A Case Study of Ralls Windfarm Project Case from the Perspective of CFIUS Review

Chan-ting CHEN¹,a,*

¹No. 555 Longyuan Road, Songjiang District, Shanghai, China
a chenchanting@126.com
*Corresponding author

Keywords: Foreign Investment, National Security Review, Chinese Corporations, Ralls, CFIUS.

Abstract. Chinese companies have been receiving more and more national security review when they are entering the U.S. market. The increased number of notifications are frustrating Chinese investors. By studying the newly happened Ralls Windfarm Project case, we are able to find that the project is rejected due to its sensitive connection with U.S. military and defense industries. We also find that the increased number of notification for Chinese companies is due to the raise of investment amount from China. We therefore suggest Chinese entrepreneurs to be fully prepared for and have a correct understanding of CFIUS review.

Introduction

Chinese enterprises have been accelerating the pace of “going out” since the financial crisis of 2007-2008. Investment in the U.S. was recorded at 8.39 billion USD in the year 2015, a growth of 60.1% on a year-on-year basis.[1] Except Hongkong, the U.S. has become the largest recipient for FDI from China. The growing number of investment by Chinese companies has raised concerns by a number of groups over the economic and security impact of the investment. These concerns are able to influence CFIUS to strengthen supervisions on investment from China.

Chinese entrepreneurs who are interested in the U.S. market therefore want to know the way to pass the national security review. Many Chinese companies have started their journey to the U.S. Among all those mergers and acquisitions, attempted buying of the “Butter Creek Projects” by Ralls, an associated corporation of Sany, is an important one. In this case, Chinese corporations, for the first time, respond actively to the national security review by bring an action against the President and CFIUS.

The Ralls Case

The Delaware based Ralls Corporation is owned by two Chinese nationals, Dawei Duan and Jialiang Wu. Both of them are principals of Chinese manufacturing company Sany. Ralls acquired four Butter Creek windfarm projects overlapping with a U.S. Navy restricted airspace and bombing zone used by military aircraft based out of Naval Air Station Whidbey Island, and also planned to install Sany’s turbines in the windfarm. Shortly after the acquisition, the United States Navy expressed concerns regarding the location of one windfarm, the Lower Ridge Windfarm, which located within the restricted airspace. Ralls therefore submitted a voluntary notice to CFIUS on June 28, 2012. [2]

The transaction was finally submitted to the President, who later found that Ralls’ control over the four companies might threaten to impair the country’s national security. The President, based on that finding, prohibited the business deal, ordered Ralls to divest, and imposed special conditions on the disposition of the projects and the turbines. [3] Ralls then brought a lawsuit against CFIUS and President Obama after the transaction was called off.

In court, Ralls asked to find that the President exceeded his statutory authority in forcing the conditions in the order, and that he acted in violation of the Constitution by treating Ralls differently than other foreign owners of neighboring wind farms. By putting forward these request, Ralls sought
declaratory and injunctive relief. Defendants questioned Court’s jurisdiction over the dispute, and moved to dismiss. [4]

CFIUS and National Security Review

The Committee on Foreign Investment in the United States (CFIUS) is a multi-agency committee specifies in carrying out national security review to foreign mergers and acquisitions of U.S. entities. Members of the Committee include Secretaries of Treasury, Defense, Commerce, State, Homeland Security, Energy, and Labor; the Attorney General of the United States; the Director of National Intelligence; and the heads of any other executive department, agency, or office the President determines to be appropriate. [5]

The national security review would be initiated by voluntary submission of any party or parties. [6] While voluntary notification is the recommended and preferred initiation mode, the review can also be initiated by the President or CFIUS if they think necessary. [7] Once started, CFIUS has thirty days to review the transaction. If the review results in a determination that the transaction may have a negative impact on national safety, the review then moves on to the 45-day investigation stage. Otherwise, the case would be discharged from national security concern. Likewise, the investigation stage ends either with a negative judgment to proceed review into the presidential decision stage, or with a positive judgment to give the transaction a permission. The president stage lasts up to 15 days, and the President will make a final decision based on CFIUS suggestion and his own judgment.

The national security review mechanism is designed as the last resort to protect the country’s interests in foreign investment domain. It is therefore given a retroactive power. The President is entitled to divestiture or even when the transaction is complete. On the other hand, a transaction, once passes the review, will no longer be checked again without change of circumstances. Those non-filed transactions, however, would be pursued by the Committee more frequently and aggressively if CFIUS or the President initiates the review. As a result, transaction parties prefer to file the notice voluntarily.

National Security Concern in Ralls Case

FINSA empowers the President to take actions to suspend or stop any potentially dangerous transaction if he finds credible evidence to make him believe the foreign control of domestic entities might threaten to impair U.S. national security and other provisions of the law could not adequately protect national security. Though national security is the key concept of FINSA and the review mechanism, neither FINSA nor Congress has officially defined the term. The Act, instead, lists specific factors of consideration. Those factors are domestic production for national defense; the capability and capacity of domestic industries to meet national defense requirements; the impact of foreign control of domestic industries and commercial activity to national security; the effect of dangerous countries’ control of military goods, equipment and technology; the effect of the transaction to U.S. international technological leadership, critical infrastructure, and critical technologies; the ownership of the foreign investors; and the long-term requirement of U.S. for energy sources and critical resources. [8] The Act also gives the President and CFIUS discretions to define national security consideration generally or on a case by case basis.[9]

Due to the confidentiality of national security issue, FINSA exempts the President and CFIUS from disclosing information and documents to the public. According to this confidentiality clause, the President and CFIUS generally do not release their reasoning to the public. As in Ralls’s windfarm project case, neither CFIUS explained reasons when issuing mitigation orders, nor the President articulated explanations when ordered Ralls to divest its assets. [10] Still, the court’s report reveals that concerns of the transaction mainly focus on the location of the windfarm.

The four acquired Butter Creek windfarms overlapped with a U.S. Navy restricted airspace and bombing zone. Sensitive geographical location would fall into the first three consideration factors, which emphasizes the capacity and capability of national defense industries and its importance to U.S. security. The concern may also relate to Rall’s connection with China. Just as Ralls allegation that
there were windfarm projects close to the restricted airspace, and hundreds of turbines had been located in or near the restricted airspace. Some of those turbines were manufactured by foreign corporations and some windfarm projects were owned by foreign investors. However, none of those foreign made or owned stuff received objection from the government.[11]

**Court’s Jurisdiction in Foreign Investment National Security Review**

FINSA says that “[t]he action of the President … and … the findings of the President … shall not be subject to judicial review.”[12] In case Ralls v. CFIUS et al., plaintiff Ralls asked the Court to review findings of the President and CFIUS. The defendants, following the finality provision, argued that the Court had no jurisdiction to hear the dispute. The Court agreed with the defense, and found that the statute clearly made the presidential behavior nonreviewable in this issue. The district court accordingly abstained itself from reviewing the ultra vires and equal protection challenges to the President’s findings as claimed by the plaintiff. The finality clause corroborates two things. One is presidential exclusive right on international commerce conferred by the U.S. Constitution. The other one is the unique nature of CFIUS review, functioning as the last resort protecting the country’s security in foreign investment domain.

FINSA’s non-judicial reviewable requirement, however, is literally limit to President’s finding and decision on the case. The law does not explain whether the Presidential actions are subject to judicial review on proceeding issues. The trial court of Ralls found that there was “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.”[13] This statement, for the first time, explains Court’s perspective of judicial role in international investment domain. Although foreign investment national security review power exclusively belongs to the President, Court can supervise the process of foreigners’ property divestiture. The court of appeal affirmed the trial court’s finding that there was deprivation of Ralls constitutionally protected property interest without due process.[14] Ralls’ windfarm project might be a start where judicial role begins to play a role in foreign investment national security review.

**Discrimination to Chinese Corporation?**

For many Chinese investors and officials, they are eager to know whether a special and stricter standard is adopted to review M&As from China, or whether CFIUS discriminates against Chinese investors. Yet these are questions difficult to answer. Even U.S. entrepreneurs and academics have devided opinions on these issues. There is a suspicion that Chinese corporations are treated differently. This suspicion starts from CNOOC’s aborted Unocal bid, and has a tendency to prevail due to frequent notification of Chinese investors in recent years. In 2011, the number of covered transactions from China reached double digits for the first time. The following three years witnessed the difficulties for Chinese enterprises to realize their American dreams, with 23, 21, and 24 transactions reviewed in 2012, 2013 and 2014 respectively. (Table I) The rocked number and percentage of covered transaction convinces people that discrimination does exist. (Figure I)

<table>
<thead>
<tr>
<th>year</th>
<th>Number of Chinese M&amp;A</th>
<th>Covered Transactions</th>
<th>Total Covered Transactions</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>1</td>
<td>64</td>
<td>64</td>
<td>1.56</td>
</tr>
<tr>
<td>2006</td>
<td>0</td>
<td>111</td>
<td>111</td>
<td>0</td>
</tr>
<tr>
<td>2007</td>
<td>3</td>
<td>138</td>
<td>138</td>
<td>2.17</td>
</tr>
<tr>
<td>2008</td>
<td>6</td>
<td>155</td>
<td>155</td>
<td>3.87</td>
</tr>
<tr>
<td>2009</td>
<td>4</td>
<td>65</td>
<td>65</td>
<td>6.15</td>
</tr>
<tr>
<td>2010</td>
<td>6</td>
<td>93</td>
<td>93</td>
<td>6.45</td>
</tr>
</tbody>
</table>
The U.S. Treasury Deputy Assistant Secretary for Investment Security Aimen Mir at the Council on Foreign Relations denied the previous assumption. He said that “CFIUS approach[ed] transactions involving Chinese acquirers with the same national security focus, analytical rigor, commitment to proportionality, adherence to clear procedures, and level of accountability, as it [did] transactions from any other country.”[15] According to Mir, the reason why in 2013 and 2014 acquisition by Chinese companies accounted for the largest number of notices of any country was due to the rapid expanding investment. He also pointed out that most of those covered transactions, where the acquirer was a Chinese company, were the result of voluntary filings. [16]

Implication of Ralls Case to Chinese Corporations

Be Fully Prepared for CFIUS Review

The year of 2006 witness a buying spree of Chinese investors in the U.S. market. There is Anbang Insurance Group buying hotel chain Starwood and an unknown Chinese real estate and investment firm buying the Chicago Stock Exchange. Deals from China are worth over USD 23 billion deals in the first quarter of 2016.[17] The influx of Chinese capital made U.S. legislators sound the alarm and CFIUS stymie Chinese deals. The recent CFIUS Annual Report to Congress shows that China has received more reviews than any other country for the three consecutive years since 2012.[18] Continued significant Chinese investment suggests that more Chinese deals will encounter CFIUS reviews in 2016. Therefore, it would be a wise move for Chinese entrepreneurs to fully prepare for dealing with CFIUS and lawmakers concerning the national security issue.

However, anxiousness and worry about the review is not necessary, since only a small percent of the notified cases will proceed to investigation stage and most of the cases will be released after eliminating national security suspicion or reaching a mitigation agreement. For instance, despite the increase in the number of CFIUS notices involving Chinese investors, the overall rate of CFIUS investigations remains consistent. The 2014 CFIUS report also suggests the fact that notified transactions would not necessarily be investigated. [19]
Treat CFIUS Review Correctly

There is a misunderstanding that the foreign investment national security review is used to simply prohibit takeover activities that may threaten the country’s safety. Instead, what the President and CFIUS really pursue is to seek the balance between the role of foreign investment in the economy and the potential threat to national security. The final purpose of the mechanism is to absorb foreign capital as much as possible based on the premise of ensuring the national security of the United States.[20] Therefore, it is highly recommended to actively cooperate and negotiate with CFIUS to find out a mutually accepted mitigation measures. These measures could be making sure that only authorized persons can access certain technology and information, establishing appropriate mechanisms to ensure the compliance of implementation of requirements, limiting certain products and services to U.S. locations and citizens, etc.[21]

Also, it is a wise choice to hire experienced U.S. public relation corporations and law firms to handle the national security review. Law is not entirely independent of politics, especially in the situation of national security review when the key terms are deliberately undefined and the executors are endowed with considerable discretions. A good example is the DP World case, where Congress finally stopped the case after CFIUS had already nodded at it. Ralls case is another example, in which Ralls hired experienced legal team and found a tactic cause of action.

Summary

As more and more Chinese investors are heading for the U.S. market in the post crisis era, CFIUS review to Chinese corporations has become increasingly frequent. Plus the complex diplomatic relations between the two countries, it is easy to create a mutual retaliation in the field of investment. By studying Ralls windfarm project case, we conclude that CFIUS evaluations are mostly according to the characteristics of transactions, and to a great extent are origin-neutral. We also suggest Chinese entrepreneurs to draw experience from Ralls case, studying and using the U.S. law to protect self-interests when doing business in the U.S.

References

[14] See Ralls Corporation, Appellant V. Committee On Foreign Investment In The United States, Et Al., Appellees, 758 F.3d 296.


