CFIUS Risks After The *Ralls* Decision

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Introduction

On October 9, 2013, the U.S. District Court for the District of Columbia issued its final ruling in the battle between Ralls Corporation ("Ralls") and the Committee on Foreign Investment in the United States ("CFIUS" or the "Committee"), finally dismissing Ralls' remaining claims and ending, absent an appeal, Ralls' hope to recoup its now ill-fated investment in four wind farm projects in Oregon.[1] Ralls sued CFIUS and the President in 2012, alleging that its due process rights had been violated when the President ordered Ralls to divest its interest and assets in the wind farm projects, which it had acquired earlier that year. Ralls purchased the wind farm projects without first submitting the transaction for review by CFIUS. After Ralls completed the transaction, CFIUS requested that the parties submit a notice to the Committee, in accordance with CFIUS' regulations,[2] so the Committee could review the transaction to determine whether Ralls' acquisition presented national security concerns. Submissions to CFIUS are "voluntary," although the Committee retains the authority to review any transaction if parties decline to file a notice. Therefore, submitting a notice when requested is in a party's interest because it provides as much of a seat at the table as the statute and regulations allow.

The district court's October ruling confirms the President's broad authority under FINSA to take action when he (through CFIUS) determines that control of a U.S. business might harm U.S. national security. In so doing, the *Ralls* case demonstrates vividly the high-stakes risks associated with foregoing CFIUS review of foreign direct investments ("FDI") in U.S. businesses. In her opinion, Judge Jackson rejected Ralls' assertion that it had any property rights subject to Constitutional protections because "Ralls undertook the transaction and voluntarily acquired [the] 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." (Emphasis added.) Slip op. at 12. Citing the "powerful incentive" created by FINSA to seek prior review of its transaction, the court faulted Ralls for arguing that it acquired state property rights worthy of protection when it "chose not to avail itself of th[e] opportunity" of CFIUS review prior to the acquisition and instead "went ahead and assumed th[e] risk." Slip op. at 13-14.

Background

Ralls, a U.S. company, was formed by two senior officers (the CFO and VP) of

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Sany Group ("Sany"), a Chinese wind turbine manufacturer, for the purpose of purchasing wind farms and other energy-related assets that would use Sany's wind turbines to "demonstrate their quality and reliability to the United States wind industry."[3] In March 2012, Ralls acquired all of the rights and interest of Terna Energy USA Holding Corp. ("Terna")[4] and closed the deal without notifying CFIUS. The parties did not file a CFIUS notice even though the project sites were "all located in or near the eastern region of . . . restricted airspace" used by the U.S. Navy for flight testing and other sensitive military training. 926 F.Supp.2d at 74. According to Ralls' amended complaint, a CFIUS filing was not warranted because (a) other wind farm projects (which used turbines manufactured outside the U.S.) existed in or near the restricted air space; (b) other turbines were located in or near the western region of the restricted air space; and (c) the company had consulted with the Federal Aviation Administration and the U.S. Navy and had taken actions in accordance with specific concerns expressed by those agencies. *Id*.

After the transaction closed, CFIUS contacted Ralls and requested that the parties file a voluntary notice to allow CFIUS to review the deal to determine whether any national security concerns existed. The parties filed their notice in June 2012, and, within a month, CFIUS determined that national security concerns warranted immediate, interim mitigation as well as further investigation. CFIUS imposed interim mitigation measures on July 25, 2012 (amended on August 2, 2012) that required Ralls effectively to cease all activities at the project sites and not transfer the projects until CFIUS had completed its review.

In September 2012, CFIUS recommended that the President "block" the transaction, and on September 28, 2012, the President issued an order that required Ralls to divest "all interests" in the projects within 90 days. *Id*. at 77. The President's order restricted the manner in which the divestiture was to proceed, denied Ralls access to the properties, and required removal of all items, structures and physical objects produced by the Sany Group.

In its lawsuit, Ralls argued that the President's actions were beyond the scope of authority granted under FINSA and constituted an unconstitutional taking of Ralls' property in violation of the due process clause of the Fifth Amendment. On February 22, 2013, in *Ralls I*, the court dismissed all but one of Ralls' claims – the due process challenge. In its October 9, 2013 opinion (after briefing of the due process issue), the court again ruled against Ralls, rejecting its remaining claim because Ralls "assumed" the risk that the transaction could be divested when it did not seek pre-acquisition review by CFIUS. In its order, the court held that Ralls did not have a protected property interest and that, even if it did have a protected interest, it was not denied sufficient process. The court described the well-established rule in takings cases that a property interest under the Fifth Amendment[5] requires that "a person must have more than an abstract need or desire and more than a unilateral expectation." Slip op. at 15. According to the court, Ralls did not have a "legitimate claim of entitlement to" the wind farm projects because foreign companies are on notice that "they do not have an entitlement to engage in mergers, acquisitions or takeovers in the United States." Slip op. at 15. Therefore, Ralls was "on notice" that until the transaction was cleared by CFIUS, the President retained the authority to prohibit it.

Post *Ralls* CFIUS Risk

Ralls' experience provides valuable insight for foreign companies involved in or planning an investment in the United States and for U.S. companies involved in those transactions. Few companies take advantage of the safe harbor that CFIUS review provides. With no statute of limitations, transactions that are not reviewed remain indefinitely subject to CFIUS action, while those reviewed and closed are no longer subject to CFIUS inquiry (absent false statements or material omissions in the original submission). Thus, submitting a transaction to CFIUS for review does not just reduce the risk of later action, it eliminates it. Despite this safe harbor, the vast majority of FDI transactions are not reported to CFIUS. CFIUS has, since 2008, reviewed only about 100-150 transactions each year out of the large number of foreign direct investment transactions in the U.S. With CFIUS' broad mandate, extending to national security, law enforcement, defense industrial base and critical infrastructure, many transactions raise national security concerns, and often the parties involved are not aware of the risks that arise by failing to submit these transactions to CFIUS for review. While some transactions slip through the cracks, others do not, and the Committee often requests that parties submit the required information to allow a CFIUS review. This was the case with Ralls.

The Ralls decision underscores two important points for those engaging in FDI in the U.S.:

1. It confirms the difficulty of obtaining judicial review of Presidential decisions, including decisions to block transactions, under FINSA. *See* 50 U.S.C. app. § 2170(e). The court decisively rejected due process challenges because the transaction was not notified *prior to* its completion (and likely even if it was, as the court concluded that the opportunity to interact with CFIUS represented adequate process for constitutional purposes). Because CFIUS reviews transactions for national security concerns, its decisions and actions are subject to great deference, and, absent extraordinary circumstances, the Committee's and the President's actions are unreviewable. Therefore, the court emphasized, parties looking for increased certainty should "avail [themselves] of th[e] opportunity" to obtain "pre-acquisition review" of their transactions.

2. The risks associated with failing to obtain CFIUS review before closing can be severe. Ralls was forced to cease all activity at the four wind farm project sites and divest the properties it had acquired. Beyond the legal fees it spent (and continues to spend), the divestiture order put Ralls in a well-publicized bind, making its divestiture an effective fire sale. Had Ralls sought pre-closing review of its transaction, it would have known of the U.S. government's concerns and could have decided either to forego the transaction or worked out an acceptable mitigation plan. Ralls sued Terna in an attempt to undo its mistake, but that, too, was rebuffed.[6] Thus, by failing to file a CFIUS notice before it closed, Ralls assumed all of the risk. For its part, Terna was forced to fight Ralls in court to avoid having its transaction unwound. While Terna has been allowed to go forward with its sale of the collateral Ralls pledged, it is by no means finished. Moreover, it remains to be seen whether an action for breach of representations and warranties could be sustained under the same or similar facts.

Ralls is not the only time that CFIUS has ordered divestiture following review of a closed transaction. At three other cases resulted in divestiture orders - *Procon, Poaris* and *Huawei*. When combined with the increased number of mitigation agreements imposed by CFIUS, the lessons are clear: transactions involving acquisitions or investments by foreign companies in U.S. businesses should be carefully analyzed for CFIUS risk, and, where a transaction involves actual or potential national security, critical infrastructure, defense industrial base or law enforcement issues, the risks associated with foregoing CFIUS review must be carefully weighed. As Ralls learned the hard way, getting it wrong can be costly.

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1. *Ralls Corp. v. Committee on Foreign Investment in the United States*, Civ. No. 12-1513 (D.D.C. Oct. 9, 2013). (referred to herein as "Slip op.") On October 16, 2013, Ralls filed its notice of appeal.

2. 31 C.F. R. Part 800. CFIUS was established in the 1970s as a Presidential advisory committee. Executive Order 11,858 (May 7, 1975). In 1998, the Exon-Florio amendments to the Defense Production Act of 1950 (50 U.S.C. app 2170), contained in the Omnibus Trade and Competitiveness Act of 1988, Pub.L. 100–418, 102 Stat. 1425, (Aug. 23, 1988), provided the first formal authorization for the Committee. In 2007, Congress enacted the Foreign Investment and National Security Act of 2007, Pub.L. 110–49, 121 Stat. 246 (July 26, 2007) ("FINSA"), enhancing the Committee's membership and clarifying its scope and authority.

3. *Ralls Corp v. Comm.* On Foreign Investment in the United States, 926 F.Supp.2d 71 (D.D.C. 2013) ("Ralls I"). The facts recited by the Court were taken from Ralls' complaint which, because the decisions were based on a motion to dismiss, were assumed as presented in the Ralls complaint.

4. Terna is a subsidiary of a publicly traded Greek company.

5. Ralls also asserted, and the court rejected, an equal protection claim. Although not mentioned by either party, the divestiture order in Ralls was not unique. CFIUS ordered divestitures in at least four cases from 2011-12, including one, *Procon,* that was strikingly similar to that in *Ralls.*

6. *Ralls Corp. v. Terna Energy USA Holdings Corp.*, Civ No. 13-cv-739 (D.N.Y. 2013). Ralls sued both to void the initial transaction and to prevent Terna from selling Texas land that Ralls had pledged as collateral for the Oregon purchase. Adding more expense, Ralls initially sued in the District of Columbia. That suit was dismissed for lack of jurisdiction. Ralls then re-filed in New York, which temporarily stayed Terna's planned sale, but a month later the court lifted the stay.

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