

# Limiting Foreign Investment

NEW ACT'S IMPACT ON UTILITIES

BY BERNAYS T. BARCLAY AND TIMOTHY MARTIN

 AFTER CHINA NATIONAL OFFSHORE OIL'S FAILED bid for Unocal and the public debacle around the Dubai Ports World deal, a spotlight was turned on the little-known Committee on Foreign Investment in the United States.

Congress moved quickly to shore up weaknesses it saw in the previously obscure CFIUS process for approving foreign investments in the United States that might pose a threat to national security. In July, President Bush signed the Foreign Investment and National Security Act of 2007, and on October 24, FINSA took effect, amending legislation commonly known as Exon-Florio.

Although much of FINSA merely codifies existing practice, its changes to CFIUS as well as its expanded definition of national security, are likely to result in more scrutiny for – and the delay or even denial of – transactions involving foreign buyers in the U.S. power and utility sector.

CFIUS concerns itself with covered transactions, which are transactions whereby a foreign entity could gain control – even limited control – over a business with U.S. operations. Covered transactions are reviewed for their effect on national security, which includes the security of critical infrastructure, including major energy assets.

FINSA defines critical infrastructure broadly as “systems and assets, whether physical or virtual, so vital to the United States that [their] incapacity or destruction would have a debilitating impact on national security.”

Although it is possible that draft regulations scheduled to be released by CFIUS this year may be narrower, the Homeland Security Act of 2002 expressly includes power production, generation, and distribution systems within the term critical infrastructure. Given this framework, and with DOE now added by FINSA as a voting member of CFIUS, we see no reason why CFIUS would exclude the power and utility industry from its scope.

Upon acceptance of written notification of a covered transaction, CFIUS initiates a 30-day review to determine the proposed deal's potential effect on national security. Filings are confidential and voluntary, but if a party does not file, it runs the risk that CFIUS or the president will unilaterally initiate a review of the transaction, even after it has been completed.

Exon-Florio specified five factors to be considered, at a minimum, during this review. Two addressed the effect of a transaction on national defense requirements; three

addressed its potential effect on national security. To these five factors FINSA adds, among others, the potential effects on critical infrastructure including major energy assets; whether the transaction involves a foreign government; consideration of long-term U.S. energy requirements; and any other factors the president or CFIUS deem appropriate.

At the conclusion of the 30-day review, a second stage 45-day investigation is mandatory if the transaction threatens to impair national security and that threat has not yet been mitigated by agreement or otherwise. It can also be triggered if the transaction involves a foreign government-controlled acquirer, except where the U.S. treasury secretary and the head of the lead agency in the review jointly determine that the transaction will not impair the security of the United States. Following the 45-day investigation, CFIUS makes a recommendation to the president regarding further action. Within 15 days of that recommendation, the president must announce the decision whether or not to suspend or prohibit the transaction. The decision of the president is not reviewable by any court.

With the weakened dollar and the continued interest of foreign utilities, banks and other investors in U.S. power industry investments, we expect to see increasing CFIUS activity in this industry. As mentioned above, national security is no longer limited to traditional notions of the defense sector.

The expanded FINSA definition is likely to include a large swath of the power industry potentially including companies with major transmission facilities or significant generating capacity in their physical custody and control. DOE, which is the sector-specific agency for identifying and protecting critical infrastructure for the energy and electric power sector – except for commercial nuclear power facilities – will be on alert for transactions that should be reviewed by CFIUS for possible national security implications. And if a foreign government, or an entity controlled by one, is involved in a power industry acquisition, the parties may face even longer delays due to the mandatory second stage 45-day investigation of transactions involving foreign government-controlled acquirers that are not excepted by the Treasury Department and the lead review agency.

Because FINSA increases Congressional oversight of CFIUS, its most significant change may be the one it never mentions. Transactions involving foreign buyers will face new and potentially higher political and public relations hurdles than under Exon-Florio.

Considering this changed legal and political landscape, a target company should explore early in the deal the possibility of foreign government influence over a foreign acquirer, and all transactions involving foreign buyers need to be guided carefully, long before the first formal filing with CFIUS.

*Bernays T. Barclay is a partner and Timothy Martin is an associate in the New York office of Torsys law firm.*

## NewsFlash

### CALIFORNIA ISO ALLOCATION

www.energycentral.com

The California Independent System Operator has posted the results of its allocation process for long-term transmission rights.

The grid operator has issued a 10-year financial hedge for transmission users, providing them with a stable cost structure. These efforts are consistent with the goals of the 2005 energy act to promote expansion of the transmission grid.