Pillsbury Winthrop Shaw Pittman LLP

This article first appeared in slightly modified form in
Executive Legal Advisor
January 28, 2008

Foreign Investment Limited in U.S. Energy and Infrastructure Assets

by Robert A. James and Christopher R. Wall

Energy

Robert A. James
+1.415.983.7215
rob.james@pillsburylaw.com

Christopher R. Wall
+1.202.663.9250
cwall@pillsburylaw.com

Robert A. James is a partner in the Houston and San Francisco offices of Pillsbury and co-leader of the firm's Energy industry team. Christopher R. Wall is the senior international trade partner in the firm's Washington, DC, office.

This article is reprinted with permission from the January 28, 2008 issue of *Executive Legal Advisor*, a *Texas Lawyer* publication (www.texaslawyer.com). © 2008 ALM Properties, Inc. Further duplication without permission is prohibited. All rights reserved.

For more information about us, please visit **www.pillsburylaw.com**

Discussions of international investment in the oil, gas and infrastructure sectors typically conjure up the image of American funds in search of projects abroad. But that picture is rapidly changing, as foreign sources of money, technology and experience size up the United States as an attractive place to own and run businesses.

Foreign energy producers, including government-controlled companies, regard U.S. refineries and markets as logical outlets for their output. Current examples include the CITGO Petroleum Corp. subsidiary of Petróleos de Venezuela S.A. and Russia's LUKOIL Oil Co. with its Getty-branded gasoline stations in the Northeast.

Several decades of experience with public-private partnerships (PPPs) have turned overseas investors into sophisticated buyers of infrastructure such as highways, water and wastewater systems, and airports. Americans have watched Spanish, Australian and other international firms bid for their toll roads. The moratorium on PPP development recently enacted in Texas was motivated, in part, by concerns over sending toll road revenues abroad.

U.S. energy and infrastructure assets will continue to draw global interest. Executives whose businesses may be parties to such acquisitions should know the principal legal restrictions affecting foreign investment.

State law: Restrictions on international investment largely are a matter of federal law, since courts have held that the U.S. Constitution prevents states from discriminating against foreign commerce. Some state law procurement restrictions have run afoul of the federal government's authority to conduct diplomatic relations.

Exon-Florio and CFIUS: The 1988 Exon-Florio Amendment to the Defense Production Act of 1950, named after the late Nebraska Sen. James Exon, empowers the president to block foreign acquisitions of U.S. companies that threaten to impair national security. The president delegated authority to investigate transactions to the Committee on Foreign Investment in the United States (CFIUS), a multi-agency body with representatives from the U.S. Departments of State, Defense, Justice and Commerce and other federal agencies.

CFIUS initially focused on defense contractors and high-technology companies. In the 1990s the concept of national security broadened to include telecommunications and Internet service providers. The public furor over two high-profile offerings — the 2005 proposed acquisition of Unocal Corp. by

China National Offshore Oil Corp. and the 2006 acquisition by Dubai Ports World of a company that operated several major U.S. ports — further expanded the concept to include natural resources and critical infrastructure.

Following these transactions, Congress enacted the Foreign Investment and National Security Act of 2007 (FINSA) in July 2007. Although FINSA officially went into effect on Oct. 24, 2007, CFIUS has been operating for some time under its new procedures, which include involving more senior government officials in CFIUS decision-making and designating a lead agency for certain reviews. As such, the U.S. Department of Homeland Security now plays an influential role in CFIUS reviews and may require foreign buyers to mitigate perceived national security threats with requirements that go beyond applicable regulations, such as screening contractors and personnel and special reporting.

FINSA also made a number of substantive changes to the original law. For example, it officially includes "critical infrastructure," "homeland security" and "energy security" within the concept of national security, potentially making many more transactions subject to review, such as those involving power plants, liquefied natural gas terminals and toll roads. FINSA presumes that acquisitions involving foreign government-owned companies will be subject to full-scale investigations unless national security issues identified in the transaction have been mitigated. CFIUS is in the process of drafting regulations to be published next April that will provide guidance on how FINSA will be interpreted and applied.

Issues and Opportunities

Technology transfers: An acquired U.S. company may need to obtain licenses from the U.S. Department of Commerce to export technology to the foreign buyer's home country. Simply disclosing controlled technical data to nationals of the acquirer's home country can be deemed to be an export subject to Commerce Department regulations. Defense-related technologies used in energy projects, such as satellite systems in offshore platforms or surveillance systems for mapping, are subject to much stricter State Department licensing requirements. Post-acquisition, these controls can make it difficult to integrate a U.S. company into global information systems.

Vessels, aircraft and communications: Although most areas of the American economy are open to foreign investment, some infrastructure sectors are restricted, such as the construction, ownership, flagging or operation of ships engaged in coastwise trade from U.S. port to U.S. port under the Jones Act. The Federal Aviation Act restricts foreigners from acquiring 100 percent control of U.S. airlines, and the Federal Communications Commission regulates the transfer of radio and other telecommunications licenses to foreign persons.

Mineral leases: Federal law prohibits foreign individuals and legal entities from directly holding many types of federal oil, gas and mineral leases. But they generally can form U.S. corporations to make the same acquisitions, in some cases conditioned on their home country's extending reciprocal treatment to Americans.

Tax, commercial and other issues: Executives' tax lawyers will want to take advantage of treaties and credits available in the home country and to avoid

Foreign Investment Limited in U.S. Energy and Infrastructure Assets

The U.S. Department of Homeland Security now plays an influential role in CFIUS reviews and may require foreign buyers to mitigate perceived national security threats with requirements that go beyond applicable regulations.

problems with transfer pricing rules and unitary tax regimes by structuring arms-length terms for flows of products and services between onshore and offshore subsidiaries. Counterparties will demand waivers of sovereign immunity from government-owned entities and consent to local jurisdiction or arbitration for disputes. Foreign investors must submit periodic reports on investment levels to the Bureau of Economic Analysis within the Commerce Department.

Mitigating risks: The court of public opinion will hear some of the most significant issues for overseas investors in U.S. energy and infrastructure assets. Business history is replete with examples of investors who ignored the apprehensions of local populations and governments to their detriment.

Joint ventures and contracts with local parties can reduce risks but require yielding some control. Indirect or partial business holdings may avoid triggering regulations but may dim the attractiveness of the deal.

Foreign investors can be drawn into U.S. courts and subject to U.S. laws for conduct that occurs inside or outside the country, and it may become the responsibility of executives to ensure that they structure their investments with that risk in mind. Proponents as well as adversaries of foreign investment will want to consider the full range of issues and opportunities facing foreign investment in these sectors and plan accordingly.

Foreign investors can be drawn into U.S. courts and subject to U.S. laws for conduct that occurs inside or outside the country, and it may become the responsibility of executives to ensure that they structure their investments with that risk in mind.