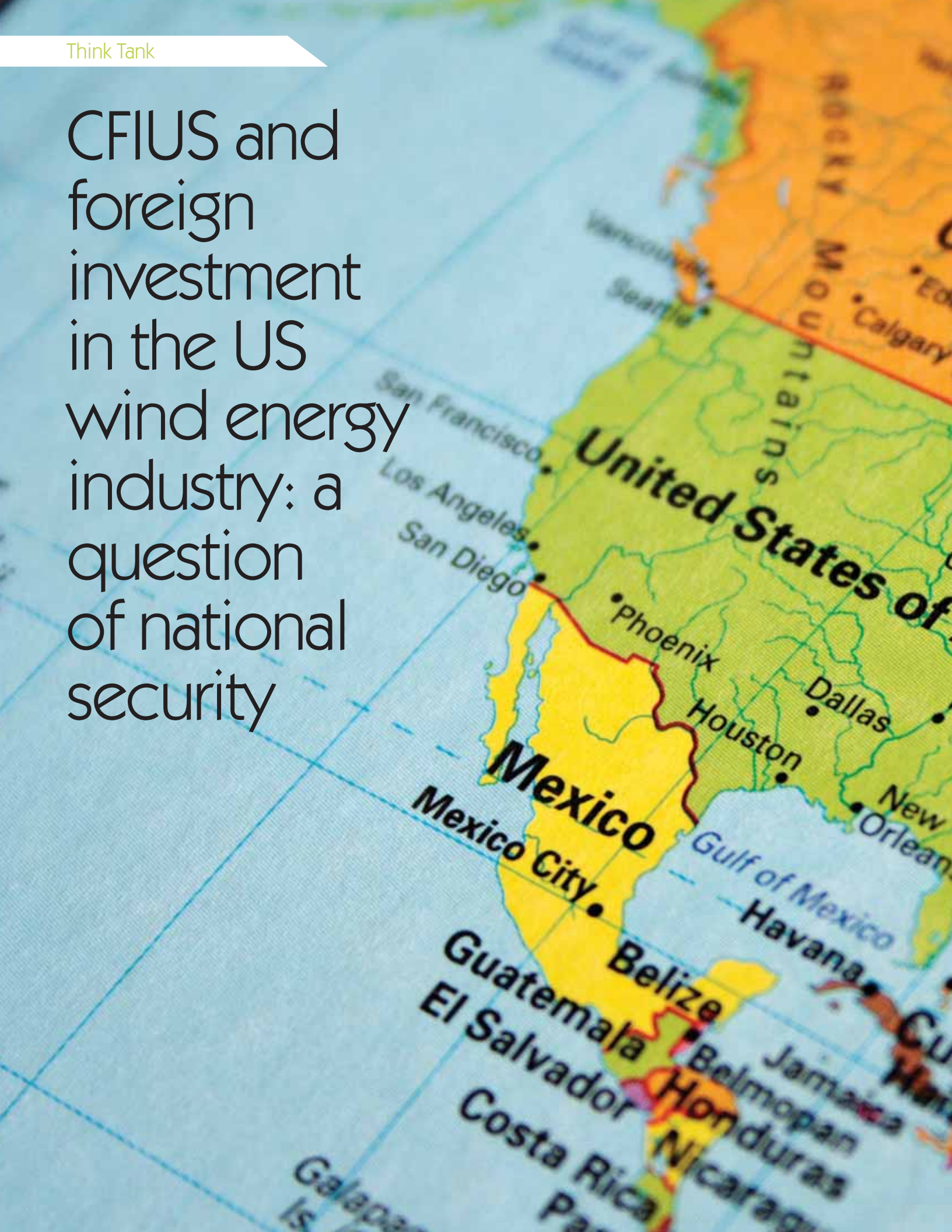


CFIUS and foreign investment in the US wind energy industry: a question of national security





The **Committee on Foreign Investment** in the United States, known as CFIUS, was formed for the purpose of permitting the President to determine the effect on **national security** of a transaction that results in foreign control of a US business. **Foreign investments** in domestic wind energy generation projects may come under scrutiny, and parties to such transactions must be mindful that **CFIUS** has the power to ‘impose, monitor and enforce mitigation agreements or conditions’ on such transactions. **Richard G. Reinis** a counsel in the **Century City office** of **Steptoe & Johnson LLP** examines what this means for the **renewables sector**.

This issue has gained particular prominence with the new administration’s support of alternative energy in the stimulus package and otherwise, and new wind energy projects are expected to be under way this year and for years to come. In order to continue this growth, however, the wind energy industry requires financial investment, much of which will come from foreign investors. The American Wind Energy Association (AWEA) estimates that in 2008, wind energy accounted for an investment in the US economy of \$17bn. Much of this funding came from Europe, where wind plays a much more important role in electricity supply.

With this country’s open investment environment, US industry has always enjoyed foreign investment throughout the economy, and the wind energy sector is no different. Two years ago, European utilities, with a large assist from easy credit and a strong Euro, were very active in the American market, acquiring development companies at high multiples

just to gain a foothold in this market. That has changed dramatically, but interest continues, especially in wind energy projects that will permit high-quality, smaller investments.

Such investments require an understanding of CFIUS regulations. Although it has been around for decades, CFIUS was most notably in the public eye in the wake of the Dubai Ports World deal. The CFIUS statute authorizes the President to investigate the impact on US national security of mergers, acquisitions, and takeovers by foreign persons. If a transaction would result in an impairment of national security that could not be mitigated by agreement with the parties, the President may block the transaction or order divestiture of an already-completed deal. This power may be exercised long after the deal has closed, and might occur when unwinding a deal would be very costly. The probability of such an outcome is low, however, and the President has only once blocked a transaction under this provision.

CFIUS filings are voluntary. If the parties file, they ensure that the transaction has received regulatory approval and will not be subject to a post-closing inquiry. In deciding whether to file with CFIUS, the parties should determine

and acquisitions that may result in foreign control of a US business in any industry. A US subsidiary controlled by a foreign entity is a 'foreign person' for CFIUS purposes. Transactions may result in 'control' in many ways,

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whether the subject of the deal or the identity of the foreign investor potentially raise issues related to national security. A CFIUS notice involves answering a set of questions about the parties, the transactions, and the assets at stake, filing with CFIUS, and 30 days of patience. (In a small number of sensitive cases, including some involving 'critical infrastructure', the total review period is 75 days.)

While CFIUS reviews transactions only for potential implications for national security, that concept includes effects on 'critical infrastructure', such as major energy assets. 'Critical infrastructure' refers to systems that are so vital to the country that their incapacity or destruction would have a debilitating impact on national security. Wind farms can be considered major energy assets, and like all energy systems, their incapacity could touch on issues of national security. Therefore, parties to foreign investment transactions in US wind farms or the wind energy industry should be mindful of the CFIUS process.

In determining whether to go through the CFIUS review process, parties should consider two questions: Does CFIUS have jurisdiction? and, if so, is it in the parties' interest to file a voluntary notice?

Does CFIUS have jurisdiction?

The CFIUS regulations are broadly worded and cover any transaction 'by or with any foreign person, which could result in control of a US business by a foreign person'. CFIUS generally has jurisdiction to review mergers

and unfortunately, there are no bright lines. Control is broadly defined as the 'power, direct or indirect, whether or not exercised . . . to determine, direct, or decide important matters affecting an entity'. This may be best understood by noting what is not required when determining whether a foreign person may control a US business. It is not necessary that the foreign person own more than 50% of the voting or equity interests of the entity or that the foreign investor has influence over the fortunes of the venture. It does not require that foreign persons are directors or officers of the business.

Covered transactions are defined largely by the exemptions to the CFIUS regulations. Loans and leases are not generally covered. A purchase of assets is not necessarily a purchase of a US business. If a foreign person acquires land, for example, such a purchase is not covered. What is critical is what is done on the land. A transaction which results in foreign control of any person engaged in interstate commerce in the US is likely to be a covered transaction, unless specifically carved out. Two such carve-outs may offer comfort to wind energy companies. First, there is an exemption for a foreign investor who holds 10% or less of the voting interests of the entity solely for the purpose of passive investment. Second and most notably for the wind energy industry, the review process specifically excludes start-up or 'greenfield' investments. Therefore, initial foreign investments in new US wind farms may fall entirely outside the scope of the CFIUS regime.

Should a CFIUS Notice be filed?

Assuming the transaction is covered by the CFIUS process, the parties still may not need to file with CFIUS. The parties may wish to discuss the matter with CFIUS before making the filing decision. The risks of opting not to file must be weighed carefully, and the parties must then decide whether it is in their best interests to make the filing. (CFIUS has the right to require parties to file in certain situations. It does so only rarely and in particularly sensitive cases, but it is not a good thing for a foreign investor to be called and asked why its transaction has not been the subject of a filing.)

A foreign investor intent upon controlling a US wind energy company is not likely to leave unresolved the potential undoing of a deal by the US Government and domestic partners, developers, or others involved in the transaction will be reluctant to indemnify such an investor against the inherent risk. Approval by CFIUS offers safe harbor to investors.

The primary benefit of a CFIUS filing is that it provides the parties with certainty following approval. Once CFIUS approves a deal, the US Government will not revisit the issue – or require the deal to be undone – for national security reasons. Therefore, as a general rule, it makes sense to file a notice unless resources (e.g. time, financial, or human) are particularly short or other compelling reasons exist. The filing process is not onerous and a notice can be prepared relatively quickly.

If the parties are not inclined to file voluntarily on this basis, however, we still recommend that parties notify CFIUS of any deals that may reasonably have national security implications. The CFIUS review process is only meant to examine transactions in which foreign control of a US business or assets might touch on national security issues. While few if any wind farm investments are likely to encounter turbulence from CFIUS, for peace of mind, an investor might decide to seek CFIUS clearance for investments in an off-shore wind farm where undersea mapping, radar 'shadow' or navigation issues are involved, an elevated wind farm in US Air Force or commercial flight patterns, a wind farm within observation distance of a sensitive, national security installation, or in proximity of any other significant national security site.

Another factor is the identity of the foreign investor. If a foreign government (or entity controlled by a foreign government) is involved, then it would be more advisable to file a CFIUS notice. Also, CFIUS would be more interested in acquisitions in the energy sector by certain countries (for example: China, Russia, Middle Eastern countries) than by traditional allies such as Canada or the UK. Finally, parties should consider exactly what opportunities the wind farm offers – or more specifically – what a foreign owner of the particular wind farm can do with that project that might negatively affect national security.

For example, there have been recent press reports that foreign spies have infiltrated the US electric grid and may have the ability to disrupt the power supply at will. If a foreign owner of a US wind farm could use that system to engage in espionage, obtain sensitive technology, or disrupt other energy transmission or distribution channels, then national security might be an issue. On the other hand, if the wind farm is solely capable of providing power generation (that at worst could be shut off), then there seems to be little risk.

All that said, it is prudent to explore the reaction of national and homeland security agencies to the particular wind farm project being acquired by calling CFIUS. CFIUS employs reasonable people, knowledgeable about the process and the enabling legislation, and usually very forthcoming. Informal discussions can be carried out without triggering an obligation to file.

Conclusion

The US wind energy industry and potential foreign investors should all be aware of the CFIUS review process. The Conference Report to the 1988 law authorizing this review process declared that Congress in no way intended to impose barriers to foreign investment in general when it created this process. The focus is on the incremental impact on national security from the acquisition of foreign control over a US business.

With the new US interest in the development of renewable sources of energy, one can understand that even that emphasis will not impede start-up investing. The regulatory regime does not cover true 'greenfield' investments in US wind farms, but it does potentially

cover any other foreign investment, even in a relatively young start-up enterprise, when 'control' is vested in that investor. If a transaction is covered, it is up to the parties to decide whether to file a voluntary notice with CFIUS. If there is any reason to believe that the subject of the deal or any party involved would raise a red flag with the US government for national security reasons, then we suggest filing with CFIUS. There are few situations where the urgency to close a deal warrants the uncertainty created by not filing. In an era of risk abatement, the offer of safe harbor from the US government is hard to resist.

About the author

Richard G. Reinis is of counsel in the Century City office of Steptoe & Johnson LLP, www.steptoelaw.com where he practices in the Business Solutions and Litigation departments. His clients are from diverse industries, including energy, real estate, consumer brands, apparel, retail, and others. Since joining the firm, he has been involved as lead counsel in mergers and acquisitions of middle market companies and significant commercial litigation. Transactions that have concluded under his leadership include the sale of an LED company, an apparel company, a blanket company, an energy company, and a large Californian ranch. He has represented buyers in connection with the acquisition of an apparel company, a wind energy generation company, and other businesses. He has served as lead counsel in trade secrets litigation, probate matters, and licensing disputes.

Mr Reinis began his law practice in 1969. Prior to joining Steptoe, he practiced with a law firm of international renown and a law firm he founded. Over the years, he has gained extensive experience in business organizations, labor and employment matters, real estate transactions, franchising, licensing, and assisting companies in workouts. Mr Reinis has hands-on business experience as a manufacturer and as the largest franchisee of Krispy Kreme Doughnuts.

He has also served as an expert witness on apparel-related litigation matters and is a court-appointed Special Master. He previously served as lead counsel in several state court jury trials and has experience with the American Arbitration Association, the ICC, and Federal Court litigation.

He is trustee and secretary of the Maxwell H Gluck Foundation, a member of the Endowment Investment Committee of the University of California at Riverside Foundation, and lectures nationally to business organizations and business school students. Mr Reinis is a former Board member of LAFLA, LA Children's Museum, and the State Bar Fund. He was the founder of the Compliance Alliance, the nation's largest volunteer organization dedicated to FLSA compliance. On behalf of the USDOL, he lectured national retailers on FLSA issues. ▲

