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Court Rules CFIUS National Security Review Process To Be Unconstitutional

Foreign companies seeking to invest in the United States received welcome news last week when a federal appeals court in Washington, D.C. ruled that the federal government's process for reviewing foreign investments in the United States is unconstitutional. *Ralls Corp. v. Committee on Foreign Investment in the United States, et al.*, No. 13-5315 (D.C. Cir. July 15, 2014). The court held that when the federal government decides to impose national security-related requirements on a foreign investor, the government must share unclassified evidence supporting its decision so that the investor has an opportunity to review and rebut the evidence. While the implications of this decision are still to be sorted out, its effect is certain to be far-reaching.

Since the late 1970's, an informal committee of Cabinet-level officers has reviewed foreign investments to determine whether they threatened national security interests. The informal committee, known as the Committee on Foreign Investment in the United States ("CFIUS"), has the authority to block transactions that have not yet occurred and to order foreign companies to divest themselves of investments in the United States if the committee concludes that the investment potentially threatens the national security interests of the United States. After the Dubai Ports controversy erupted in 2006, Congress passed legislation strengthening the review process. CFIUS responded by stepping up its enforcement efforts. Although CFIUS still imposes conditions on fewer than 100 foreign investments per year, its increasing activity has been a cause for concern for more and more foreign investors.

In 2012, CFIUS recommended that the President of the United States order Ralls Corporation, a U.S. company owned by Chinese investors, to divest itself of an investment in a windmill farm located near restricted airspace used by the Navy for training on drone aircraft. The president issued the order and Ralls filed suit to attempt to save its investment.

The case is instructive for several reasons. First, it highlights the fact that CFIUS can intervene and force a company to divest itself of an investment even after the transaction is complete. Although most foreign investors take advantage of CFIUS's procedures to pre-clear a transaction that could raise national security concerns, CFIUS is not limited to reviewing only transactions that investors submit for its consideration. In this case, Ralls did not submit its investment to CFIUS for preclearance and ultimately had to defend itself after the acquisition was complete.

Second, the case illustrates that CFIUS review is not limited to defense industry contractors or others whose businesses on their face intersect with national security concerns. Windmills do not ordinarily implicate United States national security interests, but in this case, their location raised serious concerns.

Third, the case demonstrates the broad scope of CFIUS's authority to intervene in private investments if it concludes that those investments pose a threat to U.S. national security interests. In most cases that it reviews, CFIUS approves the transaction without any conditions, but in an increasing number, CFIUS has required the transaction to be restructured or imposed other conditions in order to grant approval. In a few, such as the Ralls transaction, CFIUS will recommend that the President use his authority to block a transaction or order a foreign investor to divest even after the transaction is complete.

It was that process of post-transaction divestment that was under scrutiny in the opinion released last week by the United States Circuit Court of Appeals for the District of Columbia, the federal court immediately below the United States Supreme Court that hears most federal administrative law cases. The appeals court held that CFIUS's process violated the Due Process Clause of the Fifth Amendment of the United States Constitution. The federal government had urged the court to defer to CFIUS and its informal process because national security is at stake. A lower court had previously agreed and had ruled in the government's favor, but the appeals court refused to accept the government's invitation.

While acknowledging that national security interests justify deferring to the government's judgment and giving the government great leeway to structure its process, the court ruled that government's process did not meet the constitutional minimum. The appellate court held that before the President orders an investor to divest, CFIUS must give the investor the opportunity to review unclassified evidence supporting the decision and to rebut that evidence. The court's decision does not require CFIUS to adopt any formal procedures, and it does not require CFIUS to divulge classified information. But it does require the government to justify its decisions and give private investors an opportunity to challenge those decisions.

Because the court did not outline any specific procedures that CFIUS must follow to share evidence with an investor, it is unclear how this decision will be implemented. The federal government may also decide to appeal the decision, and it may take a few years for the government to fully respond. Regardless of how the government decides to react to the court's decision, it is likely that CFIUS will continue to maintain both a pre-clearance procedure and the ability to review transactions after they have occurred. It is also likely that CFIUS will maintain a relatively informal process that will not resemble a trial or administrative hearing. But the court's decision will require CFIUS to be more open in sharing unclassified information with investors, and it is likely to adopt a more formalized process to allow investors to review and respond to that evidence. That should help investors dealing with CFIUS review and make the process more transparent to foreign investors, and could make the United States a friendlier place for investment.

The court's decision in *Ralls Corp. v. Committee on Foreign Investment in the United States* may also inspire other agencies within the federal government to review their administrative procedures in making national security decisions affecting private investors and updating them to conform with the court's standards. If these changes occur, that too may make the United States a more transparent and friendlier jurisdiction in which to invest.

Although the outlines of these changes are currently unclear, the court's decision is likely to provoke change. Now as ever, it is wise for investors to have experienced counsel to help them navigate that change.

For more information about the CFIUS and the impact of the *Ralls Corp. v. Committee on Foreign Investment in the United States* decision, please contact the author of this alert or your Butzel Long attorney.

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