RECENT DEVELOPMENTS IN TEXAS, UNITED STATES, AND INTERNATIONAL ENERGY LAW

I. INTRODUCTION

This section of Recent Developments in Texas, the United States, and International Energy Law consists of selected discussions of legislation, regulations, and recent case law that affect the energy industry. The first section focuses on Texas. It includes short summaries of recent Texas appellate court decisions. The second section focuses on United States and international issues, including summaries of a few recent court decisions in other states and a recent United States Supreme Court decision, as well as an article by Maria C. Faconti analyzing how the President and the Committee on Foreign Investment in the United States enforce the Defense Production Act to review foreign direct investment in the context of *Ralls Corporation v. Terna Energy USA Holding Corporation*.

II. RECENT DEVELOPMENTS IN TEXAS ENERGY LAW

A. Texas Oil, Gas, and Energy Case Summaries

1. Envtl. Processing Sys., L.C. v. FPL Farming Ltd., No. 12-0905, 2015 WL 496336 (Tex. Feb. 6, 2015).

Issue: Is deep subsurface wastewater migration actionable as a common law trespass in Texas?

FPL Farming Ltd. owns land for rice farming in Liberty County, Texas. In 1996, Environmental Processing Systems (EPS) began operating a wastewater disposal facility on an adjacent five-acre tract under a permit from the Texas Commission on Environmental Quality (TCEQ).[1] At the initial permitting hearing, FPL's predecessor-in-title (Frost) requested a hearing to contest EPS's permit application, but subsequently reached a settlement agreement with EPS under which Frost dropped the contest and bound all successors-in-title to the same. EPS then began wastewater injection operations in the Frio rock formation.[2]

In 1999, EPS applied to the TCEQ for a permit amendment to increase the volume of wastewater it could inject into the Frio formation. FPL, then the owner of the farming land adjacent to the EPS injection tract, requested a hearing to contest the permit amendments. Although the administrative law judge presiding over the hearing found it likely that wastewater would seep into the subsurface of FPL's land in the future, he held that FPL could not exclude EPS from injecting into the deep subsurface because FPL still had the unimpaired right to get its own injection well permit.[3] The TCEQ granted the permit amendments, and the district court affirmed. In 2003, the Austin Court of Appeals affirmed, but noted the possibility that FPL may have a cause of action for damages should wastewater migrate and cause actual harm to FPL's property.[4]

Almost three years following the appellate affirmation, FPL sued EPS, alleging that wastewater had migrated beneath FPL's land and possibly contaminated the groundwater. FPL sued for injunctive relief and damages for trespass, negligence, and unjust enrichment. The contested issues at trial were: whether there was an actual wastewater entry

1. In 2002, the Texas Natural Resource Conservation Commission's (TNRCC) name was changed to the TCEQ. *TNRCC is Now the TCEQ*, TEX. COMM'N ON ENVTL. QUALITY (Sept. 1, 2002), http://www.tceq.texas.gov/about/name_change.html. The events giving rise to this case took place during this transition. Envtl. Processing Sys., L.C. v. FPL Farming Ltd., No. 12-0905, 2015 WL 496336, at *1 (Tex. Feb. 6, 2015).

2. *FPL Farming*, 2015 WL 496336, at *1.

3. *Id.*

4. *Id.*

beneath FPL's land, whether FPL consented to any such entry, and the amount of damages. The jury found for EPS on all claims and issues, and the court entered a take-nothing judgment. The Beaumont Court of Appeals affirmed, holding that FPL could not recover damages in tort, as a matter of law, because the TCEQ had authorized EPS's actions via its injection permit. The Texas Supreme Court reversed on the ground that a government-issued permit does not shield its holder from civil tort liability, but left open the question of whether subsurface wastewater migration can constitute a trespass.[5]

The Beaumont Court of Appeals reversed the trial court's take-nothing judgment on remand, holding that:

> (1) Texas recognizes a common law trespass cause of action for deep subsurface water migration; (2) consent is an affirmative defense to trespass, on which EPS bore the burden of proof, and therefore the jury charge was improper; (3) FPL Farming was not entitled to a directed verdict because there was some evidence that it (or Frost) impliedly consented to the subsurface entry; and (4) the trial court erroneously excluded the settlement agreement between EPS and Frost from evidence.[6]

Both EPS and FPL petitioned the Texas Supreme Court for review: EPS challenged the court of appeals' recognition of a trespass cause of action in this context and its holding that consent is an affirmative defense, while FPL challenged the denial of its motion for a directed verdict and the reversal of the exclusion of the EPS–Frost settlement agreement.[7]

The court, through Justice Green, first tackled the question of whether lack of consent is an element of a trespass cause of action, under which the plaintiff would bear the burden of proof, or whether consent is an affirmative defense, for which the defendant would bear the burden. Acknowledging that the court had not previously addressed the question, Justice Green analyzed the issue under numerous historical precedents that revealed the common definition of trespass. According to this analysis, trespass is: "(1) entry (2) onto the property of another (3) without the property owner's consent or authorization."[8] Justice Green emphasized that the court has always used lack of consent in the definition of trespass. This definition, naturally, places the burden of proving the lack of consent on the plaintiff.

In rebutting FPL's argument that consent is an affirmative defense and thus would place the burden of proof on EPS, the Justice outlined two

5. *Id.* at *2.
6. *Id.*
7. *Id.*
8. *Id*. at *4.

elements from precedent: "(1) '[t]he comparative likelihood that a certain situation may occur in a reasonable percentage of cases'; and (2) the difficulty in proving a negative."[9] He highlighted the dearth of case law on consent in trespass cases given that it is rarely an issue, but concluded it would not be difficult for a landowner to prove lack of consent because the landowner is in the best position to provide such evidence. Based on this, Justice Green held lack of consent to be an element of the trespass cause of action, placing the burden of proof on the plaintiff—in this case, FPL.

After analyzing the definition of trespass and its burden of proof, the court held that it was consistent with the definition of trespass submitted to the jury at trial. Justice Green held that, since the jury charge placed the burden on FPL, the jury charge provided the proper definition of trespass by placing the burden of proving lack of consent on the plaintiff. As this holding rendered any error in submitting the subsurface-trespass question to the jury harmless, the court ultimately declined to determine whether Texas law recognizes a trespass cause of action for deep subsurface water migration.[10]

Justice Green quickly disposed of FPL's directed verdict argument, noting that because it relied on EPS having the burden of proving FPL's consent to the alleged entry, the argument rested on an erroneous premise.[11] But Justice Green noted in *dicta* that FPL would have been entitled to a directed verdict had it conclusively established that it did not consent to EPS's alleged entry; FPL, however, failed to argue or cite any evidence to support such an argument. In his conclusion, Justice Green again emphasized the longstanding definition of trespass in Texas and held that FPL had failed to conclusively establish a lack of consent on its part.

9. *Id.* at *8 (quoting 20801, Inc. v. Parker, 249 S.W.3d 392, 397 (Tex. 2008)).
10. *Id.* at *9–10.
11. *Id.* at *9.

2. Hooks v. Samson Lone Star, Ltd. P'ship, No. 12-0920, 2015 WL 393380 (Tex. Jan. 30, 2015)

Issue: Does the statute of limitations bar claims of fraud and breach of contract brought by a mineral owner against a lessee?

In 2006, Charles G. Hooks (Hooks) filed suit against Samson Lone Star, Limited Partnership (Samson) alleging several claims, which after amendment included fraud, fraudulent inducement, statutory fraud, breach of contract, and failure to pay royalties.

Seven years prior to suit, Hooks executed three oil and gas leases with Samson covering land in Hardin County and Jefferson County, Texas. The lease covering land in Jefferson County barred pooling and included an offset obligations clause that required the lessee to "drill an offset well, pay . . . compensatory royalties, or release the offset acreage," if another "gas well were completed within 1,320 feet of Hooks' lease line but was not unitized with Hooks' acreage."[12]

A year after signing the leases, Samson drilled a well that bottomed approximately 134 feet *within the protected boundary* as defined in the offset obligations clause.[13] Rather than choose from one of the three options in the clause, Samson offered Hooks the opportunity to amend the lease to pool his land with a unit encompassing the new well. Samson's proposal included a plat showing that the well bottomed *beyond the protected boundary*, avoiding the "offset obligations" clause.

The same plat was filed with the Texas Railroad Commission as required in a pooling application with the signature and certification of Glenn Lanoue, Samson's landman.[14] The plat labeled the proposed location of the well, included data without the "proposed" designation, and specified the "'X' and 'Y' coordinates for the well's bottom-hole location, the distance of the well from various survey lines, and the well's surface location along with the bottom hole's location relative to the surface."[15] Samson had also previously filed a directional survey with the Texas Railroad Commission that displayed the correction location of the well's bottom hole within the protected boundary around Hooks' lease.[16]

12. Hooks v. Samson Lone Star, Ltd. P'ship, No. 12-0920, 2015 WL 393380, at *2 (Tex. Jan. 30, 2015).

13. *Id.* The well "bottomed about 1,186 feet from Hooks' lease, within the 1,320–foot protected zone." *Id.*

14. *Id.* at *4.

15. *Id.* The plat contained several notations, including one stating that the well's bottom hole was "1400' ± scaled' FEL Unit," where "FEL" meant "'from the eastern line of the pooled unit." *Id.* at *5. Hooks' lease line, however, was not the eastern line of the unit. *Id.*

16. *Id.* at *2.

Nearly six years after agreeing to the amended lease, Hooks discovered Samson's alleged misrepresentation of the well's location and brought his claims in court. After trial, the jury awarded Hooks over $20 million in damages stemming from Samson's fraud and found that Hooks had exercised reasonable diligence in attempting to discover Samson's fraud.

After the jury verdict, the Court of Appeals for the First District of Texas reversed.[17] The appellate court held that "Hooks knew or should have known . . . [about] the alleged fraud no later than" when Samson proposed to amend the lease, reasoning that the requisite public records were available at the Texas Railroad Commission.[18] Thus, the appellate court barred Hooks' claim with the four-year statute of limitations for fraud.[19]

Following the appellate ruling, Hooks petitioned the supreme court of Texas for review. After granting review, Justice Devine wrote an opinion for the court reversing the First Court of Appeals on the issue. Before the high court, Hooks asserted that the statute of limitations was tolled until he "knew or should have known of facts that in the exercise of reasonable diligence would have led to the discovery" that Samson's plot misrepresented the location of the well's bottom hole.[20] Relying on the jury's determination that reasonable diligence would result in the lessor's discovery of the alleged misrepresentation in 2007, Hooks concluded that the statute of limitations did not bar his fraud claims, arguing that reasonable diligence is a question of fact. Samson, in contrast, argued that reasonable diligence is a matter of law and that in this case, had Hooks exercised reasonable diligence, he "would have discovered the true location of the well's bottom hole in 2000 or 2001."[21]

After considering the parties' arguments, the court held that reasonable diligence in discovering fraud is a question of fact. The court reasoned that the statute of "limitations does not start to run until the fraud with respect to the contract is discovered or the exercise of reasonable diligence would discover it."[22] However, the court acknowledged that "'the date a cause of action accrues is normally a question of law.'"[23] Accordingly, reasonable diligence is a matter of law

17. Samson Lone Star, Ltd. P'ship v. Hooks, 389 S.W.3d 409, 428–29 (Tex. App.—Houston [1st Dist.] 2012), *aff'd in part, rev'd in part sub nom.* Hooks v. Samson Lone Star, Ltd. P'ship, No. 12-0920, 2015 WL 393380 (Tex. Jan. 30, 2015).

18. *Id.* at 429.

19. TEX. CIV. PRAC. & REM. CODE ANN. § 16.004(a)(4) (West 2013).

20. *Hooks*, 2015 WL 393380, at *2.

21. *Id.*

22. *Id.* at *3.

23. *Id.* (quoting Etan Indus., Inc. v. Lehmann, 359 S.W.3d 620, 623 (Tex. 2011) (per curiam)).

in some cases in which a plaintiff has "actual or constructive notice, or when information is 'readily accessible and publicly available.'"[24]

Against this backdrop, the court distinguished Hooks' claim where "the public record itself was . . . tainted by the fraud" from cases in which reasonable diligence was a matter of law.[25] Because "'fraud vitiates whatever it touches,'"[26] the court refused to elevate the reasonable-diligence standard to mandate a duty to double-check more recent filings at the Texas Railroad Commission against earlier filings. Thus, "[a]lthough reasonable diligence should examine readily available information in the public record, it may stop at more recent filings with the Railroad Commission . . . ."[27]

The court also found many of Samson's arguments, focusing on whether reasonable diligence was exercised, better suited for a factfinder to evaluate as a question of fact, rather than for a court to determine as a matter of law. Samson had argued that the directional survey was the "gold standard" for specifying the well's bottom-hole location, and that the Lanoue plat was merely filed to show the pooled unit's lines, rather than the location of the well's bottom hole.[28] Samson further argued that Hooks should have investigated inconsistencies between statements Lanoue made to him and the well's bottom-hole location specified on the Lanoue plat.

Finally, the court considered Hooks' other claims for breach of the most-favored-nations clause,[29] breach of the formation-production clause,[30] unpooling,[31] breach of the Hardin County offset provisions,[32] attorneys' fees,[33] and interest rates.[34]

In sum, the court reversed by concluding that reasonable diligence in discovering fraud is a question of fact, and remanded the case back to the First Court of Appeals to consider the evidence with regard to the fraud claims and associated damages, as well as the evidence pertaining to

24. *Id.* at *4 (quoting Shell Oil Co. v. Ross, 356 S.W.3d 924, 929 (Tex. 2011)).
25. *Id.*
26. *Id.* at *5 (quoting Borderlon v. Peck, 661 S.W.2d 907, 909 (Tex. 1983)).
27. *Id.* at *5.
28. *Id.*
29. The court held "that the court of appeals erred in holding that Samson did not breach the most-favored-nations clause" by applying the primary legal consequence of pooling and by declining to evaluate whether market forces increased royalty rates. *Id.* at *6–7.
30. *Id.* at *7–9 (affirming the court of appeals' rejection of Hooks' breach of formation-production claims).
31. *Id.* at *9–10 (affirming the court of appeals' rejection of Hooks' unpooling claims).
32. *Id.* at *12 (remanding to the court of appeals with instructions to evaluate the breach of the Hardin County offset provisions on the merits).
33. *Id.* at *13 (reversing the court of appeals because Hooks prevailed on the most-favored-nations claim).
34. *Id.* (affirming in part and reversing in part the court of appeals' post-judgment interest rate judgment).

when Hooks should have discovered Samson's fraud.[35] Samson filed a motion for rehearing on March 16, 2015.[36] The motion is still pending before the court.

3. KCM Fin. LLC v. Bradshaw, No. 13-0199, 2015 WL 1029652 (Tex. Mar. 6, 2015)

Issue: Did the executive interest holder breach its duty of utmost good faith and fair dealing when executing a mineral lease?

In 1960, J.A. and Lota Fay Driskill executed two deeds covering nearly 2,000 acres of land in Hood County, Texas. The deeds conveyed both the surface and all mineral interests, but reserved a non-participating royalty interest (NPRI) that was equal to an undivided one-half of the royalty and required that the royalty be at least one-eighth. Betty Lou Bradshaw later inherited this NPRI that reserved a minimum one-sixteenth share of gross production.

In 2005, Gary Humphreys purchased the surface and mineral estate for approximately $19 million. Soon afterward, Humphreys assigned his interest to Texas Shepco, LP (Texas Shepco) and contracted with Peter Bennis to jointly develop the tract. As part of his agreement with Bennis, Humphreys effectively assigned two-fifths of his royalty interest and two-fifths of his interest in the contract to Bennis. Bennis then proceeded to negotiate a sale to Chesapeake Energy (Chesapeake).

Unfortunately, the deal required Texas Shepco and their manager, R.J. Sikes, to re-assign their interest to Humphreys or to negotiate with Chesapeake directly. Rather than working with Humphreys or Chesapeake, however, Sikes negotiated a contract with Range Resources Corporation. Sikes, as manager of Texas Shepco, also established a partnership with R. Crist Vial to develop oil and gas, and formed Steadfast Financial LLC (Steadfast). Finally, Sikes became the managing member of Steadfast.[37]

Soon after the creation of Steadfast, Humphreys walked away from his negotiations with Chesapeake, terminated his assignment to Texas Shepco, and reassigned his interest to Steadfast.[38] The only remaining interest to consider was Bradshaw's NPRI. Steadfast immediately expressed concern to Humphreys that Bradshaw could file suit relying on

35. *Id.* at *6.
36. Jess Davis, *Oil Group Says Texas Justices Got $21M Royalty Ruling Wrong*, LAW360 (Apr. 23, 2015, 7:27 PM), http://www.law360.com/articles/647104/oil-group-says-texas-justices-got-21m-royalty-ruling-wrong.
37. Steadfast Financial LLC changed its name to KCM Financial, LLC. *See* KCM Fin. LLC v. Bradshaw, No. 13-0199, 2015 WL 1029652, at *4, n.4 (Tex. Mar. 6, 2015).
38. Bennis amended his contract with Humphreys to benefit from the arrangement with Steadfast. *See id.* at *4, n.5.

the deed language. Notably, Steadfast, recognizing that a one-fourth royalty option would most likely avoid litigation, proceeded to offer a one-fourth royalty and a $200,000 bonus payment.

After extended negotiations and a series of transactions, Steadfast closed the contract, sold the surface estate to Range Resources, and executed a mineral lease with Range Production I, L.P. (collectively, Range). On the property interest burdened by Bradshaw's NPRI, Steadfast reserved a one-eighths royalty interest and approximately a $13 million bonus.[39] According to the 1960 deeds, Bradshaw was entitled to the minimum one-sixteenth share of gross production with the remaining half belonging to Steadfast. After closing, Steadfast assigned part of its royalty interest to Bennis, who then conveyed a portion of his interest to Ronny Korb (a bank colleague). Steadfast also assigned parts of its remaining interest to a set of royalty owners, including Sikes and Vial (collectively, the Royalty Owners).

Bradshaw subsequently filed suit alleging that Steadfast had breached its fiduciary duty as executive interest holder to Bradshaw's NPRI by entering a mineral lease with Range. Bradshaw contended that the market in the area surrounding the tract had established a one-fourth royalty as a standard—twice the one-eighth royalty reserved by Steadfast. Moreover, Bradshaw argued that Steadfast's negotiation for a below-market royalty and an above-market bonus amounted to self-dealing. Although Range and Steadfast maintained separate counsel for representation in their transaction, Bradshaw also alleged "that Range conspired with Steadfast and aided and abetted the breach" of the fiduciary duty.[40]

After filing suit, Bradshaw filed a motion for partial summary judgment on the issue that the deeds defined a minimum royalty and not a fixed royalty. The trial court granted Bradshaw's motion and the court of appeals affirmed the decision. Bradshaw also brought additional claims of fraudulent transfer against Bennis, Korb, and the Royalty Owners. Finally, Bradshaw sought a constructive trust on Range's payments to the Royalty Owners. The defendants filed numerous summary judgment motions and the trial court rendered a take-nothing judgment.

The court of appeals reversed and remanded all claims except those asserted against Bennis and Korb.[41] The court focused on Steadfast's fiduciary duty to Bradshaw under the "utmost good faith and fair dealing" standard and concluded a genuine issue of material fact existed.

39. The lease bonus was $7,505 per acre. *Id.* at *5.
40. *Id.*
41. Bradshaw v. Steadfast Fin., L.L.C., 395 S.W.3d 348, 376 (Tex. App.—Fort Worth 2013).

The court also determined that Range and the Royalty Owners were not entitled to summary judgment because of Bradshaw's unresolved breach of fiduciary duty claim asserted against Steadfast. Accordingly, Steadfast, Range, and the Royalty Owners petitioned the Texas Supreme Court for review.

After granting review, Justice Guzman, writing for a unanimous court, affirmed as to Bradshaw's claim against Steadfast, but reversed on the claims against Range, the Royalty Owners, and the constructive trust. The court provided a thorough discussion of the executive interest holder's fiduciary duty and made clear that "[a]n executive owes a non-executive a duty that prohibits self-dealing but does not require the executive to subjugate its interests to those of the non-executive."[42] Thus, "the controlling inquiry is whether the executive engaged in acts of self-dealing that unfairly diminished the value of the non-executive interest."[43]

While the executive is not required to negotiate the highest possible royalty, the executive's negotiation is necessarily limited by the duty of utmost good faith and fair dealing. Accordingly, the court noted that the inquiry is not whether the executive and non-executive receive the *same royalty*, but whether the executive and non-executive receive the *same benefit*. This inquiry, however, must consider the bundle of rights exclusive to the executive interest holder, such as bonus payments and delay rentals.

Considering the standard for summary judgment and the unique unfixed royalty in the 1960 deeds, the court concluded there is some evidence sufficient to create an issue of material fact. Bradshaw pointed to several pieces of evidence: Steadfast's offer of a one-fourth royalty to Humphreys; an offer to Bradshaw to lease in exchange for a one-fourth royalty; five leases in the surrounding area with a one-fourth royalty, two of which involved Range; an affidavit of a landman stating that the bonus was excessive; and evidence of the parties acknowledging that Bradshaw would not share in the excessive bonus. Thus, the court reversed and remanded the breach of fiduciary duty claim.

The court proceeded to reject, as a matter of law, Bradshaw's conspiracy and aiding and abetting claims against Range, and Bradshaw's constructive-trust and fraudulent-transfer claims against the Royalty Owners. In regards to the conspiracy and aiding and abetting claims, none of these parties had a fiduciary duty to Bradshaw. Furthermore, in regards to the constructive trust, the Royalty Owners had royalty interests traced back to the one-half royalty transferred by the Driskills in

42. *KCM Fin.*, 2015 WL 1029652, at *8.
43. *Id.*

the 1960 deeds. Bradshaw, therefore, could "not convert the unreserved one-half interest into [her] property."[44] Finally, Bradshaw failed to present any evidence in regards to her fraudulent-transfer claim showing that Steadfast was insolvent when it assigned its one-half of royalty interest to the Royalty Owners. Accordingly, the Texas Supreme Court reversed the court of appeals on all claims against Range and the Royalty Owners.

On remand, the trial court will have an opportunity to proceed on Bradshaw's claim against Steadfast. Executive interest holders should pay close attention to what a non-executive interest is entitled to and consider how best to maximize their interests while fulfilling their duty of utmost good faith and fair dealing.

4. Tex. Rice Land Partners, Ltd. v. Denbury Green Pipeline–Tex. LLC, No. 09-14-00176-CV, 2015 WL 575179 (Tex. App.—Beaumont Feb. 12, 2015, no pet. h.)

Issue: Is a pipeline owner and operator a common carrier—under the Texas Supreme Court's new test—with the power of eminent domain when it largely serves entities affiliated with it, even if it was available for hire?

a. Procedural History

Denbury Green Pipeline–Texas LLC (Denbury Green) owns and operates a carbon dioxide pipeline, the Green Line. Texas Rice Land Partners, Ltd. (Texas Rice) owns a cattle ranch and rice farm. Denbury Green sought to build the Green Line across Texas Rice's property. Texas Rice denied Denbury Green's request to survey the land.

Denbury Green obtained a temporary injunction from the 172nd District Court in Jefferson County, Texas. The court then granted summary judgment in favor of Denbury Green, issuing a permanent injunction against Texas Rice. The court held that Denbury Green, as a common carrier with the power of eminent domain, could survey the land without interference from Texas Rice. The Beaumont Court of Appeals affirmed.[45] The Texas Supreme Court, however, remanded the case after developing a new test for determining common carrier status.[46]

On remand to the district court, the court applied the Texas Supreme Court's new test and held, once again, that Denbury Green was a common carrier under section 111.002(6) of the Texas Natural Resources Code and Section 2.105 of the Texas Business Organizations Code. As a

44. *Id*. at *14.
45. Tex. Rice Land Partners, Ltd. v. Denbury Green Pipeline–Tex. LLC, 296 S.W.3d 877, 878 (Tex. App.–Beaumont 2009), *rev'd*, 353 S.W.3d 192 (Tex. 2012).
46. Tex. Rice Land Partners, Ltd. v. Denbury Green Pipeline–Tex., LLC, 363 S.W.3d 192 (Tex. 2012).

common carrier, Denbury Green had the power of eminent domain under Section 111.019 of the Texas Natural Resources Code. The court also held that the Green Line was a carbon dioxide common carrier pipeline that serves the public. The district court then granted summary judgment for Denbury Green and issued a permanent injunction against Texas Rice. Texas Rice, once again, appealed to the Beaumont Court of Appeals. The appellate court reversed and remanded.

b. Facts

Denbury Green formed in 2008 to construct, own, and operate the Green Line—for the transportation of carbon dioxide. Denbury Green does not buy, sell, explore for, or produce carbon dioxide. In April 2008, the Texas Railroad Commission granted Denbury Green's permit to operate the Green Line and classified Denbury Green as a common carrier. Denbury Green completed the pipeline in 2010.

Denbury Onshore, LLC, with which Denbury Green is affiliated, owns another pipeline—as well as part of the Green Line. Denbury Onshore, along with other third-party leaseholders, also owns interest in two field units. Denbury Onshore's interest in those units is nearly 90%. For a fee, Denbury Green's Green Line serves these units owned by Denbury Onshore.

In addition to serving the two field units, Denbury Green claimed that the Green Line was available to other entities, too. The Green Line is located near oil fields. Denbury Green said these oil fields are potential shippers, and they built the Green Line near these fields with this in mind. Furthermore, Denbury Green alleged it anticipated use from various entities along its route.

In 2008, Denbury Green and Air Products, LLC discussed using the Green Line to transport anthropogenic carbon dioxide. In 2012, the parties contracted for such. In 2012, Airgas Carbonic, Inc. approached Denbury Green about using the Green Line. In 2013, the parties signed a contract to transport carbon dioxide on the Green Line. Air Products and Airgas Carbonic testified that they would not have expanded their operations but for the Green Line. In all of its arrangements, Denbury Green never obtained title or possession of any product it transported.

In sum, although the Green Line served several field units owned largely by Denbury Onshore—an affiliate—from its inception, Denbury Green alleged that the Green Line was always intended to serve other owners and "transport carbon dioxide for hire[.]"[47]

47. Tex. Rice Land Partners, Ltd. v. Denbury Green Pipeline–Tex. LLC, No. 09-14-00176-CV, 2015 WL 575179, at *2 (Tex. App.—Beaumont Feb. 12, 2015, no pet. h.) (internal quotation marks omitted).

c. The Law

A common carrier "owns, operates, or manages, wholly or partially, pipelines for the transportation of carbon dioxide or hydrogen in whatever form to or for the public for hire, but only if . . . it becomes a common carrier subject to the duties and obligations conferred or imposed by this chapter[.]"[48]

Section 111.019 of the Texas Natural Resources Code allows common carriers to use eminent domain when necessary to construct, maintain, or operate a common carrier pipeline.[49] Section 2.105 of the Texas Business Organizations Code further states that a limited liability company classified as a common carrier in the pipeline business—for the purpose of transporting carbon dioxide—has the powers conferred on a common carrier by sections 111.019 through 111.022 of the Texas Natural Resources Code.[50]

Thus, the court held that section 2.105 is not an independent basis for exercising eminent domain authority. An entity must meet Chapter 111's common carrier requirement. Importantly, after holding that common carrier status must be determined under Chapter 111, the court analyzed the Texas Supreme Court's new test for determining common carrier status.

The Texas Supreme Court held, "for a person *intending to build* a [carbon dioxide] pipeline to qualify as a common carrier under Section 111.002(6), a reasonable probability must exist that the pipeline will at some point after construction serve the public by transporting gas for one or more customers who will either retain ownership of their gas or sell it to parties other than the carrier."[51] Applying this new test, the appellate court held that a party's intent at the time of the decision to build a pipeline is key. The appellate court found this to be especially true since Texas Rice challenged Denbury Green's common carrier status in 2008—when Denbury Green first conceptualized the Green Line.[52]

d. Application of the Law

Using the new test identified by the Texas Supreme Court, the appellate court held that Denbury Green was not a common carrier and could not exercise eminent domain. The court honed in on "Denbury

48. TEX. NAT. RES. CODE ANN. § 111.002(6) (West 2011).
49. *Id.* § 111.019(a), (b).
50. TEX. BUS. ORG. CODE ANN. § 2.105 (West 2012).
51. *Tex. Rice*, 363 S.W.3d at 202 (emphasis added).
52. *Id.* "[O]nce a landowner challenges [common carrier] status, the burden falls upon the pipeline company to establish its common-carrier bona fides if it wishes to exercise the power of eminent domain." *Id.*

Green's intent at the time of its plan to construct the Green Line" to determine whether it was constructed to serve the public.[53]

Denbury Green argued that it is a common carrier because (1) Airgas used the Green Line to transport its own carbon dioxide; (2) Denbury Green intentionally placed the Green Line near oil fields housing potential shippers reasonably likely to use the Green Line; and (3) even though Denbury Onshore owned a majority of the field units the Green Line served, the Green Line also served the third parties who had remaining interests in those units.

The court rejected Denbury Green's first contention. The Green Line did serve Airgas. Airgas owned the transported carbon dioxide at all times. Yet, Denbury Green failed to show intent to serve the public. Denbury Green conceptualized the Green Line in 2008 and completed it in 2010. Airgas did not approach Denbury Green until 2012. Thus, that the Green Line served the public in 2012 is irrelevant to Denbury Green's intent in 2008—when it first contemplated the Green Line.

The appellate court denied Denbury Green's second argument regarding its placement near oil fields. Denbury Green argued that it intentionally built the Green Line near oil fields in anticipation of business. The court held that Denbury Green's subjective beliefs, without more, were conclusory and not competent evidence of intent. The court reasoned that "subjective beliefs do not demonstrate, as a matter of law, a reasonable probability that, at the time Denbury Green intended to build the Green Line, the pipeline's purpose was to serve the public."[54]

Lastly, the court rejected Denbury Green's arguments related to the third-party interests in the Denbury Onshore field units. The Green Line did serve third parties with an interest in the units. Furthermore, Air Products' anthropogenic carbon dioxide was shipped on the Green Line. And, Denbury Onshore, also on behalf of the other interest owners, bought this product. Yet, Denbury Onshore, the affiliate, owned a majority interest in the units and operated them. In fact, only a small percentage of third-party owners ratified these transportation agreements essentially executed by Denbury Onshore. Finally, the other interest owners did not take title or possession of the carbon dioxide from the Green Line. Thus, the court held that reasonable jurors could differ as to Denbury Green's intent to serve the public through its contracts with Denbury Onshore and Air Products.

53. Tex. Rice Land Partners, Ltd. v. Denbury Green Pipeline–Tex. LLC, No. 09-14-00176-CV, 2015 WL 575179, at *3 (Tex. App.—Beaumont Feb. 12, 2015, no pet. h.).

54. *Id.* at *4 (citations omitted).

In the end, "a fact issue [existed] regarding whether [Denbury Green's] taking serves a *substantial* public interest."[55] The court, therefore, held "that reasonable minds could differ regarding whether, at the time Denbury Green intended to build the Green Line, a reasonable probability existed that the Green Line would serve the public."[56] Denbury Green could not prove common carrier status—with the power of eminent domain—at the summary judgment stage. The appellate court reversed and remanded the case. Denbury Green has until June 3, 2015 to file a petition for review to the Texas Supreme Court.

III. RECENT DEVELOPMENTS IN UNITED STATES AND INTERNATIONAL ENERGY LAW

A. United States Oil, Gas, and Energy Case Summaries

1. Dart Cherokee Basin Operating Co., LLC v. Owens, 135 S. Ct. 547 (2014)

Issue: Is a defendant removing a case to federal court required to provide supporting evidence for the amount in controversy in its notice of removal?

Brandon W. Owens filed a class action suit against Dart Cherokee Basin Operating Company, LLC and Cherokee Basin Pipeline, LLC (collectively, Dart) in the District Court of Wilson County, Kansas seeking a "fair and reasonable" compensation for alleged underpayments in royalties.[57]

In response to Owens' filing, Dart removed the case to federal court relying on the Class Action Fairness Act of 2005 (CAFA).[58] CAFA grants federal courts jurisdiction over minimally diverse classes involving more than 100 members where the amount in controversy is greater than $5 million.[59] Because Owens did not allege a defined amount in controversy in his state-court petition, Dart averred that the alleged underpayments were over $8.2 million.

Owens promptly filed a motion to remand the case back to state court, asserting that Dart's notice of removal was incurably deficient for failing to include evidence supporting the stated amount in controversy. In an effort to cure the alleged deficiency, Dart submitted a declaration

55. *Id.* at *5 (citing Coastal States Gas Producing Co. v. Pate, 309 S.W.2d 828, 833 (Tex. 1958)).
56. *Id.* at *5 (citations omitted).
57. *See* Owens v. Dart Cherokee Basin Operating Co. LLC, No. 12-4157-JAR-JPO, 2013 WL 2237740, at *1 (D. Kan. May 21, 2013), *petition denied*, No. 13-603, 2013 WL 8609250 (10th Cir. June 20, 2013), *cert. granted*, 134 S. Ct. 1788 (2014), *vacated and remanded*, 135 S. Ct. 547 (2014).
58. *See* 28 U.S.C. § 1332(d) (2013) (defining federal jurisdiction for class actions).
59. *Id.* § 1332(d)(2), (d)(5)(B).

containing detailed calculations totaling more than $11 million. Owens contended, however, that Dart could not cure its removal notice with post-removal evidence because, as a matter of law, the notice was deficient at the time of removal.

The district court granted Owens' motion and remanded the case back to state court. Relying on Tenth Circuit precedent holding "that reference to factual allegations or evidence outside of the petition and notice of removal is not permitted to determine the amount in controversy," the district court concluded that Dart was required to include the post-removal declaration with its notice of removal.[60]

The Tenth Circuit then denied Dart's petition to appeal on two occasions. First, a divided panel denied review.[61] Second, an evenly divided court denied Dart's en banc petition.[62] Consequently, Dart filed a petition for certiorari in the Supreme Court. The Court promptly granted review to resolve a circuit split.[63] In a narrow five to four decision, Justice Ginsburg, writing for the majority, vacated and remanded the case back to the Tenth Circuit.

The Court began by analyzing the language of the statute covering removal notices.[64] Section 1446(a) merely requires "a short and plain statement of the grounds for removal."[65] The "short and plain statement" language tracks the general pleading standard in Rule 8(a) of the Federal Rules of Civil Procedure. The Court also found the legislative history congruent with a liberal pleading standard where Congress noted its intent to "simplify the 'pleading' requirements for removal."[66] The Court concluded that when a defendant seeks to remove a case to federal court, the claimed amount in controversy should receive the same scrutiny as a plaintiff's pleading. In short, a defendant need only plausibly allege an amount in controversy sufficient for federal jurisdiction, and need only submit evidence establishing the allegation if the plaintiff disputes or the court questions the amount.[67]

After considering the issue of removal, the Court reviewed its jurisdiction over the case. Neither party, oddly enough, questioned the Court's jurisdiction to review the case. Rather, Public Citizen, Inc. in an

60. *Owens*, 2013 WL 2237740, at *4.
61. Dart Cherokee Basin Operating, Co., LLC v. Owens, No. 13-603, 2013 WL 8609250 (10th Cir. June 20, 2013), *cert. granted*, 134 S. Ct. 1788 (2014), *vacated and remanded*, 135 S. Ct. 547 (2014).
62. Dart Cherokee Basin Operating Co., LLC v. Owens, 730 F.3d 1234 (10th Cir. 2013).
63. *See Dart*, 135 S. Ct. at 553 (listing the conflicting holdings).
64. *See* 28 U.S.C. § 1446(a) (2013) (laying out the general requirements for removal).
65. *Id.*
66. H.R. REP. NO. 100-889, at 71 (1988).
67. *See* 28 § U.S.C. 1446(c)(2)(B) (2013) (noting that removal is proper "if the district court finds, by the preponderance of the evidence, that the amount in controversy" satisfies the jurisdictional amount).

amicus brief supporting Owens was the first to raise the issue. Public Citizen observed that section 1453(c)(1) grants discretionary review to the court of appeals.[68] According to Public Citizen, the Supreme Court lacked jurisdiction to review the district court's decision because the Tenth Circuit denied review of Dart's petition for permission to appeal.

The Court, however, ducked the Public Citizen argument by concluding that the Tenth Circuit abused its discretion in denying review. Justice Scalia wrote a vigorous dissent joined in large part by Justices Kennedy, Kagan, and Thomas.[69] The Court originally granted review to resolve the circuit split on the issue of what a removal notice should contain. According to the dissent, the Court later understood that the only addressable issue was whether the Tenth Circuit abused its discretion in denying review. Thus, the dissent contended that the Court should have "confess[ed] error and . . . dismiss[ed] the case as improvidently granted."[70]

In addition to disagreeing with the majority's avoidance of the jurisdictional question, the dissent also disagreed with the majority's substantive reasoning of how the Tenth Circuit abused its discretion in denying review. The Ginsburg majority found an abuse of discretion for two primary reasons. First, under the Tenth Circuit's own standard for reviewing CAFA issues,[71] the Tenth Circuit should have accepted review because the case would have an impact on future removal notices and may preclude the issue from arising again. Second, the Tenth Circuit's denial was premised on the Tenth Circuit's erroneous precedent that required defendants to include evidence supporting an alleged amount in controversy in notices of removal.

The Scalia dissent disagreed with both reasons. First, the dissent argued that the issue could return to the Tenth Circuit because a party may appeal a district court's decision addressing whether a defendant's notice of removal contained sufficient evidence.[72] Second, the dissent argued that several others reasons could have motivated the Tenth Circuit's denial of review. For instance, the Tenth Circuit may have been

68. *Id.* § 1453(c)(1) (2013) ("[A] court of appeals *may accept* an appeal from an order of a district court granting or denying a motion to remand a class action to the State court from which it was removed." (emphasis added)).

69. Justice Thomas joined Scalia's dissent except for the last sentence. Thomas also wrote his own dissent arguing that the Court lacked jurisdiction to review the Tenth Circuit's denial of review. *See* Dart Cherokee Basin Operating Co., LLC v. Owens, 135 S. Ct. 547, 562 (2014) (Thomas, J., dissenting).

70. *Dart*, 135 S. Ct. at 559 (Scalia, J., dissenting).

71. *See* BP America, Inc. v. Oklahoma ex rel. Edmondson, 613 F.3d 1029, 1035 (2010) (favoring review when a "case promises to leave the ambit of the federal courts for good, precluding any other opportunity for [the defendant] to vindicate its claimed legal entitlement . . . to have a federal tribunal adjudicate the merits").

72. The dissent also noted that the issue may arise if an attorney makes a mistake and files a notice of removal without supporting evidence.

unable to complete the appeal within 60 days,[73] or the case may have been "a poor vehicle for deciding the issue presented . . . ."[74]

Despite the narrow majority, the Court signaled a willingness to review removal issues and consider challenges to the discretionary review of circuit courts. Royalty owners considering class actions against oil and gas operators, particularly within the Tenth Circuit's jurisdiction, should consider the liberal pleading standards for removal before filing suit in state court. Finally, on remand, the Tenth Circuit may provide a permissible reason for its decision to deny Dart's review, further providing guidance on removal notices.[75]

2. Harrison v. Cabot Oil & Gas Corp., 110 A.3d 178 (Pa. 2015)

Issue: A lessor unsuccessfully sought declaratory relief to invalidate a lease. Does that action repudiate the lease and entitle the lessee, an oil and gas producing company, to equitable extension of the primary lease term?

In August 2007, Wayne Harrison leased land to Cabot Oil & Gas Corp. to exclusively explore oil and gas resources. The lease had a primary term of five years, gave Cabot the option to extend the primary term under certain circumstances, and contained an extended term if certain conditions were met.

"Approximately halfway through the primary lease term,"[76] Harrison sought a declaratory judgment that the lease was invalid. At this point, Cabot had not commenced activity on the property. Cabot argued that the lease was valid and counterclaimed. Cabot sought a declaratory judgment that, if Harrison's claim failed, the lease's primary term would be equitably extended by the period of time that the lawsuit was pending. Cabot argued, "the cloud upon the lease created by" the lawsuit prevented it from reasonably commencing operations on the land.[77]

The district court held that the lease was valid, but that the doctrine of equitable extension did not apply.[78] Cabot appealed the district court's equitable extension ruling to the United States Court of Appeals for the Third Circuit.

73. *See* 28 U.S.C. § 1453(c)(2) (2013) ("[T]he court shall complete all action on such appeal, including rendering judgment, not later than 60 days after the date on which such appeal was filed, unless an extension is granted under paragraph (3).").

74. *Dart*, 135 S. Ct. at 559 (Scalia, J., dissenting).

75. *See Dart*, 135 S. Ct. at 558 n. 8 (majority opinion) (inviting the Tenth Circuit to explain its decision on remand).

76. Harrison v. Cabot Oil & Gas Corp., 110 A.3d 178, 179 (Pa. 2015).

77. *Id.* Cabot introduced testimony that it would have cost between $4 and $7 million to produce gas on the land, and the economic risk was not worthwhile until the court resolved the lease challenge. *Id.* at 180 (citations omitted).

78. *See* Harrison v. Cabot Oil & Gas Corp., 887 F. Supp. 2d 588, 596–98 (M.D. Pa. 2012) (relying primarily on Derrickheim Co. v. Brown, 451 A.2d 477 (Pa. 1982)).

Granting Cabot's motion, the Third Circuit certified a question to the Supreme Court of Pennsylvania regarding "whether the primary term of an oil and gas lease should be equitably extended by the courts, where the lessor has pursued an unsuccessful lawsuit challenging the validity of the lease."[79] This issue was one of first impression for the state.

Cabot argued largely on contract and equity-based grounds, such as: a party is entitled to the benefit of its bargain; filing a declaratory judgment repudiates a lease; lessors should not be able to contest leases to forestall a lessee's operations without consequence; and lessors should not be able to opportunistically initiate legal proceedings to hopefully obtain "the freedom to pursue more lucrative arrangements."[80]

The court began its analysis by recognizing that "contractual remedies, including equitable ones, generally flow from a breach of an agreement."[81] In Pennsylvania, "anticipatory repudiation or breach requires an 'absolute and unequivocal refusal to perform or a distinct and positive statement of an inability to do so.'"[82] The court held that filing a declaratory judgment seeking to invalidate a lease does not anticipatorily repudiate that lease.[83] A declaratory judgment action "does not entail such an unequivocal refusal to perform;"[84] in fact, declaratory judgments serve to resolve issues before repudiation occurs.[85]

After explaining the general law in Pennsylvania, the court turned to whether it should "adopt a special approach to repudiation pertaining to oil and gas leases, as a substantial number other jurisdictions would appear to have done."[86]

The Pennsylvania Supreme Court recognized the majority view from oil and gas producing jurisdictions: "a lessor's . . . lease-validity challenge constitutes an effective repudiation of the agreement . . . [and] it is therefore appropriate for the courts to award an extension of the primary lease term, measured according to the length of time the unsuccessful lawsuit was pending."[87] These jurisdictions reason that a lawsuit, and the risk of its success, makes it economically unreasonable for companies to

79. *Harrison*, 110 A.3d at 179.
80. *Id.* at 182.
81. *Id.* at 184 (citing McShea v. City of Phila., 995 A.2d 334, 340 (Pa. 2010)).
82. *Id.* (citing 2401 Pa. Ave. Corp. v. Fed'n of Jewish Agencies of Greater Phila., 489 A.2d 733, 736 (Pa. 1985) (quoting McClelland v. New Amsterdam Cas. Co., 185 A. 198, 200 (Pa. 1936))).
83. *Id.* at 184–85; *see Harrison,* 887 F. Supp. 2d at 597.
84. *Harrison*, 110 A.3d at 185 (citations omitted).
85. *Id.*
86. *Id*.
87. I*d.* at 180 (citing Rougon v. Chevron, U.S.A. Inc., 575 F. Supp. 95, 100 (M.D. La. 1983) (quoting Hanszen v. Cocke, 246 So. 2d 200, 203 (La. Ct. App. 1971)); Sw. Energy Prod. Co. v. Elkins, 374 S.W.3d 678, 685 (Ark. 2010); Greer v. Carter Oil Co., 25 N.E.2d 805, 810 (Ill. 1940); *cf.* Kothmann v. Boley, 308 S.W.2d 1, 4 (Tex. 1957); Bingham v. Stevenson, 420 P.2d 839, 842 (Mont. 1966)).

commence or continue operations during the proceedings, and it would be unfair for an unfruitful lease challenge to irreparably harm the lessee.[88] In fact, the court acknowledged that the majority view is "essentially one of black-letter law, as reflected in several prominent treatises in the field."[89]

Pennsylvania, addressing the issue for the first time, departed from the majority view and declined to "adopt a special approach to repudiation pertaining to oil and gas leases."[90] The court based its holding on Pennsylvania's concrete legal principles of repudiation described above. Pennsylvania law prioritizes the terms of a lease over equitable considerations, even when a company reasonably ceases operations until a lease challenge is resolved.[91] The court also described various policy considerations that Harrison and several amici argued, which affirmed rejecting a special exception for oil and gas leases.

For example, Harrison argued that oil and gas producing companies have superior bargaining power over lessors. Further, Harrison argued that Cabot's position would deter lessors from bringing potentially meritorious claims.[92] Importantly, the court agreed that companies are not only free, but are on sufficient notice, to include tolling provisions in their leases to mitigate against delays from a lessor's lease-validity challenge. Lastly, the amici persuasively argued, according to the court, that "lease-validity litigation [is one of many risks] encountered by oil and gas producing companies as a prerequisite to the rich rewards which may be attained by those willing to accept them[.]"[93]

In the end, the court recognized the high costs and risks in oil and gas exploration. According to the court, however, those costs and risks do not justify lightening contract law's legal principles or lessening the rights of landowner-lessors to seek a declaratory judgment.

The court did not rule out the possibility that oil and gas producing companies may obtain equitable relief in certain circumstances—such as when affirmative repudiation of a lease occurs.[94] Yet, it held that "the mere pursuit of declaratory relief challenging the validity of a lease does not amount to such."[95]

88. *Id.*
89. *Id.* at 182 (citing 3 PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS, OIL AND GAS LAW § 604.7 (2009); 2 NANCY SAINT–PAUL, SUMMERS, OIL & GAS § 14:36 (2014)).
90. *Id.* at 185.
91. Derrickheim Co. v. Brown, 451 A.2d 477, 480.
92. *See* Lauchle v. Keeton Group LLC, 768 F. Supp. 2d 762 (M.D. Pa. 2011).
93. *Harrison*, 110 A.3d at 184 (citation omitted).
94. *Id.* at 186 (citing Bingham v. Stevenson, 420 P.2d 839, 841–42 (Mont. 1966); Muller v. Leyendecker, 697 S.W.2d 668, 672 (Tex. App.—San Antonio 1985, writ ref'd n.r.e)).
95. *Id.* at 186.

3. State ex rel. Morrison v. Beck Energy Corp., Slip Opinion No. 2015-Ohio-0485

Issue: Does the Home Rule Amendment to the Ohio Constitution grant a city the power to enforce its own permitting scheme on top of the state system regulating oil and gas drilling?

In 2011, Beck Energy Corporation obtained a permit under R.C. Chapter 1509 from the Ohio Department of Natural Resources (ODNR) allowing the company to drill an oil and gas well within the city limits of Munroe Falls.[96]

The permit was obtained under R.C. 1509, which provided for uniform statewide regulation of oil and gas production in the state of Ohio.[97] In 2004, the Ohio legislature repealed "all provisions of law that granted or alluded to the authority of local governments to adopt concurrent requirements with the state" regulating oil and gas production.[98] The legislature centralized the regulation authority in the state, giving the ODNR "sole and exclusive authority to regulate the permitting, location, and spacing of oil and gas wells and production operations within the state" except for activities under federal regulations.[99]

Once Beck Energy began drilling, the city issued a stop-work order and sought an injunction, arguing that Beck Energy violated several provisions of the Munroe Falls Codified Ordinances. Beck Energy argued that the local ordinances conflicted with the state regulations under R.C. 1509, but the trial court held for the city and granted a permanent injunction barring Beck Energy from drilling the well until it complied with the ordinances. The court of appeals reversed the trial court's decision, holding that R.C. 1509.02 prohibited the city from enforcing the five specific ordinances and ruled that the Home Rule Amendment to the Ohio Constitution did not give the city the authority to implement its own requirements on oil and gas drilling.[100]

Before analyzing the specific merits of the case, Justice French discussed the limits of the Home Rule Amendment, which grants "[m]unicipalities . . . [the] authority to exercise all powers of local self-government and to adopt and enforce within their limits such local . . .

96. State ex rel. Morrison v. Beck Energy Corp., Slip Opinion No. 2015-Ohio-485, at ¶ 2. The permit is necessary to "drill a new well, drill an existing well any deeper, reopen a well, convert a well to any use other than its original purpose, or plug back a well to a source of supply different from the existing pool . . . ." OHIO REV. CODE. ANN. § 1509.02 (West 2015).

97. *Beck Energy*, No. 2015-Ohio-485, at ¶ 2.

98. Legislative Service Commission Bill Analysis, Sub. H.B. No. 278 (2004).

99. OHIO REV. CODE. ANN. § 1509.02 (West 2015).

100. State ex rel. Morrison v. Beck Energy Corp., 2013-Ohio-356, 989 N.E.2d 85, ¶ 74–77 (9th Dist.), *aff'd*, 2015-Ohio-485.

regulations, as are not in conflict with general laws."[101] In determining whether a municipal ordinance must yield to a state statute under the Home Rule Amendment, the court applied a three-prong test in which the ordinance must yield to the state statute if "(1) the ordinance is an exercise of the police power, rather than of local self-government, (2) the statute is a general law, and (3) the ordinance is in conflict with the statute."[102] Under this test, Justice French, writing for the majority, determined that the five municipal ordinances could not be enforced and must yield to the Ohio state statute, R.C. 1509.02.

Beginning the analysis, the first prong of the three-part test is to determine if the municipal ordinance was an exercise of police power rather than local self-governance. Justice French reasoned that any "'municipal ordinance, which prohibits the doing of something without a municipal license to do it, is a police regulation' within the meaning of the Home Rule Amendment."[103] Here, the court stated that the ordinance was an exercise of police power because it prohibited the act of drilling for oil and gas without a municipal permit instead of regulating form or structure of the local government.[104]

The second prong deals with determining if the state statute is a general law. A statute is a general law if it satisfies four requirements:

> (1) be part of a statewide and comprehensive legislative enactment, (2) apply to all parts of the state alike and operate uniformly throughout the state, (3) set forth police, sanitary, or similar regulations, rather than purport only to grant or limit legislative power of a municipal corporation to set forth police, sanitary, or similar regulations, and (4) prescribe a rule of conduct upon citizens generally.[105]

In this case, the city only disputed the second condition, asserting that R.C. 1509.02 neither applied to all parts of the state nor operated uniformly throughout the state because only the eastern part of Ohio contains economically viable amounts of oil and gas. Justice French rejected this argument, however, holding that R.C. 1509 was a general law under this analysis, and continued to recognize that even if the general law does not operate in all areas of the state, it can operate

101. OHIO CONST. art. XVIII, § 3; State ex rel. Mill Creek Metro. Park Dist. Bd. of Comm'rs. V. Tablack, 714 N.E.2d 917, 919 (Ohio 1999).

102. Mendenhall v. Akron, 881 N.E.2d 255, 260 (Ohio 2008).

103. State ex rel. Morrison v. Beck Energy Corp., Slip Opinion No. 2015-Ohio-485, at ¶ 17 (quoting Auxter v. City of Toledo, 183 N.E.2d 920, 922 (Ohio 1962)).

104. *Id.* (noting that the city did not dispute the classification of the ordinance as an exercise of police power).

105. *Mendenhall*, 881 N.E.2d at 261.

uniformly throughout the state because it applies to all political subdivisions equally.[106]

Finally, the third prong under the test is to determine if the ordinances conflict with the state statute. "A conflict exists if 'the ordinance permits or licenses that which the statute forbids and prohibits, and vice versa.'"[107] On further discussion, the Supreme Court held that the ordinances conflicted with R.C. 1509.02 in two ways.

First, the court determined that the ordinances prohibited state licensed oil and gas production within the city. Justice French recognized an existing precedent establishing that a city ordinance conflicts with a state license when it "restrict[s] an activity which a state license permits."[108] Because both the state statute and municipal ordinances regulated the same subject matter—oil and gas drilling—Justice French determined the laws conflicted. Second, the court determined that R.C. 1509.02 gave the ODNR the exclusive authority to regulate oil and gas wells and production within Ohio, including permitting, and in Ohio, a conflict exists when the language of the statute intended to preempt local regulation.[109]

Satisfying the three-part test, the court held that the Home Rule Amendment did not allow the municipality to obstruct oil and gas activities that the state has permitted under R.C. 1509.[110] Because the regulatory scheme under the state statute regulated oil and gas activities within the state, the five municipal ordinances conflicted with a general law and the judgment of the court of appeals was affirmed, prohibiting the city from enforcing the five ordinances.

This case was closely decided four to three, with one justice concurring in the judgment. Justice O'Donnell wrote separately in his concurrence to emphasize the limited scope of the holding to only the five specific municipal ordinances.[111] Justice O'Donnell agreed with the majority that the municipal ordinance conflicted with R.C. 1509.02 and was preempted by Chapter 1509, but determined that the court had not decided whether the state intended to preempt all local zoning ordinances limiting land use that did not regulate oil and gas drilling.

106. *See* Clermont Envtl. Reclamation Co. v. Wiederhold, 442 N.E.2d 1278, 1283 (Ohio 1982) (holding that a statute regulating hazardous waste facilities and prohibiting political subdivisions from imposing regulations still operated uniformly throughout the state even though it was not feasible in some parts of the state).

107. *Beck Energy*, No. 2015-Ohio-485, at ¶ 24 (citing Struthers v. Sokol, 140 N.E. 519 (Ohio 1923)).

108. Ohio Ass'n of Private Detective Agencies, Inc. v. N. Olmsted, 602 N.E.2d 1147, 1150 (Ohio 1992).

109. *See* Westlake v. Mascot Petrol. Co., 573 N.E.2d 1068, 1071 (Ohio 1991).

110. *Beck Energy*, No. 2015-Ohio-485, at ¶ 34.

111. *Id.* (O'Donnell, J., concurring).

Taking a different view, Justice Lanzinger's dissent determined that R.C. 1509.02 allowed municipalities to employ zoning regulations that did not conflict with the statute.[112] Because the city ordinances were mere zoning regulations, no conflict with the state statute existed. Thus, the dissent determined the city could enforce its ordinances. The dissent further reasoned that municipalities can supplement general laws if the zoning ordinances do not conflict with the statute. Finally, Justice Lanzinger looked to other jurisdictions faced with similar situations, and contended that Ohio local zoning ordinances could "coexist with . . . statewide regulations governing drilling."[113]

While the holding in this case is limited specifically to these five city ordinances, the court held that R.C. 1509 unequivocally prohibits municipalities from regulating in a way that "discriminates against, unfairly impedes, or obstructs the activities and operations covered by R.C. 1509.02."[114] This holding may lead to further litigation of other municipal ordinances alleged to conflict with state regulation of oil and gas activities. Nevertheless, the oil and gas industry in Ohio likely benefits from this holding. It removes double licensing, since municipalities lack the authority to regulate oil and gas drilling, and it gives the ODNR sole and exclusive authority to regulate oil and gas drilling within the state. Additionally, the court's holding may have implications in other states with similar regulations. Other courts in Pennsylvania,[115] Colorado,[116] and New York[117] have permitted local governments to exercise such authority. With this conflict across states, more jurisdictions may be subject to litigation surrounding the tension between local and state regulations of oil and gas activities.

112. *Id.* at ¶ 58 (Lanzinger, J., dissenting).

113. *Id.* at ¶ 74.

114. *Id.* at ¶ 30 (majority opinion).

115. Huntley & Huntley, Inc. v. Borough Council of Borough of Oakmont, 964 A.2d 855, 866 (2009) (concluding that a state statute superseding all municipal ordinances that regulated oil and gas operations did not preempt local zoning ordinances, which had the effect of excluding oil and gas wells from certain districts); *see also* Robinson Twp., Wash. Cnty. v. Pennsylvania, 83 A.3d 901, 997 (Pa. 2013) (holding that section 3305(a) of the Pennsylvania Consolidated Statutes does not violate the separation of powers doctrine). However, on remand, the Commonwealth Court enjoined the application and enforcement of section 3305 in its entirety because the Pennsylvania Supreme Court held that sections 3215(b)(4) and (d), 3303, and 3304 were unconstitutional, and as these were the "only substantive provisions of 'th[e] chapter'" and were not severable. Robinson Twp. v. Pennsylvania, 96 A.3d 1104, 1120 (Pa. Commw. Ct. 2014).

116. Bd. of Cnty. Comm'rs, La Plata Cnty. v. Bowen/Edwards Assocs., Inc., 830 P.2d 1045 (Colo. 1992) (holding that the state act did not preempt county's authority to enact land-use regulations for oil and gas operations within county).

117. Wallach v. Town of Dryden, 16 N.E.3d 1188, 1203 (N.Y. 2014) (holding that the zoning laws of Dryden and Middlefield were valid because the state legislature did not show a "clear expression of preemptive intent" over the local government ordinances)

B. FOREIGN DIRECT INVESTMENT IN THE UNITED STATES AND THE DEFENSE PRODUCTION ACT—A LOOK AT *RALLS CORPORATION V. TERNA ENERGY USA HOLDING CORPORATION*

MARIA C. FACONTI*

I. INTRODUCTION

Not only is the United States the world's largest foreign direct investor, but it is also the largest beneficiary of foreign direct investment (FDI).[1] Since 2006, FDI inflows have totaled $1.5 trillion with total net U.S. assets of foreign affiliates totaling $3.9 trillion in 2012,[2] and 2012 inflows totaling $166 billion.[3] The United States is considered an attractive investment climate because of its growing energy sector, its status as the world's largest consumer market, its skilled and productive workforce, its appropriate legal protections and predictable regulatory environment, and its highly innovative environment.[4] These factors make the United States a top destination for FDI.

The implications of FDI on the United States economy have become more important as foreign firms acquire more U.S. businesses. For example, in 2010, foreign firms owned more than 30,000 businesses within the United States, according to the Department of Commerce.[5] Of these foreign-owned businesses, a disproportionate number are involved in manufacturing.[6]

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1. Jonathan Masters, *Foreign Investment and U.S. National Security*, COUNCIL ON FOREIGN RELATIONS (Sept. 27, 2013), http://www.cfr.org/foreign-direct-investment/foreign-investment-us-national-secuirty/p31477.
2. DEP'T OF COMMERCE AND THE PRESIDENT'S COUNCIL OF ECON. ADVISERS, FOREIGN DIRECT INV. IN THE UNITED STATES 1 (2013), http://www.whitehouse.gov/sites/default/ files/ 2013fdi_report_-_final_for_web.pdf.
3. *Id.* at 2–3.
4. *Id.*
5. Masters, *supra* note 1.
6. *Id.*

Though the United States is considered a favorable environment for FDI, companies wishing to acquire or invest in U.S. companies must be cognizant of the risks associated with such investment, especially those risks arising from the Defense Production Act (DPA).[7] The DPA allows for the federal government to review, suspend, or prohibit any covered foreign purchase of a U.S. business "that threatens to impair the national security of the United States."[8] This article will look at the background of FDI in the United States and its national security implications, specifically, how the DPA was designed to protect national security. Next, this article will examine the process the DPA created for review of foreign investment in the United States, specifically, the review conducted by the Committee on Foreign Investment in the United States (CFIUS or the Committee). Finally, this article will look at *Ralls Corporation v. Terna Energy USA Holding Corporation*,[9] a case in which the Executive Branch blocked an investment because of its implications for national security, and the effect of this decision on future FDI investment in the U.S. energy sector.

II. FOREIGN DIRECT INVESTMENT, NATIONAL SECURITY, AND THE DEFENSE PRODUCTION ACT

The United States, like many other countries, puts restrictions on FDI. Domestic concerns with foreign transactions are typically focused on mergers, acquisitions, and takeovers of already-established domestic firms, as opposed to new, or "greenfield," investments.[10] CFIUS was established in 1975 in order to review acquisitions of U.S. firms by foreign entities.[11] This move came at a time when lawmakers were uneasy about the amount of investment that OPEC-nations were making within the United States.[12] The Committee was given the responsibility of reviewing transactions that had the potential of having significant consequences on U.S. interests.[13]

In 1988, amidst growing concerns regarding the power of CFIUS, as well as concerns over increased investment by Japanese companies, Congress strengthened the 1950 Defense Production Act with the Exon–Florio Amendment.[14] The Exon–Florio Amendment granted the

7. Masters, *supra* note 1; Defense Production Act of 1950, 50 U.S.C. app. § 2170 (2012) (as amended by the Foreign Investment and National Security Act of 2007).

8. 50 U.S.C. app. § 2170(b)(2)(B).

9. Ralls Corp. v. Comm. On Foreign Inv. in the U.S., 926 F. Supp. 2d 71 (D.D.C. 2013).

10. Masters, *supra* note 1.

11. JAMES JACKSON, CONG. RESEARCH SERV., RL33388, THE COMMITTEE ON FOREIGN INVESTMENTS IN THE UNITED STATES 1 (2014).

12. *Id.*

13. *Id.*

14. Marc Greidinger, *The Exon-Florio Amendment: A Solution in Search of a Problem*, 6 Am. U. L. Rev. 111, 111–12 (1991).

President far-reaching authority to block a foreign acquisition on "national security" grounds.[15] The Reagan administration then delegated this power to CFIUS.[16]

More recently, the Foreign Investment and National Security Act of 2007 (FINSA) amended the DPA once again.[17] The FINSA provided Congress with greater oversight over CFIUS while also expanding the definition of national security in order to include critical infrastructure, as defined by the 2001 USA PATRIOT Act.[18]

As it currently stands, the DPA requires CFIUS to investigate deals involving foreign investments where a domestic entity is owned or controlled by a foreign power.[19] Specifically, "Section 721 gives CFIUS and the President the authority to take action in connection with a covered transaction, which 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."[20] The result is that the DPA effectively shifts the burden of proof onto foreign firms to show that their ownership of the domestic entity does not present a risk to U.S. national security, which can be difficult to prove.[21]

III. COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES REVIEW

CFIUS is an inter-agency organization which is chaired by the Secretary of the Treasury and operates at the discretion of the President.[22] The Committee is comprised of the heads of the Department of Justice, the Department of Homeland Security, the Department of Energy, the Department of State, the Department of Commerce, and the Department of Defense.[23] Other members of the Committee include the Director of the Office of Science and Technology Policy, as well as the

15. *Id.* at 117.
16. *Id.* at 115 n.26.
17. Foreign Investment and National Securities Act of 2007, Pub. L. No. 110-49, 121 Stat. 246 (2007).
18. *Id.* at Pub. L. No. 110-49, § 7, § 2(a)(5), 121 Stat. 246, 248, 257*; see also* Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001, Pub. L. No. 107-56, 2001 U.S.C.C.A.N. (115 Stat.) 272 (2001).
19. Daniel Spitzer & Maureen R. Monaghan, *U.S. Government Blocks Foreign Investment in Renewal Energy Project*, 4 Legal & Tax Newsl. 8, 8 (2012), http://www.hodgsonruss.com/assets/htmldocuments/1_2_1/Articles/2012/MRM%20DAS%20GACoC%20Newsletter%201%2013.pdf.
20. Ralls Corp. v. Comm. on Foreign Inv. in the U.S., 926 F. Supp. 2d 71, 76 (D.D.C. 2013) (internal quotation marks omitted) (citing 50 U.S.C. app. § 2170(a)(3) (2012)).
21. *See* Masters, *supra* note 1; *see also* JAMES K. JACKSON, FOREIGN INVESTMENT, CFIUS, AND HOMELAND SECURITY: AN OVERVIEW, CONG. RESEARCH SERV. 3 (2011).
22. Masters, *supra* note 1; 50 U.S.C. app. § 2170(k)(3), (k)(1).
23. Masters, *supra* note 1; 50 U.S.C. app. § 2170(k)(2)–(3).

United States trade representative.[24] Officers of the Council of Economic Advisers, the Office of Management and Budget, the National Security Council, the Homeland Security Council, and the National Economic Council are also contributing members.[25] Finally, the Secretary of Labor and the Director of National Intelligence are non-voting, *ex officio* members.[26]

Under the DPA, a party to a transaction may submit a joint written notice to CFIUS before closing the transaction to obtain approval of the transaction; this written notice is voluntary.[27] If a party does not initiate review by submitting written notice to the Chairperson of the Committee, the President or CFIUS may initiate review at any time, even after the transaction has closed.[28]

CFIUS staff then conducts reviews of foreign deals which might have implications for U.S. national security.[29] The concept of national security is broadly construed, and includes potential effects on critical infrastructure, that is, infrastructure considered to be so vital to the nation that its destruction or incapacitation would be debilitating to national security.[30] This definition thus includes any infrastructure related to the energy sector.[31]

Every year CFIUS reviews dozens of deals involving foreign investment in U.S. companies that might have national security concerns.[32] However, those reviews only pertain to "covered transactions," which are defined as those mergers, takeovers, or acquisitions resulting in "foreign control of any person engaged in interstate commerce in the United States."[33] This definition is broad and includes any transaction "by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in

24. Masters, *supra* note 1.
25. 50 U.S.C. app. § 2170 Sec. 3 Establishment (c).
26. *Id.* at § 2170 (b)(2)(4)(D).
27. Richard G. Reinis, *CFIUS and Foreign Investment in the U.S. Wind Energy Industry: A Question of National Security*, 1 POWER AND ENERGY SOLUTIONS: NORTH AMERICA, at 58, *available at* http://www.pes.eu.com/assets/misc/think-tank-cfiuspdf-62.pdf.
28. 50 U.S.C. app. § 2170(b)(1)(C)–(D).
29. Masters, *supra* note 1.
30. Reinis, *supra* note 27, at 58.
31. The investment in the energy sector is increasingly becoming thought of as a risk to national security and therefore a focus of CFIUS because "there have been recent press reports that foreign spies have infiltrated the United States electric grid and may have the ability to disrupt the power supply at will" and it is believed that a foreign owner might be able to use "that system to engage in espionage, obtain sensitive technology, or disrupt other energy transmission or distribution channels . . . ." *Id.* at 59. *See* 50 U.S.C. app. § 2170(f)(6) (listing "the potential national security-related effects on . . . major energy assets" as a factor to be considered in the President's determination of whether CFIUS action is necessary).
32. Spitzer & Monaghan, *supra* note 19, at 8.
33. 50 U.S.C. app. § 2170(a)(3).

the United States."[34] In addition, the term "control" has been broadly interpreted and includes "power, direct or indirect, whether or not exercised . . . to determine, direct, or decide important matters affecting an entity."[35] Therefore, as used in the DPA, "control" does not necessarily require a controlling interest, such as a 50% voting or equity interest, or that a foreign person be an officer or director. The definition simply requires that the foreign entity have influence over the U.S. company.[36]

Some types of transactions are not included. For example, greenfield investments[37] (which are transactions conducted for the sole purpose of investment) and transactions in which the foreign investor "has no intention of determining or directing the basic business decisions of the issuer"[38] are not covered transactions under the DPA. In addition, loans and leases are generally not covered because those transactions generally do not include the requisite amount of control or influence to spark CFIUS review.[39] Likewise, a simple asset purchase is not necessarily considered a purchase of a U.S. business.[40] Additionally, investments in which foreign investors hold an interest equal to 10% or less in a U.S. company, solely for the purpose of holding a passive investment, are not subject to CFIUS review.[41] CFIUS review is therefore contingent on a level of control by the foreign person brought about as a result of the transaction.

Once a deal is submitted for formal review, CFIUS has thirty days to review the proposal to determine if further scrutiny is warranted.[42] During this initial review, CFIUS staff can request party feedback as well as additional information from the parties in order to conduct their analysis.[43] For the most part, this request involves the companies answering various questions about themselves, the assets, and the transaction.[44] Most CFIUS reviews conclude after this initial thirty day period because it is determined no national security risk exists.[45] During the initial CFIUS thirty day review, CFIUS considers eleven specific

34. 50 U.S.C. app. § 2170(a)(3); s*ee also* Reinis, *supra* note 27, at 58 (noting that a U.S. subsidiary controlled by a foreign entity is considered a foreign person under the Act).

35. Reinis, *supra* note 27, at 58; *see also* DEP'T OF THE TREASURY, CFIUS REFORM: FINAL REGULATIONS ISSUED ON NOVEMBER 14, 2008 1 (2008), http://www.treasury.gov/ resource-center/international/foreign-investment/Documents/Summary-FinalRegs.pdf.

36. Reinis, *supra* note 27, at 58.

37. Also known as start-up investment. DEP'T OF THE TREASURY, *supra* note 35, at 1.

38. OFFICE OF THE FEDERAL REGISTER, L.S.A., LIST OF C.F.R. SECTIONS AFFECTED 1231 (2003).

39. Reinis, *supra* note 27, at 58.

40. *Id.*

41. *Id.*

42. Masters, *supra* note 1; *see* 50 U.S.C. app. § 2170(b)(1)(A), (E) (2012).

43. Masters, *supra* note 1.

44. Reinis, *supra* note 27, at 58.

45. *Id.*

factors set forth in 50 U.S.C. app. § 2170(f) to assess the transaction's effects on national security.[46] During its review, if CFIUS determines that "the transaction threatens to impair the national security of the United States and that threat has not been mitigated,"[47] it must "immediately conduct an investigation of the effects of [the] covered transaction on the national security of the United States . . . and take any necessary actions in connection with the transaction to protect the national security."[48] Because of their implications for national security, some foreign deals are flagged for further investigation which can last up to forty-five days, during which time the parties may negotiate a mitigation agreement with CFIUS in order to cure the national security concerns.[49] Specifically, transactions which are considered to involve "major energy assets" result in heightened CFIUS scrutiny, which involves a mandatory forty-five day investigation, unless CFIUS, during its initial review, concludes that the acquisition will not impair national security.[50]

If, after the forty-five day investigation period, CFIUS determines that a transaction threatens to impair U.S. national security interests, and that this threat has not been mitigated, CFIUS has the authority to attempt to mitigate the concerns by "tak[ing] any necessary actions in connection with the transaction" in order to protect national security.[51] Once the investigation period concludes, CFIUS is required either to submit a report to Congress documenting the results of the investigation or to submit the matter to the President.[52] If CFIUS makes an adverse recommendation to the President, the President will then have fifteen days to make a final determination on the transaction.[53]

Currently, the President has the discretion to block a transaction if two criteria are met. First, the President must have credible evidence that the transaction will in some way impair national security; and second, the President must additionally determine that no other U.S. law is sufficient to safeguard national security.[54] Such acts by the President are protected by the DPA which further states that "[t]he actions of the President under paragraph (1) of subsection (d) of this section and the findings of the President under paragraph (4) of subsection (d) of this section shall

46. Ralls Corp. v. Comm. on Foreign Inv. in U.S., 758 F.3d 296, 303 (D.C. Cir. 2014).
47. 50 U.S.C. app. § 2170(b)(2)(B)(i)(I).
48. *Id.* at § 2170(b)(2)(A).
49. Masters, *supra* note 1.
50. Spitzer & Monaghan, *supra* note 19, at 9.
51. 50 U.S.C. app. § 2170(b)(2)(A)–(B).
52. *Id.* at § 2170(b)(3)(B).
53. Masters, *supra* note 1. The President is directed 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." 50 U.S.C. app. § 2170(d)(1)–(2).
54. Masters, *supra* note 1.

not be subject to judicial review."[55] Though the President has this authority, formal orders are rarely issued because companies usually abandon their deals once faced with CFIUS opposition.[56]

Put simply, the DPA gives the President the authority to investigate the national security implications of acquisitions, mergers, and takeovers by foreign persons.[57] If it is determined that a transaction will result in the impairment of U.S. national security, and that impairment cannot be mitigated by agreement between the parties, the President has the authority to block the transaction, or to order divestment even if the deal has already been closed.[58]

When conducting the review, CFIUS not only considers the nature of the business being acquired, but also the foreign entity acquiring the control.[59] It is important to note that even if the home country of the acquiring firm is an ally of the United States, CFIUS may still consider the transaction a risk to national security.[60] In 2010 alone, more than one-third of transactions that drew CFIUS notice involved firms based in Canada and the United Kingdom, two strong United States allies.[61]

Though the country of the acquiring foreign entity is an important factor, it appears that the nature of the business being acquired might be the most significant consideration during CFIUS review. Specifically, CFIUS tends to focus on those transactions involving technology, defense, and natural resources, such as oil and gas.[62] Other factors that tend to pique CFIUS interest are "whether the acquisition target (1) has contracts with the United States government; (2) possesses sensitive or classified technologies; or (3) controls critical infrastructure, including major energy assets."[63] Therefore, transactions involving the energy sector are likely to instigate CFIUS review. Companies involved in these industries should pay particular attention to the risks associated with the DPA.

It is important to note that the federal government only reviews a small fraction of the hundreds of foreign investments that occur annually, and of those reviewed investments, it only blocks a transaction on a rare occasion.[64] Even though many transactions can facially instigate CFIUS

55. 50 U.S.C. app. § 2170(e).
56. Spitzer & Monaghan, *supra* note 19, at 8.
57. Reinis, *supra* note 27, at 58.
58. *Id.* at 57.
59. Spitzer & Monaghan, *supra* note 19, at 9.
60. *Id.*
61. *Id*.
62. *Id.*
63. *Id.* (internal quotation marks omitted). For example, such "national security concerns may arise" where there is an attempt to exercise "[f]oreign control over network assets like pipelines and electric transmission, and particularly nuclear generation." *Id.*
64. Masters, *supra* note 1.

review, between 2008 and 2011 only 10% of transactions involving the acquisition of United States firms by foreign firms were reviewed.[65] Of those reviewed transactions, almost 90% were completed, with none blocked by presidential order.[66] However, in 2012, President Obama, acting on a CFIUS recommendation, blocked a transaction in Oregon involving a windfarm and the Ralls Corporation (Ralls) because of the transaction's implications for national security.[67] The following case concerning this blocked transaction provides insight into the application of the DPA, as well as its implications on FDI in the U.S. energy sector. The case should serve as a warning for companies as to the importance of a voluntary CFIUS filing submitted prior to closure of a transaction which might be subject to review. As the events surrounding the *Ralls* transaction show, the implications of a presidential order can be extreme, and entirely avoided by a CFIUS review prior to closing, because once CFIUS approves a deal, the United States Government will not reexamine the transaction, protecting it from the *Ralls* fate.[68]

IV. *RALLS CORPORATION V. TERNA ENERGY USA HOLDING CORPORATION*

In 2008, it was estimated that wind energy accounted for approximately $17 billion of investment in the U.S. economy, most of which came from Europe.[69] This type of energy-focused FDI into the U.S. economy has the potential of instigating review by CFIUS. As noted above, the vast majority of FDI does not undergo a CFIUS review, and it is rare that the President will block a deal based on a CFIUS review.[70] On September 28, 2012, one such rare block occurred when President Obama issued a presidential order that required the Chinese-controlled Ralls to unwind a windfarm project acquisition located near a military base in Oregon.[71]

A. *The Ralls–Terna Transaction*

In March 2012, Ralls purchased four American-owned limited liability companies, each of which was associated with the development of a windfarm project in north-central Oregon, collectively known as the

65. *Id.*
66. *Id.* The transactions that were reviewed and not completed were abandoned before the President could have blocked the transaction. The firms withdrew their transactions instead of receiving a negative CFIUS recommendation. *Id.*
67. *Id.*
68. Reinis, *supra* note 27, at 58.
69. *Id.* at 57.
70. Masters, *supra* note 1.
71. Spitzer & Monaghan, *supra* note 19, at 8; *see also* Ralls Corp. v. Comm. On Foreign Inv. in the U.S., 926 F. Supp. 2d 71, 79–80 (D.D.C. 2013).

Butter Creek projects.[72] Ralls is a Delaware corporation owned by two Chinese nationals who are also executives of Sany Group (Sany), a Chinese manufacturing company.[73] The four purchased companies (Project Companies) were owned by Terna Energy USA Holding Corporation (Terna), a Delaware corporation that is a subsidiary of a publicly traded Greek company.[74] Ralls intended to acquire these windfarms in order to install Sany wind turbines.[75] The Butter Creek projects, however, overlap with a restricted airspace and bombing zone operated by the U.S. Navy and used by military aircraft.[76] In addition, the Lower Ridge windfarm is located within restricted airspace and three other sites are located less than seven miles from the restricted airspace.[77]

B. CFIUS Review and the Presidential Order

On June 28, 2012, Ralls and Terna submitted voluntary notice to CFIUS regarding the transaction, after which Ralls closed the transaction, acquired the projects, and began construction and installation of the turbines.[78] This voluntary notice, however, was given after the transaction closed, and only after the U.S. Navy expressed concerns over the proximity of the Lower Ridge windfarm to the base.[79] Despite Ralls's agreement to relocate the windfarm, CFIUS asked Ralls to file a voluntary notice of the transaction pursuant to Section 721(b)(1) of the DPA, otherwise the Department of Defense would trigger CFIUS review through agency notice.[80] During the statutory thirty day review, CFIUS asked Ralls and Terna several questions and had one meeting with the company to discuss the transaction, but CFIUS refused to disclose any evidence in connection with national security concerns.[81] On July 25, 2012, CFIUS issued their "Order Establishing Interim Mitigation Measures" regarding the Ralls–Terna transaction.[82] Then, on August 2, 2012, CFIUS issued an amended order declaring that the Ralls–Terna transaction was considered a "covered transaction" that presented risks to U.S. national security.[83] Finally, after the statutory forty-five day

72. *Ralls*, 926 F. Supp. 2d at 78.
73. *Id.*
74. *Id.*
75. Ralls Corp. v. Comm. on Foreign Inv. in the U.S., 987 F. Supp. 2d 18, 18 (D.D.C. 2013), *rev'd and remanded sub nom.*, 758 F.3d 296 (D.C. Cir. 2014).
76. *Ralls*, 926 F. Supp. 2d at 78.
77. *Id*
78. *Id.* at 78, 89; *see also Ralls*, 987 F. Supp. 2d at 24.
79. *Ralls*, 987 F. Supp. 2d at 24; *Ralls*, 926 F. Supp. 2d at 78.
80. *Ralls*, 987 F. Supp. 2d at 24.
81. *Ralls*, 926 F. Supp. 2d at 79.
82. *Id.*
83. *Id.* (internal quotation marks omitted).

period for investigation, CFIUS submitted a report regarding the transaction to the President.[84]

On September 28, 2012, President Obama exercised his power under Section 721 of the DPA to prohibit the transaction.[85] The President issued an order entitled, "Order Regarding the Acquisition of Four U.S. Wind Farm Project Companies by Ralls Corporation,"[86] (Presidential Order or Order) which found that Ralls's purchase of the four American-owned companies would allow Ralls to exercise control of those companies such that Ralls "might take actions that threaten to impair the national security of the United States."[87] More specifically, the Order made two findings: (1) that there was credible evidence that might lead the President to believe that Ralls, alone or through its subsidiaries, might take actions through its control of the Butter Creek Project Companies that threaten to impair U.S. national security; and (2) that, in the President's judgment, provisions of law outside of Section 721 and the International Emergency Economic Powers Act do not provide appropriate and adequate protection to the national security matter.[88] The Order decreed that the Terna–Ralls transaction was prohibited and therefore Ralls's ownership of the Butter Creek Project Companies was prohibited in any manner, including through subsidiaries of Ralls, Sany, and Ralls's owners.[89] In addition, the Order required Ralls to "divest all interests in the Butter Creek [P]roject [C]ompanies, their assets, and any operations developed, held, or controlled by them."[90] Finally, the Order prohibited Ralls, any of its subsidiaries, its owners, and Sany "from selling or otherwise transferring, proposing to sell or transfer, or facilitating the sale or transfer of any items produced by Sany to any third party for use at the project sites" and "prohibit[ed] Ralls from completing a sale or transfer of the [P]roject [C]ompanies or their assets to any third party . . . ."[91] Therefore, not only did the Order require the unwinding of the acquisition through mandatory divestment, but it also inevitably froze the assets in the hands of Ralls, as it limited the company's ability to sell its assets.

84. *Ralls*, 987 F. Supp. 2d at 24.
85. *Ralls*, 926 F. Supp. 2d at 76, 80.
86. *Id.* at 79–80 (internal quotation marks omitted).
87. *Id.* at 80.
88. *Id.*
89. *Id.*
90. Ralls Corp. v. Comm. on Foreign Inv. in the U.S., 987 F. Supp. 2d 18, 25 (D.D.C. 2013), *rev'd and remanded sub nom.*, 758 F.3d 296 (D.C. Cir. 2014).
91. *Ralls*, 926 F. Supp. 2d at 80.

C. Judicial Challenges to CFIUS Order and Presidential Order

Ralls challenged the initial CFIUS interim order, as well as the subsequent presidential order, arguing that CFIUS had exceeded its statutory authority, that its actions were arbitrary and capricious, and that the President's Order violated Ralls's constitutional rights to due process and equal protection.[92] The complaints were initially filed in the D.C. District Court, and resolved over the course of several months and numerous judicial orders and opinions. Ralls then appealed the adverse rulings regarding its challenge to CFIUS's interim order, the Presidential Order, and its due process claim, arguing the Presidential Order constituted a governmental taking.[93] On appeal, the D.C. Circuit Court of Appeals reversed the district court's decisions and remanded the case "with instructions that Ralls be provided the requisite process."[94]

1. District Court Determination

After the CFIUS determination that the Ralls's project threatened national security, the President issued a permanent order in the form of a Presidential Order concluding that the transaction posed a threat to national security and prohibiting the transaction, requiring Ralls to divest itself of the Project Companies.[95] Neither of the Orders disclosed the nature of the national security threat the transaction posed or the evidence on which CFIUS or the President relied in issuing their orders and provided Ralls with no opportunity to rebut the evidence.[96] Upon this determination, Ralls challenged the CFIUS Order, as well as the Presidential Order in the D.C. District Court, alleging that the orders violated the Due Process Clause of the Fifth Amendment to the United States Constitution, arguing that "neither CFIUS nor the President . . . provided Ralls the opportunity to review and rebut the evidence upon which they relied" in making their determinations.[97] The D.C. District Court, upon a request by CFIUS and the President to dismiss the action, found that "Section 721 barred judicial review of Ralls's *ultra vires* and equal protection challenges to the Presidential Order but not Ralls's due process challenge . . . ."[98] As to the takings argument, the district court further found that Ralls had no constitutionally protected interest

92. *Id.* at 81.
93. Brief for Appellant at 1–2, Ralls Corp. v. Comm. on Foreign Inv. in the U.S., No. 13-5315, 2014 WL 507444 (D.C. Cir. Feb. 7, 2014) (appealing its due process challenge to CFIUS' orders and the President's Order, and the district court's ruling that its claims against CFIUS are moot).
94. Ralls Corp. v. Comm. on Foreign Inv. in U.S., 758 F.3d 296, 325 (D.C. Cir. 2014).
95. *Id.* at 301–02.
96. *Id.* at 306.
97. *Id.* at 302.
98. *Id.* at 306.

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."[99] The court based their determinations on the express language of the statute, which specifically states "[t]he actions of the President . . . and the findings of the President . . . shall not be subject to judicial review."[100] Furthermore, the court found that "Section 721(d)(1) does not limit the President's authority to merely suspending or prohibiting a transaction; rather, it grants the President extremely broad authority to '*take such action for such time as the President considers appropriate* to suspend or prohibit' transactions," with the President having the authority to accomplish the prohibition in whatever manner deemed necessary.[101]

The district court also stated that a judicial review of whether there was an appropriate basis for a Presidential Order is the type of inquiry prohibited by the finality provision of Section 721.[102] The court held that Congress structured the statute so as to protect the President's findings because "the President is only authorized to take action if he finds that there is no other way to protect the national security," which would only occur in limited but important circumstances.[103]

2. D.C. Circuit Court of Appeals

Ralls appealed the lower court determination to the D.C. Circuit, which ultimately reversed the district court opinion.[104] The D.C. Circuit relied on the text of Section 721 and its legislative history in making their determination that Congress did not intend to bar judicial review of procedural due process challenges to the Presidential Order.[105] The D.C. Circuit, in its determination, pointed out that judicial review precludes review of constitutional claims only if there is "clear and convincing" evidence that Congress intended to preclude judicial review.[106] The Court recognized that the Supreme Court has required "'the clearest evocation of congressional intent to proscribe judicial review of constitutional claims' in light of the 'constitutional dangers inherent in

99. Ralls Corp. v. Comm. on Foreign Inv. in the U.S., 987 F. Supp. 2d 18, 27 (D.D.C. 2013), *rev'd and remanded sub nom.*, 758 F.3d 296 (D.C. Cir. 2014).
100. 50 U.S.C. app. § 2170(e); *see also* Ralls Corp. v. Comm. On Foreign Inv. in the U.S., 926 F. Supp. 2d 71, 76 (D.D.C. 2013).
101. *Ralls*, 926 F. Supp. 2d at 88 (emphasis added) (quoting 50 U.S.C. app, § 2170(d)).
102. *Id.* at 89.
103. *Id.* at 90.
104. *See* Ralls Corp. v. Comm. on Foreign Inv. in U.S., 758 F.3d 296, 307–14 (D.C. Cir. 2014).
105. *Id.* at 311 (applying the clear and convincing evidentiary standard for statutory bars to judicial review of constitutional claims).
106. *Id.* at 308.

denying a forum in which to argue that government action has injured interests that are protected by the Constitution.'"[107]

Regarding the DPA, the D.C. Circuit concluded that "neither the text of the statutory bar nor the legislative history of the statute provides clear and convincing evidence that the Congress intended to preclude judicial review of Ralls's procedural due process challenge to the Presidential Order."[108] The Court determined that "the text does not preclude judicial review of Ralls's as-applied constitutional claim by barring review of all 'actions of the President under paragraph (1) of subsection (d).'"[109] The more natural reading of the restriction is that "courts are barred from reviewing final action[s] the President takes to *suspend or prohibit* any covered transaction that threatens to impair the national security of the United States";[110] "[t]he text does not, however, refer to the reviewability of a constitutional claim challenging the *process* preceding such presidential action."[111]

The Court further rationalized that the current nature of congressional oversight over the President's actions does not demonstrate that Congress intended to withhold a judicial forum for due process claims that challenge the procedures used in review.[112] The Court rejected the view that, "by reserving to itself such limited review of presidential actions and critical technology assessments, the Congress intended to abrogate the Courts' traditional role of policing governmental procedure for constitutional infirmity and perform that function itself."[113] Ultimately, the Court found that Congress intended for the judiciary to retain its role in determining whether procedures employed in the CFIUS determination met the essential standards of fairness as provided by the Due Process Clause.[114]

In addition, the Court held that the due process challenge did not constitute a non-justiciable political question. In reaching this decision, the Court recognized that "[m]atters intimately related to foreign policy and national security are rarely proper subjects for judicial intervention." The Court nonetheless concluded that it was an "error to suppose that every case or controversy which touches foreign relations lies beyond

107. *Id.* (quoting Ungar v. Smith, 667 F.2d 188, 193 (D.C. Cir. 1981)).
108. *Id.* at 311.
109. *Id.* (quoting 50 U.S.C. app. § 2170(e) (2012)).
110. *Id.*(internal quotation marks omitted).
111. *Id.* (quoting 50 U.S.C. app. § 2170(d)(1)).
112. *Id.* at 312. "Congressional oversight of the President under the current version of the statute consists of an annual, ex post review of 'decisions or actions by the President' taken under Section 721 and the President's assessment of foreign efforts to acquire critical technologies." *Id.* (quoting 50 U.S.C. app. § 2170(m)(2)(B)).
113. *Id.*
114. *Id.*

judicial cognizance."[115] The Court noted that the due process claim made by Ralls did not challenge (1) the President's determination that its acquisition threatened national security or (2) the President's prohibition of the transaction to mitigate the perceived national security threat.[116] The Court found that these determinations would constitute non-justiciable political questions because they would require the Court to exercise judgment in the realm of foreign policy and national security.[117] In contrast, the question of "whether the Due Process Clause entitles [a company] to have notice of, and access to, the evidence on which the President relied" in making a national security determination and "an opportunity to rebut that evidence" was a proper question for the Court to decide.[118] This due process claim "does not encroach on the prerogative of the political branches" and "does not require the exercise of non-judicial discretion."[119] Therefore, it is "susceptible to judicially manageable standards" and can thus be reviewed by the Court .[120]

After determining that the due process challenge was properly before the Court, the D.C. Circuit looked into whether the Presidential Order deprived Ralls of its constitutionally protected property interests in the Project Companies and their assets without due process of law.[121] The Court, based on the district court's determination, found that Ralls obtained state-law property interests "when it acquired 100% ownership of the Project Companies and their assets, including local easements permitting the construction of wind turbines, power purchase and generator interconnection agreements with the local utility, transmission interconnection and management agreements with nearby windfarms, and the necessary permits and approvals to construct wind turbines," stating that these items constituted "property" under Oregon law.[122] However, unlike the district court conclusion that Ralls's state law property interests were *not* constitutionally protected, the D.C. Circuit found that upon completion of the transaction, Ralls's state-law property interests had fully vested and therefore the due process protections had attached, concluding that the "Federal Government cannot evade the due process protections afforded to state property by simply announcing that future deprivations of property may be forthcoming."[123] The Court further surmised that "[t]here is no contingency built into the *state* law from which Ralls's property interests derive and to which interests due

115. *Id.* at 313 (internal quotation marks omitted).
116. *Id.* at 314.
117. *Id.*
118. *Id.*
119. *Id.*
120. *Id.*
121. *Id.* at 315.
122. *Id.*
123. *Id.* at 316 (internal quotation marks omitted).

process protections traditionally apply."[124] The Court also found that Ralls had not waived its property interests through its failure to seek preapproval of the transaction, concluding that the failure to seek preapproval does not constitute "a waiver when the regulatory scheme expressly contemplates that a party to a covered transaction may request approval—if the party decides to submit a voluntary notice at all—either before *or after* the transaction is completed."[125]

Ultimately, the Court found that Ralls was entitled to due process before the deprivation of its property interests, which included the right to know the factual basis for the action as well as the opportunity to rebut the evidence supporting that action—as these are essential to satisfy due process.[126] The Court concluded that the Presidential Order "deprived Ralls of its constitutionally protected property interests without due process of law."[127] The Court also clarified that due process does not require the disclosure of information deemed classified because "classified information 'is within the privilege and prerogative of the executive,'" and the Court does not intend to require a breach in security.[128] The Court's determination made it clear that "a substantial interest in national security supports withholding only the *classified* information but does not excuse the failure to provide notice of, and access to, the unclassified information used to prohibit the transaction."[129] Because Ralls did not have the opportunity to present evidence to CFIUS, tailor its submissions to the concerns of the President and CFIUS, or rebut the factual premises underlying the presidential action, Ralls was denied due process.[130]

As an important clarification, the Court noted that its holding was "only that Ralls must receive the procedural protections [the Court has] spelled out before the Presidential Order prohibits the transaction" and that "[a]dequate process at the CFIUS stage . . . would also satisfy the President's due process obligation."[131]

Although the D.C Circuit remanded the case to the district court to provide Ralls with due process, this dispute gives added weight to the notion that a company should file with CFIUS prior to the completion of

124. *Id.* at 316–17.
125. *Id.* at 317.
126. *Id.* at 318.
127. *Id.* at 319.
128. *Id.* (quoting Nat'l Council of Resistance of Iran v. Dep't of State, 251 F.3d 192, 209–10 (D.C. Cir. 2001)).
129. *Id.* at 320.
130. *Id.*
131. *Id.*

any transaction because the protections to property afforded after a presidential veto are *de minimis* at best.[132]

D. Lessons Learned in Unwinding

During the appeals process, but after the Ralls–Terna transaction was declared to be a prohibited transaction and Ralls was required to divest all interest in the windfarms within ninety days, the issue became one of unwinding the contract, as the purchase had already taken place when the Order was issued.[133] The agreements between Ralls and Terna did not contain provisions relating to a presidential block of the transaction.[134] As a result, Ralls demanded that Terna repay all of the money that had been paid under the Master Wind Projects Memberships Interests Purchase Agreement because the President in effect made the transaction void *ab initio*.[135] However, Terna disagreed and notified Ralls on December 24, 2012, that because Ralls failed to make the final installment payment under the contract on December 12, 2012, Ralls was in default, and that if Ralls did not remit payment within fourteen days, Terna would exercise its right to sell the provided collateral.[136] On January 17, 2013, Ralls was notified that a public sale of the pledged collateral would be held.[137]

The agreements between Terna and Ralls provide a cautionary tale to other companies to include provisions in its agreements that contemplate an unwinding due to presidential order. Even if CFIUS is required to provide the information used when determining a national security threat, it is unlikely this procedural hurdle will result in a determination by CFIUS that a transaction does not threaten national security. The D.C. Circuit ruling is merely a procedural hurdle that CFIUS can easily meet. It does not permit a court to review the sufficiency of the evidence relied on by CFIUS in its determination that there is a threat to national security.

Additionally, the outcome of this transaction shows that "[t]here are very, very strong incentives for those companies for which acquisitions could potentially affect national security to file" since "[t]he potential negative ramifications of not filing are very, very severe . . . [and] the

132. *See* Joint Status Report at 1, Ralls Corp. v. the Comm. on Foreign Inv. in the U.S., No. 1:12-cv-01513-ABJ (D.D.C. Nov. 24, 2014) (noting that CFIUS disclosed 3,487 pages of unclassified information for Ralls to discern).
133. *See* Ralls Corp. v. Terna Energy USA Holding Corp, 920 F. Supp. 2d 27, 29 (D.D.C. 2013); *see also* Ralls Corp. v. Comm. on Foreign Inv. in the U.S., 926 F. Supp. 2d 71, 89 (D.D.C. 2013).
134. *See Ralls*, 920 F. Supp. 2d at 29.
135. *Id.* at 30.
136. *Id.*
137. *Id.*

transaction can be unwound at any time."[138] Most, if not all, of the negative outcomes associated with the Ralls–Terna transaction could have been avoided by submitting voluntary notice to CFIUS prior to closing. However, Ralls did not do this, and as the agreements were written, Ralls was left with few options after the transaction was blocked. Knowing that transactions involving the energy sector are highly sensitive and likely to attract CFIUS scrutiny, companies engaging in these transactions should not only voluntarily file with CFIUS prior to the closing of the transaction, but should also include provisions that contemplate the possibility of the transaction being blocked because of national security concerns.

V. CONCLUSION

Ralls shows the implications of parties not consulting with CFIUS staff before engaging in a transaction that might have national security implications. One main benefit of voluntary CFIUS filing is that once approved by the government, the transaction will not be subject to any further CFIUS review for national security implications, giving parties assurance that their transaction will not be unwound after closing due to perceived national security risks.[139] Completing an acquisition without first voluntarily filing with CFIUS can be a costly mistake, especially if the transaction entails certain risks, such as proximity to a military facility or a relationship with the energy sector.[140] CFIUS has the power to review any transaction with a potential risk to U.S. national security and can do so on its own initiative, at any time, even years after a transaction has been completed.[141] Additionally, CFIUS is authorized to impose its own measures designed to mitigate any security risk, which can include complete divestiture of a completed acquisition.[142] Even with the minor requirement of the D.C. Circuit for procedural due process, the determinations made by CFIUS will likely not be affected; therefore, the risks associated with a company not seeking prior CFIUS approval are still great. If a company does not have the appropriate measures in its transaction agreements, the results can be devastating for the foreign company. Following the Order in *Ralls*, the company was not allowed to

138. Ralls Corp. v. Comm. on Foreign Inv. in the U.S., 987 F. Supp. 2d 18, 28 (D.D.C. 2013), *rev'd and remanded sub nom.*, 758 F.3d 296 (D.C. Cir. 2014) (citing *H.R. 5337, Reform of National Security Reviews of Foreign Direct Investments Act: Hearing Before the Subcomm. on Domestic & Int'l Monetary Policy, Trade, & Tech. of the H. Comm. on Fin. Servs.*, 109th Cong. 31 (2006) (testimony of David Marchick, Attorney, Covington & Burling)).

139. Reinis, *supra* note 27, at 58.

140. Spitzer & Monaghan, *supra* note 19, at 8.

141. *Id.*

142. *Id.*

sell its assets to a third party without first giving notice to CFIUS, which had to consent to the potential buyer.[143]

However, *Ralls* can also guide potential foreign investors on how to best approach an energy transaction (or other significant transaction) in the United States. For example, a smoother transaction occurred in 2010 when China National Offshore Oil Corp. (CNOOC) entered into a deal with Oklahoma-based Chesapeake Energy Corp. (Chesapeake), in which CNOOC agreed to pay Chesapeake $1.08 billion for a one-third stake in Chesapeake's 600,000-acre interest in the Eagle Ford Shale formation.[144] The deal was structured so that CNOOC did not acquire control over production or an ownership stake in Chesapeake itself.[145] Through the deal, CNOOC was able to acquire insight into how an operator decides where to locate drill sites, as well as how to set up infrastructure around wells.[146] That information can be useful to the company in future oil endeavors, by giving CNOOC exposure to American technology and management techniques.[147] This CNOOC–Chesapeake transaction successfully avoided any negative attention by CFIUS, in stark contrast to CNOOC's attempted $18.5 billion acquisition of Unocal Corp., a California-based energy company, in 2005.[148] After the CNOOC–Unocal deal was announced, it generated staunch political opposition because it was thought that CNOOC was a proxy for the Chinese government, attempting to secure a strategic and valuable U.S. energy asset.[149] The opposition was so strong that members of CFIUS indicated that they would recommend to then-President George W. Bush to block the deal.[150] Faced with such severe opposition, CNOOC eventually abandoned its bid for Unocal.[151]

One main difference between the unsuccessful CNOOC–Unocal and Ralls–Terna transactions and the successful CNOOC–Chesapeake transaction was the type of interest being acquired. The successful CNOOC–Chesapeake transaction involved a non-ownership interest in the company which made clear that the foreign investor would not have control over the American company, therefore reducing the security

143. *Id*.
144. Ryan Dezember & James T. Areddy, *China Foothold in U.S. Energy*, WALL ST. J., Mar. 6, 2012, at A1, *available at* http://www.wsj.com/articles/SB10001424052970204883304577223083067806776.
145. *Id.*
146. *Id.*
147. *Id*.
148. *Id*.; *see also* David Barboza, *China Backs Away from Unocal Bid*, N.Y. TIMES (Aug. 3, 2005), http://www.nytimes.com/2005/08/02/business/worldbusiness/02iht-unocal.html.
149. Barboza, *supra* note 148.
150. Dezember & Areddy, *supra* note 144.
151. *Id*.; *see also* Joshua W. Casselman, *China's Latest 'Threat' to the United States: The Failed CNOOC-Unocal Merger and Its Implications for Exon-Florio and CFIUS*, 17 IND. INT'L & COMP. L. REV. 155, 161–64 (2007).

concern.[152] Other successful transactions have used a similar strategy. In 2012, Chinese oil company Sinopec entered into a deal with Devon Energy Corp. (Devon), an Oklahoma-based company, in which Sinopec acquired a one-third stake in approximately 1.3 million acres of drilling property in Michigan, Ohio, and elsewhere.[153] Like the successful CNOOC–Chesapeake transaction, the Sinopec–Devon deal allowed the U.S. company to keep full operating control while also maintaining control over the sale of the oil and gas.[154] These successful transactions show that, for DPA purposes, it is for the foreign company to both play a passive role in the U.S. company and to seek a minority stake in that company.

In light of *Ralls* and these other significant transactions, it is apparent that a successful recipe for FDI in the U.S. energy sector would be for the foreign investor to seek a minority stake in the U.S. company, ensure that the foreign investor plays a passive role, and keep foreign investors from certain countries (such as China) that are at arm's length from sensitive U.S. technologies.[155] In addition, voluntary notice to CFIUS is essential prior to closing, and if CFIUS approval is not received prior to closing, closing agreements should contain unwinding provisions. It appears that joint ventures, especially in the oil and gas industry, are considered less threatening, specifically when the U.S. company maintains control of the assets. Foreign companies desiring to invest in U.S. industries, specifically in the energy sector, should look to the highlighted successful transactions for guidance on how to structure a deal to best protect their investment.

152. *See Cnooc to Pay $1.08 Billion for Stake in Texas Shale Gas Project*, BLOOMBERG (Oct. 11, 2011), http://www.bloomberg.com/news/2010-10-11/cnooc-unit-to-pay-1-08-billion-in-cash-for-stake-in-gas-project.html.

153. Anna Driver, *Sinopec, Devon in $2.2 Billion Shale Deal*, REUTERS (Jan. 3, 2013), http://www.reuters.com/article/2012/01/03/devonenergycorp-idUSL3E8C36L720120103.

154. *Id*.

155. *See generally* Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States, 73 Fed. Reg. 74,567 (Dec. 8, 2008), *available at* http://www.treasury.gov/resource-center/international/foreign-investment/Documents/CFIUSGuidance.pdf (providing an overview of CFIUS review).