>*Ralls*, 758 F.3d at 316-17 (citing *Dames & Moore v. Regan*, 453 U.S. 654, 672-73 (1981)).

<sup>109</sup>*Ralls*, 758 F.3d at 316-17.

<sup>110</sup>*Id.* at 317-18 (citing *Mathews v. Eldridge*, 424 U.S. 319 (1976)).

<sup>111</sup>*Mathews*, 424 U.S. at 335.

<sup>112</sup>*Ralls*, 758 F.3d at 318 (quoting *Mathews*, 424 U.S. at 333).

<sup>113</sup>*NCRI*, 251 F.3d at 208-09.

<sup>114</sup>360 U.S. 474 (1959).

<sup>115</sup>*Id.* at 479.

<sup>116</sup>*Id.* at 506.

<sup>117</sup>*Ralls*, 758 F.3d at 318, 320 (citing *Greene*, 360 U.S. at 496).

<sup>118</sup>*Ralls*, 758 F.3d at 320; compare with *NCRI v. Dep’t of State*, 373 F.3d 152, 158 (D.C. Cir. 2004) (upholding the State Department’s designation of NCRI as an FTO as consistent with due process and finding that “the voluminous

Based on these considerations, the court held that Ralls' entitlement to due process meant "at the least" that Ralls should be afforded: (i) notice of the official action; (ii) access to the unclassified information "on which the official actor relied," and (iii) an opportunity to rebut the evidence.<sup>119</sup> The court made clear that due process did not require the disclosure of classified information.<sup>120</sup> It was not sufficient, in the court's view, that Ralls had had an opportunity to present evidence to CFIUS before CFIUS made its determination. The court held that Ralls should also have had the chance to address particular national security concerns as specified by CFIUS.<sup>121</sup> In the court's view, adequate due process during the CFIUS review would satisfy the due process obligations of the President.<sup>122</sup> The D.C. Circuit further agreed with Ralls on appeal that its claims against the CFIUS order should be addressed under the exception to the mootness doctrine, for claims that are "capable of repetition yet evading review."<sup>123</sup>

In addition, the court noted that the government had raised for the first time, in oral argument before the appellate court, a claim that disclosure of certain unclassified information could be shielded by executive privilege. The Executive Branch may invoke this privilege to protect intra-governmental communications that, as one D.C. District Court described, are "integral to an appropriate exercise of the executive's decisional and policy making functions."<sup>124</sup> The court declined to consider this argument because the government had failed to raise it prior to oral argument, but noted that the district court could consider on remand whether executive privilege would apply in this case.

On October 2, 2014, the D.C. Circuit remanded the case to the district court to provide the necessary due process protections to Ralls, while allowing the presidential order to stand in the interim.<sup>125</sup> Although the government had the opportunity to appeal the decision of the D.C. Circuit to an *en banc* panel on the D.C. Circuit, or to the Supreme Court, it did not do so. As of this writing, the *Ralls* case is proceeding apace, having been remanded to the district court by the D.C. Circuit.<sup>126</sup> On November 6, the district court ordered the Government "to provide Ralls with access to all unclassified material contained in the record compiled by CFIUS and all unclassified factual findings or evidence underlying CFIUS's recommendation to the President by November 20, 2014."<sup>127</sup> The district court noted that if the government wished to assert executive privilege over any documents, it would need to produce a privilege log to Ralls and the court identifying the documents it is withholding and reasons for withholding them, by December 8, 2014.<sup>128</sup>

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*Footnote continued*

unclassified materials contained in the administrative record by themselves and by a comfortable margin provide sufficient support for the Secretary's conclusion"). See also *Al Haramain Islamic Foundation, Inc. v. U.S. Dep't of Treasury*, 686 F.3d 965, 987-88 (9th Cir. 2011) (finding that, under a different sanctions regime, party sanctioned by OFAC is entitled to notice from OFAC giving statement of reasons for investigation, noting *NCRI* "may suggest" this is required for FTOs but "the plaintiffs in [*NCRI*] never raised that specific issue"); *Chai v. Dep't of State*, 466 F.3d 125, 132-33 (D.C. Cir. 2006) (rejecting designated FTO's due process claim where, even though government failed to provide FTO with administrative record prior to designation, government subsequently provided FTO with record and performed *de novo* determination of their status and rendered the earlier procedural error "harmless").

<sup>119</sup>*Ralls*, 758 F.3d at 320.

<sup>120</sup>*Id.* at 319.

<sup>121</sup>*Id.* at 320.

<sup>122</sup>*Id.*

<sup>123</sup>*Id.* at 321-25.

<sup>124</sup>*Black v. Sheraton Corp. of Am.*, 371 F. Supp. 97, 100 (D.D.C.1974).

<sup>125</sup>*Id.* at 325 (citing *NRCI*, 251 F.3d at 209 (noting the D.C. Circuit left the FTO designation in place because, while "a strict and immediate application of the principles of law which we have set forth herein could be taken to require a revocation of the designations before us . . . we also recognize the realities of the foreign policy and national security concerns asserted by the Secretary in support of those designations.")). See also *U.S. v. Ralls Corp.*, Case No. 1:13-cv-02026, Dkt. No. 29 (D.D.C. Nov. 6, 2014) at 2-3.

<sup>126</sup>On October 6, Ralls filed a motion to dismiss in a related enforcement action that the US government filed in D.C. district court in December 2013, seeking to compel Ralls to comply with the CFIUS order while Ralls' appeal in *Ralls v. CFIUS* was pending before the D.C. Circuit. *U.S. v. Ralls Corp.*, Case No. 1:13-cv-02026, Dkt. No. 23 (D.D.C. Oct. 2014). Ralls stated in its motion that the court should dismiss the enforcement action as moot because Ralls was planning to divest its interest in the project companies and sell them to an individual Ralls identified as Dr. Xuexin Tang. On November 6, the district court dismissed Ralls' motion without prejudice, finding the case was not moot in light of the presidential order's requirements, "particularly . . . in light of the unusual circumstances – such as the plan to sell a \$6,000,000 asset for \$50,000 – that raise questions about the arms-length nature of the proposed transaction." *Id.*, Dkt. No. 29.

<sup>127</sup>*Id.*, Dkt. No. 29 at 3.

<sup>128</sup>On November 21, 2014, CFIUS provided Ralls with documents totaling 3,487 pages, consisting of unclassified materials before CFIUS. CFIUS also provided Ralls with a privilege log describing two documents, the unclassified

At the joint request of the government and Ralls, the court issued a protective order on December 12, 2014, whereby the parties may designate portions of information as “Confidential – Attorneys’ Eyes Only Pursuant To Protective Order.” The order noted that protected material would include portions of two specific documents that the government had been withholding from production, claiming that the documents contained sensitive but unclassified military information and were protected from disclosure by statute.<sup>129</sup> The order is limited, however, only to “specific material that qualifies under the appropriate standards,” and requires the designating party, “to the extent practicable,” to “designate for protection only those parts of material, documents, items, or oral or written communications that qualify – so that other portions of the material, documents, items, or communications for which protection is not warranted are not swept unjustifiably within the ambit of this Order.”<sup>130</sup> If a party objects to the other party’s designation of information under the protective order, and the parties cannot resolve the dispute between themselves, the objecting party may bring a challenge in court no later than 28 days after its initial objection.<sup>131</sup> In any such challenge, the objecting party will bear the burden of showing that the designation is improper.<sup>132</sup>

The court stated in its November 6 order that, following discovery, it will form a schedule “for the next series of events” in the case, which will include at the least: (1) an opportunity for Ralls “to respond to and/or rebut the information in writing”; (2) consideration by CFIUS of Ralls’ submissions, followed by an updated recommendation to the President and notice to Ralls “of the substance of that recommendation”; (3) CFIUS’s transmission of Ralls’ submission to the President along with its updated recommendation; and (4) CFIUS and the President informing Ralls “whether the Presidential Order has been reaffirmed, rescinded, or revised in any way . . . [a]fter the President has considered the record in its entirety.”<sup>133</sup> Finally, the court directed the parties to confer regarding a schedule for briefing the CFIUS order claims.<sup>134</sup> The parties have jointly represented a wish to complete discovery before submitting briefs on the CFIUS order claims, to “conserve judicial resources” and “serve the interests of the parties.”<sup>135</sup>

## B. Due process implications

Although, as discussed below, there is a possibility for future litigation in other US federal courts, the D.C. Circuit’s decision in *Ralls* represents a significant affirmation of the importance of due

*Footnote continued*

portions of which were withheld in whole or in part due to an assertion of privilege. The privilege log is unavailable to the public at this time. *See id.* at 3-4; Minute Order, *Ralls v. CFIUS*, Case No. 1:12-cv-01513 (D.D.C. Dec. 8, 2014). Ralls had the opportunity to file any opposition to the pleading by December 31, but did not do so.

<sup>129</sup>*Ralls v. CFIUS*, Case No. 1:12-cv-01513, Dkt. No. 70 at 2 (Dec. 12, 2014). The order described these documents as: (1) a document entitled “Information Paper – Subject: Impact of Wind Turbine Projects to NWSTF Boardman (R5701) (Apr. 8, 2011)”; and (2) a document entitled “CFIUS Case 12-044 – Ralls Corporation – Certain Assets of Terna Energy USA – Transactional Risk Review (July 31, 2012).” The statute invoked by the government was 10 U.S.C. § 130e, which authorizes the Secretary of Defense to exempt military “critical infrastructure security information” from disclosure under the Freedom of Information Act, where “the public interest consideration in the disclosure of such information does not outweigh preventing the disclosure of such information.” 10 U.S.C. § 130e(a) (cited in *Ralls*, Case No. 1:12-cv-01513, Dkt. No. 70 at 2). Military “critical infrastructure security information” is defined as “sensitive but unclassified information that, if disclosed, would reveal vulnerabilities in Department of Defense critical infrastructure that, if exploited, would likely result in the significant disruption, destruction, or damage of or to Department of Defense operations, property or facilities, including information regarding the securing and safeguarding of explosives, hazardous chemicals, or pipelines, related to critical infrastructure or protected systems owned or operated by or on behalf of the Department of Defense, including vulnerability assessments prepared by or on behalf of the Department of Defense, explosives safety information (including storage and handling), and other site-specific information on or relating to installation security.” 10 U.S.C. § 130e(c).

<sup>130</sup>*Ralls v. CFIUS*, Case No. 1:12-cv-01513, Dkt. No. 70 at 3.

<sup>131</sup>*Id.* at 5.

<sup>132</sup>*Id.*

<sup>133</sup>*Id.* at 4. No such schedule has been issued at the time of this writing.

<sup>134</sup>Although not the subject of this article, the outcome of consideration by the district court of claims relating to the CFIUS order could be significant for foreign investors, potentially providing them with additional leverage over the Committee where CFIUS is seeking to impose mitigation measures. At issue is the scope of CFIUS’s authority to impose interim mitigation measures during the course of a review and investigation in order to address national security concerns, including whether the measures used in *Ralls* were consistent with the Administrative Procedure Act, and the scope of any such measures. Of particular focus in *Ralls* is whether the CFIUS order effectively blocked the transaction – an authority reserved for the President – and in so doing, exceeded CFIUS’s statutory authority.

<sup>135</sup>*Ralls v. CFIUS*, Case 1:12-cv-01513, Dkt. No. 66 (D.D.C. Nov. 14, 2014) at 1.



process in an area – national security – where the Executive Branch has traditionally been accorded deference. Foreign investors, including sovereign wealth funds, should be heartened by the decision, not only because of the potential for more engagement in the course of reviews, but also because it supports the basic posture of the US as open to foreign investment.

Of equal importance is that the decision does not affect the basic framework of the CFIUS process. Neither the President's authority to suspend or prohibit transactions nor CFIUS's ability to review transactions for national security concerns are affected. The major implication of the decision from a due process perspective will thus depend on the scope of the due process ultimately required by the courts, which will need to be balanced against governmental interests, reflecting the longstanding tension between national security and due process.

The D.C. Circuit is not the final arbiter on the issue of whether and what due process is required in the CFIUS process. The government could have filed a petition before the US Supreme Court to review the D.C. Circuit's decision (although such petitions are rarely granted), but has declined thus far to do so.<sup>136</sup> Even if this case ultimately does not go to the Supreme Court, it is possible that other federal appellate courts may have the opportunity to weigh in on the issue and reach different conclusions from the D.C. Circuit's holding in *Ralls*.<sup>137</sup> However, the D.C. Circuit remains the most likely venue for future CFIUS cases, as it is the appellate court that hears most of the cases involving US regulatory and administrative legal challenges<sup>138</sup> – and it has a higher reversal rate of agency decisions than the other federal appellate courts do, which may make it a more advantageous choice of forum from the perspective of a private party seeking to challenge CFIUS's actions.<sup>139</sup> Another CFIUS challenge could come before another federal appellate court in the future, though, even the chances of another challenge are slim given the significant financial costs and time-consuming nature of litigation in US courts. Nonetheless, if such a challenge were to come before another federal court and the court were to reach a different result than the D.C. Circuit in *Ralls* did, divergent interpretations of what due process is required may increase the likelihood that the Supreme Court would review that challenge to resolve any differences between the circuits.<sup>140</sup>

It is unlikely that the ultimate outcome of the *Ralls* transaction will change once the prescription by the district court winds its way through the process. The most important question, therefore, is the scope of due process that will, as a result of the case, now need to be provided to future parties that undergo a CFIUS review. Absent additional guidance from the courts or the government, it appears that the required due process could be achieved without upending the existing CFIUS process. Even so, transparency for foreign investors is likely to increase only at the margins, for reasons discussed below. Nevertheless, one of the most important short term

<sup>136</sup>If the government had decided to seek Supreme Court review of the D.C. Circuit's decision, it would have been required to submit a written notification to the D.C. Circuit of its intent to petition the Supreme Court, and request the D.C. Circuit to stay the issuance of the mandate, which officially places a case back within the jurisdiction of the district court. Fed. R. App. Pr. Rule 41(d)(2). The government did not submit any written notification to this effect before the case was remanded to the district court.

<sup>137</sup>Some US statutes do vest exclusive jurisdiction in certain courts, where private parties can bring challenges under those laws in those courts only. As discussed above, however, Section 721 only expressly addresses judicial review to the extent that it: (1) precludes such review for the actions and findings of the President, and (2) authorizes the US government to bring an enforcement action "to seek appropriate relief, including divestment relief . . . to implement and enforce this subsection." 50 U.S.C. App. § 2170(d)(3). (CFIUS regulations also authorize the government to bring enforcement actions against parties for submitting false statements to CFIUS, or for material breaches of a mitigation agreement, in any federal district court. 31 C.F.R. § 800.801(f).) Although *Ralls* brought its action in D.C. federal court, Section 721 does not restrict the ability of a private party to bring a due process challenge against the President or against CFIUS in another federal district court.

<sup>138</sup>Cass R. Sunstein & Adrian Vermeule, *Libertarian Administrative Law*, at 1, Univ. of Chicago L. Rev. (forthcoming) (Harvard Public Law Working Paper No. 14-29) (June 29, 2014) (describing the D.C. Circuit as "the nation's most important regulatory court"); Eric M. Fraser, David K. Kessler, Matthew J.B. Lawrence, & Stephen A. Calhoun, *The Jurisdiction of the D.C. Circuit*, CORNELL JOURNAL OF LAW AND PUBLIC POLICY 131, 144-53, Vol. 23 No. 1 (2013) ("[M]ost administrative law students, scholars, and practitioners already know [that] the D.C. Circuit plays a special role in administrative law, as well as in other important, quintessentially federal subject matter areas like national defense.") (discussing tendency of Congress to vest, sometimes exclusively and sometimes non-exclusively, jurisdiction in the D.C. Circuit in crafting judicial review provisions in legislation).

<sup>139</sup>Douglas H. Ginsburg, Remarks, *Remarks Upon Receiving the Lifetime Service Award of the Georgetown Federalist Society Chapter*, 10 Geo. J.L. & Pub. Pol'y 1, 3-4 (2012).

<sup>140</sup>Note, though, that of the federal appellate circuits' decisions on issues of administrative law, the D.C. Circuit's opinions are most likely to be upheld by the Supreme Court. *Id.*

implications is likely to be the opportunity for enhanced engagement with CFIUS, which may result in more informed decision-making by the government, which will now operate within the shadow of judicial review. Fitting extra steps into what is already a very tight period for review and investigation will be challenging for CFIUS. However, this will be especially true if, in future cases, it decides to assert executive privilege over unclassified documents it would otherwise be required to produce, and litigation over document production issues results.<sup>141</sup> Should more onerous due process requirements ultimately be required by courts, however, it is possible that the government may seek legislative changes, particularly if the required due process cannot be afforded within the existing strict CFIUS time frames – time frames established to facilitate foreign direct investment transactions.

As for access to unclassified evidence supporting the decision, there are essentially three key questions that remained after the D.C. Circuit opinion in *Ralls*: how the government must produce the information; what information must be provided; and when the government must provide it to parties. Citing *NCRI* and *Morrissey v. Brewer*, the D.C. Circuit emphasized that due process was “not a technical conception with a fixed content unrelated to time, place and circumstances.”<sup>142</sup> Rather, it was flexible, calling for “such procedural protections as the particular situation demands.”<sup>143</sup> In *NCRI*, the court specifically envisioned that access to the required information could be given short of a formal hearing:

[T]here must then be some compliance with the hearing requirement of due process jurisprudence – that is, the opportunity to be heard at a meaningful time and in a meaningful manner recognized in *Mathews*, *Armstrong*, and a plethora of other cases. We do not suggest ‘that a hearing closely approximating a judicial trial is necessary.’ We do, however, require that the Secretary afford to entities considered for imminent designation the opportunity to present, *at least in written form*, such evidence as those entities may be able to produce to rebut administrative record or otherwise negate the proposition that they are foreign terrorist organizations (emphasis added).<sup>144</sup>

In the present *Ralls* case, the D.C. Circuit confirmed that flexibility when it remanded the case to the district court with instructions only “that Ralls be provided the requisite process set forth herein, which should include access to the unclassified evidence on which the President relied and an opportunity to respond thereto.” The D.C. Circuit thus indicated that there will be a fair amount of flexibility as to the form that disclosure of this information, and rebuttal by the parties, is required to take. As noted earlier, consistent with the recent order by the district court to produce “all unclassified material contained in the record compiled by CFIUS and all unclassified factual findings or evidence underlying CFIUS’s recommendation to the President,” the government has produced over 3,000 pages of unclassified material to Ralls. The district court has further provided that the opportunity to rebut by Ralls will be in writing.<sup>145</sup>

As for what information must be provided, the district court has made abundantly clear that the information CFIUS must produce must include all unclassified material in the record, factual findings, and evidence underlying CFIUS’s recommendation, subject to the assertion of executive privilege. The court strongly emphasized that classified information need not be provided in support of official action – only the unclassified information, although, as the developments in *Ralls* suggest, even unclassified information may be restricted only to sharing with a party’s attorneys under a protective order.<sup>146</sup> Depending on what CFIUS has produced, and whether Ralls objects that the production still does not comport with due process, the issue of what CFIUS is required to provide may continue to be an issue of dispute.

Moreover, as already noted above, the possibility that such unclassified information could also be protected by executive privilege remains in future cases.<sup>147</sup> The fact that the government only

<sup>141</sup>Likewise, from the perspective of a private party, challenging any privilege assertions could further protract litigation, increasing legal costs and decreasing the attractiveness of the proposed transaction from a business standpoint.

<sup>142</sup>*Ralls*, 758 F.3d at 317.

<sup>143</sup>*Id.* (quoting *Morrissey v. Brewer*, 408 U.S. 471, 481 (1972)).

<sup>144</sup>*NCRI*, 251 F.3d at 205 (quoting *Mathews*, 424 U.S. at 333).

<sup>145</sup>*Ralls v. CFIUS*, Case No 1:12-cv-01513, Dkt. No. 66 (D.D.C. Nov. 14, 2014) at 4.

<sup>146</sup>*Ralls*, 758 F.3d at 325.

<sup>147</sup>*Id.*; see also, e.g., 10 U.S.C. §§ 130c (authorizing withholding from public disclosure “sensitive information of foreign governments”); 130d (authorizing withholding from public disclosure “confidential business information and

asserted privilege with respect to two of the unclassified documents it produced to Ralls, however, indicates that the government (or at least the current Presidential Administration) is inclined to be conservative in its assertion of the privilege. A protracted back and forth about executive privilege in future cases is unlikely to be in the interest of either the government or the parties. Similarly, the fact that the government and Ralls jointly sought a protective order from the government for documents that the government claimed were protected under 10 U.S.C. § 130e supports a view that it is in the parties' best interests to resolve discovery disputes as efficiently as possible.

That the protective order in *Ralls* only permits the government to restrict disclosure of specific protected material, rather than withhold entire documents that only contain some protected material, also indicates that courts are unlikely to allow CFIUS to withhold documents in full if those documents contain some unclassified and some classified information (or information that is otherwise restricted). CFIUS collects a range of information as part of a review, including information from the parties, public sources, and government sources, including the classified National Security Threat Assessment prepared by the Director of National Intelligence.<sup>148</sup> Under Section 721, in order to propose mitigation measures for consideration by the Committee, the lead agency or agencies must prepare a "risk-based analysis" (RBA) that supports their proposal.<sup>149</sup> If unclassified information is used in this document, CFIUS might be able to pull the unclassified information from the RBA. Ralls could argue, however, that CFIUS is required to produce the actual RBA in full with the classified information redacted, so the private party could understand how much of the underlying information or evidence was classified versus how much of it was unclassified. Whether CFIUS is in fact required to provide redacted documents in full is just one example of an issue that a court may later be required to address once the parties are in the weeds of the document production process.

Indeed, although CFIUS does rely on both classified and unclassified evidence,<sup>150</sup> in most cases, the classified materials are likely to be the key decisional documents. The FTO designation cases may not provide particularly helpful precedent in this area, as it is not entirely clear from them how the court would view adequate due process where the information relied on is mostly classified (thus, arguably rendering the disclosure of unclassified information meaningless in the context of providing parties with the ability to effectively rebut a decision).<sup>151</sup> Nevertheless, under the theory of *NCRI*, if both classified and unclassified information are relied on, protections should nevertheless be provided "despite our uncertainty that *NCRI* could effectively rebut the Secretary's evidence."<sup>152</sup>

Given the above, providing unclassified information to the parties is unlikely to provide any real transparency as to the basis for decision and, therefore, limited opportunity for meaningful rebuttal. It is, however, likely to require enhanced and earlier engagement between the parties and CFIUS, which could have important benefits. Although CFIUS often meets with parties either before or early in a review, it has in the past been less inclined to meet once mitigation discussions are under way within the Committee. To the extent that the *Ralls* decision creates a more routine avenue for engagement at an earlier stage, it could have a positive effect on the process and even promote more informed outcomes.

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*Footnote continued*

other sensitive but unclassified homeland security information in the possession of the Department of Defense that is shared . . . with State and local personnel); 130e (authorizing withholding "critical infrastructure security information from disclosure").

<sup>148</sup>73 Fed. Reg. at 74,569.

<sup>149</sup>50 U.S.C. App. § 2170(l)(1)(B).

<sup>150</sup>The government has represented in *Ralls* that CFIUS and the President relied on both unclassified and classified evidence. *Ralls*, 758 F.3d at 320 n.19.

<sup>151</sup>As noted in *PMOI II*, "none of the AEDPA [FTO designation] cases decides whether an administrative decision relying critically on undisclosed classified material would comport with due process because in none was the classified record essential to uphold an FTO designation." *PMOI v. U.S. Dep't of State*, 613 F.3d 220, 231 (D.C. Cir. 2010). Judge Henderson, the author of the *Ralls* opinion, in her concurring opinion in *PMOI II*, emphasized that she was remanding the case because the Secretary had stated that she relied on both classified and unclassified material, yet had given *PMOI* no opportunity to review the unclassified material. *Id.* at 231-32. Though not entirely clear, this suggests that Judge Henderson believes due process obligations would not be triggered if the Secretary declared that the government relied upon classified information only in reaching a determination.

<sup>152</sup>*Ralls*, 758 F.3d at 318-19 (citing to *NCRI*, 251 F.3d at 209).

The effect of the decision on investors may also be limited because CFIUS may interpret the requirement narrowly so as to apply only to those investors who close transactions, thereby clearly obtaining a property interest for which due process would be required. *Ralls* purchased the wind farm companies before filing with CFIUS. The D.C. Circuit in *Ralls* gave considerable weight to the fact that the property interest arose when the deal closed.<sup>153</sup> The majority of the transactions that CFIUS reviews, however, are not consummated prior to filing, and parties may or may not have entered into binding agreements prior to a review. As a result, the property interest relied on by the court to trigger due process may not arise in most of the transactions CFIUS reviews.

The last key question is, at what point should due process be provided in future transactions that CFIUS reviews? In deciding whether a property interest existed in *Ralls* – and therefore implicated the Fifth Amendment Due Process Clause – the D.C. Circuit made clear that courts should look to the relevant state laws in making such determinations.<sup>154</sup> As a result, CFIUS arguably could take the position that due process is not required for transactions that have not closed, which, as noted above, comprise the majority of transactions that it reviews.

It seems unlikely, however, that CFIUS will interpret the requirement so narrowly. It will make for a more efficient process for CFIUS to develop consistent procedures under which it provides due process to parties for all transactions (regardless of whether they have closed) prior to taking any action that will impact such parties, such as proposing mitigation measures. Thus, as a routine matter, the Committee could choose to provide parties with the unclassified basis for any mitigation measures that it may propose in connection with any particular transaction at the time that it proposes such measures. Developing procedures that apply uniformly to all transactions will likely be more efficient (and risk less litigation) than engaging in an analysis of state law in each case to determine whether, and at what point, a property interest exists in connection with a particular transaction.<sup>155</sup>

In addition, from CFIUS's perspective, to adopt a narrow interpretation risks creating a perverse incentive for parties to close transactions prior to filing with CFIUS, something that it emphatically discourages. Transactions that have closed prior to review are generally more difficult to mitigate if later found to be problematic from a national security perspective. Mitigation after closing can also be more onerous for foreign investors who might find that the economic rationale for their deal falls apart with post-closing mitigation over which they have little control. However, at what point in the course of a review CFIUS will decide to draw this line is not clear at present. What is clear is that this line-drawing exercise creates the potential for more legal challenges in different fora surrounding CFIUS action, and that the potential for litigation increases the more significantly parties' rights are affected. Under these circumstances, and in order to avoid future court challenges, CFIUS may consider noticing a proposed rule-making to clarify the process under which it will provide due process to parties in future transactions.

As noted above, from CFIUS's perspective, getting to a consensus view earlier in the process in order to allow for engagement with the parties (including for effective rebuttal) within the tight statutory time frame will be challenging. CFIUS has limited resources, and a 2014 caseload that likely came close to rivalling its caseload in 2008, when CFIUS reviewed 155 transactions (to date, the most transactions it has reviewed in any other year).<sup>156</sup> Again, the FTO precedents do not appear to provide a precise analogy. The FTO designation process as outlined in AEDPA does not include any set deadlines by which the Secretary of State must make her initial determination that the organization: (1) is a foreign organization; (2) "engages in terrorist activity . . . or terrorism . . . or retains the capability and intent to engage in terrorist activity or terrorism"; and (3) threatens US national security.<sup>157</sup> The statute does establish a deadline for the Secretary to act on an FTO's petition to revoke the designation (i.e., 180 days from the date the FTO files the petition),

<sup>153</sup>*Ralls*, 758 F.3d at 316.

<sup>154</sup>*Id.* at 315 ("Because the Constitution protects rather than creates property interests, the existence of a property interest is determined by reference to existing rules or understandings that stem from an independent source such as state law.") (citing *Phillips*, 524 U.S. at 164) (other citations and quotation marks omitted); *id.* ("[P]roperty interests 'attain . . . constitutional status by virtue of the fact that they have been initially recognized and protected by state law.'") (quoting *Paul v. Davis*, 424 U.S. 693, 710 (1976)).

<sup>155</sup>For example, in some states, it may be that a property interest arises prior to closing, such as where there is a binding contract under state law.

<sup>156</sup>COMMITTEE ON FOREIGN INV. IN THE UNITED STATES ANN. REP. TO CONGRESS, *supra* note 12, at 3.

<sup>157</sup>8 U.S.C. § 1189(a)(1).

but this can only take place two years after the designation has already occurred.<sup>158</sup> Although this is a lengthy time for an FTO to wait to seek revocation of the Secretary's action, it at least appears to provide ample time for due process and rebuttal to occur.

In the CFIUS context, the time frame for review is tight – 75 days if a case goes to investigation. Therefore, the most likely outcome of *Ralls* for future cases is that more cases will go into a 45-day investigation following the initial 30-day review as CFIUS struggles to fit additional steps into the strict time frames of the review and investigation period. There could also be more withdrawals and re-filings by parties, as discussed above, to give the Committee more time to process cases. The effect ultimately could be to extend the statutory time frame for review through these informal mechanisms. A withdrawal is not within the control of CFIUS, however, and if the Committee finds that it is unable to accommodate due process requirements within the statutory time frame, it may have to ask Congress to amend the statute to provide for more time.

### III. STRATEGIES FOR FOREIGN INVESTORS, SUCH AS SOVEREIGN WEALTH FUNDS

Only time will tell what the ramifications of the *Ralls* case in terms of due process will be for foreign investors going forward. To the extent that the outcome results in foreign investors and sovereign wealth funds having greater engagement with, and insight into, the inner workings of CFIUS, that will be a positive outcome for foreign investment. The law does not discriminate between cases filed by acquirers from any particular country. Nevertheless, because of the prevalence of state ownership, sovereign wealth fund transactions are subject to heightened scrutiny and, as a result, carry higher risk of challenge. The outcome of the *Ralls* case, however, is unlikely to change the fundamental strategies for an investor undergoing a CFIUS review – fundamental strategies such as the following:

- *Conduct due diligence*: Certain transactions, particularly in the aerospace, defense, telecommunications and software industries, are likely to receive increased scrutiny. Moreover, given the recent focus on proximity to military or sensitive installations, due diligence with respect to the location of fixed assets is critical. Acquirers, particularly sovereign wealth funds, will need to be selective; where concerns are present, they may wish to consider partnering with other – possibly US – investors, and taking a true minority stake in the US business. (Note: Separate and apart from CFIUS considerations, the presence of a foreign minority investor may affect a US company's security clearance, depending on the size of the investment. Further, US export controls will limit access to controlled technologies).
- *File before the transaction is closed, even if jurisdiction is unclear*: Although the filing process is ostensibly voluntary, as noted above, the Committee can review transactions even if they have not been voluntarily filed. Filing voluntarily avoids the appearance of impropriety. Most importantly, if a filing is not made and the transaction is closed, it remains forever open to CFIUS review and could ultimately be unwound or significantly impacted by mitigation. After review, however, the parties obtain a "safe harbor," and the transaction is not subject to further CFIUS review absent fraud, misrepresentation, or an intentional and material breach of a mitigation agreement. Although it is possible that the ultimate outcome of the *Ralls* case could change this strategy, until it is clear how CFIUS intends to implement any final decision in the *Ralls* case, it will in most cases be prudent to file before closing a transaction.
- *Develop a comprehensive strategy at the outset*: Where a major transaction is in a potentially sensitive industry, consideration should be given early on to a comprehensive strategy, including, as necessary, a political strategy, to ensure that key decision-makers, such as government agencies, or members of Congress, are informed about the transaction and a base of knowledge about the acquirer is developed. Where a foreign acquirer is new to the US market and intends to make multiple acquisitions in the United States, development of a long-term strategy in which initial investments are made in less sensitive industries, with the goal of making additional investments in more sensitive industries once it is better known, should be considered.

<sup>158</sup>*Id.* § 1189(a)(4)(B)(ii), (iv).



- *Engage with individual agencies and CFIUS early:* Before filing a notice, it is often possible to engage with individual agencies with interest in a particular transaction. Once the notice has been filed with CFIUS, the Treasury generally prefers that communication be directed through it, making it harder to communicate with individual agencies that may have concerns. It can also be helpful to approach CFIUS itself before filing to request a meeting with the entire Committee to allow agencies the time to familiarize themselves with the foreign acquirer and the transaction. It also is prudent to be proactive in developing a climate of trust with CFIUS, including requesting meetings with key staff to explain complicated transactions. In all cases, it is essential to be complete and forthright when responding to questions.
- *Anticipate mitigation in transactions involving highly sensitive assets:* If CFIUS finds national security risks, it may require mitigation measures as the price of approval, which could include the sale of problematic assets. Careful consideration should be given early on to the nature of the assets; anticipating what measures CFIUS might require; and taking action, including the possible sale of assets prior to a filing, to minimize possible national security concerns in connection with the review. Parties with complicated transactions may also wish to identify potential mitigation requirements and discuss them with CFIUS early on.
- *Retain experienced advisors at an early stage:* The confidential nature of the CFIUS process means that there is little public information about how CFIUS treats particular transactions. It is essential to consult experienced CFIUS counsel who have worked with the government agencies comprising CFIUS and understand their concerns. Consultation early on can avoid costly mistakes.

## CONCLUSION

When the Treasury Department promulgated its final rules implementing FINSA in 2008, it stated that “[t]he longstanding policy of the U.S. Government . . . is to welcome foreign investment,” and that CFIUS would “continue its practice of focusing narrowly on genuine national security concerns alone, not broader economic or other national interests” in determining whether a transaction warrants investigation or even prohibition on national security grounds.<sup>159</sup> Traditionally, US law has afforded the Executive Branch broad discretion in determining whether a particular foreign investment presents a national security risk. The *Ralls* decision affirms the open investment policy of the US and does not interfere with the President’s ability to ultimately prohibit a transaction for national security reasons.

Nevertheless, the decision places certain constitutional limitations on Executive Branch discretion in this area. Although the full extent of those limitations will depend on the scope of due process ultimately afforded by the courts, foreign investors—at least for now—are likely to benefit only at the margins, with the opportunity for enhanced engagement and possibility of additional insight into the process. This will not affect, however, continued heightened scrutiny by CFIUS. A full understanding by foreign investors, including sovereign wealth funds, of the CFIUS process, and of the factors that the Committee emphasizes in its review, is therefore critical as sovereign wealth funds and other foreign investors increase their investments in the United States.

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<sup>159</sup>73 Fed. Reg. at 74,705.