

CFIUS Process and Due Process: Presidential orders blocking transactions on national security grounds – the process, and the Ralls appellate decision requiring Due Process

US Appellate court finds that the due process protection requires that the subjects of a CFIUS review are entitled to receive unclassified information upon which CFIUS and the President base their decisions to block or unwind a transaction.

The President of the United States, acting upon the recommendation of the Committee on Foreign Investment in the United States (“CFIUS”) has the power to block or unwind any transaction – i.e., merger, acquisition, takeover or joint venture -- which could result in foreign control of any person engaged in interstate commerce in the United States, if CFIUS and the President deem that the transaction can result in a national security risk. This power is granted under the Defense Production Act of 1950, as amended in 2007 by the Foreign Investment in National Security Act (“FINSA”). CFIUS is an interagency committee composed of the Secretaries of designated federal agencies.¹

CFIUS jurisdiction attaches to a transaction only if it could result in foreign control over the US business --- *control* is key, but the law provides CFIUS with relatively broad discretion to determine whether an investment involves a change of control. (See my upcoming post “**CFIUS and FINSA: Analyzing “foreign control”, “national security risk” and other factors**”.)

The Process

Neither the law nor CFIUS requires any filing in order to pre-approve a transaction. Rather, FINSA gives companies involved in cross-border acquisitions or investments in US businesses the opportunity to voluntarily obtain a clearance of the transaction by filing a notice with CFIUS at no cost to the parties. However, CFIUS can initiate its own investigation if the parties do not choose to voluntarily make a filing. Without CFIUS clearance for a given transaction, the US President retains the power to block or unwind the transaction indefinitely, such that a transaction is open to potential unraveling at any time. If successful, a CFIUS review results in a “no action letter” from CFIUS insulating the transaction from subsequent Presidential action. Additionally, if CFIUS determines that the transaction is not within its jurisdiction, it will notify the parties to that effect and conclude the view process.

There is no standard form for submissions, and no filing fee. The voluntary review process involves a confidential submission to CFIUS by both parties containing a broad range of business information about both the target and the acquirer, including information about foreign investors and their parents, the US targets, and detailed information about the transaction. There is no specific legal burden on the part of the

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parties to show that a transaction does not present national security threat, rather the parties simply are obliged to provide CFIUS with all the information required by the statute and regulations to answer all questions posed by CFIUS so that CFIUS can make a recommendation to the President. The parties are allowed to meet with CFIUS to attempt to show that the transaction serves a legitimate purpose and is therefore in the national interest, and to generally explain the purpose of the transaction and what safeguards are in place to make sure that there is no national security threat, but there is no particular legal burden on the parties to do so. The statute does not provide for consultations between CFIUS and officials and other countries; however, CFIUS may rely on public sources of information and government sources, including a classified national security threat assessment provided by the US Director of National Intelligence.

CFIUS is willing to accept a prefiling notice and to speak to the parties informally regarding potential transactions, however it does not render advisory opinions and will not comment on the likelihood of approval during a prefiling process.

CFIUS reviews are confidential and neither the outcome nor the reasoning is released to the public, so information that becomes publicly available is limited to information released voluntarily or leaked to the media. Herein lies the crux of the issue that gave rise to the lawsuit about which the US court of appeals for the DC Circuit rendered an opinion on July 15, 2014, regarding due process.

[Due Process, and Blocking or Unwinding Transactions](#)

The US president has wide discretion to block a transaction if he finds that there is "credible evidence" that leads him to believe that the "foreign interest" proposing to acquire a US company "might" take action that "threatens to impair the national security", and the provisions of other laws do not provide adequate and appropriate authority to protect the national security. "National security" is not defined in the statute or the regulations, but is interpreted broadly (see my upcoming post "**CFIUS and FINSA: Analyzing "foreign control", "national security risk" and other factors**" for a discussion of this topic).

The president's action is taken by directing the US Attorney General to seek any appropriate relief in a US federal court. Due to the blanket ability of the President to take action indefinitely, including to unwind a transaction months or even years after it has been consummated, it behooves the parties who believe they may fall within the jurisdiction of CFIUS to consider carefully whether to commence a voluntary review before consummating a transaction. In recent years CFIUS has required parties to make a CFIUS filing after the transaction had already closed -- for example, in 2011 China's Huawei Technologies abandoned its acquisition of a US computer company, 3 Leaf Systems, after CFIUS recommended that it do so, and in 2012 Ralls Corporation, a Delaware corporation with operations in Georgia and which is owned by two Chinese nationals who are executives of the Sany Group, a Chinese entity, was ordered by the US President to divest assets and a wind farm after a post-closing CFIUS review due to the location of the wind farm in and around restricted airspace and a bombing zone maintained by the US Navy. Despite the fact that CFIUS determinations and Presidential Orders are explicitly not subject to judicial review, Ralls sued CFIUS and President Obama in an attempt to enjoin enforcement of the CFIUS divestiture order on the grounds that CFIUS exceeded its statutory authority and acted arbitrarily in violation of the Administrative Procedure Act, and in a manner that violated the Due Process Clause and Equal Protection Clause of the Fifth and Fourteenth Amendments to the US Constitution. The District Court dismissed all claims, and on appeal the DC Circuit Court, on July 15 (after satisfying itself that it had jurisdiction over the matter) overturned the District Court with respect to the due process claim.

Both sides of the Ralls dispute agreed that Ralls possessed state law property interests in the assets. That interest is enough to trigger due process protection. The heart of the due process argument -- that Ralls was deprived of property without due process of law -- rests upon the fact that Ralls was not given access to the information upon which CFIUS and the President made the determination that the transaction raised national

security concerns. The appellate court rejected the lower court's reasoning that the ability of Ralls to present its own evidence to CFIUS officials was enough to satisfy due process, the Appellate Court concluded that Ralls must be provided with the *unclassified* information that formed the basis of the CFIUS recommendation in order to have an opportunity to address that evidence and tailor its submission or rebut the factual premises underlying the Presidential action.

The lower court also dismissed the equal protection claim and the claim that the President acted outside the scope of his authority in ordering that the assets be divested ("*ultra vires*") on the grounds that the claims were moot, but the appellate court disagreed and sent the matter back down to the lower court to reconsider the merits of those claims. The outcome of the lower court's reconsideration of the equal protection and *ultra vires* claims could have a significant impact on the CFIUS process.

[More Background on the Process: Timing](#)

For those parties contemplating a CFIUS filing, the entire review process can take up to 90 days. The process begins with a 30 day review period, after which CFIUS will either issue a report to Congress that is essentially a "no action" letter and let the transaction proceed, or it will commence a second-stage 45-day investigation if any CFIUS member agency believes that the transaction under review threatens to impair US national security and that the threat has not been mitigated, or if the initial CFIUS review reveals the potential for a transfer of control over a US business to a foreign government or an entity financed or controlled by a foreign government or if the transaction involves control of critical infrastructure by a foreign person that might impair national security. If CFIUS cannot clear a transaction during the second stage due to national security concerns raised by one of its member agencies, CFIUS will send a recommendation regarding the transaction to the President, who has 15 days to decide whether to block or unwind the transaction or to allow it to proceed.

[Mitigating Agreements for CFIUS Clearance](#)

Although not commonly used, FINSAs allow CFIUS to condition clearance on the parties entering into an agreement with the US government to mitigate national security concerns, including agreeing to provisions to monitor and enforce the conditions. Some such conditions, for example, could be:

- A requirement to appoint a US citizen as a security officer for the US business
- The isolation of certain US businesses or assets or technology so that foreign persons do not have access to them
- US government review of export control and security policies
- Requirement to notify the US government if there is a change in executive management of US business
- An agreement regarding a cyber security plan

CFIUS may apply monetary penalties from US \$250,000 up to the value of the transaction against parties where intentional conduct or gross negligence resulted in a breach of a mitigation agreement, or may reopen investigation in the case of intentional material breach of the agreement.

[Managing the Process and the Media](#)

Although the submissions to CFIUS are confidential, the process can take place in a highly charged political environment, with members of Congress and local public officials making their views known to the press, potentially even introducing resolutions in Congress in opposition or approval of a certain transaction. Such high

profile action often opens the door for other interested parties to express their views, write editorials etc. The parties should intend to be proactive in trying to control the information about the proposed transaction and the CFIUS review and how the parties and the transaction is portrayed in the media, so as to circumvent the work of antagonist who might be able to influence the process for political or financial reasons. Develop a press strategy to ensure that any facts given to the media are accurate, make contact with members of Congress who sit on the committees that are part of CFIUS, and attempt to recruit Congressional supporters if the type of foreign investment at issue can help in broader economic terms, for example if it might create jobs or result in special investment in a particular geographic area. Identify potential opponents of the investment and try to address their concerns head on.

¹ Chaired by the US Treasury Department and populated by the Secretaries of other statutorily designated federal agencies such as Treasury, Homeland Security, Commerce, State, Energy, and other members that the President deems appropriate.



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