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UNREASONABLE DELAYS: CFIUS REVIEWS OF ENERGY TRANSACTIONS

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I. Introduction

The role of foreign investment in the U.S. energy sector has changed significantly in recent years. The development of domestic oil and gas resources has resulted in a significant increase in foreign interest in the U.S. as a target for investment in the wide range of industries connected to domestic oil and gas production, transportation, and use.[1] Such investment is important to the continued growth and success of the U.S. energy sector and, in order to facilitate these ventures, the regulatory process surrounding energy transaction investment should not impose unreasonable delays. Unfortunately, delays and burdens associated with the Committee on Foreign Investment in the Unites States (CFIUS) are playing an increasingly significant and frustrating role in energy transactions.

This Article is not intended to discuss the wide range of substantive issues involved in a CFIUS review of energy transactions, but instead to call attention to timing concerns that have received little attention. As a result of legal and regulatory changes, CFIUS reviews of energy transactions are confronting lengthy delays that introduce needless uncertainty and costs into the investment climate. These delays frustrate the intended role of CFIUS review and make it unnecessarily difficult for energy transactions to be designed and executed in an efficient manner.

II. Living in the Now: CFIUS after FINSA

The U.S. has long struggled with efforts to balance concerns about the national security implications of foreign investment with the economic benefits of encouraging foreign investment in the U.S. CFIUS, an interagency committee chaired by the Department of the Treasury and charged with reviewing foreign acquisitions of U.S.

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[1] *See, e.g.*, *Foreign Investors Play Large Role in U.S. Shale Industry*, U.S ENERGY INFO. ADMIN. (Apr. 8, 2013), http://www.eia.gov/todayinenergy/detail.cfm?id=10711.

businesses, was created as the tool to help find this balance.[2] CFIUS was created by Executive Order in 1975 and given limited jurisdiction and power to review foreign investment in the U.S., although CFIUS jurisdiction and powers were expanded in 1988 when Congress adopted the Exon-Florio amendment to section 721 of the Defense Production Act.[3] Since 1988, CFIUS has had significant discretion to review foreign investment in the U.S. with almost complete confidentiality and protection from judicial review, providing the public and the investing community with virtually no precedent that can be used to predict CFIUS behavior.[4]

Although the Exon-Florio regime provided CFIUS with broad powers, its process has had a rather narrow substantive scope. These limits resulted from a desire to prevent CFIUS from unduly interfering with foreign investment, and regulations at the time focused on transactions involving "products, services, and technologies that are important to U.S. national defense requirements."[5]

In addition to having a narrow scope, the review process under Exon-Florio was fairly simple and predictable. Parties would file a notice voluntarily (or CFIUS would require that a notice be filed), and CFIUS would conduct an initial review within 30 days.[6] If CFIUS identified a need for further investigation, the committee could use an additional 45 days to conduct an investigation, and ultimately conclude the investigation with a recommendation for Presidential action.[7] This recommendation was required to be taken or rejected within 15 days of being sent to the President.[8] The CFIUS regulations establishing this process were vague in many respects, but in practice parties to most energy transactions that were unrelated to defense could plan around the CFIUS process knowing that benign transactions would generally be cleared by CFIUS after the initial 30-day review, which began when the parties submitted a formal voluntary notice.[9]

However, for companies involved in the energy sector, CFIUS procedure was fundamentally changed by the controversy surrounding the acquisition of the port management business of Peninsular and Oriental Steam Navigation Company (P&O) by Dubai Ports World (DP World), an entity ultimately owned by the government of the

[2] *See* 50 U.S.C. app. § 2170(k) (2012).

[3] *See generally* Stephen K. Pudner, *Moving Forward from Dubai Ports World—The Foreign Investment and National Security Act of* 2007, 59 ALA. L. REV. 1277, 1278–81 (2008); James F.F. Carroll, *Back to the Future: Redefining the Foreign Investment and National Security Act's Conception of National Security*, 23 EMORY INT'L L. REV. 167, 167–68 (2009) (describing historical origins of CFIUS regulatory mandate).

[4] *See* Pudner, *supra* note 3, at 1281; 50 U.S.C. app. § 2170(e).

[5] Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons, 56 Fed. Reg. 58,774, 58,775 (Nov. 21, 1991) (to be codified at 31 C.F.R. pt. 800).

[6] *Id.* at 58,786.

[7] *Id.*

[8] *Id*. at 58,787.

[9] *Id.* at 58,784–87.

United Arab Emirates.[10] DP World's acquisition of P&O included a transfer of leases for management of six major U.S. ports.[11] Although CFIUS cleared the DP World transaction, it sparked significant controversy and scrutiny of the CFIUS process that ultimately resulted in DP World selling all of the assets in question to U.S. entities in order to defuse the controversy.[12] In the wake of the DP World transaction, the legal foundation for CFIUS reviews of foreign investment in the U.S. was overhauled by the enactment of the Foreign Investment and National Security Act of 2007 (FINSA) [13] and the promulgation of new regulations by CFIUS in 2008.[14]

FINSA and subsequent regulations made a variety of significant changes to the nature and process of CFIUS review. This Article will discuss the following aspects of the CFIUS review process:

- Broadening the definition of national security to explicitly include "issues relating to 'homeland security', including its application to critical infrastructure" and noting that this review includes "major energy assets."[15]
- Creating a three-tiered pre-notice, review, and investigation process that includes an initial pre-notice submission, a 30-day review of a formal notice (either filed voluntarily by parties or required to be filed by CFIUS), followed by a 45-day investigation if certain conditions are met.[16]
- The creation of a presumption that foreign acquisitions involving critical infrastructure and acquisitions by government-owned investors require a 45-day investigation phase, unless senior CFIUS officials sign off that no investigation is needed.[17]

III. New Delays: International Energy Transactions Under FINSA

A. The Unlimited Definition of Critical Infrastructure

Prior to FINSA, determining whether a transaction fell under CFIUS jurisdiction was a simpler task for energy transactions. If the transaction resulted in a foreign-owned or controlled entity obtaining control over an existing U.S. business, and that business was involved with products or services that had a particular relationship to national security, such as materials essential to national defense, then submission to CFIUS

[10] *See* Deborah M. Mostaghel, *Dubai Ports World Under Exon-Florio: A Threat to National Security or a Tempest in a Seaport?*, 70 ALB. L. REV. 583, 583 (2007).

[11] *See id.* at 606.

[12] *See id.* at 607.

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

[14] Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons, 73 Fed. Reg. 70,702 (Nov. 21, 2008) (to be codified at 31 C.F.R. pt. 800).

[15] 50 U.S.C. app. § 2170(a)(5), (f)(6) (2012).

[16] *Id.* § 2170(b).

[17] *Id.*

review was prudent. CFIUS would review the notice submitted by the parties to the transaction and, if national security issues were identified, a 45-day review could be added to the initial 30-day review period. In the context of most energy transactions, those not involving energy assets connected to the U.S. military or occupying a dominant market share position in a particular energy sector, it was normal to abstain from submitting a transaction for CFIUS review because no national security issues could be identified, and those transactions that were submitted for review were often cleared by CFIUS within the first 30-day review period. The confidentiality of the CIFUS process has made reliable data difficult to obtain, but in 2006 the Congressional Research Service (relying on research conducted by outside sources) reported that CFIUS reviewed approximately 1,500 transactions from 1988 until 2005, with only twenty-five of those transactions being subjected to a full investigation.[18]

Determining how an energy-related notice will be treated by CFIUS is a more complex endeavor now because of FINSA's treatment of "critical infrastructure."[19] Critical infrastructure is defined as "systems and assets . . . so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security."[20] This term is important because FINSA added a new provision to the law requiring that CFIUS take into account "the potential national security-related effects on United States critical infrastructure, *including major energy assets*" when conducting a review of a transaction.[21]

While it is clear that these changes expand the scope of CFIUS review, it is less clear where that expansion ends. In particular, questions remain as to what sorts of infrastructure are included in the critical infrastructure category, other than "major energy assets," and what exactly makes an energy asset "major."[22] These questions remain unanswered, as CFIUS has refused to provide examples of infrastructure that might be considered critical infrastructure in their regulations.[23]

The FINSA language governing critical infrastructure has left the energy sector in the unfortunate position of being the only industry sector mentioned specifically as an example of critical infrastructure, with no indication of the types of energy assets that are considered neither major nor critical.[24] This direct reference to the energy sector is important because, in the author's experience, spotlighting energy assets has both compelled more parties involved in international energy transactions to file CFIUS notices in order to contain the risk of subsequent CFIUS review of those transactions and

[18] JAMES K. JACKSON, CONG. RESEARCH SERV., RS22197, THE EXON-FLORIO NATIONAL SECURITY TEST FOR FOREIGN INVESTMENT 4 (2006).
[19] 50 U.S.C. app. § 2170(a)(6).
[20] *Id.*
[21] *Id.* § 2170(f)(6) (emphasis added).
[22] *Id.*
[23] *See* 31 C.F.R. § 800.208 (2012)
[24] 50 U.S.C. app. § 2170(f)(6).

has resulted in those notices facing longer delays as a result of the FINSA provisions discussed below.

B. The New "Pre-Notice" Notice

During the Exon-Florio era of CFIUS, parties could prepare a voluntary notice pursuant to CFIUS regulations and, as long as that notice included all of the information listed in the regulations, the 30-day review period would begin upon filing notice.[25] However, that process has changed substantially in the wake of FINSA.

Although FINSA made no mention of any pre-notice consultations, CFIUS promulgated regulations in which pre-notice consultations assumed a new and formal role in the CFIUS process. The language included in the post-FINSA CFIUS regulations provides that parties to transactions are "encouraged to consult" with CFIUS in advance of filing a notice and to file a draft notice in "appropriate cases."[26] The regulatory language further states that all pre-notice materials must be provided to CFIUS "at least five business days before the filing of a voluntary notice."[27]

The pre-notice process has been described by CFIUS as a tool to help CFIUS "understand the transaction and to suggest information that the parties may wish to include in their notice to assist [CFIUS] in addressing any national security considerations as efficiently as possible."[28] While this objective seems reasonable, in practice the pre-notice period has become a functionally mandatory process that introduces new and unpredictable delays into the CFIUS review process. Although the CFIUS regulations indicate that a draft notice should be filed when appropriate, the reality is that CFIUS expects a draft notice in all cases. Once CFIUS receives the draft notice, CFIUS will often call for explanations or information beyond that required by regulations,[29] and it has become common practice for CFIUS to require early submission of the Personal Identifier Information (PII).[30] CFIUS has made it clear to filers that notices found to be insufficiently clear or complete will be rejected[31], and in practice this has meant that only after CFIUS deems a pre-notice sufficiently clear and complete will CFIUS recommend that a formal voluntary notice be filed. If parties were to act without such a recommendation, they risk having the formal notice rejected by CFIUS as incomplete, meaning that the formal review process would never begin.[32]

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[25] *See* Mostaghel, *supra* note 10, at 595.

[26] 31 C.F.R. § 800.401(f) (2012).

[27] *Id*.

[28] Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons, 73 Fed. Reg. 70,702, 70,711 (Nov. 21, 2008) (to be codified at 31 C.F.R. pt. 800).

[29] 31 C.F.R. § 800.402 (2012).

[30] *Id.* § 800.402(c)(6)(vi).

[31] *See Filing Instructions*, U.S. DEP'T OF TREASURY, http://www.treasury.gov/resource-center/international/foreign-investment/Pages/cfius-filing-instructions.aspx (last visited April 12, 2013).

[32] *See Committee on Foreign Investment in U.S. (CFIUS)*, U.S. DEP'T OF TREASURY,

The creation of a technically voluntary, but functionally mandatory, pre-notice process has added a significant amount of time to the CFIUS approval process, particularly for complex energy transactions. Not accounting for the time required to prepare the initial draft notice, the pre-notice consultation process can often drag on for weeks as parties scramble to collect all the individual bits of data requested by CFIUS. For complex energy transactions that involve multiple international parties, a variety of subsidiaries, and complex, geographically dispersed assets, the pre-notice process often involves scores of request and fact-finding missions at the behest of CFIUS. During this entire period, there is no clock running on the CFIUS pre-notice process and the formal review clock is not yet started. For energy transactions that operate under tight timelines as a result of tax periods or other exogenous factors, these weeks can sometimes make the difference between a transaction being viable or not.

C. Mandatory 45-day Investigation for Critical Infrastructure

The virtually unlimited definition of critical infrastructure may capture any substantial energy asset, and it creates an additional layer of delays during CFIUS reviews of energy transactions in the post-FINSA world.[33]

The normal period of review for a non-controversial transaction prior to the adoption of FINSA was 30 days.[34] By regulation, a CFIUS review only moves to an additional 45-day investigation if CFIUS finds that national security risks necessitate the additional investigation.[35] However, FINSA altered those procedures because Congress included a requirement in FINSA that a 45-day investigation be conducted for any transaction that "would result in control of any critical infrastructure of or within the United States by or on behalf of any foreign person" if that transaction could "impair national security."[36]

This aspect of CFIUS has had direct consequences on the timing of CFIUS reviews of energy transactions. As discussed, under the broad and ambiguous definition in FINSA, which CFIUS has declined to narrow, virtually any energy-related asset can be considered critical infrastructure, the destruction of which could arguably impair national security in some manner, however small.[37] Accordingly, CFIUS is able to use this provision to justify adding an additional 45 days to the review of practically any notice concerning energy assets, meaning that the formal review period is actually a minimum

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http://www.treasury.gov/resource-center/faqs/CFIUS/Pages/default.aspx (last visited April 12, 2013) ("The time that it takes for the Staff Chairperson to determine that the notice complies with §800.402 after it has been submitted by the parties depends upon a variety of factors, including the notice itself and whether parties have submitted a draft notice before submitting the formal notice.").

[33] *See* U.S.C. app. § 2170(a)(6) (2012).

[34] *See* Mostaghel, *supra* note 10, at 595.

[35] *See* 31 C.F.R. § 800.501(a)(2) (2012).

[36] 50 U.S.C. app. § 2170(b)(2)(B).

[37] *See id.* § 2170(a)(6).

of 75 days for most energy related transactions. As such, the notion that CFIUS is bound to a 30-day review period is simply not the case for most energy transactions.

IV. Conclusions

Although the energy sector was not the focus of the DP World controversy or FINSA, many benign energy transactions are confronting the type of CFIUS delays that one would expect to be associated only with uniquely sensitive assets such as cutting-edge technology or defense equipment. Changes in timing and cost expectations can often make the difference between success or failure in complex international energy deals and, even under the best of conditions, negotiating and closing energy transactions is a difficult and time-consuming endeavor. While the role of foreign investment in the U.S. energy sector is increasingly important, the changes FINSA made to the CFIUS process have introduced delays and unnecessary uncertainty for foreign investors and U.S. energy companies.

While every transaction poses unique substantive and analytical issues related to CFIUS, there are common problems faced by most international energy transactions that trigger CFIUS jurisdiction. As a result of the breadth of the term "critical infrastructure," the creation of a new pre-notice mandate, and the statutory imposition of an additional 45-day investigation period for transactions involving critical infrastructure, many parties must simultaneously struggle to escape CFIUS review and plan for a review period that has become as long 90 days when the pre-notice period is included. Given that the ability to provide details necessary for a formal notice means parties cannot file until they have agreed to the details of a transaction,[38] and that CFIUS informs counsel that they prefer that notice is filed prior to closing,[39] many energy transactions are required to wait in limbo for up to three months pending CFIUS review.[40]

The unnecessary delays faced by energy transactions can discourage important foreign investment and create unexpected problems that result in aborted transactions as result of events that occur during the long CFIUS review period. As such, there is risk going forward that an increasing number of parties might consider choosing to avoid these delays by not filing a voluntary notice, which leaves a lingering risk of a transaction being reviewed and potentially unwound by CFIUS after it has closed.

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[38] *See* 31 C.F.R. § 800.402 (2012) (listing all of the information regarding a transaction required for a complete notice).

[39] This practice is not reflected in any formal regulations or guidance, but in the author's experience CFIUS treats post-closing filings with more skepticism, and will require a fulsome explanation of why the notice was not filed prior to closing.

[40] While the specifics of all such transactions are confidential, one need only to review the recent acquisition of Nexen Inc. by CNOOC to see an example where CFIUS approval took over six months. *See* 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.

Decisions regarding whether to file a voluntary notice with CFIUS should be motivated by reasonable evaluations of national security issues and risks and not by the costs associated with delays. If parties choose not to file notices due to concerns about delays, it is likely that some transactions that may raise real or perceived national security issues will be not be reviewed by CFIUS before closing. When the media later reports on either the actual or alleged risks of these transactions, the risk of more controversies like DP World becomes more pronounced. Such controversies undermine the confidence that foreign investors have in the U.S., harming the economy and the energy sector. Furthermore, it is possible that some of the transactions that seek to avoid CFIUS review, in order to avoid delays, may pose actual national security risks if those transactions result in substantive—and not merely hypothetical—security vulnerabilities.

U.S. national security, the U.S. energy sector, and the larger U.S. economy would be well served if CFIUS would treat energy transactions in a more rational manner. CFIUS should promulgate guidance regarding the types of energy assets that are likely to be considered critical infrastructure and should be willing to terminate reviews after the initial 30-day review for assets that are outside of the defined scope of critical infrastructure. Additionally, the pre-notice process should be more clearly defined and should not include requests for information outside of what is required by CFIUS regulations. If these changes were made, it would allow CFIUS to focus their resources on transactions that raise legitimate national security risks and would allow parties involved in most energy transactions to submit a notice to CFIUS with confidence that the review could be completed in a reasonable timeframe.