Chinese M&A in the United States: Challenges, Considerations & Opportunities

Materials for Panel Sponsored By:
Wachtell, Lipton, Rosen & Katz
Chinese Buyers – High Growth & Unique Challenges

- Cross-border M&A volume involving a Chinese acquirer has increased substantially in recent years
  - Grew 45% year over year in 2015
  - On pace to increase by **180%** year over year in 2016
- However, transactions involving Chinese bidders present unique perceived challenges
  - Enforceability concerns
  - Chinese regulatory issues
  - CFIUS
  - Negotiation considerations

Source: Thomson; IMF definitions.
2016 is annualized based on data for 2016 Q1 & Q2.
Ensuring Enforceability of Transaction Agreements

• Perceived Challenges
  – Chinese courts may be unlikely to enforce U.S. court judgments
  – Chinese courts may be hesitant to enforce foreign arbitration awards
  – Target has limited protection if a Chinese bidder has limited/no U.S. based assets

• Solutions
  – Escrow funds in the United States
    • Unlikely to cover full purchase price, but will usually cover all of the amount of the highest possible reverse break-up fee
    • While common, such a provision is usually a key negotiating point
    • Full amount sometimes deposited at signing, with a phased schedule also common (e.g., HNA/Ingram Micro, Shuanghui/Smithfield)
  – Irrevocable letter of credit at a U.S. bank
    • Often limited to the amount of the reverse break-up fee (e.g., Apex & PNG/Lexmark)
  – Bind any U.S. subsidiaries or affiliates of the Chinese acquirer
Chinese Regulatory Issues

• Chinese regulators that may provide input into the proposed acquisition
  – Ministry of Commerce of the PRC (MOFCOM)
  – National Development and Reform Commission (NDRC)
  – Various industrial sector regulators

• State-owned or state-sponsored entities (SOEs) may present special considerations
  – May receive easier treatment from Chinese regulators on the merits of any transaction
  – In the event of buyer’s remorse, concerns that a Chinese bidder may be able to fashion a regulatory “escape hatch” given the lack of transparency common to Chinese regulators
  – SOEs often have a complex organizational structure

• Reverse break-up fee (RBF) triggers to mitigate concerns regarding PRC regulatory approval
  – Failure of PRC regulatory authorities to clear the transaction
    • Common RBF trigger
    • In most situations limited to specific regulatory approvals, though some targets have negotiated catch-all provisions
CFIUS Review

- The Committee on Foreign Investment in the United States (CFIUS) reviews the national security effects of foreign investments in U.S. companies or operations.
  - CFIUS can block deals to acquire “control” of U.S. companies or require mitigation measures (generally conduct of business restrictions, sometimes divestitures)
    - While it is possible to structure a transaction to avoid “control,” there is no clear rule for what constitutes “control”
  - Transactions can be voluntarily submitted for CFIUS review, but CFIUS may also investigate on its own and can even unwind a transaction after it has closed
  - The rationale behind CFIUS’s decisions is generally not public, so reverse diligence on a Chinese bidder is critical
- Reverse break-up fee trigger?
  - Targets want failure to gain CFIUS approval to trigger payment of the RBF
    - Chinese bidders often resist, due to the opacity and U.S. based nature of the process
    - A number of sellers have successfully bargained for such a provision
Case Study:
Lexmark / Apex Tech. & PAG Asia Capital

• On April 19, 2016 a consortium of Chinese buyers, led by Apex Technologies and PAG Asia Capital agreed to buy Lexmark International for $40.50 per share ($3.6 billion) in an all-cash transaction

• Chinese consortium agreed to a reverse break-up fee of $150 million (4.2% of purchase price)
  – Chinese consortium obtained letter of credit for $150 million at NY branch of Bank of China

• Regulatory Approval
  – If Chinese regulators scuttle the deal, Lexmark is entitled to full $150 million RBF
  – If CFIUS fails to clear the deal, Lexmark is entitled to $95 million RBF (2.6% of purchase price)
  – If deal is terminated by foreign antitrust regulators, Lexmark is entitled to $95 million RBF

• Lexmark stock closed at $37.60 on July 8, 2016

• Deal is still pending
Case Study: Ingram Micro / HNA Group

- On February 17, 2016 a unit of the Chinese conglomerate HNA Group agreed to buy Ingram Micro for $38.90 per share ($6.0 billion) in an all-cash transaction

- HNA agreed to a reverse break-up fee (RBF) of up to $400 MM (6.7% of purchase price)
  - RBF would be $200 million if deal was terminated before 3/17/16, $300 million if terminated on or after 3/18/16 and before 4/17/16, and $400 million if terminated on or after 4/17/16
  - HNA placed $400 million into an escrow account at Deutsche Bank in the U.S.
    - $200 million within one week of signing, $100 million more within one month of signing, $100 million more within two months of signing
  - Two other Chinese bidders refused to offer a RBF, which may partly explain the failure of their bids
- RBF triggered by both failure to get Chinese approvals and by failure of CFIUS to clear the transaction
- Ingram Micro stock closed at $35.30 on July 8, 2016
- Deal is still pending
# Case Study:
Fairchild Semiconductor / China Resources & Hua Capital

## Timeline of Events

<table>
<thead>
<tr>
<th>Event</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>On November 18, 2015, ON Semiconductor agreed to purchase Fairchild for $20.00 per share ($2.4 billion) in an all-cash transaction.</td>
<td></td>
</tr>
<tr>
<td>On December 4, ON Semiconductor filed its tender offer statement and Fairchild filed its recommendation statement.</td>
<td></td>
</tr>
<tr>
<td>On December 8, Fairchild issued a press release stating that it had received an unsolicited topping bid of $21.70 per share from an undisclosed party.</td>
<td></td>
</tr>
<tr>
<td>On December 14, Fairchild announces that it did not reasonably expect China Resources and Hua Capital’s $21.70 per share bid to result in a superior proposal.</td>
<td></td>
</tr>
<tr>
<td>On December 28, China Resources and Hua Capital made a revised bid of $21.70 per share. The bid now included a $200 million RBF for failure to obtain U.S. or Chinese antitrust or regulatory approval and a $108 million RBF for failure to obtain CFIUS approval.</td>
<td></td>
</tr>
<tr>
<td>On January 5, Fairchild announced that it would enter into discussions with China Resources and Hua Capital because the December 28 proposal would reasonably be expected to result in a superior proposal.</td>
<td></td>
</tr>
<tr>
<td>On February 8, the Fairchild board determined that it would be unlikely to determine that the December 28 proposal was a superior proposal without improvement to the RBF relating to CFIUS approval.</td>
<td></td>
</tr>
<tr>
<td>On February 12, China Resources and Hua Capital made a revised bid of $22.00 per share. The bid included a “hell or high water” obligation with respect to CFIUS approval and a $300 million RBF related to Chinese regulatory approval.</td>
<td></td>
</tr>
<tr>
<td>On February 16, Fairchild’s Board of Directors announced that the China Resources and Hua Capital bid did not constitute a superior proposal.</td>
<td></td>
</tr>
</tbody>
</table>
# Case Study: Affymetrix / Origin Technologies

<table>
<thead>
<tr>
<th>Timeline of Events</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>On January 8, 2016, Thermo Fisher agreed to buy Affymetrix for $14 per share ($1.3 billion) in an all-cash transaction.</td>
</tr>
<tr>
<td>2</td>
<td>On February 24, Affymetrix filed its proxy statement relating to the merger and announced that the special meeting would take place on March 24.</td>
</tr>
<tr>
<td>3</td>
<td>On March 18, Origin Technologies, a newly formed special purpose vehicle managed by former Affymetrix executives, issued a public letter announcing an unsolicited all-cash topping bid of $16.10 per share. The proposal included a $75 million reverse termination fee with unspecified triggers supported by a letter of credit.</td>
</tr>
<tr>
<td>4</td>
<td>On March 20, Thermo Fisher submitted an open letter to the Affymetrix board highlighting the perceived shortcomings of the Origin proposal.</td>
</tr>
<tr>
<td>5</td>
<td>On March 21, Affymetrix rejected Origins topping bid of $16.10 per share explaining that it could not be reasonably expected to constitute a superior proposal.</td>
</tr>
<tr>
<td>6</td>
<td>On March 22, Origin increased its all-cash offer to $17.00 per share. The proposal included a “hell or high water” provision to take any actions required to obtain regulator approvals and a $100 million reverse termination fee for failure to obtain financing, which itself required certain Chinese regulatory approvals. The RBF was not triggered by a failure to receive CFIUS approval.</td>
</tr>
<tr>
<td>7</td>
<td>On March 23, the Affymetrix Board of Directors agreed to engage in discussions with Origin and postponed the shareholder vote on the merger with Thermo Fisher that was originally scheduled for March 24.</td>
</tr>
<tr>
<td>8</td>
<td>On March 28, the Affymetrix Board of Directors stated that the Origin offer did not constitute a superior proposal and Origin withdrew its offer.</td>
</tr>
<tr>
<td>9</td>
<td>On March 31, Affymetrix shareholders approved the Thermo Fisher deal.</td>
</tr>
</tbody>
</table>

Source: Bloomberg
Appendix
## Transaction Data Points Related to Chinese Acquisitions of U.S. Public Companies with Deal Values over $100 million

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Integrated Memory Logic/Chipone Technology, E-town</td>
<td>Pending</td>
<td>6/2/2016</td>
<td>136</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (4.8%)</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Lexmark International/Apex Technology, PAG Asia Capital et al.</td>
<td>Pending</td>
<td>4/19/2016</td>
<td>3,600</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (up to 4.2%; CFIUS or foreign antitrust termination results in 2.6% RBF)</td>
<td>Yes</td>
<td>$150m letter of credit from New York Branch of Bank of China must be delivered to Lexmark no later than seven business days after the deal is signed</td>
</tr>
<tr>
<td>Ingram Micro Inc./Tianjin Tianhai Investment Company</td>
<td>Pending</td>
<td>2/17/2016</td>
<td>6,000</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (3.3%, 5.0% or 6.7% based on date of termination); capped</td>
<td>Yes</td>
<td>Escrow deposited in three parts: $200m within one week of signing $100m within one month $100m within two months (Escrow with Deutsche Bank Trust Company Americas)</td>
</tr>
<tr>
<td>Multi-Fineline Electronix/Suzhou Dongshan Precision Manufacturing</td>
<td>Completed</td>
<td>2/4/2016</td>
<td>589</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (4.7%); uncapped for willful breach</td>
<td>Yes</td>
<td>Escrow deposited in three parts: $20m on signing date $7.45m within week of signing $10m upon acquiror election to extend drop-dead date (Escrow with Citibank N.A., New York)</td>
</tr>
<tr>
<td>Syngenta AG/ChemChina</td>
<td>Pending</td>
<td>2/3/2016</td>
<td>43,000</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (6.5%)</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Mattson Technology/Beijing E-Town International Investment</td>
<td>Completed</td>
<td>12/1/2015</td>
<td>286</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (6%); uncapped for willful breach</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>
### Transaction Data Points Related to Chinese Acquisitions of U.S. Public Companies with Deal Values over $100 million (cont’d)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fidelity &amp; Guaranty Life/Anbang Insurance Group</td>
<td>Pending</td>
<td>11/9/2015</td>
<td>1,575</td>
<td>Yes</td>
<td>Yes</td>
<td>No RBF; uncapped</td>
<td>N/A</td>
<td>No</td>
</tr>
<tr>
<td>Avolon Holdings Limited/Bohai Leasing</td>
<td>Completed</td>
<td>9/3/2015</td>
<td>7,000</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (4.6%)</td>
<td>Yes</td>
<td>Escrow deposited in two parts: $200m within one business day of signing $75m within seven business days of signing $75m had previously been placed in escrow in connection with potential equity investment (Escrow with Citibank N.A.) Consequence of Failure to Fund: Seller has termination right, and Parent must pay Parent Termination Fee</td>
</tr>
<tr>
<td>Planar Systems/Leyard Optoelectronic</td>
<td>Completed</td>
<td>8/12/2015</td>
<td>150</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (5.3%); capped</td>
<td>No</td>
<td>Escrow in amount of reverse break fee due at signing. (Escrow with Wilmington Trust, NA)</td>
</tr>
<tr>
<td>Xueda Education Group/Xiamen Insight Investment</td>
<td>Completed</td>
<td>7/26/15</td>
<td>350</td>
<td>No</td>
<td>Yes</td>
<td>Yes, $4.4m (4.0%) for failure to obtain Acquiror shareholder approval; $14m (13.0%) for Acquiror breach or failure to close; $17m (15.8%) for all other RTF scenarios</td>
<td>N/A</td>
<td>Within five business days after Target’s shareholder approval is obtained (RMB-denominated escrow account in PRC with escrow agent to be agreed by parties) Consequence of Failure to Fund: Does not give rise to termination right or Additional Parent Fee</td>
</tr>
</tbody>
</table>
## Transaction Data Points Related to Chinese Acquisitions of U.S. Public Companies with Deal Values over $100 million (cont’d)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Metalico/Total Merchant Limited</td>
<td>Completed</td>
<td>6/15/2015</td>
<td>102</td>
<td>No</td>
<td>No</td>
<td>No RBF; uncapped</td>
<td>N/A</td>
<td>$3.12m within 21 days after signing (with a nationally recognized U.S. bank) Aggregate consideration (sufficient to pay all shareholders and make certain other closing payments) three business days prior to Target’s shareholder meeting (with the U.S. branch of Maybank Banking Berhad) <strong>Consequence of Failure to Fund:</strong> Seller has termination right, but does not trigger Parent Termination Fee</td>
</tr>
<tr>
<td>China Mobile Games and Entertainment Group/Pegasus Investment Holdings</td>
<td>Completed</td>
<td>6/9/2015</td>
<td>689</td>
<td>No</td>
<td>Yes</td>
<td>Yes, (7.5%)</td>
<td>N/A</td>
<td>Within five business days after signing (Escrow with Shenzhen branch of China Merchants Bank) <strong>Consequence of Failure to Fund:</strong> Seller has termination—but does not trigger Parent Termination Fee</td>
</tr>
<tr>
<td>OmniVision Technologies/Hua Capital and others</td>
<td>Completed</td>
<td>4/30/2015</td>
<td>1,729</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (3.2%); capped</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Integrated Silicon Solution/Hua Capital and others</td>
<td>Completed</td>
<td>3/12/2015</td>
<td>731</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (2.8%); capped</td>
<td>No</td>
<td>Escrow deposited into two accounts at signing: $11.4m in RMB equivalent (Deutsche Bank (China)) $7.8m (China Merchants Bank) Target was similarly required to deposit its termination fee.</td>
</tr>
</tbody>
</table>
## Transaction Data Points Related to Chinese Acquisitions of U.S. Public Companies with Deal Values over $100 million (cont’d)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Meadowbrook Insurance Group/Fosun International Limited</td>
<td>Completed</td>
<td>12/30/2014</td>
<td>433</td>
<td>No</td>
<td>Yes</td>
<td>No RBF; uncapped</td>
<td>N/A</td>
<td>No</td>
</tr>
<tr>
<td>Montage Technology Group/ShangHai Pudong Science and Technology Investment</td>
<td>Completed</td>
<td>6/11/14</td>
<td>599</td>
<td>No</td>
<td>Yes</td>
<td>Yes, $67.9m (12.8%)</td>
<td>N/A</td>
<td>Escrow deposited in two parts: 50% at signing (or on first business day escrow account is set up to receive deposits) 50% within five business days after target shareholder approval (Escrow with Citibank, N.A. in New York) Target was similarly required to deposit its termination fee. <strong>Consequence of Failure to Fund:</strong> Seller has termination right and Parent must pay Parent Termination Fee</td>
</tr>
<tr>
<td>Chindex International/Shanghai Fosun Pharmaceutical</td>
<td>Completed</td>
<td>2/17/2014</td>
<td>433</td>
<td>No</td>
<td>Yes</td>
<td>Yes (7.1%); uncapped for willful breach</td>
<td>N/A</td>
<td>No</td>
</tr>
<tr>
<td>Smithfield Foods/Shuanghui International</td>
<td>Completed</td>
<td>5/29/2013</td>
<td>4,718</td>
<td>Yes</td>
<td>No</td>
<td>Yes (5.8%); uncapped for willful breach</td>
<td>No</td>
<td>Escrow in amount of reverse termination fee due at signing. (Escrow with Bank of China, New York branch)</td>
</tr>
<tr>
<td>A123 Systems/Wanxiang America Corporation</td>
<td>Completed</td>
<td>12/11/2012</td>
<td>257</td>
<td>Yes</td>
<td>No</td>
<td>Yes (9.7% for CFIUS failure; 5.1% for other triggers); capped</td>
<td>Yes</td>
<td>Escrow in the amount of $13.3m deposited before signing. $25m deposit for CFIUS failure due in escrow 1 day after signing.</td>
</tr>
<tr>
<td>Complete Genomics/BGI-Shenzhen</td>
<td>Completed</td>
<td>9/17/2012</td>
<td>108</td>
<td>Yes</td>
<td>Yes</td>
<td>No RBF; uncapped</td>
<td>N/A</td>
<td>Yes (promissory note)</td>
</tr>
</tbody>
</table>
January 11, 2016

Cross-Border M&A –
2016 Checklist for Successful Acquisitions in the United States

Global M&A volume in 2015 exceeded $5 trillion, an all-time high. Booms inevitably raise questions about their sustainability, and it remains to be seen how long this one will last, but as of this writing M&A shows no signs of slowing.

Last year’s volume exceeded 2014’s by $1.4 trillion, as well as the prior 2007 record. One-third of the 2015 volume represented cross-border deals, approximately 40% of which ($637 billion) involved U.S. companies. Incoming deals to the United States were valued at $433 billion, also an all-time high. Acquirors from Germany, France, Canada, Japan and the United Kingdom accounted for approximately half of the volume of acquisitions into the United States, and acquirors from China, India and other emerging economies accounted for approximately 5%. Cross-border deals involving U.S. companies included a number of record-breaking transactions, including Pfizer’s announced $160 billion combination with Allergan, ACE’s $28.5 billion acquisition of Chubb, Visa’s $24 billion acquisition of Visa Europe, and Air Liquide’s $13.4 billion acquisition of Airgas.

We expect current trends to continue into 2016, driven, in the United States and several other key regions, by strong corporate earnings, large corporate cash balances in search of yield, continued availability of attractive debt financing to well-capitalized borrowers and generally high stock prices. A focus on industry consolidation in a number of sectors and a thirst for technology and brands in growing economies similarly are expected to continue to motivate cross-border deals. That said, regional conflicts, terrorist acts and the U.S.’s decision to gradually increase interest rates may have a countervailing impact.

As far as the U.S.’s receptivity to foreign acquisitions, even in a world that is increasingly fractured by international tensions and profound disagreements on politics and policy, U.S. deal markets continue to be relatively hospitable. With careful advance preparation, strategic implementation and sophisticated deal structures that anticipate likely concerns, most acquisitions in the U.S. can be successfully achieved. Cross-border deals involving investment into the United States are more likely to fail because of poor planning and execution than fundamental legal or political restrictions.

The following is our updated checklist of issues that should be carefully considered in advance of an acquisition or strategic investment in the U.S. Because each cross-border deal is unique, the relative significance of the issues discussed below will depend upon the specific facts, circumstances and dynamics of each particular situation:

• Political and Regulatory Considerations. Even though non-U.S. investment in the United States remains mostly well-received and is generally not politicized, prospective non-U.S. acquirors of U.S. businesses or assets should undertake a thoughtful analysis of U.S. political and regulatory implications well in advance of any acquisition proposal or program, particularly if the target company operates in a sensitive industry or if the acquiror is sponsored or financed by a foreign government, or organized in a jurisdiction where a
high level of government involvement in business is generally understood to exist. It is imperative that the likely concerns of federal, state and local government agencies, employees, customers, suppliers, communities and other interested parties be thoroughly considered and, if possible, addressed prior to any acquisition or investment proposal becoming public. It is also essential that a comprehensive communications plan, focusing not only on public investors but also on all these core constituencies, be in place prior to the announcement of a transaction so that all of the relevant constituencies can be addressed with the appropriate messages. It will often be useful, if not essential, to involve local public relations firms at an early stage in the planning process.

Similarly, potential regulatory hurdles require sophisticated advance planning. In addition to securities and antitrust regulations, acquisitions may be subject to CFIUS review (discussed below), and acquisitions in regulated industries (e.g., energy, public utilities, gaming, insurance, telecommunications and media, financial institutions, transportation and defense contracting) may be subject to an additional layer of regulatory approvals. Regulation in these areas is often complex, and political opponents, reluctant targets and competitors may seize on perceived weaknesses in an acquiror’s ability to clear regulatory obstacles. While we expect to see continuity in the enforcement policies at the federal level for the foreseeable future, it will be particularly important during the final phase of the Obama administration to pay careful attention to the perspectives of both parties and the political dynamics at work in Washington. Our experience validates the view that any high-profile transaction may result in congressional reflexes being exercised, as evidenced by recent Senate hearings relating to the pending ABI-SABMiller transaction and its impact on the craft beer industry in the United States.

Finally, depending on the industry involved and the geographic distribution of the workforce, labor unions will continue to play an active role during the review process. Pre-announcement communications plans must feature this aspect as well.

- **Transaction Structures.** Non-U.S. acquirors should be willing to consider a variety of potential transaction structures, especially in strategically or politically sensitive transactions. Structures that may be helpful in sensitive situations include no-governance and low-governance investments, minority positions or joint ventures, possibly with the right to increase ownership or governance over time; partnering with a U.S. company or management or collaborating with a U.S. source of financing or co-investor (such as a private equity firm); or utilizing a controlled or partly controlled U.S. acquisition vehicle, possibly with a board of directors having a substantial number of U.S. citizens and a prominent U.S. citizen as a non-executive chairman. Use of preferred securities (rather than ordinary common stock) should also be considered. Even more modest social issues, such as the name of the continuing enterprise and its corporate location or headquarters, or the choice of the nominal acquiror in a merger, can affect the perspective of government and labor officials.

- **CFIUS.** Under current U.S. federal law, the Committee on Foreign Investment in the United States (CFIUS) — a multi-agency governmental body chaired by the Secretary of the Treasury, and the recommendations of which the President of the United States has personal authority to accept or reject — has discretion to review transactions in which
non-U.S. acquirors could obtain “control” of a U.S. business or in which a non-U.S. acquiror invests in U.S. infrastructure, technology or energy assets. Although filings with CFIUS are voluntary, CFIUS also has the ability to investigate transactions at its discretion, including after the transaction has closed. Three useful rules of thumb in dealing with CFIUS are:

- first, in general it is prudent to make a voluntary filing with CFIUS if the likelihood of an investigation is reasonably high or if competing bidders are likely to take advantage of the uncertainty of a potential investigation;

- second, it is often best to take the initiative and suggest methods of mitigation early in the review process in order to help shape any remedial measures and avoid delay or potential disapproval; and

- third, it is often a mistake to make a CFIUS filing prior to initiating discussions with the U.S. Department of the Treasury and other officials and relevant parties. In some cases, it may even be prudent to make the initial contact prior to the public announcement of the transaction. CFIUS is not as mysterious or unpredictable as some fear — consultation with Treasury and other officials (who generally want to be supportive and promote investment in the U.S. economy) and CFIUS specialists will generally provide a good sense of what it will take to clear the process. Retaining advisors with significant CFIUS expertise and experience is often crucial to successful navigation of the CFIUS process. Transactions that may require a CFIUS filing should have a carefully crafted communications plan in place prior to any public announcement or disclosure of the pending transactions.

- Acquisition Currency. While cash remains the predominant form of consideration (although less predominant compared to 2014, as a percentage of deal activity) in cross-border deals into the U.S., non-U.S. acquirors should think creatively about potential avenues for offering U.S. target shareholders a security that allows them to participate in the resulting global enterprise. For example, publicly listed acquirors may consider offering existing common stock or depositary receipts (e.g., ADRs) or special securities (e.g., contingent value rights). When U.S. target shareholders obtain a continuing interest in a surviving corporation that had not already been publicly listed in the U.S., expect heightened focus on the corporate governance and other ownership and structural arrangements of the non-U.S. acquiror, including as to the presence of any controlling or large shareholders, and heightened scrutiny placed on any de facto controllers or promoters. Creative structures, such as the issuance of non-voting stock or other special securities of a non-U.S. acquiror, may minimize or mitigate the issues raised by U.S. corporate governance concerns. However, the world’s equity markets have never been more globalized, and the interest of investors in major capital markets to invest in non-local business never greater, and equity consideration, or equity issuance to support a transaction, should be carefully considered in appropriate circumstances.

- M&A Practice. It is essential to understand the custom and practice of U.S. M&A transactions. For instance, understanding when to respect — and when to challenge — a tar-
get’s sale “process” may be critical. Knowing how and at what price level to enter the
discussions will often determine the success or failure of a proposal; in some situations it
is prudent to start with an offer on the low side, while in other situations offering a full
price at the outset may be essential to achieving a negotiated deal and discouraging com-
petitors, including those who might raise political or regulatory issues. In strategically or
politically sensitive transactions, hostile maneuvers may be imprudent; in other cases,
unsolicited pressure might be the only way to force a transaction. Takeover regulations
in the U.S. differ in many significant respects from those in non-U.S. jurisdictions; for
example, the mandatory bid concept common in Europe, India and other countries is not
present in U.S. practice. Permissible deal protection structures, pricing requirements and
defensive measures available to U.S. targets also may differ from what non-U.S. ac-
quirors are accustomed to in deals in their home countries. Sensitivity must also be given
to the distinct contours of the target board’s fiduciary duties and decision-making obliga-
tions under state law.

• **U.S. Board Practice and Custom.** Where the target is a U.S. public company, the cus-
toms and formalities surrounding board of director participation in the M&A process, in-
cluding the participation of legal and financial advisors, the provision of customary fair-
ness opinions and the inquiry and analysis surrounding the activities of the board and the
financial advisors, can be unfamiliar and potentially confusing to non-U.S. transaction
participants and can lead to misunderstandings that threaten to upset delicate transaction
negotiations. Non-U.S. participants need to be well-advised as to the role of U.S. public
company boards and the legal, regulatory and litigation framework and risks that can
constrain or prescribe board action. These factors can impact both tactics and timing of
M&A processes and the nature of communications with the target company.

• **Distressed Acquisitions.** Distressed M&A is a well-developed specialty in the United
States, with its own subculture of sophisticated investors, lawyers and financial advisors.
The United States continues to be a popular destination for restructurings of multinational
corporations, including those with few assets or operations in the country, because of its
debtor-friendly reorganization laws. Among other advantages, the U.S. bankruptcy sys-
tem has expansive jurisdiction, such as a world-wide stay of actions against a debtor’s
property and liberal filing requirements, and provides relative predictability in outcomes.
It favors rehabilitation over liquidation, generally preserves existing management, and al-
 lows for the imposition of debt restructurings on non-consenting creditors, making reor-
ganizations more feasible. In recent years, large foreign companies have increasingly
turned to Chapter 15 of the United States Bankruptcy Code, which accords debtors which
are subject to foreign insolvency proceedings key protections from creditors in the U.S.
and has facilitated restructurings and asset sales approved abroad. Firms evaluating a po-
tential acquisition of a distressed target based in the United States should consider the full
array of tools that the bankruptcy process makes available, including acquisition of the
target’s fulcrum debt securities that are expected to become the equity through an out-of-
court restructuring or plan of reorganization, acting as a plan investor or sponsor in con-
nection with a plan of reorganization, backstopping a plan-related rights offering or par-
ticipating as a bidder in a court-supervised “Section 363” auction process. Transaction
certainty is of critical importance to success in a transaction in bankruptcy and non-U.S.
participants accordingly need to plan carefully (especially with respect to transactions
that might be subject to CFIUS review, as discussed above) to ensure that they will be on a relatively level playing field with U.S. bidders. Acquirors also need to consider the differing interests and sometimes conflicting agendas of the various constituencies in a bankruptcy case, including bank lenders, bondholders, distressed-focused hedge funds and holders of structured debt securities and credit default protection, as well as landlords and trade creditors.

- **Financing.** Volatility in the global credit markets continued and intensified throughout 2015, which resulted in frequent closings of the “windows” in which particular sorts of financing are available, particularly for non-investment grade issuers. While the volume of financing and the rates at which financing has been available for investment grade issuers continues to be favorable and has facilitated acquisitions, high-yield issuers looking for acquisition financing have struggled in 2015. The availability of committed financing, particularly for deals requiring a long closing period or a substantial amount of financing, has become constrained, more costly and less predictable. The policy of U.S. bank regulators to clamp down on financing activity for highly leveraged deals has affected these deal financings in many respects, but primarily has resulted in the rise of non-bank lenders often willing to compete aggressively on pricing and terms. Moreover, high-yield debt investors are being increasingly selective on a company-by-company basis, where similarly rated companies are seeing diverging treatment in the high yield markets. On the other hand, the convergence of European and U.S. debt markets offers borrowers a broader range of opportunities, and some almost entirely U.S-based transactions have been financed on more favorable terms through eurobond offerings.

Important questions to ask when considering a transaction that requires debt financing include what is the appropriate leverage level for the resulting business; where financing with the most favorable terms and conditions is available; how committed the financing is or should be; which lenders have the best understanding of the acquiror’s and target’s businesses; whether to explore alternative, non-traditional financing sources and structures, including seller paper; whether there are transaction structures that can minimize financing and refinancing requirements, including structures where sellers retain significant equity in a combined business; and how comfortable a target will feel with the terms and conditions of the financing.

- **Litigation.** Shareholder litigation accompanies virtually every transaction involving a U.S. public company but is generally not a cause for concern. Excluding the context of competing bids in which litigation plays a role in the contest, and of going-private transactions initiated by controlling shareholders or management, which form a separate category requiring special care and planning, there are virtually no examples of major acquisitions of U.S. public companies being blocked or prevented due to shareholder litigation, nor of materially increased costs being imposed on arm’s-length acquirors. In most cases, where a transaction has been properly planned and implemented with the benefit of appropriate legal and investment banking advice on both sides, such litigation can be dismissed or settled for relatively small amounts or other concessions, with the positive effect of foreclosing future claims and insulating the company from future liability. Sophisticated counsel can usually predict the likely range of litigation outcomes or settlement costs, which should be viewed as a cost of the deal.
While well-advised parties can substantially reduce the risk of U.S. stockholder litigation, the reverse is also true – the conduct of the parties during negotiations can create “bad facts” that in turn may both encourage stockholder litigation and provoke judicial rebuke, including significant monetary judgments. Sophisticated litigation counsel should be included in key stages of the deal negotiation process. In all cases, the acquiror, its directors, shareholders and offshore reporters and regulators should be conditioned in advance (to the extent possible) to expect litigation and not to view it as a sign of trouble. In addition, it is important to understand the U.S. discovery process in litigation as it is significantly different than the process in other jurisdictions and, even in the context of a settlement, will require the acquiror to provide responsive information and documents (including emails) to the plaintiffs.

- **Tax Considerations.** U.S. tax issues affecting target shareholders or the combined group may be critical to structuring the transaction. In transactions involving the receipt by U.S. target shareholders of non-U.S. acquiror stock, the potential application of so-called “anti-inversion” rules, which could render an otherwise tax-free transaction taxable to exchanging U.S. target shareholders and also result in potentially significant adverse U.S. tax consequences to the combined group, must be carefully evaluated. Non-U.S. acquirors frequently will need to consider whether to invest directly from their home jurisdiction or through U.S. or non-U.S. subsidiaries, the impact of the transaction on tax attributes of the U.S. target (e.g., loss carryforwards), the deductibility of interest expense incurred on acquisition indebtedness, and eligibility for reduced rates of withholding on cross-border payments of interest, dividends and royalties under applicable U.S. tax treaties. In particular, non-U.S. acquirors should carefully monitor any proposed changes to the U.S. tax rules governing the deductibility of interest payments from U.S. to non-U.S. affiliates (i.e., “earnings-stripping”) in light of recent announcements by the IRS and Treasury to issue additional guidance to further limit the benefits of “inversion” transactions. Because the United States does not have a “participation exemption” regime that exempts dividend income from non-U.S. subsidiaries, a non-U.S. acquiror of a U.S. target with non-U.S. subsidiaries should analyze the tax cost of extracting such subsidiaries from the U.S. group.

- **Disclosure Obligations.** How and when an acquiror’s interest in the target is publicly disclosed should be carefully controlled and considered, keeping in mind the various ownership thresholds that trigger mandatory disclosure on a Schedule 13D under the federal securities laws and under regulatory agency rules such as those of the Federal Reserve Board, the Federal Energy Regulatory Commission (FERC) and the Federal Communications Commission (FCC). While the Hart-Scott-Rodino Antitrust Improvements Act (HSR) does not require disclosure to the general public, the HSR rules do require disclosure to the target’s management before relatively low ownership thresholds can be crossed. Non-U.S. acquirors have to be mindful of disclosure norms and timing requirements relating to home country requirements with respect to cross-border investment and acquisition activity. In many cases, the U.S. disclosure regime is subject to greater judgment and analysis than the strict requirements of other jurisdictions. Treatment of derivative securities and other pecuniary interests in a target other than common stock
holdings also varies by jurisdiction, and such investments have received heightened regul-
atory focus in recent periods.

• **Shareholder Approval.** Because few U.S. public companies have one or more controlling
shareholders, obtaining public shareholder approval is typically a key consideration in
U.S. transactions. Understanding in advance the roles of arbitrageurs, hedge funds, institu-
tional investors, private equity funds, proxy voting advisors and other important market
players – and their likely views of the anticipated acquisition attempt as well as when
they appear and disappear from the scene – can be pivotal to the success or failure of the
transaction. It is advisable to retain a proxy solicitation firm to provide advice prior to
the announcement of a transaction so that an effective strategy to obtain shareholder ap-
proval can be implemented.

• **Integration Planning.** One of the reasons deals sometimes fail is poor post-acquisition
integration, particularly in cross-border deals where multiple cultures, languages and his-
toric business methods may create friction. If possible, the executives and consultants
who will be responsible for integration should be involved in the early stages of the deal
so that they can help formulate and “own” the plans that they will be expected to execute.
Too often, a separation between the deal team and the integration/execution teams invites
slippage in execution of a plan that in hindsight is labeled by the new team as unrealistic
or overly ambitious. However, integration planning needs to be carefully phased in as
implementation cannot occur prior to the receipt of certain regulatory approvals.

• **Corporate Governance and Securities Law.** U.S. securities and corporate governance
rules can be troublesome for non-U.S. acquirors who will be issuing securities that will
become publicly traded in the United States as a result of an acquisition. SEC rules, the
Sarbanes-Oxley and Dodd-Frank Acts and stock exchange requirements should be evalu-
ated to ensure compatibility with home country rules and to be certain that the non-U.S.
acquiror will be able to comply. Rules relating to director independence, internal control
reports and loans to officers and directors, among others, can frequently raise issues for
non-U.S. companies listing in the United States. Non-U.S. acquirors should also be
mindful that U.S. securities regulations may apply to acquisitions and other business
combination activities involving non-U.S. companies with U.S. security holders.

• **Antitrust Issues.** To the extent that a non-U.S. acquiror directly or indirectly competes or
holds an interest in a company that competes in the same industry as the target company,
antitrust concerns may arise either at the federal agency or state attorneys general level.
Although less typical, concerns can also arise if the foreign acquiror competes either in
an upstream or downstream market of the target. As noted above, pre-closing integration
efforts should also be conducted with sensitivity to antitrust requirements that can be lim-
iting. Home country competition laws may raise their own sets of issues that should be
carefully analyzed with counsel. The administration of the antitrust laws in the United
States is carried out by highly professional agencies relying on well-established analyti-
cal frameworks. The outcomes of the vast majority of transactions can be easily predict-
ed. In borderline cases, while the outcome of any particular proposed transaction cannot
be known with certainty, the likelihood of a proposed transaction being viewed by the
agencies as raising substantive antitrust concerns and the degree of difficulty in overcom-
ing those concerns can be. In situations presenting actual or potential substantive issues, careful planning is imperative and a proactive approach to engagement with the agencies is generally advisable.

- **Due Diligence.** Wholesale application of the acquiror’s domestic due diligence standards to the target’s jurisdiction can cause delay, waste time and resources or result in missing a problem. Due diligence methods must take account of the target jurisdiction’s legal regime and, particularly important in a competitive auction situation, local norms. Many due diligence requests are best channeled through legal or financial intermediaries as opposed to being made directly to the target company. Making due diligence requests that appear to the target as particularly unusual or unreasonable (not uncommon in cross-border deals) can easily cause a bidder to lose credibility. Similarly, missing a significant local issue for lack of local knowledge can be highly problematic and costly.

- **Collaboration.** Most obstacles to a deal are best addressed in partnership with local players whose interests are aligned with those of the acquiror. If possible, relationships with the target company’s management and other local forces should be established well in advance so that political and other concerns can be addressed together, and so that all politicians, regulators and other stakeholders can be approached by the whole group in a consistent, collaborative and cooperative fashion.

As always in global M&A, results, highpoints and lowpoints for 2016 are likely to include many surprises, and sophisticated market participants will need to continually refine their strategies and tactics as the global and local environment develops. However, the rules of the road for successful M&A transactions in the United States remain well understood and eminently capable of being mastered by well-prepared and well-advised acquirors from all parts of the globe.

Adam O. Emmerich           Robin Panovka
David A. Katz              Scott K. Charles
Ilene Knable Gotts         Andrew J. Nussbaum
Joshua R. Cammaker         Mark Gordon
Eric M. Rosof              Joshua M. Holmes
T. Eiko Stange            Gordon S. Moodie
Raaj Narayan              Francis J. Stapleton
Foreign Investors Skip CFIUS Review at Their Peril

U.S. District Court Dismisses Challenge to President’s Authority

October 21, 2013

Background

On October 9, 2013, the U.S. District Court for the District of Columbia dismissed the first serious judicial challenge to the President’s authority to block foreign acquisitions that are deemed a threat to U.S. national security. The case, *Ralls Corporation v. Committee on Foreign Investment in the United States*, ___ F. Supp. __, 2013 WL 5565499 (D.C.D.C.), (“*Ralls*”), was brought on behalf of Ralls, a Chinese-owned Delaware corporation, after it was forced to unwind its purchase of membership interests in several wind farm projects located near a sensitive Navy installation where drone training missions are conducted.

The transaction was not submitted for pre-acquisition review by the Committee on Foreign Investment in the United States ("CFIUS"), a multi-agency panel authorized by the Defense Production Act, (50 U.S.C. App. § 2061 et seq.), to assess transactions that present a potential threat to the national security of the United States. Under the law, filing is voluntary, but transactions that are not reviewed are open to scrutiny in perpetuity. Moreover, CFIUS can initiate reviews on its own – whether the parties file or not. In the *Ralls* case, CFIUS contacted the company post-closing and invited it to submit a voluntary notice – making clear that the Department of Defense would initiate review if Ralls did not file. Given the choice, Ralls filed notice roughly four months after the acquisition.

Following CFIUS review, acting on the panel’s recommendation, President Obama issued an order that, among other things:

- prohibited the transaction;
- prohibited Ralls from owning the companies;
- required Ralls to divest all of its interests in the companies that owned the wind farms, in their
assets, and in any operations developed, held, or controlled by them;

- prohibited Ralls and persons acting on their behalf from accessing the project sites;
- prohibited Ralls from facilitating the sale or transfer of products produced by its affiliate (the Sany Group) for use by third parties at the site;
- required that all structures, physical objects, and installations be removed from the project sites; and
- prohibited the sale or transfer of the wind farm companies until these conditions were satisfied.

Nor could Ralls do the demolition work themselves; the order required that they retain U.S. citizen contractors – approved by CFIUS – to do the work. Even sale to a U.S. buyer was blocked until it was clear that all items “deposited, installed, or affixed (including concrete foundations)” after the Ralls purchase had been removed. Briefly stated, the order required Ralls and its affiliates to back out completely and restore the companies – and the land – to their original position. In essence, Ralls was required to do everything but salt the earth. (Although no public explanation was offered, and no discovery of eavesdropping equipment ever publicly reported, the exhaustive measures ordered by Treasury called to mind President Reagan’s demolition of the newly built U.S. embassy in Moscow – at a cost of nearly $200 million – after it was found to have been “heavily penetrated” by Soviet listening devices. See The New York Times, October 27, 1988, available at http://www.nytimes.com/1988/10/27/world/reagan-backs-replacing-moscow-embassy.html.) Ralls has denied any involvement in espionage.

The Ralls Lawsuit

The Ralls lawsuit argued that the President’s order (and the interim CFIUS order) were ultra vires, a violation of the Administrative Procedures Act (5 U.S.C. Subchapter II), an unconstitutional violation of the equal protection clause of the United States Constitution, and an unconstitutional deprivation of property without due process. Earlier this year, the Court dismissed all but the due process claim on grounds that the Court lacked subject matter jurisdiction, since the statute authorizing CFIUS prohibits judicial review of the merits of the President’s decision.

On October 9, the due process claim was dismissed as well. First, the U.S. District Court ruled that Ralls had demonstrated no “cognizable liberty or property interest,” noting that Ralls acquired its property rights “subject to the known risk of a Presidential veto” and had waived the opportunity to obtain a determination from CFIUS and the President before entering the transaction. Quoting Alvin v. Suzuki, 227 F. 3d 107, 116 (3d Cir. 2000), the Court added: “If there is a process on the books that appears to provide due process, the plaintiff cannot skip that process and use the federal courts as a means to get back what he wants.” In other words, there is only one bite at the apple.

Second, the Court found that, even if it agreed that the President’s order had deprived Ralls of some protected interest, the company had received sufficient process. Ralls had been provided notice of the impending action and an opportunity to be heard. The fact that Ralls never received an articulation of the reasons behind the President’s decision was deemed inconsequential, because the statute bars judicial review of the President’s decision, “which can be based on any factor that he deems appropriate.”
The CFIUS Process

The President’s decision to veto the Ralls acquisition marked only the second time that a transaction has been rejected by Presidential order under CFIUS, although many transactions have been withdrawn or re-structured to meet CFIUS concerns. To find a precedent, it’s necessary to go back to President George H. W. Bush’s 1990 veto of China National Aero-Technology Import and Export Corporation’s (“CATIC”) acquisition of a controlling interest in MAMCO Manufacturing Co., an aircraft parts manufacturer.

Most – indeed, virtually all – transactions before CFIUS are approved. Many are approved with little question. CFIUS says it reviewed 318 foreign investment transactions from 2010 through 2012. Although the CFIUS process is confidential, we only know of one – Ralls – that was blocked outright.

Undoubtedly, however, several transactions have required restructuring or partial divestment to U.S. buyers. Still others were approved subject to mitigation orders that impose restrictions on such matters as the foreign buyer’s ability to control the company, how sensitive technologies must be managed, the nationality of the management and/or R&D teams, the location and relocation of facilities, and access by the foreign owners to key intellectual property. With such issues at stake, it should not be surprising that parties that seek to avoid the CFIUS process are greeted with suspicion when they finally show up.

It is notable that 120 of the 318 transactions reviewed between 2010 and 2012 (more than a third) went to full investigation. The CFIUS process is multi-part, with an initial 30-day review following a five to seven day pre-filing period – and an additional 45-day “full investigation” for cases involving government-controlled buyers and more complex cases that cannot be resolved in the initial review. (A 15-day presidential review follows if a case is not cleared after investigation. Is not at all unknown for cases to be withdrawn and re-filed when investigations bog down, if the prospect of clearing the deal (with or without conditions) is real.)

Four Lessons from the Ralls Decision

1. When in doubt, file.

There’s no question that acquisitions of defense contractors and companies that hold facility security clearances will require CFIUS review. But when Congress enacted the Foreign Investment and National Security Act of 2007 (“FINSA”), it also provided for investigation of acquisitions that would result in foreign control of “critical infrastructure” that could impair U.S. national security. The statute defines “critical infrastructure” to mean “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).

In evaluating a target, therefore, it’s necessary to assess the asset against the FINSA test. If it is any kind of a close question, the prudent course is to file.

Plainly, transactions involving transportation, telecommunications, and water can implicate national security. So can transactions involving the food supply, as the Chinese acquisition of Smithfield Foods made clear. (Notably, the Smithfield deal was reviewed – and cleared – by CFIUS.) So can transactions in the energy sector. Indeed, in their report accompanying the Senate bill, the Committee on Banking, Housing, and Urban Affairs observed that “[t]he Committee expects that acquisitions of U.S. energy companies or assets by foreign governments or companies controlled by foreign governments … will
be reviewed closely for their national security impact.” (Sen. Rept. 110-80, at 8.) (Emphasis added.) Indeed, investors should expect CFIUS review of any acquisition by a foreign government or a foreign government-controlled entity.

2. Location, Location, Location: What’s next door? What’s in the closet?

The Ralls transaction was not blocked because Ralls acquired four wind farms. Indeed, in 2013, Sany acquired a wind farm in Colorado without incident. This time, however, they ran the transaction by CFIUS. (See “Ralls CFIUS block alters Sany’s future investment strategy in US,” Financial Times, March 1, 2013, available at http://www.ft.com/intl/cms/s/2/1ff1eb98-82b8-11e2-a3e3-00144feabdc0.html#axzz2i153glru.) The Ralls transaction was blocked because it was near a sensitive military station. Too near.

Location is key. But it’s not just about location. Although not a factor in the Ralls case, an acquisition may merit CFIUS review because the assets being acquired are U.S. export-controlled, or – even if the company holds no security clearances – are components of America’s “critical infrastructure.” Rumors that Blackberry Ltd., a Canadian company, might be acquired by Lenovo Group Ltd., a Chinese computer manufacturer, sent up immediate red flags, because Blackberry devices are widely used by U.S. government officials, including the President. While the U.S. Government is officially silent, a recent Wall Street Journal article quotes a Department of Defense official’s pointed observation that “[t]he department closely monitors major industry developments such as acquisitions and mergers and will ensure that national security standards are met…. “Lenovo Would Face Scrutiny in Washington if It Bids for Blackberry,” Wall Street Journal, October 18, 2013. (Even acquisitions of foreign companies can be reviewed by CFIUS if the acquisition will include U.S. businesses.)

3. Be realistic.

If an acquiring company hails from a country with a history of cyber-attacks on U.S. targets, or if (and there is no evidence this was a factor in the Ralls case) the acquiring company has a checkered history of compliance with U.S. law, or a roster of unsavory trading partners, these factors will be taken into account in the “risk assessment” that is performed for all CFIUS reviews. If the target company owns export-controlled technology – and U.S. law bars or tightly controls export of the technology to the country where the acquiring firm is headquartered – the transaction not only requires CFIUS review, but is unlikely to go forward unless CFIUS can be convinced that the technology can be protected against unauthorized export.

4. Filing brings protection.

Ralls did not concern a large transaction. Nevertheless, according to a contemporaneous article in Bloomberg Business Week, Sany expected to lose $20 million, exclusive of legal fees, when the acquisition was blocked – and another $25 million in U.S. tax incentives because they could not get the wind farms into service before the end of 2012. (See “Sany Affiliate May Lose $20 Million on U.S. Wind-Farm Ban,” October 3, 2012, available at http://www.businessweek.com/news/2012-10-03/sany-affiliate-may-lose-20-million-on-u-dot-s-dot-wind-farm-ban.)

Filing allows for notice that a transaction is in trouble – before the deal closes. In her decision in the Ralls case, Judge Jackson quoted from the 2005 testimony of Robert Kimmett, then-Deputy Secretary of the Treasury, before the Senate
Committee on Banking, Housing, and Urban Affairs, who said that he “cannot imagine in the post-Sarbanes-Oxley world … how any director could give the go-ahead on a transaction [that had not been completed], because the President’s authority to unwind that transaction is without limit if the person has not received approval....” *Ralls*, supra at (Bracketed material original).

By contrast, Judge Jackson noted, if a transaction is submitted for review, and CFIUS concludes that the acquisition does not present a threat to the national security, “the President and committee [absent fraud] may not initiate another review of the transaction.” *Id.* See 50 U.S.C. app. §2170(b)(1)(D).

*Ralls* filed a Notice of Appeal to the U.S. Court of Appeals for the District of Columbia Circuit on October 16, 2013. Although the *Ralls* appeal, if successful, could serve to rein in CFIUS and impose new procedural steps in the name of due process, there is no prospect that CFIUS will be uprooted, and no serious likelihood that the appeals courts will create opportunities to second-guess the President – in court – on the national security implications of commercial transactions.

In the meanwhile, foreign investors and their U.S. targets are best advised to plan for CFIUS review in any transaction that touches on national security – including transactions that involve “critical infrastructure.”

By Christopher R. Brewster, Special Counsel in the National Security/CFIUS/Compliance Practice Group of Stroock & Stroock & Lavan LLP.

**For More Information**

For a copy of the *Ralls* decision or guidance on the CFIUS process for reviewing foreign acquisitions, please contact Christopher R. Brewster (cbrewster@stroock.com, 202.739.2880) or any member of the National Security/CFIUS/Compliance Practice Group in Stroock’s Washington, D.C. office at 202.739.2800.
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
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. Sovereign wealth funds had a milestone year in 2013 for acquisitions—a record $174.7 billion in direct transactions. Sovereign wealth fund investment continued to increase in 2014. As of September 2014, there were $511.3 billion in direct transactions, a 20.6 percent increase that can largely be attributed to increased real estate deals. Sovereign wealth fund assets are predicted to grow substantially, and are well on their way to hit forecasts of $8.6 trillion by 2016. 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.

Against this backdrop, sovereign wealth funds have shown particular interest in investing in the United States. Scarcely a day goes by that we do not hear about another major acquisition by a sovereign wealth fund in the United States. 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. A large cultural center and office building in downtown Washington, D.C. has opened with funds provided by a Qatar-based sovereign wealth fund.


\[\text{\footnotesize \textsuperscript{6}}\text{See BLOOMBERG, supra note 1, at 2.}\]

\[\text{\footnotesize \textsuperscript{7}}\text{Other prominent foreign companies have also recently purchased everything from movie theatres, (Zachary R. Mider, China’s Wanda to Buy AMC Cinema Chain for $2.6 Billion, BLOOMBERG (May 21, 2012, 3:33 PM), http://www.bloomberg.com/news/2012-05-21/china-s-wanda-group-to-buy-amc-cinema-chain-for-2-6-billion.html), to a US pork producer in the United States, including the $4.7 billion purchase last year by Shuanghui International Holdings of Smithfield Foods, Inc., the American pork producer—the largest Chinese acquisition of a US company to date. Nathalie Tadenia, Smithfield Shareholders Approve Shuanghui Deal, WALL STREET JOURNAL (Sept. 24, 2013, 11:16 AM), http://online.wsj.com/articles/SB1000142405270230421339024579095961880018346. Deals of note currently in the US market include the purchase by Lenovo, a Chinese company, of the low-end server business of IBM and the Motorola handset business, Juro Osawa, the US market include the purchase by Lenovo, a Chinese company, of the low-end server business of IBM and the Motorola handset business.}\]


\[\text{\footnotesize \textsuperscript{9}}\text{Steven Pearlstein, Can a Texas Developer and Qatar Investment Make D.C.’s CityCenter a Success?, WASHINGTON POST (Oct. 22, 2011), http://www.washingtonpost.com/can-a-texas-developer-and-qatar-investment-make-dcs-citycenter-a-success/2011/10/17/gIQAePMi6L_story.html (noting project was on “life support” and “what saved CityCenter was an investment of $622 million by the government of Qatar, whose sovereign wealth fund likes the visibility and perceived stability of investing in downtown Washington.”).}\]
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. At the same time, the activities of sovereign wealth funds can raise national security concerns because they are controlled by foreign governments. 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.

Moreover, a recent decision from a US federal appellate court, Ralls Corp. 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. 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.” 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.
Following the Unocal controversy in 2005 and the Dubai Ports controversy in 2006, Congress amended Exon-Florio with the Foreign Investment and National Security Act of 2007 (FINSA) (Section 721 of the Defense Production Act of 1950, as amended) (“Section 721”). Although FINSA 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.” 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.”

FINSA also enhanced congressional oversight (and thereby imposed greater political accountability) by, among other things, mandating that CFIUS provide Congress with reports following its investigations. 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 FINSA 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 FINSA. 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. 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.” 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. 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. Most recently, in 2012, President Barack Obama suspended the proposed acquisition of the American coal mining company Alpha Natural Resources by a Chinese company.

16In 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).

17The 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.


22See, 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).
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. In addition, there are two non-voting members (the Director of National Intelligence and the Secretary of Labor), and five observer White House offices. 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."  

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. Such a transaction is termed a "covered transaction." The Committee does not have jurisdiction over so-called "greenfield" investments, although some have recommended that the law be amended to grant it such jurisdiction. 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. 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."

Footnote continued

Amendment—The MAMCO Divestiture, Harv. Int’l L.J. 286 (1999); 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.").

\footnotetext{27}{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).

\footnotetext{28}{50 U.S.C. App. § 2170(k)(j).


\footnotetext{30}{50 U.S.C. App. § 2170(k)(j).

\footnotetext{31}{31 C.F.R. § 800.501(a).

\footnotetext{32}{Id. § 800.201.

\footnotetext{33}{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/pubs/ft/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.”).


\footnotetext{35}{31 C.F.R. § 800.224.

\footnotetext{36}{Id. § 800.203(a)(i).}
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.\textsuperscript{37} "Control" is the ability – whether or not exercised – to "determine, direct, or decide" important business matters affecting an entity.\textsuperscript{38} 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.\textsuperscript{39} 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.”\textsuperscript{40}

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.\textsuperscript{41} Although CFIUS reviews are confidential and officially non-public, news reports and securities filings provide a window into many reviews.\textsuperscript{42} 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.\textsuperscript{43} 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.\textsuperscript{44} 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.\textsuperscript{45}

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.\textsuperscript{46} Member agencies also can file on their own if they believe that a transaction presents national security considerations.\textsuperscript{47} 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

\textsuperscript{37}Id. § 800.216.
\textsuperscript{38}Id. § 800.204.
\textsuperscript{39}Id. § 800.204(a).
\textsuperscript{40}Id. §§ 800.211; 800.226.
\textsuperscript{41}See id. § 800.226.
\textsuperscript{42}Id. § 800.702.
\textsuperscript{43}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-idUSBRE91O1A420130225.
\textsuperscript{46}31 C.F.R.§ 800.401(b).
\textsuperscript{47}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. 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. 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.

Although the law sets forth an illustrative list of factors 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.

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...
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).  

(ii) the vulnerability posed by the US business;  

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?55 What are the home country’s cybersecurity policies? Are there ties between the acquirer’s management and military or intelligence
agencies?57 Is the home country reputed to engage in commercial or state espionage?58 Does the
acquirer do business in countries subject to US sanctions?59 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.”60

What constitutes “critical infrastructure” is determined by CFIUS on a case-by-case basis. 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.62

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,
ergy, natural resources, or other goods and services vulnerable to sabotage, espionage or
cybersecurity risk.63 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.64 Is the US business an important part of US critical
infrastructure, such as energy pipelines, transportation, ports, and financial systems?65 Is the US
business subject to US export controls?66 In the current environment, CFIUS regularly assesses

---

50 Office of Investment Security; Guidance Concerning the National Security Review Conducted by the Committee
considers whether the foreign acquirer has the capability or intention to cause harm. Id. at 74,569.

51 Whether there is vulnerability depends on whether the nature of the US business or its relationship to a weakness
or shortcoming in a system, or structure creates susceptibility to impairment of US national security. Id. at 74,569.

52 See 50 U.S.C. App. § 2170(f)(4), (g); 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.

53 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.

54 See Committee on Foreign Inv. in the United States Ann. Rep. to Congress, supra note 12, at 36.

55 See 50 U.S.C. App. § 2170(m)(3)(i); 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”).

56 See Committee on Foreign Inv. in the United States Ann. Rep. to Congress, supra note 12.


58 The CFIUS definition of critical infrastructure essentially adopts the definition of the same term in the USA
PATRIOT Act, 42 U.S.C. § 5595c(6). 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

59 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.

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

61 See id. at 74,570.

62 See id. at 74,569, 74,570.
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.67

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.68

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.69

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.70

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.71

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.72 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.”73 In addition, FINSA authorizes the

67See 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.
70Committee on Foreign Inv. in the United States Ann. Rep. to Congress, supra note 12, at 20.
71Id.
72Id.
73Id. 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.”\footnote{74}

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.\footnote{75} Thus, the Committee will look at the range of facts discussed above under “Threshold factors for jurisdiction.”\footnote{76} 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.\footnote{77} 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.\footnote{78} 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.\footnote{79}
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.80 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.”81 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.82 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 acquiree 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.83

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.84 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),85 and purchases of unused buildings (assuming customer lists, intellectual property, or other proprietary information or personnel used to operate the building, are not included).86

8173 Fed. Reg. at 74,571.
8250 U.S.C. App. § 2170(f)(6); see also supra note 45, for listing of other factors in § 2170(f).
84Sovereign Wealth Fund Institute, Real Estate Investments More Attractive for Sovereign Wealth Funds, supra note 3.
85Depending 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.
8631 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. 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. 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. 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).
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.90 Following CFIUS review, the transaction was vetoed by President Obama on September 28, 2012, on grounds that the acquisition threatened US national security.91

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,”92 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.93 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.94

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.”95 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).96

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)97 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.98 The three-
panel concluded that Congress had not intended to preclude judicial review of all claims under Section 721.\textsuperscript{99} Thus, although final action by the President prohibiting the transaction was immune from judicial review, due process claims relating to the CFUJS 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.”\textsuperscript{100}

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.\textsuperscript{101} 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.”\textsuperscript{102}

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).\textsuperscript{103} Under this line of cases, organizations with a sufficient “constitutional presence” in the United States are entitled to due process,\textsuperscript{104} but the merits of a determination by the State Department as to whether an organization’s activities threaten US national security are nonjusticiable.\textsuperscript{105} 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.”\textsuperscript{106}

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

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.”).\textsuperscript{99}
\textsuperscript{99}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.
\textsuperscript{100}369 U.S. 186, 217 (1962) (quoted in Ralls, 758 F.3d at 313).
\textsuperscript{101}Baker, 369 U.S. at 211-17.
\textsuperscript{102}Ralls, 758 F.3d at 313 (citing Haig v. Agee, 453 U.S. 280, 292 (1981); Baker, 369 U.S. at 211).
\textsuperscript{103}See Ralls, 758 F.3d at 313-14.
\textsuperscript{104}National Council of Resistance of Iran v. Dep’t of State, 251 F.3d 192, 202 (D.C. Cir. 2001) (NCRI).
\textsuperscript{105}People’s Mojahedin Org. of Iran v. Dep’t of State, 182 F.3d 17, 23 (D.C. Cir. 1999) (PMOI I).
\textsuperscript{106}Ralls, 758 F.3d at 314.
companies, “due process protections necessarily attached.”107 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.108 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.”109

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.110 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.”111 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.”112

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.113 The court also briefly considered the Supreme Court decision in Greene v. McElroy,114 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.”115 The Greene case does not appear to be exactly on point: In contrast to the CFUS 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.116 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.”117 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.118

---

107 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).
108 Ralls, 758 F.3d at 316-17. (citing Dames & Moore v. Regan, 453 U.S. 654, 672-73 (1981)).
109 Ralls, 758 F.3d at 316-17.
110 Id. at 317-18 (citing Mathews v. Eldridge, 424 U.S. 319 (1976)).
111 Mathews, 424 U.S. at 335.
112 Ralls, 758 F.3d at 318 (quoting Mathews, 424 U.S. at 333).
113 NCRI, 251 F.3d at 208-09.
115 Id. at 479.
116 Id. at 506.
117 Ralls, 758 F.3d at 318, 320 (citing Greene, 360 U.S. at 496).
118 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.\(^{119}\) The court made clear that due process did not require the disclosure of classified information.\(^{120}\) 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.\(^{121}\)

In the court’s view, adequate due process during the CFIUS review would satisfy the due process obligations of the President.\(^{122}\) 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.”\(^{123}\)

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.”\(^{124}\) 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.\(^{125}\) 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.\(^{126}\) 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.”\(^{127}\) 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.\(^{128}\)

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 NCR “may suggest” this is required for FTOs but “the plaintiffs in [NCR] 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”).

Ralls, 758 F.3d at 320.

Id. at 319.

Id. at 320.

Id.

Id. at 321-25.


Id. at 325 (citing NCR, 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.

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.

Id., Dkt. No. 29 at 3.

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. 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.” 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. In any such challenge, the objecting party will bear the burden of showing that the designation is improper.

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 . . . [after the President has considered the record in its entirety].” Finally, the court directed the parties to confer regarding a schedule for briefing the CFIUS order claims. 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.”

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 process and the need for clear and fair procedures in national security reviews. The court’s decision underscores the importance of protecting sensitive information while ensuring that the parties have the opportunity to challenge the protection of such information in a timely manner. This is critical for maintaining the balance between national security concerns and due process rights, especially in cases involving foreign investors and the government’s authority to impose mitigation measures.

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.

129Ralls 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 NWSFT Boardman (R5701) (Apr. 8, 2011); and (2) a document entitled “CFIUS Case 12-044 – Ralls Corporation – Certain Assets of Tema 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).

130Ralls v. CFIUS, Case No. 1:12-cv-01513, Dkt. No. 70 at 3.

131Id. at 5.

132Id. at 4. No such schedule has been issued at the time of this writing.

133Although 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.

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.136 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.137 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 challenges138 – 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.139 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.140

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

---

136 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.

137 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(c)(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.


139 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.\footnote{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.}

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 \textit{Ralls}: how the government must produce the information; what information must be provided; and when the government must provide it to parties. Citing \textit{NCRI} and \textit{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.”\footnote{\textit{Ralls}, 758 F.3d at 317.} Rather, it was flexible, calling for “such procedural protections as the particular situation demands.”\footnote{\textit{Id.} (quoting \textit{Morrissey v. Brewer}, 408 U.S. 471, 481 (1972)).}

In \textit{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 \textit{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, \textit{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).\footnote{\textit{NCRI}, 251 F.3d at 205 (quoting \textit{Mathews, Armstrong}, 408 U.S. 471, 481 (1972)).} In \textit{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 \textit{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, \textit{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).\footnote{\textit{NCRI}, 251 F.3d at 205 (quoting \textit{Mathews, Armstrong}, 408 U.S. 471, 481 (1972)).}

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 \textit{Ralls} suggest, even unclassified information may be restricted only to sharing with a party’s attorneys under a protective order.\footnote{\textit{Ralls v. CFIUS}, Case No 1:12-cv-01513, Dkt. No. 66 (D.D.C. Nov. 14, 2014) at 4.} 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.\footnote{\textit{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.148 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.149 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,150 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).151 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.”152

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.

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”).
14873 Fed. Reg. at 74,569. 14950 U.S.C. App. § 2170(l)(1)(B). 150The 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. 151As 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. 152Ralls, 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. 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. 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 CFIUS 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.

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 rivaling its caseload in 2008, when CFIUS reviewed 155 transactions (to date, the most transactions it has reviewed in any other year). 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. 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),

---

155 Ralls, 758 F.3d at 316.
156 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)).
157 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.
158 Committee on Foreign Inv. in the United States Ann. Rep. to Congress, supra note 12, at 3.
159 524 U.S. § 1189(a)(4).
but this can only take place two years after the designation has already occurred. 158 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.

158 Id. § 1189(7)(A)(B)(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.159 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.

**Acknowledgements**

The authors thank Joel Slawotsky at the Radzyner School of Law, Interdisciplinary Center, Herzliya, Israel, for his significant editorial contributions to this article, and John C. Baer at Stroock & Stroock & Lavan LLP for his extensive research assistance.

---

15973 Fed. Reg. at 74,705.