

No Letup In US Scrutiny Of Foreign-Backed Energy Projects

By **Keith Goldberg**

Law360, New York (October 11, 2013, 7:46 PM ET) -- President Barack Obama's unwinding of a Chinese-owned company's purchase of an Oregon wind farm, which a Washington federal court fully backed on Wednesday, is a reminder to U.S. energy companies and their would-be foreign investors that they must promptly identify and address national security concerns in order to win over increasingly wary authorities, experts say.

U.S. District Judge Amy Berman Jackson on Wednesday tossed what was left of Ralls Corp.'s suit against Obama over his 2012 rejection of its purchase of the wind farm from Terna Energy USA Holding Corp. She found that the company waived its opportunity to test whether its acquisition would be blocked and wasn't denied due process because it accepted the risks of a presidential veto when it went forward with the deal without seeking a review by the Committee on Foreign Investment in the U.S.

Judge Berman threw out most of the Ralls suit in February, saying the court cannot rule on whether the president exceeded his authority in blocking the deal.

"It shows that the threat of a deal being unwound is real, that this is not simply a theoretical boogeyman that has been set up to scare investors," Stroock & Stroock & Lavan LLP special counsel Chris Brewster said. "The lesson I think you take away from this is, 'When in doubt, file.' There's not going to be two bites at the apple."

That's especially the case when it comes to foreign investors seeking a piece of U.S. energy assets, which have increasingly shown up on CFIUS radar in part because of the U.S. energy boom that has foreign firms — both state-owned and privately owned — eager for a piece of the action.

Morgan Lewis & Bockius LLP partner Steve Mahinka, the firm's pointman for CFIUS issues, estimates that energy deals have accounted for one-third to one-half of the transactions reviewed by the committee within the past couple of years.

"If you're investing in an energy project, whether it's reserves, distribution, transmission or generation assets, it's going to be considered by CFIUS to be subject to review," Mahinka said.

The CFIUS review process is notoriously opaque, with no public filings and a tight-lipped regulator. Though outright rejections remain rare, experts say the committee is also taking a harder line when it comes to greenlighting cross-border energy asset deals, including imposing mitigation requirements to lessen national security concerns.

"The two big things in recent years of concern to CFIUS are cybersecurity and geographic proximity to sensitive facilities," Mahinka said. "The nature of the energy business is that it is an interconnected industry; it's a network industry. The connections increasingly raise concerns about cybersecurity."

Geographic proximity is what doomed the Ralls deal — the wind turbines were close to a U.S. Navy base. Experts say it's also likely that those concerns led the CFIUS to demand that Canadian oil producer Nexen Inc. shed some of its U.S. assets or restrict access for Chinese nationals to its offshore rigs in exchange for approving its \$15.1 billion sale to China's Cnooc Ltd. in February.

Nexen owned sizable minority stakes in two large deepwater fields in the Gulf of Mexico, one of which was less than 50 miles from a Navy base and near subsea telecommunications cables.

"The acquisition of the reserves was not really the focus of the agency, the focus was that some of the extraction platforms were close to installations of concern," Mahinka said.

Properly structuring transactions — what U.S. energy assets a foreign company is buying and how it will hold those assets — is vital to avoid being red-flagged by the CFIUS, says Thompson & Knight LLP partner Debra Villarreal, who represented state-owned China Petroleum & Chemical Corp., better known as Sinopec, in its recent \$1 billion purchase of a 50 percent stake in Chesapeake Energy Corp.'s natural gas shale play in Oklahoma.

"Is there important technology that the [target] company owns? Is there significant intellectual property? For exploration and production, are any of the fields near military bases and shipyards? If so, the seller may want to carve those assets out into separate transactions," Villarreal said. "It also becomes more problematic if a foreign company wants to take control of a company. Those things can also cause more issues rather than entering into a joint venture."

For U.S. energy companies, finding a foreign buyer that passes CFIUS muster comes down to a three-word mantra: Do your homework.

"If you're talking about a government-controlled entity, you have to make sure they won't have the rights to operate or a controlling stake. Look at the nature of your assets and where they're located," Villarreal said. "How much control does this third-party have, and how closely tied are they to a foreign government or a foreign country that the U.S. has security-related concerns about? That's kind of the two-prong question that [authorities] look at."

But all that advance work may be for naught if you don't make a deal contingent on CFIUS approval or allow parties to walk away if the committee imposes mitigation measures that are too onerous, experts say. As the Ralls case demonstrates, the government has broad discretion when it comes to evaluating the national security risks of a deal, and once it makes its decision, it's virtually impossible to challenge.

"The trick here is to never get yourself in the situation that Ralls did — spending the money without getting the clearance they needed," said Sutherland Asbill & Brennan LLP energy partner Mark Herlach, who represents clients before the CFIUS. "It's a more robust process, and it's one you can't ignore upfront."

Ralls is represented by Paul D. Clement, Viet D. Dinh, H. Christopher Bartolomucci, George W. Hicks and Brian J. Field of Bancroft PLLC; Tim T. Xia of Morris Manning & Martin LLP; and Steven S. Honigman.

The case is Ralls Corp. v. Committee on Foreign Investment in the U.S., et al., case number 1:12-cv-01513, in the U.S. District Court for the District of Columbia.

--Editing by Jeremy Barker and Philip Shea.

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