New Regulations Expand CFIUS’s National Security Authorities to U.S. Energy Sector Investments

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Changes May Impact Foreign Acquisition of Critical Infrastructure and Real Estate Necessary for Solar, Wind, and Other Energy Projects

On February 13, 2020, the U.S. Treasury implemented updated regulations that could have a profound effect on foreign investments in the U.S. domestic energy sector. These changes implement new measures that impose greater scrutiny on foreign developers seeking to acquire real estate or associated land rights – including through purchases, leases, or easements – that are necessary for wind, solar or other energy projects. In some instances they may also require foreign developers and investors involved in U.S.-based critical infrastructure projects to make mandatory filings with the Committee on Foreign Investment in the United States (CFIUS) and undergo lengthy national security reviews.

Mandated under the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), the two new regulations expand CFIUS’s authority to review cross-border investments, mergers, acquisitions, and joint ventures involving U.S. energy companies, as well as energy production assets located in the United States. This
means that CFIUS and its partner agencies will take a more active role in reviewing, approving, and potentially unwinding energy sector investments that present national security risks. These developments follow the seminal 2014 decision in Ralls Corp. v. CFIUS, in which the U.S. Court of Federal Appeal upheld the U.S. Government’s authority to unwind the Chinese acquisition of wind farms located near a sensitive U.S. Navy facility.

These changes carry two practical implications for U.S. energy sector transactions. In some cases, the revised regulations may strengthen the rationale for making voluntary CFIUS filings where a foreign person acquires real estate or land rights necessary for solar, wind, or other energy projects near sensitive military installations. In other cases, the updated CFIUS regulations will require mandatory filings for cross-border transactions involving U.S. companies that own or operate certain categories of “critical infrastructure,” as well as those that possess “critical technologies” and operate in various “critical industries.” A brief description of these developments follows below.

Real Estate & Land Rights

As a general rule, the new real estate regulations give CFIUS the authority to review any merger, acquisition, investment, or joint venture that results in a foreign person obtaining ownership, leases, concessions or other property rights in U.S.-based real estate. Collectively these changes implement FIRRMA’s statutory requirements while memorializing CFIUS’s longstanding authority to investigate, block, and unwind real estate transactions deemed to threaten U.S. national security. These broad authorities cover real estate purchases and leases, as well as the acquisition of concessions, easements, or other land rights that may be necessary for solar, wind, or other U.S.-based energy products.

These new rules can present an unexpected surprise for foreign investors and developers pursuing acquisition or development of U.S. energy sector projects. This is particularly true when the relevant real estate is located near military installations and other U.S. Government facilities. Yet the new regulations also temper CFIUS’s authority by establishing objective criteria based on two key factors: facility type and geographic proximity. The first factor categorizes facilities based on their military or strategic value. The second factor, in turn, prioritizes risks by examining the distance between these facilities and the real estate interests that foreign investors wish to acquire. This proximity varies from as little as one mile for lower-priority bases, to as far as 99 miles in the case of higher-security facilities. And in the case of facilities sheltering the U.S. nuclear arsenal, the new geographic proximity rules can capture entire counties.

The new CFIUS regulations also contain exceptions designed to exclude real-estate transactions that involve residential homes, as well as those occurring within various “urban zones.” Additional exceptions may also apply depending on the nature of the land rights that U.S. parties exercise. CFIUS also published a list of sensitive facilities and their locations as part of the new regulations – a measure designed to communicate its enforcement priorities and limit unnecessary speculation. Taken together the result is a set of predictable rules that can help foreign investor identify higher-risk transactions, together with clearer, more
predictable pathways for parties considering the merits of submitting a voluntary CFIUS filing.

Critical Infrastructure

In addition to the real estate regulations discussed briefly above, CFIUS also implemented a new set of regulations imposing mandatory filings requirements for certain energy sector transactions. These requirements arise under two scenarios. The first arises when the U.S. target company manufactures, operates, owns, services, or otherwise supplies certain “critical infrastructure.” This new requirement reflects FIRMA’s attempt to address emerging Homeland Security risks while memorializing some factors that CFIUS has long employed in energy sector transactions. The stated goal is to ensure that seemingly innocuous investments do not become proverbial Trojan Horses for foreign actors seeking to disrupt U.S. communications, transportation, or energy networks.

The new CFIUS regulations define critical infrastructure broadly to cover “bulk power” facilities for generating, transmitting, or distributing electric energy identified under the Federal Power Act. This definition includes electrical storage devices connected to bulk power systems, as well as any electrical power generation or transmission systems that directly services to – or are otherwise located on – certain U.S. military installations. Other energy-related installations that constitute “critical infrastructure” for CFIUS purposes include oil refineries, and crude oil storage facilities, and oil and gas pipelines, as well as terminals and underground storage facilities for liquefied Natural Gas (LNG). Even if a foreign investment does not implicate the real estate issues described above, a mandatory CFIUS filing may still be necessary if the transaction triggers these or other critical infrastructure categories.

Critical Technologies & Industries

The second mandatory filing scenario occurs when the U.S. target company has certain “critical technologies” and conducts business in certain “critical industries.” Under the new regulations, CFIUS will maintain (and eventually expand) the same list of “critical technologies” that it evaluated under the CFIUS Pilot Program during the past year. This term captures a broad spectrum of dual-use commercial technologies, including some that energy companies may use in the ordinary course of business. Examples in the renewable power sector could potentially include sensors or communications equipment used to monitor or manage power generation assets. In the oil and gas sectors, high-tech articles like seismic sensors or robots used for exploration, production, and maintenance operations may trigger similar controls. The more advanced the technology in question, the more likely it will be deemed “critical” for CFIUS purposes.

Like the Pilot Program, the new CFIUS regulations require mandatory filings whenever a U.S. target company business designs, develops, fabricates, manufacturers, or tests one or more critical technologies that are either “utilized in” or “specifically designed for” one or more critical industries. CFIUS identified these industries using 27 distinct North American Industrial Classification System (NAICS) codes. These include Petrochemical Manufacturing, Primary Battering
Manufacturing, and Power, Distribution, and Specialty Transformer Manufacturing, among others. Although the primary goal is to capture aerospace and defense activities, these rules may still implicate energy sector transactions depending on the U.S. target company’s activities.

**Practical Approaches**

Although the new CFIUS regulations may appear daunting, foreign investors in the U.S. energy sector (and their domestic counterparts) can successful identify and address these potential challenges by taking five consecutive steps. These are as follows:

- **Step 1 – Determine whether the transaction is a “foreign investment.”**
  This includes any merger or acquisition investment or joint venture that results in a foreign party acquiring ownership, controls, or concessions in the U.S. target business or any U.S.-based entities or assets. This includes transactions involving U.S. subsidiaries or investment funds that are ultimately owned or controlled by foreign parties (including minority investors, limited partners, and offshore tax blockers).

- **Step 2 – Examine the U.S. target’s assets and operations for critical infrastructure.** If the target company manufactures, operates, owns, services, or otherwise supplies one or more categories of critical infrastructure, then a mandatory CFIUS filing is probably required. Failure to make such a filing under these circumstances carries the same consequences discussed above. But if the target does not meet the critical infrastructure test, and there is no critical technology or critical industry risks, then the parties can probably avoid a mandatory filing.

- **Step 3 – Determine whether the U.S. target meets the critical technology and critical industry test.** If so, then a mandatory CFIUS filing is probably required. Failure to make such a filing can lead to significant fines that can equal the value of the underlying transaction, as well as the transaction being blocked or unwound. But if the U.S. target does not meet these former Pilot Program criteria, then the next step is to evaluate critical infrastructure.

- **Step 4 – Identify real estate and property concessions near U.S. military installations.** If the foreign party seeks to acquire real estate or associated land rights near a military installation, or a U.S. target that has property or property rights near a military installation, then a voluntary CFIUS filing may be appropriate. When considering whether to make a voluntary filing, parties should carefully weigh the upfront costs and delays associated with CFIUS review against the substantial consequences that potentially result if CFIUS (or one of its constituent agencies) discover the real estate transaction at a later date and raises national security concerns. The more sensitive the circumstances, the greater the rationale for taking a proactive approach.

- **Step 5 – Determine whether exceptions apply.** The new CFIUS regulations contain several exceptions that may help parties avoid mandatory filings or diminish the risks of future CFIUS investigations. Notable examples include
special treatment for certain Australian, British, and Canadian investors, exceptions for urban zones and certain residential real estate transactions, and clearer definitions for transactions that involve passive investors that do not acquire certain control rights. All of these exceptions are fact-specific, however, so careful legal analysis is necessary to determine whether they might apply.

Three additional recommendations merit consideration. First, foreign investors seeking to acquire U.S. real estate interests (or otherwise in U.S. energy sector transactions) will be in a much stronger position to manage CFIUS requirements if they make this five-step analysis a routine part of their diligence process prior to entering into a transaction. This includes purchases, leases, or easements for wind, solar or other energy projects. Conducting this analysis before seeking to acquire land interests or at the transaction’s Letter of Intent stage is often the best way to manage project development or transaction timing and budgeting expectations while still ensuring sufficient time for any necessary national security review. With the CFIUS review process lasting anywhere between 30 and 135 days, prior planning and preparation can be crucial to commercial success.

Second, U.S. target companies that possess “sensitive personal data” on individuals serving in the U.S. military or other executive branch agencies should carefully review the new CFIUS regulations to determine whether a mandatory CFIUS filing is required. This includes personally identifiable information, information regarding U.S. Government clearances, and various forms of biometric, genetic, or medical information. Although these issues are less likely to arise in the energy sector than in the aerospace or defense sector, the U.S. Government’s past experiences with security breaches makes CFIUS and its partner agencies particularly sensitive to these risks.

Finally, foreign investors that are not required to make a mandatory filing under the new CFIUS regulations should carefully consider the legal (and sometimes political) protections that a voluntary filings can provide. This is because parties that successfully navigate the longer, more intensive voluntary CFIUS process often become eligible for certain “safe harbor” protections under CFIUS’s regulations and the Defense Production Act of 1950. With Washington increasingly viewing cross-border transactions and investments through a national security lens, these protections may be helpful for foreign investors operating in more sensitive circumstances.

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