

THE JOURNAL OF FEDERAL AGENCY ACTION

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Before Acquiring a U.S. Company, Do Not Forget to Consider This Important Regulatory Hurdle

Eric McClafferty, Matthew C. Luzadder, Alla M. Taher, and Jeffrey Hunter*

The authors explain that when a non-U.S. company acquires a U.S. company, the acquisition may need to be reviewed by the U.S. Committee on Foreign Investment in the United States.

The United States is the world's top destination for foreign direct investment (FDI).¹ In 2021, the United States recorded the largest increase of inward FDI of all economies.² European and other foreign companies are deeply embedded in traditional and renewable U.S. energy markets, having invested over \$400 billion in U.S. energy-related industries.³ It is expected that FDI into renewable energy will continue to grow substantially in the coming years.⁴

For non-U.S. companies, sometimes it makes sense to enter or expand in the lucrative U.S. market through an acquisition or merger. But there are significant regulatory hurdles to overcome when a non-U.S. company tries to buy or control a U.S. company, including understanding whether the proposed transaction must (or should) go through a review by the U.S. Committee on Foreign Investment in the United States (CFIUS or Committee).

Chaired by the U.S. Secretary of the Treasury, CFIUS includes representatives from several U.S. departments and agencies who are tasked with reviewing the national security implications of foreign investments in U.S. companies. In 2018, the U.S. Congress expanded the jurisdiction of CFIUS by passing the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA). FIRRMA also made significant changes to the CFIUS review process. As a result, many more foreign investment transactions are subject to review and increasing scrutiny by CFIUS. This is especially true for the energy sector, where companies often deal with critical infrastructure and

technologies that implicate national security. Moreover, transactions that involve real estate purchases might need to go through a CFIUS process simply because of their location.

The overall number of transactions reviewed by CFIUS has dramatically increased over recent years.⁵ Failing to obtain a CFIUS review can have significant and costly consequences for non-U.S. investors, including monetary penalties for failure to file a mandatory review request and the forced unwinding of business transactions.⁶ For these and multiple other reasons, it is crucial for investors to thoroughly consider whether a particular transaction should be reviewed by CFIUS before it is completed.

Does My Transaction Require CFIUS Review?

CFIUS is authorized to review any “covered transaction,” which is defined broadly to include transactions that could:

1. Directly or indirectly result in foreign control of any U.S. business;⁷
2. Afford a foreign person certain rights or decision-making authority over a U.S. business that produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies (TID⁸ U.S. business),⁹ or
3. Afford a foreign person access to nonpublic technical information in possession of a TID U.S. business.¹⁰

This last prong is not limited to the non-U.S. investors themselves, but also the non-U.S. investors’ relationship contacts or vendors who may indirectly gain access to information. For example, if the business will include investors who have dealings with countries or individuals that are of national security concern, then this too may trigger a CFIUS review.

Non-U.S. energy investors will also need to consider whether their proposed transactions are covered by new CFIUS regulations. Specifically, as indicated, the new regulations 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, water, or other U.S.-based energy products.¹¹ This is especially true when the relevant real estate is located near military installations and other sensitive U.S. government facilities.¹² Every U.S. energy

investment by a non-U.S. investor should go through a location diligence process to spot CFIUS concerns.

Additionally, the regulations mandate review of certain energy sector transactions involving critical infrastructure and critical technologies.

First, review is mandatory when the target U.S. company manufactures, operates, owns, services, or otherwise supplies certain “critical infrastructure.”¹³ Critical infrastructure is broadly defined to cover “bulk-power system” facilities for generating, transmitting, distributing, or storing electric energy identified under the Federal Power Act.¹⁴ This includes “electric storage resources” that are physically connected to bulk power systems, as well as any electrical power generation, transmission, distribution, or storage system that directly services or is located on a U.S. military installation.¹⁵

The definition of “critical infrastructure” also includes other energy-related installations such as industrial control systems,¹⁶ oil refineries,¹⁷ crude oil storage facilities,¹⁸ oil and gas pipelines, as well as terminals and underground storage facilities for liquefied natural gas.¹⁹

Second, review is mandatory when the target company conducts business in “critical technologies.”²⁰ The definition of “critical technologies” captures a broad spectrum of dual-use commercial technologies, including many that are routinely used in the energy sector.²¹ This includes the equipment, components, and certain software. Many U.S. energy industry acquisition targets use controlled fluid handling processing equipment, including pumps, valves, piping, distillation columns, and other equipment that is considered critical technology. And U.S. targets also have controlled information on how to develop, produce or use this equipment, which is also critical technology. Many other types of equipment and know-how, including lasers, sensors, propulsion, and navigation items, needed to manage power generation may be included.²² Controlled defense articles or services, nuclear equipment—including their parts, components, software, and technology—and other emerging technologies may also be included.²³ Filings are also mandatory where the target company designs, develops, fabricates, manufacturers, or tests one or more “emerging and foundational technologies” as defined in the Export Control Reform Act of 2018, which are outside the definition of “critical technologies.”²⁴

Essentially, the more sensitive the technology to U.S. foreign policy and/or national security interests, the more likely it will

trigger mandatory review. Given how much critical technology is present in the U.S. energy industry, diligence regarding the presence of these items is absolutely critical to understanding if a CFIUS filing is mandatory, advisable, or not needed. In light of the complexity involved, that analysis should be guided by experienced counsel.

These rules apply broadly, are complex, and must be considered before any foreign investment in the U.S. energy sector. Even if filing does not appear to be mandatory, it may still be worthwhile to submit a notice or declaration given CFIUS's broad authority to review transactions and their increasingly active surveillance of acquisitions in the United States.²⁵

How Does the CFIUS Review Process Work?

Parties seeking safe harbor through CFIUS reviews of U.S. transactions may voluntarily undertake two processes: the Declaration process and the Notice process. CFIUS also has the authority to unilaterally review pending or completed transactions absent a voluntary filing by the parties if a member of the Committee has reason to believe that the transaction is subject to CFIUS jurisdiction and may raise national security concerns.²⁶ Note, however, that as indicated above, a filing of some sort may be mandatory, depending on the circumstances.

Declaration Process

The Declaration process involves the parties submitting a short-form Declaration notifying CFIUS of a U.S. transaction with potential national security implications to receive review and a potential safe harbor letter that bars CFIUS from subsequently initiating a review of a transaction. In some circumstances, filing at least a Declaration is mandatory, particularly where a foreign government is acquiring substantial interest in certain U.S. businesses and for certain covered transactions that involve critical infrastructure and technologies (as previously described).²⁷ The number of covered transaction Declarations assessed by CFIUS has substantially increased over the years, from just 20 in 2018 to 164 in 2021.²⁸ Out of the 164 declarations assessed in 2021, CFIUS determined that 47 were mandatory filings.²⁹

CFIUS's receipt and acknowledgment of the Declaration initiates a 30-day assessment window, during which the Committee evaluates and asks questions to glean a better understanding of the reported transaction. After assessing a submitted declaration, CFIUS will:

1. Request that the parties file a written notice;
2. Inform the parties that the Committee is unable to reach a conclusion and that the parties may file a written notice;
3. Initiate a unilateral review; or
4. Notify the parties that the Committee has determined that the transaction does not pose any unresolved national security concern or that any such concern is adequately addressed by other legal authorities or mitigation measures.³⁰

In 2021, CFIUS was unable to conclude action following assessment of 12 declarations and requested the parties file a written notice in 30 of the declarations.³¹

The Declaration process can be useful if the parties' attorneys believe there may be a CFIUS interest in learning about the transaction, but there is a good chance that CFIUS will not be concerned about national security issues such that the Committee would be willing to allow the investment to proceed without a full review. There are a variety of circumstances where a Declaration process may be sufficient, but each case is different and companies should speak with experienced counsel to evaluate whether a CFIUS filing must be, or should be, made, and if that filing should be a Declaration or a request for full review.

Although there are many circumstances where a Declaration process may be sufficient, sometimes CFIUS will determine that a full Notice is necessary to satisfy its statutory obligations. It is critically important to understand that the transition to the full Notice process does not constitute a "failed" Declaration process. This action by CFIUS often means that the Committee requires more time and information to evaluate the proposed transaction. To that end, the Notice process is more in-depth, hence the longer review period. It can also mean that CFIUS identified a national security issue that requires more consideration on their part. It may also mean CFIUS might be considering certain national security risk mitigation measures they want the companies to implement,

including through a National Security Agreement, which is most effectively accomplished through the Notice context.

Notice Process

If Notice is submitted, CFIUS staff will begin what is called the “Pre-Clearance and Notice Review Period.” The pre-clearance process typically takes 10-21 days, but it can take more or less time, depending on the complexity of the Notice. Once the pre-clearance process is complete, on the following business day, CFIUS will start the formal 45-Day Review Period.³² CFIUS may extend the initial review period into a subsequent “45-Day Investigation Period,” and CFIUS must complete its review within this second 45-day window.³³

If CFIUS determines that a covered transaction presents national security risks and that other provisions of law do not provide adequate authority to address the risks, CFIUS may enter into an agreement with, or impose conditions on, the parties to mitigate such risks.³⁴ The U.S. Department of the Treasury’s Office of Monitoring & Enforcement oversees CFIUS mitigation measures established in national security agreements with transaction parties.

CFIUS generally does not require that a declaration be withdrawn and refiled, except to permit the parties to correct material errors or omissions, or to describe material changes to the transaction in the original declaration.³⁵ CFIUS may discuss with parties whether withdrawal and refiling makes sense in other circumstances. In some cases, even if a party has voluntarily chosen to abandon a transaction, CFIUS may determine that mitigation measures are needed to effectuate such abandonment and address any attendant risk that arises as a result of the transaction.³⁶ In short, once a CFIUS submission is made, CFIUS effectively retains jurisdiction over the potential acquisition.

On rare occasions, if CFIUS determines that a transaction poses unresolved national security concerns that cannot be mitigated, it will refer the transaction to the president, unless the parties choose to abandon the transaction or to withdraw and refile the case to give CFIUS more time to consider the matter, including a review of mitigation measures proposed by the parties.³⁷ The president then has to make a decision no later than 15 days after the completion of CFIUS’s investigation or the date on which CFIUS referred the

transaction to the president.³⁸ The president may suspend or prohibit the transaction, including by requiring divestment.³⁹

If CFIUS determines that there is no unresolved national security risk or that other provisions of law provide adequate and appropriate authority to address the risk, it will advise the parties in writing that CFIUS has concluded all action and will issue a “safe harbor” letter.⁴⁰ The “safe harbor” letter means that CFIUS and the president will not review the transaction again, absent certain exceptional circumstances, such as the discovery of a material misstatement.⁴¹

From 2012 to 2021, companies filed 1,829 Notices that CFIUS determined were covered transactions.⁴² Similar to the trend in Declarations, the number of covered transaction Notices assessed by CFIUS has steadily increased over the years, from 114 in 2012 to 272 in 2021.⁴³ CFIUS adopted or imposed mitigation measures to resolve national security concerns with respect to 26 of the Notices, including two notices that were withdrawn and abandoned.⁴⁴ Additionally, in nine instances, the parties withdrew the Notice and abandoned the transactions after CFIUS either informed the parties that it was unable to identify mitigation measures that would resolve its national security concerns, or it proposed mitigation measures the parties chose not to accept.⁴⁵

Conclusion

Before investing in the U.S. energy market through the acquisition of an existing U.S. company, non-U.S. companies need to be aware of and plan around CFIUS requirements. CFIUS reporting obligations may be triggered for any transaction that may result in foreign control or influence over critical U.S. infrastructure projects, sensitive U.S. technologies, or investments in certain locations. Traditional and renewable energy companies often work on matters involving critical infrastructure and critical technology. Their projects may be near ports, military bases, and other sensitive locations. It is of vital importance that parties to such transactions conduct enough due diligence and research to make an informed determination as to whether CFIUS review is required or otherwise advisable.

Not conducting a mandatory CFIUS review can lead to a civil penalty up to \$250,000 per violation, or a penalty that equals the

value of the proposed transaction, whichever is greater (not to mention the possibility of complicated and difficult forced unwinding of acquisitions that have occurred).⁴⁶

In short, non-U.S. companies should consult with expert legal counsel to determine whether review is required; and if it is, to prepare an effective CFIUS submission and to take steps to make approval likely.

Notes

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1. Jannick Damgaard & Carlos Sanchez-Munoz, United States Is World's Top Destination for Foreign Direct Investment, IMF Blog (Dec. 7, 2022), <https://www.imf.org/en/Blogs/Articles/2022/12/07/united-states-is-worlds-top-destination-for-foreign-direct-investment#:~:text=The%20United%20States%20recorded%20the,or%2011.3%20percent%2C%20last%20year>.

2. *Id.*

3. Daniel S. Hamilton & Joseph Quinlan, The Transatlantic Energy Economy, Wilson Center (Apr. 19, 2021), <https://www.wilsoncenter.org/article/transatlantic-energy-economy>.

4. Jacopo Dettoni, Renewables Set to Smash FDI Record in 2022, fDi Insights (Sept. 22, 2022), <https://www.fdiintelligence.com/content/news/renewables-set-to-smash-fdi-record-in-2022-81463>.

5. Committee on Foreign Investment in the United States, Annual Report to Congress for CY 2021 at 15-16.

6. *See* 50 U.S.C. § 4565.

7. 31 C.F.R. §§ 800.210 and 800.213(a).

8. "TID" stands for Technologies, critical Infrastructure and personal Data. *See* Fact Sheet: Final CFIUS Regulations Implementing FIRRMA, U.S. Dep't of Treasury, Office of Public Affairs, 2 (Jan. 13, 2020), <https://home.treasury.gov/system/files/206/Final-FIRRMA-Regulations-FACT-SHEET.pdf>.

9. 31 C.F.R. § 800.248.

10. 31 C.F.R. §§ 800.211, 800.213(b), and 800.248.

11. 31 C.F.R. § 802 et seq.

12. 31 C.F.R. § 802 and Appx. A.

13. 31 C.F.R. §§ 800.401(b) and 800.248.

14. *Id.*

15. 31 C.F.R. §§ 800 and Appx. A (xi)-(xiii).

16. *Id.* at Appx. A (xiv).

17. *Id.* at Appx. A (xv).

18. *Id.* at Appx. A (xvi).
19. *Id.* at Appx. A (xvii).
20. 31 C.F.R. § 800.401.
21. 31 C.F.R. § 800.215.
22. *Id.*; 15 C.F.R. § 738.2.
23. 31 C.F.R. § 800.215.
24. 31 C.F.R. § 215; 50 U.S.C. § 4817.
25. 31 C.F.R. § 800.501(c).
26. 31 C.F.R. § 800.501(c).
27. 31 C.F.R. § 800.401.
28. Committee on Foreign Investment in the United States, Annual Report to Congress for CY 2021 at 5.
29. *Id.*
30. *Id.* at viii-ix.
31. *Id.* at 4.
32. 31 C.F.R. § 800.503.
33. 31 C.F.R. §§ 800.505-508.
34. 31 C.F.R. §§ 800.101-102.
35. 31 C.F.R. § 800.406(d).
36. *Id.*
37. 31 C.F.R. § 800.508(e).
38. 31 C.F.R. § 800.508 (e).
39. 31 C.F.R. §§ 800.101-102, 701.
40. 31 C.F.R. § 800.508(d) and Exec. Order No. 11858, section 7(f) subject only to certain circumstances described in 31 C.F.R. § 800.501(c)(1)(ii).
41. *Id.* at ix.
42. *Id.* at 16.
43. *Id.* at 15-16.
44. *Id.* at 15.
45. *Id.*
46. 31 C.F.R. § 800.901.