

Client Alert

Latham & Watkins Corporate Department

Federal Court Upholds Broad Authority to Unwind Foreign Investments in US Businesses

Summary

- The court reaffirms the President's broad authority to restrict foreign investment in US businesses through the CFIUS review process without judicial review.
- The court's decision potentially allows for expansion of CFIUS authority to issue interim orders (prior to concluding a review), although the scope of that authority remains unresolved.
- CFIUS's more activist recent approach likely will not be judicially constrained.
- The decision implies that parties to a transaction bear all of the risk of having a closed transaction unwound by CFIUS, including potential loss in enterprise valuation in the divestment process.

Discussion

The United States District Court for the District for Columbia has largely decided the first litigated case testing the President's authority to block or unwind foreign acquisitions of US businesses. The court's decision, in *Ralls Corporation v. Committee on Foreign Investment in the United States*, reaffirmed the President's broad authority to restrict foreign investment in US businesses through the CFIUS process without judicial review. The decision also holds that the President may structure divestiture orders to require ancillary remedial actions (as long as they are reasonably related to implementation of the divestiture order itself). The court left open the question whether CFIUS itself can issue unilateral "interim" orders that exercise these presidential powers pending the President's decision whether to act. It also reserved the question whether the President could be required to explain the reasoning for his blockage/divestiture decisions sufficiently to allow the prospective foreign investor to respond to (and perhaps to overcome) his concerns. While the *Ralls* decision remains subject to appellate review, it is unlikely to discourage CFIUS's more aggressive recent approach to foreign investment transactions that CFIUS concludes pose a risk to US national security.

CFIUS is the interagency Executive Branch committee that considers the impact on US national security of "any merger, acquisition, or takeover ... by or with a foreign person which could result in foreign control of any person engaged in interstate

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commerce in the United States." Through its review, CFIUS determines whether the transaction poses a threat to national security interests, and whether to recommend that the President therefore block the transaction on those grounds. The President then is authorized (but not required) to "take such action for such time as the President considers appropriate to suspend or prohibit any covered transaction that threatens to impair the national security of the United States."

Ralls involved a Chinese investor's indirect purchase of four wind energy farms in the state of Oregon. The purchase closed without CFIUS review, in light of the apparently benign character of the business segment in which the target operated, but it turned out that one of the wind farm project sites was located near air space used by the US Navy for flight-testing and other sensitive military training. When the Government learned of the transaction after it closed, discussions within the Government led to a CFIUS request to the parties for a filing. That filing led to CFIUS review and, ultimately, issuance of an interim order by CFIUS, and then a final order by the President, that respectively imposed restrictions on the investor's control of the target pending presidential decision, and later a divestiture order (coupled with ancillary implementing restrictions). (Additional background information is provided in Latham's previous *Client Alert*, "[CFIUS Shows New Aggressiveness in Ordering Divestiture of Wind Energy Firms](#)"). The central issue in *Ralls* was whether under the circumstances of that case CFIUS and the President were authorized to issue interim and final orders, respectively, that:

- (i) compelled *Ralls* to divest itself of US wind energy farm assets it already had purchased;
- (ii) restricted the manner in which that divestiture would proceed by requiring the Chinese owner to remove equipment assets from the business, barring future use of such equipment on the site, and restricting the owners' operational access while the divestiture process went forward; and
- (iii) imposed reporting and other requirements on the parties until that divestiture could be completed.

Ralls — a Chinese-owned purchaser — had challenged the divestiture order, arguing that these provisions were beyond the scope of authority granted to CFIUS and the President by law, arbitrary and unenforceable even within that authority, and an unconstitutional taking of property. The court decided these questions as follows:

- The court decided that it lacked jurisdiction to review the merits of the President's discretionary determination that allowing the acquisition to remain in effect would not impair the national security. The court explained that its ruling was consistent with the generally applicable principle that the executive branch has broad authority to exercise its own judgment in the conduct of United States foreign affairs, and that courts entertain requests to review the legality of the President's decisions and actions in this area only in relatively rare circumstances. Addressing the specific language of the statute that empowered CFIUS, the court found that the language of the statute itself conferred authority of broad scope to the President, and accordingly rejected most of *Ralls*' claims. The court observed that Section 721 of the Defense Production Act of 1950, as amended, provides that "[t]he actions of the President . . . and the findings of the President [as part of the CFIUS review process] . . . shall not be subject to judicial review." The court found this language "not the least bit ambiguous about the role of the courts," and concluded that it lacked jurisdiction to hear most of *Ralls*' claims.

- The court decided that the ancillary aspects of the President's divestiture order — requiring removal of equipment; prohibiting Ralls or its agents from entering the site except to remove such equipment; and conditioning divestiture on compliance with these conditions and CFIUS approval — was within the President's broad authority to order divestiture. The court relatively easily concluded that Section 721 does not limit the President to directly "suspending" or "prohibiting" a transaction, because the statute also permits him to take "*such action for such time as the President considers appropriate to suspend or prohibit transactions.*" The court found that this language permits the President to take a variety of related actions to redress national security or law enforcement concerns — including the imposition of conditions on the manner in which a US business that already has been acquired must be divested. The court accordingly concluded that it was without jurisdiction to invalidate or review any of the specific provisions mandating detailed implementation and other activity pending divestiture. This implies, although the court did not directly decide, that the President also has broad authority to impose mitigation measures unilaterally on a transaction as a condition for approval (or on a completed acquisition for which no CFIUS filing was made).
- The court declined to review whether the President's actions *in this* case were beyond the scope of his authority, as "any assessment of the legality of the specific restrictions imposed by the President would entail consideration of whether and why the President considered those actions to be 'appropriate'" — which would amount to precisely the "type of examination that the finality provision bars." The court noted that Congress's deference to the President in such matters is consistent with the structure and legislative history of CFIUS's governing statute, which anticipate that the President will use his authority only rarely, and in the face of otherwise uncontrollable national security risk.
- The court rejected Ralls' constitutional "equal protection" claim on a similar basis, finding that "[t]he fact that the challenge in this case is dressed in constitutional garb is inconsequential." The court noted that Ralls had not alleged discrimination against a protected group (*e.g.*, a specific race or religion), and consequently that consideration of the equal protection claim would involve determining whether the alleged differential treatment was rationally related to a legitimate government purpose. The court noted that this inquiry "necessarily involves reviewing the particular factual record that was before the President when he issued the order and determining whether the actions he took were rational in light of that record," which would amount to "precisely the type of inquiry that Congress withdrew from the courts in the finality provision in section 721."
- Finally, the court decided to allow Ralls to proceed with its constitutional due process claim that even if the President's ultimate actions were judicially unreviewable, the transactional parties' constitutional right to due process required that they receive *some* explanation beyond formulaic recitation of statutory language to articulate concerns about the transaction — which could in turn permit them to assuage those concerns through argument and/or proposal of mitigation conditions that might allow the transaction to survive. The basis on which the court preserved this claim was exceptionally narrow. It did not decide that the claim had merit — or even that it might have merit — only that the statute did not necessarily disable the court from considering whether the private parties to a CFIUS filing enjoyed procedural rights, which must be protected. Thus, even if it succeeded on this claim, a private party such as Ralls would be

entitled, at most, to a more detailed explanation why the President acted as he did in issuing orders contrary to Ralls' interests. In allowing this claim to proceed, the court acknowledged that such information could be of limited value given that Section 721 could preclude any inquiry into the propriety of those reasons.

In our view, the practical implications of the *Ralls* decision are:

- (1) CFIUS's more activist recent approach will not be judicially constrained. The actions reviewed by the court were taken by the President, but all of them were recommended by CFIUS and the decision establishes a firmer legal foundation for orders that go beyond merely prohibiting a transaction or ordering divestiture. Moreover, the outcome reaffirms the legal effectiveness of a CFIUS recommendation/presidential decision to take such actions without judicial review.
- (2) The *Ralls* case also suggests that while CFIUS filings remain voluntary, CFIUS may be inclined to recommend — and courts will be extremely reluctant to review — measures pending divestiture that inevitably have the effect of reducing the value of the business that a foreign buyer may be ordered to sell upon post-closing CFIUS review. The *Ralls* court noted critically the fact that the parties to the foreign acquisition transaction had not made a filing before they closed, implying that they had assumed the risk of harsh divestiture conditions if CFIUS and the President ultimately concluded that the acquisition was inconsistent with US national security interests.
- (3) While the court found that the question whether CFIUS has authority to issue interim orders — as CFIUS did in this case — was overtaken by events and judicially unreviewable here on grounds of mootness, the *Ralls* court offered some clues that it may be difficult (though not hopeless) to overturn such orders in the future. In particular, the court noted statutory text that allows CFIUS or the designated lead among its constituent agencies to “impose, and enforce any agreement or condition with any party to the covered transaction” — but did not have occasion to address other aspects of the language that might complicate enforcement of such “interim orders” in the future. These potentially complicating factors include, for example, the express statutory requirement that any such action be grounded on a “risk-based analysis,” and the absence of any provision immunizing such analysis from judicial review.

In summary, *Ralls* strengthens CFIUS's hand somewhat by clarifying the breadth of presidential authority to act. It leaves unresolved questions concerning CFIUS's authority to act unilaterally in the interim period before the President acts. But the bottom line for would-be foreign acquirers and their domestic deal partners is that the perils of ignoring the possibility of CFIUS review are undiminished — even for transactions that would have seemed benign a relatively short time ago.

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