

WHY ARE FOREIGN INVESTMENTS IN DOMESTIC ENERGY PROJECTS NOW UNDER CFIUS SCRUTINY?

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Until recently, the Committee on Foreign Investment in the United States (CFIUS or the Committee) rarely affected domestic energy projects. That has changed, and CFIUS now actively reviews and sometimes alters transactions that result in foreign control of U.S. energy companies. In just the past several months, CFIUS has blocked an acquisition of Oregon wind farm projects (the Ralls/Terna case),¹ reportedly imposed conditions on the acquisition of a large oil and gas company (the CNOOC/Nexen case),² and approved an acquisition of a high-tech battery manufacturer only after the deal was restructured to carve out its government contracting business (the Wanxiang/A123 case).³

There are three primary drivers behind this recent scrutiny. The first is the rise of China—on the one hand as a trading and investment partner, and on the other hand, as a perceived security threat. Each of the three CFIUS cases referenced above concerned Chinese investments in domestic energy projects.⁴ The second driver is U.S. government

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¹ See Regarding the Acquisition of Four U.S. Wind Farm Project Companies by Ralls Corporation, 77 Fed. Reg. 60,281 (Oct. 3, 2012).

² Roberta Rampton & Scott Haggett, *CNOOC-Nexen Deal Wins U.S. Approval, Its Last Hurdle*, REUTERS, Feb. 12, 2013, available at <http://www.reuters.com/article/2013/02/12/us-nexen-cnooc-idUSBRE91B0SU20130212>. CFIUS proceedings and related documents are kept strictly confidential pursuant to statutory requirement. See 50 U.S.C. app. § 2170(c) (2012). Therefore, with few exceptions, there is no official public information on the results of CFIUS proceedings. However, details of newsworthy cases are often reported in the press.

³ Michael Bathon, *Wanxiang Wins U.S. Approval to Buy Battery Maker A123*, BLOOMBERG (Jan. 30, 2013), <http://www.bloomberg.com/news/2013-01-29/wanxiang-wins-cfius-approval-to-buy-bankrupt-battery-maker-a123.html>.

⁴ See Andrew Zajac, *Ralls Sues to Void U.S. Wind-Farm Purchase Obama Blocked*, BLOOMBERG (Jan. 29, 2013), <http://www.bloomberg.com/news/2013-01-29/ralls-sues-to-void-u-s-wind-farm-purchase->

concern about the vulnerability of U.S. infrastructure, particularly to a cyber attack on U.S. networked systems, such as energy grids and other energy-related assets. The third driver is a change in the balance among the agencies that comprise CFIUS. In particular, the Department of Defense has sought aggressively to use the Committee's authority to keep potential foreign adversaries far away from U.S. security facilities, while the more trade-oriented agencies have been weakened in CFIUS deliberations.⁵

CFIUS Background

CFIUS is an interagency committee chaired by the Department of Treasury.⁶ Its mandate is to review foreign investments in U.S. businesses to ensure that such investments do not adversely affect national security.⁷ More specifically, CFIUS reviews transactions that result in foreign "control" of U.S. businesses where that foreign control may affect national security.⁸

Though the Committee often reviews more than one hundred cases per year,⁹ it typically sees potential security implications in only a dozen or so.¹⁰ In those cases, CFIUS generally protects against possible adverse effects by obtaining commitments from the foreign investor. These commitments, which take the form of a "risk mitigation agreement," may include such requirements as the use of specified vetting procedures for key employees or restrictions on foreign access to sensitive technology or facilities.¹¹ When CFIUS cannot mitigate the risk presented by a transaction through an agreement,

obama-blocked.html; Rampton & Haggett, *supra* note 2; Bathon, *supra* note 3.

⁵ The authors' discussion of the Committee's changing balance draws from personal experience.

⁶ See 50 U.S.C. app. § 2170(k). The agencies statutorily charged with CFIUS obligations are the Departments of Treasury, Homeland Security, Commerce, Defense, State, Justice, Energy, Labor (as a non-voting member), and the Office of the Director of National Intelligence (also a non-voting member). *Id.* In addition, by executive order, the Office of the United States Trade Representative (USTR) and the Office of Science and Technology Policy both regularly participate in the Committee. See Exec. Order No. 13,456 § 3(b), 73 Fed. Reg. 4677, 4677 (Jan. 23, 2008).

⁷ See 50 U.S.C. app. § 2170(k).

⁸ CFIUS regulations define "control" of a U.S. business quite loosely—virtually any foreign ability to cause a company to act (or not to act) in a particular manner constitutes foreign control. See 31 C.F.R. § 800.204 (2012). However, at least "control" is defined. Whether a transaction may affect national security, though subject to a statutory "factors test," is virtually indefinable. See 50 U.S.C. app. § 2170(f). The amorphous quality of the national security inquiry is underscored by the last statutory factor: "such other factors as the President or the Committee may determine to be appropriate." *Id.* § 2170(f)(11).

⁹ See COMM. ON FOREIGN INV. IN THE U.S., ANNUAL REPORT TO CONGRESS CY 2011 2 (Dec. 2012), <http://www.treasury.gov/resource-center/international/foreign-investment/Documents/2012%20CFIUS%20Annual%20Report%20PUBLIC.pdf>.

¹⁰ See *id.* at 18 ("From 2009 through 2011, 22 cases (eight percent) resulted in the use of legally binding mitigation measures.").

¹¹ These commitments are embodied in risk mitigation agreements between the government and the acquiring parties. See 50 U.S.C. app. § 2170(l)(1) (authorizing mitigation agreements).

its recourse is to recommend that the President block the transaction.¹² The President is authorized to “take such action for such time as the President considers appropriate to suspend or prohibit any covered transaction that threatens to impair the national security of the United States.”¹³ CFIUS recommendations to the President are very rare, usually no more than one or two per year.¹⁴ In those rare cases, if the parties do not voluntarily withdraw the transaction, the President is likely to follow the Committee’s recommendations to preclude foreign control of the U.S. business. Transacting parties have forced a Presidential decision only twice in the Committee’s history, and in both cases the President exercised his authority to block the transaction.¹⁵

However, there is a significant benefit to undergoing CFIUS review from the perspective of the transacting parties. If CFIUS approves the deal, as it does in the vast majority of cases, then the deal is insulated from executive branch interference on national security grounds.¹⁶

The CFIUS process is nominally voluntary. There is no requirement that parties conducting transactions involving foreign entities notify CFIUS, even when those transactions result in foreign control or clearly involve assets relevant to national security.¹⁷ However, the Committee monitors a wide range of transactions, primarily through open media sources. If a “non-notified transaction” is of interest to CFIUS, the Committee will offer the parties the opportunity to submit a notification.¹⁸ In the event that transacting parties ignore the “voluntary” submission request, CFIUS has authority to initiate a review of a transaction on its own.¹⁹ A notice filed by the parties will invariably put the transaction in a better light than if the parties refuse to submit a notice and the Committee undertakes a review on its own accord.

The Committee’s attention to non-notified transactions, which has grown over the last few years, incentivizes transacting parties to err on the side of voluntarily notifying

¹² See Exec. Order No. 13,456 § 6(c), 73 Fed. Reg. 4677, 4678–79 (Jan. 23, 2008).

¹³ 50 U.S.C. app. § 2170(d)(1).

¹⁴ See generally COMM. ON FOREIGN INV. IN THE U.S., *supra* note 9, at 3 (indicating that “there were no transactions that resulted in a Presidential decision”).

¹⁵ In October 2012, the President blocked Ralls’ acquisition of Oregon wind farm projects. See *Regarding the Acquisition of Four U.S. Wind Farm Project Companies by Ralls Corporation*, 77 Fed. Reg. 60,281 (Oct. 3, 2012). In February 1990, the President blocked China National Aero-Technology Import and Export Corporation’s acquisition of aircraft parts manufacturer MAMCO Manufacturing, Inc. See *Order Pursuant to Section 721 of the Defense Production Act of 1950*, 55 Fed. Reg. 3935 (Feb. 6, 1990).

¹⁶ See 50 U.S.C. app. § 2170(b)(1)(D). See also EDWARD M. GRAHAM & DAVID M. MARCHICK, U.S. NATIONAL SECURITY AND FOREIGN DIRECT INVESTMENT 33–58 (2006).

¹⁷ A “notice” to CFIUS initiates the CFIUS review process. See 31 C.F.R. § 800.401 (2012). Notices are virtually always submitted jointly by the parties to the transaction that is subject to CFIUS review because the regulations require submission of information related to both parties.

¹⁸ *Id.* § 800.401(b).

¹⁹ *Id.* § 800.401(c).

CFIUS for several reasons. First, when CFIUS requests a notification in the absence of a voluntary notice, the parties begin the CFIUS process with an air of distrust. These transactions receive additional scrutiny—both because CFIUS already has decided that the transaction may raise national security concerns and because CFIUS generally is suspicious that the parties deliberately sought to avoid review. Second, because CFIUS generally requests notice only after the transaction has closed, there is greater commercial risk if CIFIUS rejects the deal or if it imposes burdensome conditions. There is no opportunity in such cases for the parties to restructure the transaction in a way that helps address the Committee’s concerns. Third, there is greater risk that CFIUS will reject a non-notified transaction or impose very burdensome conditions, because CFIUS often finds it more difficult to mitigate national security risks after a transaction has closed.

The current state of affairs with regard to CFIUS regulation can be summarized as follows: CFIUS has significant power over foreign investments in U.S. companies, and provides strong incentives for transacting parties to voluntarily submit to a review. Considering this background, we can identify several factors that have driven recent Committee attention to domestic energy projects.²⁰

The Rise of China

China’s emergence as a world power has been accompanied by concerns about Chinese espionage directed at the United States. For example, an October 2012 report by the U.S. House Permanent Select Committee on Intelligence alleged that investments by Chinese telecommunications equipment companies Huawei and ZTE presented significant national security risks.²¹ A February 2013 report by the security company Mandiant Corporation alleged that the Chinese government sponsored cyber espionage.²²

²⁰ While the Committee’s attention to domestic energy projects has been limited until recently, one notable exception was the Chinese National Offshore Oil Corporation’s (CNOOC) proposed acquisition of Unocal Oil Company in 2005. See Francesco Guerrera, *CNOOC at Odds with Congress over Unocal Deal*, FIN. TIMES (July 26, 2005), <http://www.ft.com/intl/cms/s/0/07ca91da-fdfc-11d9-a289-00000e2511c8.html>. CNOOC withdrew its bid for Unocal, as well as its CFIUS notice, amid U.S. political pressure. See Ben White, *Chinese Drop Bid To Buy U.S. Oil Firm*, WASH. POST (Aug. 3, 2005), <http://www.washingtonpost.com/wp-dyn/content/article/2005/08/02/AR2005080200404.html>. The House of Representatives enacted a non-binding resolution opposing the transaction and stating that CNOOC’s planned acquisition of Unocal “would threaten to impair the national security of the United States.” See H.R. Res. 344, 109th Cong. (2005). A bill was introduced in the Senate to prohibit the sale and the House passed an amendment to an appropriations bill that would have prohibited CFIUS from approving the deal. See S. Res. 1412, 109th Cong. (2005); H.R. Res. 3058, 109th Cong. (2005).

²¹ See U.S. HOUSE OF REPRESENTATIVES PERMANENT SELECT COMM. ON INTELLIGENCE, 112TH CONG., INVESTIGATIVE REPORT ON THE U.S. NATIONAL SECURITY ISSUES POSED BY CHINESE TELECOMMUNICATIONS COMPANIES HUAWEI AND ZTE 44–46 (Oct. 8, 2012), *available at* <http://intelligence.house.gov/sites/intelligence.house.gov/files/documents/Huawei-ZTE%20Investigative%20Report%20%28FINAL%29.pdf>.

²² MANDIANT, APT1: EXPOSING ONE OF CHINA’S CYBER ESPIONAGE UNITS (Feb. 2013), http://intelreport.mandiant.com/Mandiant_APT1_Report.pdf.

In March 2013, the U.S. National Security Advisor alleged that Chinese entities are the sources of “sophisticated, targeted theft of confidential business information and proprietary technologies through cyber intrusions emanating from China on an unprecedented scale.”²³ In addition, the U.S. Government has recently accused the Chinese military of launching cyber attacks against U.S. government and private networks.²⁴

At the same time, the flow of Chinese direct investment into the U.S.—one indicator of the U.S.-China economic relationship—has been growing rapidly, from \$129 million in 2006, to \$1.9 billion in 2009, to \$6.5 billion in 2012.²⁵ This trend has resulted in more instances of Chinese investment in U.S. energy projects and companies. With China joining the United States as the world’s biggest consumers of energy,²⁶ the development of energy projects should be an arena for extensive investment and collaboration between the two world powers. In fact, in President Obama’s first year in office, the Administration announced multiple cooperative energy development measures with China and there have been regular follow-on efforts.²⁷

Yet extensive collaboration also can give rise to conflict, leading the U.S. to view China as a strategic threat as well as a partner. This threat has led CFIUS to closely examine recent Chinese investment in U.S. energy projects. Such transactions present concerns such as U.S. energy security, China’s ability to infiltrate U.S. power systems, the transfer of key technology to China, and the proximity of foreign-controlled projects to sensitive military facilities.

Infrastructure Vulnerability

In recent years, the energy sector has become a focus of national security concerns, along with traditional security-related areas such as defense, telecommunications, and high technology. As the power grid is increasingly reliant on electronic systems, energy projects are now a main point of vulnerability to the United States. Other energy projects may present national security implications for reasons of energy independence or the valuable technology involved. Accordingly, the 2007

²³ Thomas Donilon, Nat’l Sec. Advisor to President Obama, *The United States and the Asia-Pacific in 2013* (Mar. 11, 2013) (transcript available at <http://asiasociety.org/new-york/complete-transcript-thomas-donilon-asia-society-new-york>).

²⁴ David E. Sanger, *U.S. Blames China’s Military Directly for Cyberattacks*, N.Y. TIMES (May 6, 2013) http://www.nytimes.com/2013/05/07/world/asia/us-accuses-chinas-military-in-cyberattacks.html?pagewanted=all&_r=0 (citing U.S. Department of Defense report on Military and Security Developments Involving the People’s Republic of China).

²⁵ See *Chinese Investment Monitor*, RHODIUM GROUP, <http://rhg.com/interactive/china-investment-monitor> (last visited Apr. 20, 2013).

²⁶ Spencer Swartz & Shai Oster, *China Tops U.S. in Energy Use*, WALL ST. J. (July 18, 2010), <http://online.wsj.com/article/SB10001424052748703720504575376712353150310.html>.

²⁷ See, e.g., U.S. DEP’T OF ENERGY, *U.S.-CHINA CLEAN ENERGY COOPERATION* (Jan. 2011), available at http://energy.gov/sites/prod/files/USChinaCleanEnergy_0.PDF.

amendments to the CFIUS statute stressed the importance of the energy sector.²⁸ Among the list of factors CFIUS must consider in its proceedings are “the potential national security-related effects on United States critical infrastructure, including major energy assets,” and “the long-term projection of United States requirements for sources of energy and other critical resources and material.”²⁹

The CFIUS cases referenced at the outset of this article—Ralls/Terna, CNOOC/Nexen, and Wanxiang/A123—all involved Chinese investments in energy companies that, from the perspective of CFIUS, represented potential national security vulnerabilities.³⁰ The acquisition by Chinese-owned Ralls Corp. of assets from Greek-owned Terna concerned wind farm projects that would connect to a regional electric grid and that were near a Department of Defense flight facility.³¹ The CNOOC acquisition of Canadian energy company Nexen involved oil platforms in the Gulf of Mexico that the Department of Defense viewed as strategic locations.³² Wanxiang’s purchase of A123, a high-tech battery manufacturer, stalled until the parties decided that Wanxiang would not acquire A123’s defense-related business.³³

In other words, CFIUS viewed many of the assets at issue as potentially exploitable to the detriment of U.S. security. Coupled with U.S. concern about China as an espionage threat and source of cyber attacks, each case presented a combustible mixture. Fortunately, CFIUS ultimately approved the CNOOC/Nexen and Wanxiang/A123 cases in early 2013.³⁴ However, in both cases the parties reportedly had to undertake substantial commitments to ensure CFIUS approval. In CNOOC/Nexen, CNOOC apparently was obligated to agree to a broad range of security measures concerning Nexen’s oil platform assets in the Gulf of Mexico.³⁵ In Wanxiang/A123, Wanxiang agreed to carve out pieces of A123’s business that were of importance to the U.S. government.³⁶ On the other hand, the President blocked the Ralls/Terna deal in September 2012 because, due to the proximity to U.S. defense facilities, the President

²⁸ Foreign Investment and National Security Act of 2007, Pub. L. No. 110-49, 121 Stat. 246 (2007).

²⁹ *Id.* § 4.

³⁰ See Zajac, *supra* note 4; Rampton & Haggett, *supra* note 2; Bathon, *supra* note 3.

³¹ See Helene Cooper, *Obama Orders Chinese Company to End Investment at Sites Near Drone Base*, N.Y. TIMES, Sept. 29, 2012, at A16, available at <http://www.nytimes.com/2012/09/29/us/politics/chinese-company-ordered-to-give-up-stake-in-wind-farms-near-navy-base.html>.

³² See Sara Forden & Rebecca Penty, *Nexen Rigs Near U.S. Military Base May be Issue in CNOOC Review*, FIN. POST (Dec. 12, 2006), http://business.financialpost.com/2012/12/06/nexen-rigs-near-u-s-military-base-may-be-issue-in-cnooc-review/?_lsa=a706-0039.

³³ Erin Ailworth, *A123 Deal Hangs on Secretive Federal Panel*, BOS. GLOBE (Jan. 9, 2013), <http://www.bostonglobe.com/business/2013/01/09/deal-hangs-secretive-federal-panel/92R7hEpT6Jrgdsod9txw8M/story.html>.

³⁴ See Rampton & Haggett, *supra* note 2; Bathon, *supra* note 3.

³⁵ See Rebecca Penty & Sara Forden, *CNOOC Said to Cede Control of Nexen’s U.S. Gulf Assets*, BLOOMBERG (Mar. 1, 2013), <http://www.bloomberg.com/news/2013-03-01/cnooc-said-to-cede-control-of-nexen-s-u-s-gulf-assets.html>.

³⁶ See Bathon, *supra* note 3.

found that the Chinese owners “might take action that threatens to impair the national security of the United States.”³⁷

Changing Balance Within CFIUS

CFIUS decisions ultimately are made by individual representatives from the separate agencies that comprise the Committee. These individuals—bright, dedicated, and committed to the national interest—discuss each CFIUS case among themselves.³⁸ They gather in person at least once each week and continue their dialog through emails and by phone. These individuals each bring to bear their own experiences, knowledge, and interests. They also are obligated to represent the views of their agencies, and act consistently with their agencies’ missions, while serving on CFIUS.³⁹

For example, a cyber attack that shuts down a city’s power would concern personnel at the Department of Homeland Security more than personnel at the Office of the United States Trade Representative (USTR). Conversely, if the United States enters into a counterproductive trade dispute, it would directly affect personnel at USTR much more than at the Department of Homeland Security. In addition, the relevant personnel are held accountable by pressure and potential fallout—from inside their agencies, Congress, and the press—if their areas of expertise lead to a compromise of national security. That is not to say that concerns are strictly limited in this way, but it is a rough approximation of how representatives from each of the agencies behave. An additional layer of complexity results from the varied views on an issue shaped by Committee members’ personal experience and the agency positions for which they advocate.

Accordingly, representatives from the more security-focused agencies—the Departments of Homeland Security, Justice, and Defense—typically are more hawkish in Committee deliberations than are representatives from other agencies. On the other hand, representatives from the Departments of State and Commerce and USTR are often focused on commercial, trade, and diplomatic interests. In the past, this latter group generally defended these interests strongly. In CFIUS deliberations they argued in favor of approving deals that the hawkish agencies sought to scuttle or burden with conditions. In their view, the trade or diplomatic benefits of international commercial transactions and an open investment environment outweighed many concerns raised by the security agencies.

Recently, however, the trade-oriented agencies have been more muted in CFIUS deliberations. This change may be a function of the particular individuals involved in the

³⁷ Regarding the Acquisition of Four U.S. Wind Farm Project Companies by Ralls Corporation, 77 Fed. Reg. 60,281, 60,281 (Oct. 3, 2012).

³⁸ The authors’ discussion of the Committee’s changing balance draws from practical experience.

³⁹ While the day-to-day CFIUS participants represent the views of their agencies, certain actions require the approval of high-level political appointees. *See* 50 U.S.C. app. § 2170(b)(1)(F), (b)(2)(D)(ii), (b)(3)(C)(iv)(II).

deliberations (since the cast of individuals changes over time), or a function of policy concerns at their agencies. The State Department, for example, recently has been playing a critical role on U.S. policy vis-à-vis Iran. That may make some bureaucracies within the State Department more hawkish, which may in turn create different incentives for the State Department's CFIUS representatives. By many accounts, the representatives from the trade-oriented agencies recently appear less inclined to challenge their security-focused counterparts.

The Department of Energy plays a unique role in CFIUS because it has an interest in security, trade, and the promotion of renewable energy. Yet in recent cases involving Chinese investments in U.S. energy projects—where the Department of Energy could potentially play a leading role—its trade and environmental interests were insufficient for it actively to challenge the security-focused agencies.

At the same time, the Department of Defense, in particular, has leveraged CFIUS authority as a way to keep potential foreign adversaries away from U.S. government security facilities.⁴⁰ Defense representatives on the Committee have argued aggressively that any advantage that a potential foreign adversary might gain from U.S. investment—for example, by acquiring a company with access to an important network that could be used for a cyber attack—must be nullified. The result is occasionally the scuttling of the deal entirely, either voluntarily by the parties or by Presidential order as in the Ralls/Terna case.⁴¹

Conclusion

With counter-arguments from trade-oriented agencies now muted or absent, the hawkish agencies are determining CFIUS outcomes in cases where there are security concerns. The rise of China has brought increased Chinese investment in the United States, including energy-related investments. With this investment, however, have come security concerns, particularly regarding Chinese espionage. Coupled with concerns about infrastructure vulnerability, these dynamics have given rise to an increased number of difficult CFIUS cases that have involved domestic energy projects.

⁴⁰ See, e.g., Memorandum from Davis Graham & Stubbs LLP & Reed Smith LLP to Nw. Non-Ferrous Int'l Co. & Firstgold Corp. (Dec. 14, 2009), available at <http://graphics8.nytimes.com/packages/images/nytint/docs/memo-regarding-the-sale-of-firstgold-corp/original.pdf>.

⁴¹ Regarding the Acquisition of Four U.S. Wind Farm Project Companies by Ralls Corporation, 77 Fed. Reg. at 60,281.