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SYMPOSIUM ARTICLE

Gone With the Wind: The Ralls Transaction and Implications for Foreign Investment in the United States

Jeremy Zucker & Hrishikesh Hari*

In 2012, pursuant to a national security review conducted by the Committee on Foreign Investment in the United States (CFIUS), President Obama ordered the unwinding of Ralls Corporation's ("Ralls") acquisition of certain US wind farm companies. Ralls' legal challenge of the President's Order, and the court's opinions to date, highlight important considerations for both foreign investors and the national security community. This article contextualizes the case within a broader debate about how well CFIUS balances openness to foreign investment and protection of national security, points out important gaps in the national security review process, and considers opportunities for greater transparency.

1 Introduction

The Committee on Foreign Investment in the United States (CFIUS) was established decades ago to identify and recommend responses to threats to the national security of the United States posed by acquisitions by non-US entities of controlling stakes in US companies. As the world globalizes, the importance of a dispassionate CFIUS review grows in importance, not only to encourage foreign investment in the United States, but also to prevent retaliation against American companies in national security reviews conducted by other countries. The Committee's ability to balance promotion of foreign investment and protection of national security—and, perhaps equally as important, its ability to achieve the perception that it is striking an appropriate balance—has varied over time, often turning on the specifics of a few cases that receive relatively more attention from Congress and the public. CFIUS' recent review and eventual rejection of the acquisition by Ralls Corporation ("Ralls"), a Delaware corporation owned by two Chinese nationals, of wind farm development projects in Oregon provides a revealing glimpse into whether and how CFIUS currently is balancing protecting national security and attracting foreign investment. As we discuss in greater detail below, the Ralls case holds important lessons for both the national security review process and foreign investors.

In the Ralls case, for the first time in over two decades, pursuant to CFIUS' recommendation the President ordered that a foreign acquirer divest its interests in a US company it already had acquired.[1] Although the Ralls transaction was only the second time a president has ordered the unwinding of a completed transaction pursuant to a national security review, CFIUS has effectively blocked or required the unwinding of many other transactions without a formal order. For example, of the 269 notifications received by CFIUS from 2009–2011, 25 transactions were withdrawn during CFIUS' review or investigation period.[2] Some, if not all, of these withdrawals resulted from the parties' understanding that CFIUS concerns could not be mitigated or that mitigation measures would be so far-reaching as to render the transaction undesirable. In a few and often highly publicized instances, the national security review process

Notes

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1 The prior instance in which the President, acting on the recommendation of CFIUS, mandated divestment by a foreign acquirer also involved a Chinese buyer. In that instance, President George H.W. Bush required China National Aero-Technology Import and Export Corp (CATIC), a Chinese state-owned entity, to divest its control of MAMCO Manufacturing, Inc., a Washington state company that manufactured metal parts and assemblies for aircraft. As in the Ralls case, CATIC completed its acquisition prior to CFIUS' conclusion of its review.

2 Committee on Foreign Investment in the United States Annual Report to Congress for CY 2011, Dec. 2012, available at http://www.treasury.gov/resource-center/international/foreign-investment/Documents/2012%20CFIUS%20Annual%20Report%20PUBLIC.pdf (hereinafter CFIUS Annual Report 2012), at 9.

has been subject to political interference, or at least perceptions of same, typically with negative results for would-be foreign acquirers.[3]

President Obama's order in the Ralls case and Ralls' decision to contest this order in court have renewed scrutiny of whether the CFIUS process adequately balances openness to foreign investment and protection of national security. Below we examine the Ralls transaction, CFIUS' recommendation and the President's decision to require that the deal be unwound, and Ralls' subsequent challenge in federal court. We then assess the lessons from this and other recent CFIUS reviews with respect to US national and economic security.

2 The Ralls transaction

In 2009, Oregon Windfarms, LLC, an Oregon corporation owned by US citizens, formed four Oregon limited liability companies for the purpose of holding assets, including rights and permits, related to four separate wind farm projects in Oregon (collectively the "Butter Creek Projects").[4] The four limited liability companies in the Butter Creek Projects included Pine City Windfarm, LLC; Mule Hollow Windfarm, LLC; High Plateau Windfarm, LLC; and Lower Ridge Windfarm, LLC (collectively the "Project Companies"). Oregon Windfarms planned to build five separate wind turbines in each of the Project Companies. In December 2010, Oregon Wind Farms sold its interest in the Project Companies to Terna Energy USA Holding Corporation ("Terna").[5]

In March 2012, Ralls acquired the Project Companies. According to Ralls, its business centers on identifying opportunities to use and showcase Sany Group Co. ("Sany") wind turbines in the United States and facilitating comparison to competitor products. Sany is a Chinese company, and the owners of Ralls are vice presidents at Sany. The Butter Creek Projects presented an attractive opportunity for Ralls to erect and deploy Sany turbines because:

> the region in which the turbines would be located is home to hundreds of wind turbines, thereby allowing for direct and immediate comparison of Sany turbines to competitor turbines. At the same time, the projects would create clean, renewable energy and provide jobs to American workers.[6]

Each Project Company held assets related to the development of a wind farm, including, among other things, the government permits and approvals typically required to construct wind turbines at specific locations. In 2010 and 2011, the Federal Aviation Administration ("FAA") approved all of the planned wind farms in the Butter Creek Projects. Notably, the FAA's approval process for the turbines included review by the Department of Defense. "The purpose of the Department of Defense review is to 'prevent, minimize, or mitigate adverse impacts on military operations, readiness and testing.'"[7]

The US Navy maintains a restricted airspace and bombing zone in the general vicinity of the Butter Creek Projects. Shortly after Ralls acquired the Project Companies, the Navy expressed concerns regarding the location of one of the wind farms, as it was within the restricted space. Ralls agreed to move the wind farm outside of the restricted space, a process that required Ralls to apply for new permits from regulators. During the approval process, the Navy wrote to the Oregon Public Utility Commission on Ralls' behalf, recommending new permits be granted.[8] The Navy did not express reservations regarding any of Ralls' other wind farms outside of the restricted space.

Ralls completed its acquisition of the Project Companies in March 2012 and began construction of the Butter Creek Projects on April 23, 2012. It was anticipated that the Butter Creek Projects would yield 40 MW of wind-generated power, which would account for an estimated 0.37% of the total generating capacity of the transmission grid for PacifiCorp, and 2.3% of its wind generating capacity.[9]

Notes

[3] China National Offshore Oil Corporation's attempted acquisition of Unocal in 2005, Dubai Ports World's foiled deal with Peninsular and Oriental Steam Navigation Company in 2007, and Huawei/Bain Capital's thwarted purchase of 3Com in 2008 are well-known recent examples.

[4] *Ralls Corp. v. Barack H. Obama et al.*, U.S. District Ct. for the District of Columbia (Case No. 1:12-cv-01513-ABJ), Amended Complaint for Declaratory and Injunctive Relief, Oct. 1, 2012 (citing Mission Statement of DOD Sitting Clearinghouse, Office of the Deputy Undersecretary of Defense, Installations and Environment), at 9 (hereinafter, Amended Complaint).

[5] In March 2012, Terna sold its interest to Intelligent Wind Energy LLC (IWE), a Delaware limited liability company owned by U.S. Innovative Renewable Energy LLC (USIRE), an American-owned company registered in Delaware.

[6] *Ibid.*, at 3.

[7] Amended Complaint, *supra* n. 4, at 10 (citing Mission Statement of the DOD Siting Clearinghouse, Office of the Deputy Under Secretary of Defense, Installations and Environment).

[8] *Ibid.*, at 15.

[9] *Ibid.*, at 16 (PacifiCorp is a utility that operates in, among other places, Oregon, Washington, and California).

3 CFIUS REVIEW PROCESS AND THE RALLS DECISION

3.1 *The CFIUS Review Process*

CFIUS is an interagency committee principally comprising nine members, chaired by the Secretary of Treasury, and tasked with reviewing transactions that could result in control of a US business by a foreign person ("covered transactions"), in order to determine the effect of such transactions on the national security of the United States.[10] A "covered transaction" is defined as "any merger, acquisition, or takeover… by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States."[11]

The CFIUS review process begins either when one or both parties to a covered transaction file a voluntary notice with CFIUS or when CFIUS unilaterally initiates review of a covered transaction.[12] Upon receiving a notice, CFIUS "shall review the covered transaction to determine the effects of the transaction on the national security of the United States."[13] CFIUS considers twelve factors when conducting its review.[14] These factors include domestic production needed for projected national defense requirements, the capability and capacity of domestic industries to meet national defense requirements, the control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet national security requirements, the potential effects of an acquisition on sales of military goods, equipment, or technology to countries supporting terrorism or raising proliferation concerns, and the potential effects on US technological leadership in areas affecting national security.[15]

CFIUS is required to complete its initial review in a thirty-day period beginning on the first business day after CFIUS determines that it has received a complete notice, and is authorized to conduct an additional forty-five-day investigation if it determines further investigation is warranted because the transaction "threatens to impair the national security of the United States and ... the threat has not been mitigated during or prior to" the initial thirty-day review.[16] Further investigation is mandatory if the initial review results in a determination that: (1) the transaction is a "foreign government controlled transaction[;]" or (2) the transaction "would result in control of any critical infrastructure of or within the United States by or on behalf of any foreign person[.]"[17] During the review and investigation periods, CFIUS may request additional information from the parties.[18] CFIUS also is authorized to "negotiate, enter into or impose, and enforce any agreement or condition with any party to the covered transaction in order to mitigate any threat to the national security of the United States that arises as a result of the covered transaction."[19] Upon completion of an investigation, CFIUS may conclude that any national security concerns posed by the transaction have been addressed adequately. In the alternative, CFIUS may refer a transaction to the President for decision, in which circumstances the President is required to announce his decision within fifteen days.[20]

The President enjoys broad discretion in taking actions deemed appropriate to suspend, prohibit, or unwind any covered transaction but only upon a finding that there is "credible evidence" that indicates a foreign interest exercising control might take action that threatens to impair national security.[21]

Notes

[10] CFIUS operates pursuant to section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment and National Security Act of 2007 (FINSA) (section 721) and as implemented by Executive Order 11858, as amended, and regulations at 31 C.F.R. Part 800. The other members of CFIUS are heads of the following eight departments and offices: Department of Justice, Department of Homeland Security, Department of Commerce, Department of Defense, Department of State, Department of Energy, Office of the US Trade Representative, and Office of Science and Technology Policy. The Director of National Intelligence and the Secretary of Labor are non-voting members of CFIUS. Additionally, the following five offices observe and sometimes participate in CFIUS's activities: Office of Management and Budget, Council of Economic Advisors, National Security Council, National Economic Council, and Homeland Security Council.

[11] 50 U.S.C. app. § 2170 (a)(3).

[12] *Ibid*. § 2170(b)(1)(C), (D).

[13] *Ibid.* § 2170(b)(1)(A)(i).

[14] *Ibid.* § 2170(b)(1)(A)(ii), (f).

[15] *Ibid.* § 2170(f).

[16] *Ibid.* § 2170(b)(1)(E).

[17] *Ibid.* § 2170(b)(2); 31 C.F.R. § 800.503. This requirement can be waived only by the deputy heads of the co-lead agencies reviewing the transaction. See 50 U.S.C. app. § 2170(b)(2)(D)(i).

[18] See 31 C.F.R. § 800.403(a)(3).

[19] 50 U.S.C. app. § 2170(*l*)(1)(A).

[20] 31 C.F.R. § 800.506(b); see also Executive Order 11858 (same).

[21] 50 U.S.C. app. § 2170(d)(1). The Exon-Florio Amendment to the Defense Production Act of 1950 authorized the President, when acting based on "credible evidence," to suspend or prohibit acquisitions that are deemed a threat to national security. 50 U.S.C. app. §§2158–2170 (2000) (hereinafter Exon-Florio). Prior to the introduction of Exon-Florio, the President was required to declare a national emergency to block a transaction, or regulators would have to find a federal antitrust, environmental or securities law violation.

3.2 *CFIUS Review of the Ralls Transaction*

Ralls did not file a voluntary notification to CFIUS prior to closing their deal. Post-close, CFIUS requested that the transaction be submitted for a national security review. Ralls submitted a notice to CFIUS on June 28, 2012.[22] Even before the end of the initial thirty-day review period, CFIUS issued an Order Establishing Interim Mitigation Measures that, among other things, directed Ralls to halt construction and operations on the Butter Creek Projects.[23] At the conclusion of the thirty-day review period, CFIUS concluded that further investigation was warranted, and on July 30, 2012, CFIUS commenced a forty-five-day investigation of the transaction.[24]

Shortly thereafter CFIUS issued an Amended Order Establishing Interim Measures that required Ralls to immediately remove all items from the Butter Creek Projects, prohibited Ralls from having any access to the properties, and restricted Ralls from selling the properties until all items had been removed.[25] Finally, the Amended Order required Ralls to notify CFIUS of any potential buyer and receive CFIUS approval prior to consummating a sale.

On September 13, at the end of the forty-five-day investigation period, CFIUS made its recommendation to the President.[26] On September 28, 2012, President Obama issued an Order stating there was "credible evidence" indicating that by controlling the Project Companies Ralls "might take action that threatens to impair the national security of the United States."[27] Apart from the assertion of "credible evidence," the Order did not substantiate further the President's decision. The Order required Ralls to divest the four wind farm companies, and it authorized CFIUS to require Ralls (and its affiliates) to agree to government searches of its premises, documents, equipment, and software anywhere within the United States and to allow the government to interview its officers, employees, and agents.

On September 12, 2012, Ralls took a previously unprecedented step: it challenged in court CFIUS' and the President's authority to thwart its acquisition of the wind farm project companies.[28] Ralls challenged: (1) the Presidential and CFIUS Orders as violations of CFIUS' underlying statutory authority as well as the Administrative Procedures Act (APA), and (2) the divestiture requirements therein as an unconstitutional taking or deprivation of property without due process of law.

3.3 *The District Court Opinion*

On February 26, 2013, Judge Amy Berman Jackson of the US District Court for the District of Columbia dismissed Ralls' statutory claims as beyond the scope of judicial review.[29] Specifically, the court reasoned that Exon-Florio[30] grants the President extremely broad authority to take action to suspend or prohibit transactions that threaten national security. The court noted in dicta that Exon-Florio explicitly prohibits courts from reviewing such Presidential action, but that the President and CFIUS' orders were well within the scope of authority granted to both under Exon-Florio and the APA.

Simultaneously, the court permitted Ralls' due process argument to proceed to merits. The court reasoned that there was no clear and convincing evidence that Congress intended to exclude courts from hearing related due process challenges, stating "[t]here is a difference between asking a court to decide whether one was entitled to know what the President's reasons were and asking a court to assess the sufficiency of those reasons."[31] "The fact that [Ralls] may not be able to use the information in a certain way does not answer the question of whether it is entitled to have it."[32] Importantly, the court has not ruled yet on this claim, having determined thus far only that it has jurisdiction to hear the due process arguments. "It may be that the [court] will ultimately decide that in the context of a national security decision committed to the President's discretion, the opportunities provided to [Ralls] here comported with due process, or [Ralls] is not

Notes

[22] Amended Complaint, *supra* n. 4, at 17.

[23] *Ibid.*, at 17–18.

[24] *Ibid.*, at 19.

[25] *Ibid.*, at 18–19.

[26] *Ibid.*, at 19.

[27] See Order of Sep. 28, 2012 Regarding the Acquisition of Four US Wind Farm Project Companies by Ralls Corporation, 77 Fed. Reg. 60,281 (Oct. 3, 2012), available at http://www.whitehouse.gov/the-press-office/2012/09/28/order-signed-president-regarding-acquisition-four-us-wind-farm-project-c.

[28] Ralls initially filed suit in response to CFIUS' issuance of its Order and Amended Order. Ralls subsequently amended its complaint to reflect the issuance of the President's Order.

[29] See Amended Memorandum Opinion in *Ralls Corp. v. Barack H. Obama, et al.*, Case No. 12-cv-01513 (D.D.C. 26 Feb. 2013) (hereinafter Ralls Procedural Opinion).

[30] 50 U.S.C. app. §§2158–2170, *supra* n. 19.

[31] Ralls Procedural Opinion, *supra* n. 29, at 34.

[32] *Ibid.*

entitled to the reasons. Since that matter has not yet been fully briefed, the [court] expresses no opinion on those issues."[33]

3.4 *Implications of the District Court Opinion*

The Ralls court reaffirmed the President's broad authority to block or require the unwinding of foreign acquisitions on national security grounds without judicial review—at least with respect to the merits of such action. As the court noted, "[t]he statute is not the least bit ambiguous about the role of the courts."[34] While based on statutory authority, the decision also is in keeping with a tradition of judicial deference to discretionary decisions made by the President in the realm of foreign policy and national security.

Ralls' due process claim centers on whether CFIUS and/or the President are required to give companies an opportunity to review, respond to, or rebut any evidence upon which an Order blocking a transaction or requiring divestiture is based. A key difficulty in providing such an opportunity in this particular instance is that, according to the government, CFIUS (and the President) acted based on classified information. Thus, even if Ralls' due process arguments prevail, it is not clear whether and how Ralls would be provided an opportunity to review and respond to such evidence.

4 Broader lessons and concerns

4.1 *Companies Should Seek Pre-transaction Approval*

Perhaps the most significant take-away from Ralls' experience is that foreign acquirers would be well advised to file voluntary notices before closing a transaction and to give careful consideration before completing a transaction prior to the conclusion of CFIUS' review. CFIUS is empowered to unilaterally review all covered transactions, irrespective of whether they have already closed. Moreover, an unfavorable recommendation from CFIUS, as the Ralls case shows, can result in companies being required to divest assets or unwind a transaction. In compa -rison, utilizing voluntary notice procedures may allow companies to build credibility with the government and provides broader and timelier opportunities to address, mitigate, or cure CFIUS' objections. The main benefit of a voluntary CFIUS filing is that companies can enjoy a regulatory "safe harbor" that (in the absence of misrepresentation or changed circumstances) protects the company from further review or executive action.[35] In stark contrast, the Ralls decision shows how transactions without a safe harbor can be unwound, even after the deal has closed and construction has begun. As we discuss below, however, not every foreign investment is likely to raise national security concerns. Determining in advance when a CFIUS filing is advisable —including assessing whether the related expense and delay are merited in light of the opportunity to identify and mitigate potential deal risk—is a challenging task that may benefit from the participation of experienced outside counsel.

4.2 *Regulatory Approval Outside of CFIUS Not a Safe Harbor*

Approval from one or more federal agencies outside the CFIUS process is not the same as approval from CFIUS, even if the approving agency is among those that participate in CFIUS reviews.

Ralls relied on prior regulatory clearance from the FAA, which included approval from the Department of Defense, as well as subsequent approval of the Navy, as sufficient indication that national security concerns had been considered and addressed to the government's satisfaction.[36] Ralls interacted with the Navy through the permitting process after Ralls acquired the Project Companies. Ralls and the Navy resolved concerns regarding the location of one of the wind farms from the Butter Creek Projects through Ralls' agreement to move a wind farm outside of the restricted space. The Navy wrote to local regulators recommending new permits be granted. It appears in retrospect that the Navy was not speaking more broadly to itself or the Department of Defense such that CFIUS-type concerns were addressed adequately at the time.

Other failed investments also demonstrate that regulatory approvals outside of CFIUS from one of the various government bodies that participate in CFIUS might not suffice.[37] In 2010, Huawei's US subsidiary

Notes

[33] *Ibid.*

[34] *Ibid.*, at 2.

[35] 31 C.F.R. §§ 800.601(d)(2006).

[36] Amended Complaint, *supra* n. 4, at 10 (Noting that in 2010 and 2011, the FAA approved all of the planned wind farms in the Butter Creek Projects. Notably, the FAA's approval process for the turbines included review by the Department of Defense.)

[37] Edward Alden, Council on Foreign Relations, Oct. 5, 2012, available at http://blogs.cfr.org/renewing-america/2012/10/05/ralls-vs-cfius-what-are-the-implications-for-chinese-investment/.

purchased assets from 3Leaf. In advance of the purchase, Huawei sought and received approval of a sort from the Bureau of Industry and Security at the Department of Commerce; the Bureau confirmed that no export licenses were required to export the 3Leaf technology. Subsequently, pursuant to CFIUS' expression of interest, Huawei submitted a notice to CFIUS in November 2010. Shortly after, in February 2011, Huawei abandoned the transaction in the face of CFIUS's indications of significant concern. These examples caution against reliance on approval from one part of the US Government as a proxy for CFIUS clearance.

4.3 *Potential Posturing During an Election*

It has been suggested that the President's Order may have reflected opportunistic posturing driven by electoral considerations. Governor Romney and President Obama offered competing views in the run-up to the presidential election of whose administration would be tougher on China.[38] As the argument goes, an order in September 2012, weeks before the election, could have been a result of "tough on China" posturing. Given the mandatory timelines governing CFIUS reviews and Ralls' refusal to withdraw from the transaction, however, electoral considerations likely were incidental. Nevertheless, it may be naïve to discount the presence of political calculations. Foreign investors would be wise to consider electoral schedules when determining whether, and when, to come before CFIUS.

4.4 *Persistent Co-location is a Key Concern for CFIUS*

In the Ralls case, CFIUS apparently was concerned about the proximity of the Project Companies to sensitive US Government facilities—so-called persistent co-location.[39] Similar concerns about location had been expressed by the Navy regarding turbines within the Navy's restricted space in Oregon; it initially appeared that Ralls had taken steps sufficient to alleviate the Navy's concerns. In CFIUS' 2012 annual report to Congress (covering calendar year 2011, but submitted at year-end 2012), the Committee listed foreign control of US businesses that "[a]re in proximity to certain types of [U.S. Government] facilities" as a factor that CFIUS considers to present risks to national security.[40] At the same time, according to Ralls, wind farms containing seven foreign-made turbines are within the same restricted space as the Butter Creek Projects, including a wind farm owned by Danish investors. Not all foreign acquirers are similarly situated from CFIUS's perspective.

In particular with Chinese investors, persistent co-location appears to be paired with concerns about the buyer's motives. Several previous contemplated Chinese investments have been frustrated due to proximity of target facilities to defense installations, including Northwest Nonferrous International Investment Comp -any—Firstgold Corp., and Far East Golden Resources Investment Limited—Nevada Gold. In the gold mining cases, the buyers were not mining companies, but investment entities, potentially suggesting that "non-economic" factors were driving the transactions. Given CFIUS' proximity-based restrictions on transactions involving Chinese acquirers, it would appear the US Government is concerned about protecting the US defense apparatus from espionage. US regulators likely view at least some ostensibly "private" Chinese firms as insufficiently distinct from the Chinese government, leading to heightened scrutiny of Chinese firms irrespective of whether they are formally state-owned.[41]

In the Ralls transaction, the buyer was a windmill/windpower entity, and nothing in the public record indicated that ties to Chinese intelligence were a concern, so proximity was ostensibly the dominant concern. Furthermore, Chinese nationals have not had trouble acquiring US wind farms farther from restricted areas. For instance, Goldwind's Shady Oaks Project in Illinois and a Sany-owned wind farm in Texas did not trigger CFIUS reviews.[42]

Persistent co-location may well present legitimate national security concerns. A central question raised by the Ralls court challenge is whether and to what extent CFIUS could provide more information to the public in advance about locations of interest or concern—in general and/or with respect to particular decisions. It would seem relatively easy for CFIUS to explain proximity concerns in

Notes

[38] Pete Kasperowicz, President Obama Flexes on China, The Hill, Sep. 28, 2012 available at http://thehill.com/blogs/floor-action/energy-environment/259245-obama-blocks-chinese-investment-in-us-wind-farms.

[39] Raymond Barrett, Ralls CFIUS block alters Sany's future investment strategy in US, Financial Times, Mar. 1, 2013, available at http://www.ft.com/intl/cms/s/2/1ff1eb98-82b8-11e2-a3e3-00144feabdc0.html#axzz2QlwOEHr7.

[40] CFIUS Annual Report 2012, *supra* n. 2, at 20.

[41] Emily Rauhala, Huawei: The Chinese Company that Scares Washington, Time, Apr. 4, 2013 available at http://world.time.com/2013/04/04/huawei-the-chinese-company-that-scares-washington/.

[42] Alden, *supra* n. 37.

an unclassified manner that does not compromise national security—such that due process could be satisfied. However, such an explanation will likely raise diplomatic complications if CFIUS clarifies that it will permit some foreign acquirers, but not the Chinese, within the restricted space. Obfuscation of the proximity concern may therefore be considered a lesser, and necessary, evil. In a repeat game, however, such obfuscation will only work for so long.

4.5 *Greenfield Investments Outside of CFIUS Review*

The Ralls case also demonstrates the potential advantages of alternative deal structures that might avoid CFIUS review. CFIUS has the authority to review "covered transactions," which include, among other things, mergers, acquisitions, and takeovers involving "foreign persons" that could result in foreign control of US businesses. Certain other types of transactions, including lease arrangements and so-called greenfield investments—using capital to begin a new company or create new subsidiaries within the US—are excluded from the definition of a covered transaction.[43] Thus, Ralls could have structured the deal such that instead of acquiring the Project Companies, Ralls instead built wind farms as greenfield projects on leased land. This would have removed the transaction from CFIUS's statutory jurisdiction. In practice, the greenfield exception is narrowly construed and may not have been available to Ralls. Greenfield investments are contemplated to involve only activities such as "separately arranging for the [financing/construction] of a plant to make a new product, buying supplies and inputs, hiring personnel, and purchasing the necessary technology."[44]

If companies similarly situated to Ralls are able to take advantage of the greenfield structure, any national security concerns would be reviewed under domestic counter-espionage laws, with "vastly higher evidence standards, a contestable appeals process, and a longer lead time—all of which are absent under CFIUS."[45] By some estimates, 60% of Chinese outward foreign direct investment globally occurs through greenfield investments, compared to only 10% for mergers & acquisitions.[46] From 2003–2010, greenfield investments accounted for half of the 230 Chinese investments in the US.[47] The potential ease of gaming the CFIUS review by not entering into a "covered transaction," while attractive for foreign investors, raises concerns about gaps in CFIUS' review process from a national security perspective that merit consideration. While CFIUS reform in this regard is beyond the scope of this article, the potential for national security risk, not the structure of the transaction, should be the basis for CFIUS review.

4.6 *International Modeling and Potential Retaliation*

The United States has a strong interest in clear and speedy review processes when American companies pursue foreign investments. And the US Government's own comportment can and likely does influence the behavior of other governments in this regard. If the CFIUS review process is seen by other governments to offer neither clarity nor speed, this may be used to justify foreign protectionism. China in particular has criticized the CFIUS regulations as "excessively stringent" in the past.[48] In response to Ralls, the Chinese Minister of Commerce, Chen Deming, stated that "[a] small group of lawmakers in some developed countries still have a Cold War mentality when assessing Chinese companies' overseas investment."[49] It is widely reported that the case is being closely watched by the Chinese government.[50]

At least ten countries, including China, now have investment review processes similar to CFIUS.[51] While it is understandable that other governments utilize national security reviews, there is a risk that they will game the customary international law exception that permits measures considered "necessary to protect essential interests" to circumvent World Trade Organization rules

Notes

[43] Final Rule on Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons, 31 C.F.R. Part 800, available at http://www.gpo.gov/fdsys/pkg/FR-2008-11-21/pdf/E8-27525.pdf.

[44] C.J. Voss, Energy Law Alert: CFIUS Intervenes in Chinese-Owned Wind Project, Sep. 24, 2012 available at http://www.stoel.com/showalert.aspx?show=9813.

[45] Alden, *supra* n. 37.

[46] Alexander Hammer & Lin Jones, China's Emerging Role as a Global Source of FDI, Jan. 2012, USITC Executive Briefings on Trade, available at http://www.usitc.gov/publications/332/executive_briefings/EBOT_ChinaOFDI(HammerLin).pdf.

[47] Daniel Rosen and Thilo Hanemann, An American Open Door? – Maximizing the Benefits of Chinese Foreign Direct Investment, Asia Society, May 2011, available at http://asiasociety.org/files/pdf/AnAmericanOpenDoor_FINAL.pdf.

[48] China Blasts Draft CFIUS Regulations, U.S. Businesses Urge Revisions, Inside U.S. Trade, Jun. 13, 2008 (stating draft CFIUS regulations were "excessively stringent").

[49] Chen Zhi, China Supports Enterprises in Defending Rights Overseas: Minister, Xinhua Net (English), Mar. 8, 2013, available at http://news.xinhuanet.com/english/china/2013-03/08/c_132218360.htm (paraphrasing the Chinese Minister of Commerce's comment on Cold War attitudes in some countries).

[50] Anand Krishnamoorthy, China Watching Sany U.S. Wind-Farm Case, Minister Chen Says, Bloomberg News, Mar. 5, 2013, available at http://www.bloomberg.com/news/2013-03-05/china-watching-sany-u-s-wind-farm-case-commerce-minister-says.html.

[51] Foreign Investment: Laws and Policies Regulating Foreign Investment in 10 Countries, United States Government Accountability Office, U.S. GAO, GAO-08-320, Feb. 2008, available at http://www.gao.gov/assets/280/272998.pdf.

on non-discrimination and national treatment.[52] To prevent retaliation against American companies, more transparency and due process in CFIUS reviews may be good policy.

The US has long been a leader in developing prudential standards that are adopted internationally. Along these lines, the US has led efforts to harmonize national security review procedures and standards through the Organisation for Economic Co-operation and Development (OECD).[53] The OECD Guidelines for Recipient Country Investment Policies Relating to National Security were adopted by OECD governments on April 4, 2008. They recommend, among other things, greater accountability by using a "mix of political and judicial oversight mechanisms to preserve the neutrality and objectivity of the investment review process while also assuring its political accountability."[54] Far from allowing for judicial oversight, the US Government's response to Ralls in federal court was that CFIUS and Presidential decision-making are beyond the scope of judicial review.

Progress on efforts to harmonize national security reviews will remain slow until a more transparent national security review policy is adopted. Abroad, the US should acknowledge the legitimacy of other countries conducting their own national security reviews. At home, CFIUS should seek to serve as a model for other countries conducting national security reviews by resisting attempts to cloak protectionism under the guise of such reviews and by acting in such a manner that it might not reasonably be accused of doing so.

4.7 *Potential Impact on Foreign Investment*

CFIUS includes agencies whose missions are in tension: pro-investment agencies such as the Departments of Commerce and Treasury, and pro-security agencies such as the Departments of Defense and Homeland Security. This is deliberate. And yet, when CFIUS authority was debated and subsequently amended through the Foreign Investment and National Security Act of 2007, the proposal that the Secretary of Defense join the Secretary of Treasury as CFIUS co-chair was defeated, presumably in the spirit of demonstrating that the United States maintains an "open" investment policy even when national security concerns are considered.

It is difficult to precisely gauge the costs and benefits of national security reviews on foreign investment. On the one hand, foreign investment is cyclical. In 2012, foreign investment in the US totaled United States Dollars (USD) 174 billion, a 25% decrease from the USD 234 billion in foreign investment in 2011.[55] Both of these figures arguably would be higher if not for transactions abandoned in the face of CFIUS' concerns as well as those never pursued by potential acquirers who suspect long odds of success. How many of these additional transactions could have been consummated, with or without measures designed to mitigate national security concerns, if only the CFIUS process were more transparent?

A more transparent review process could be good foreign and economic policy, as it would simultaneously promote investment from and ease tensions with China. Chinese Commerce Minister Chen recently stated, "[f]or every three Chinese yuan planned to be invested in the United States, only one yuan is approved by the US authorities."[56] Minister Chen's comments may have some merit when Chinese investment growth in the US is compared to Europe. In 2008, China invested less than USD 1 billion in Europe and the US. However, in Europe, where fewer national security reviews make headlines, Chinese FDI has exceeded USD 10 billion in each of the last two years. In the United States, Chinese investment, while still impressive, amounted to USD 6.5 billion in 2013.[57] Given that China holds an estimated USD 3.3 trillion in foreign reserves, more predictable national security reviews likely would lead to increased Chinese investment in the United States.[58]

4.8 *Protecting the Integrity of National Security Reviews*

A key challenge for CFIUS is how to prevent protectionist pressure from tainting the integrity of the national security review process. CFIUS' interactions with Congress are a critical potential source of protectionist pressure and the perception of same. Congress exerts control over the

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[52] Claude Barfield, Telecoms and the Huawei Conundrum, American Enterprise Institute, AEI Economic Studies Series, Nov. 2011, available at http://www.aei.org/article/telecoms-and-the-huawei-conundrum/; International Investment Perspectives: Freedom of Investment in a Changing World, 207 Edition, Organisation for Economic Co-operation and Development, 2007, p. 105.

[53] Fourth Report on G-20 Investment Measures, OECD, Nov. 2010.

[54] OECD Guidelines for Recipient Country Investment Policies Relating to National Security, OECD (2008), available at http://www.oecd.org/daf/inv/investment-policy/41807723.pdf.

[55] Trends in International Investment, Organization for International Investment, Mar. 20, 2013, available at http://ofii.org/docs/FDIUS_3_20_13_FINAL.pdf.

[56] Chen Zhi, *supra* n. 49.

[57] *Ibid.*

[58] Kenneth Rapoza, How Much Longer Can China Accumulate Reserves, Forbes, May 29, 2012. available at http://www.forbes.com/sites/kenrapoza/2012/05/29/how-much-longer-can-china-accumulate-reserves/.

Committee in a number of ways: individual transaction pressure, amendments to CFIUS' organizing statutes and review process, and regular Congressional reporting requirements.[59]

The Dubai Ports World debacle in 2007 illustrated how Congress can politicize transactions. CFIUS initially approved Dubai Ports World's acquisition of Peninsular and Oriental Steam Navigation Company (P&O), a British firm that owned/leased terminal facilities in, among other countries, the United States. Notwithstanding CFIUS clearance, Congressional pressure forced Dubai Ports World to sell P&O's American port facilities to an American-controlled firm.[60] FINSA resulted from Congress' concern regarding the Committee's handling of the Dubai Ports World transaction. FINSA added several process amendments, including extensive reporting requirements to Congress on an annual and quadrennial basis.[61] These reporting requirements codify regular opportunities for Congress to scrutinize the Committee's work.

Practitioners have long advised foreign investors that developing a "Hill strategy," or a pre-CFIUS-filing consultation with certain Members of Congress, is a critical prerequisite to a CFIUS filing. Perhaps CFIUS itself should adopt a "Hill strategy." As Dubai Ports World and other companies' experiences with CFIUS show, the current "congressional role breeds random political interference and is self-defeating."[62] Over time building confidence with Congress should lead Congress to treat CFIUS with greater deference. This in turn could diminish perceptions that protectionist impulses inappropriately penetrate CFIUS and influence its decision-making.

4.9 *Transparency, Inclusiveness, and Timeliness*

It remains to be seen whether CFIUS is capable of greater transparency and openness. A number of US intelligence officials from previous administrations have commented that CFIUS "can provide more detail on the sources of their security concerns without jeopardizing U.S. intelligence efforts."[63] As a starting point, formal decisions from CFIUS that explain the rationale behind individual national security reviews may help to demonstrate that restrictions imposed by CFIUS are driven by legitimate national security considerations rather than by protectionist impulses. Further, more formal decisions would help provide precedent and reduce uncertainty surrounding foreign investment. Yet, in practice, formal decisions that explain the rationale for CFIUS' decisions may be difficult to release, given the need to honor the promise of confidentiality to companies undergoing review and CFIUS' reliance on classified information.

Areas of transparency available to CFIUS include greater inclusiveness and timeliness in the Committee's decision-making process. While the statute and regulations are widely available and provide important constraints, more can be done to optimize the perception of fairness for foreign investors undergoing review. Optimally foreign parties would emerge from the process convinced that it was fair, regardless of result. First, foreign investors should be afforded a greater opportunity to understand CFIUS' concerns, to have the chance to review, and, as appropriate, to rebut these concerns. Ralls' remaining due process challenge gets to this inclusiveness issue, and it will be interesting to see if the court determines that this is a "right" to which foreign parties to the review process are entitled. Even if the courts determine the opportunity to review and rebut is not a right, it is worth considering whether and how to extend such "privileges" to foreign participants as a matter of preserving the integrity of our national security review process. Second, more can be done to improve the speed of the review process. CFIUS should set new deadlines to determine whether transactions should be altered or blocked.[64] At a minimum, a faster review process will help show that CFIUS is responsive to foreign concerns, which may encourage more companies to submit voluntary notices, and may build greater good will from foreign investors. At best, it will provide a model for other countries to emulate and may help American investors facing similar reviews abroad.

5 Conclusion

The Ralls case is noteworthy because the company did not quietly back down in the face of CFIUS' objections. Ralls' unprecedented judicial challenge to CFIUS' and the

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[59] David Zaring, CFIUS As A Congressional Notification Service, 83 S. Cal. L. Rev. 81, 88–97 (Mar. 2008)(contextualizing several amendments to CFIUS' procedures over the past few decades as geared toward bringing the Committee in line with Congress' policy preferences).

[60] Deidre Walsh, Congress Declares War on Ports Deal, CNN, Mar. 8, 2006, available at http://www.cnn.com/2006/POLITICS/03/08/port.security/ (noting the House Appropriations Committee voted 62-2 to block the Dubai Ports World deal).

[61] Foreign Investment and National Security Act of 2007 (FINSA), *supra* n. 10.

[62] Derek Scissors, A Better Committee on Foreign Investment in the United States, The Heritage Foundation, Jan. 28, 2013, available at http://www.heritage.org/research/reports/2013/01/enhancing-the-committee-on-foreign-investment-in-the-united-states-cfius.

[63] Claude Barfield, Telecoms and the Huawei Conundrum, American Enterprise Institute, AEI Economic Studies Series, Nov. 16, 2011, available at http://www.aei.org/article/telecoms-and-the-huawei-conundrum/.

[64] Scissors, *supra* n. 62.

President's orders blocking its acquisition of the Project Companies allows the judiciary a significant opportunity to develop jurisprudence on a fundamental question: how much due process is owed to foreign acquirers undergoing CFIUS reviews. At the time this article goes to print, the US District Court has not ruled on Ralls' claim of a due process right to notice and an opportunity to be heard in the CFIUS review process. If the court ultimately agrees with Ralls, it will be important to evaluate how much due process companies can be extended in the review context, as this may have significant consequences for CFIUS going forward.

The Chinese government has recently encouraged aggrieved Chinese investors to enforce their rights in foreign courts.[65] In addition to Ralls, in recent years Aokang Group Co. Ltd. and Huawei Technologies Co. Ltd. have asserted their rights through challenges in Europe and the US respectively.[66] Whatever the court decides on Ralls' remaining due process challenge, it is clear that the court does not have the authority to review, let alone reverse, the President's divestment order.

The key lesson from the Ralls transaction for foreign investors is that they should avail themselves of the voluntary notification process. Wu Jialiang, the Chief Executive Officer of Ralls, and an executive at Sany, has stated publicly that Ralls will alter the way it structures future investments by voluntarily notifying CFIUS "to be on the safe side."[67] To that end, Ralls recently made a new USD 80 million investment in wind farms in Colorado, using Sany wind turbines, and submitted the deal to CFIUS for review.

CFIUS must continue to focus on the balance between providing a welcoming environment for foreign investment and protection of national security. A chorus of presidents, generals, and national security hawks has acknowledged the symbiotic relationship between a strong economy and national security, and openness to foreign investment has long been an engine for economic growth in the United States. Viewed from that lens, CFIUS and Congress must balance whether near-term security risks from covered transactions outweigh long-term economic and security benefits. At a time when deep budget cuts require greater reliance on foreign investment to foster economic growth, a restrictive investment policy threatens both long-term economic health and national security. CFIUS should therefore strive to protect national security by meeting demands of greater accountability and transparency.

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[65] Chen Zhi, *supra* n. 49.

[66] Sany Determined in Lawsuit Against Obama, Xinhua, Mar. 4, 2013, available at http://www.china.org.cn/business/2013-03/04/content_28116008.htm (noting Aokang Group Co., Ltd., a leading Chinese shoemaker, won an antidumping case against the European Union. Aokang was the only one of five firms who decided to go through an appeal process after their first case was lost in 2010. In 2011, Huawei Technologies Co., Ltd. won a temporary restraining order in the U.S. stopping Motorola from selling Huawei's confidential data to Nokia Siemens Networks.)

[67] Barret, *supra* n. 39.

Author Guide

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