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INFRASTRUCTURE INVESTOR

The US infra landscape is shifting for foreign investors

With more hurdles erected for overseas money, firms need to be switched on to the Trump administration's recent legislation, write Mario Mancuso, H. Boyd Greene, & Luci Hague.

On August 13, 2018, President Trump signed the Foreign Investment Risk Review Modernization Act into law as part of the National Defense Authorization Act of 2019.

FIRRMA strengthens and modernises the process by which the Committee on Foreign Investment in the US reviews foreign investment in the country's businesses to assess the impacts of such investments on US national security. While many key provisions of FIRRMA remain subject to clarifications and further refinement in regulations, the legislation broadly expands the authority and resources of CFIUS and is poised to have outsized impacts on deal timing, certainty, feasibility and costs across diverse sectors, including, especially, infrastructure.

Background

Established in 1975, CFIUS is an interagency regulatory body of the US government authorised to review "control" transactions involving a foreign person and any business engaged in the interstate commerce of the US in order to assess the impact of such transactions on the national security of the country.

CFIUS has long interpreted control very broadly, such that a foreign investor's possession of a single board seat typically confers control even if the position does not enable the investor to "out-vote" other representatives or otherwise control, in a traditional sense, the decisions of the board.

Over the past several years, members of congress and other US government policy and political stakeholders have raised alarms that CFIUS did not have sufficient legal tools and financial resources to address new and different national security risks arising from, among other things, complex co-invest and other transaction structures and minority, non-controlling investments in US companies.

In parallel, the scope of CFIUS's national security analysis has become increasingly far-reaching. CFIUS has raised questions about industry sectors and transactions that historically have not been considered to have national security implications, and several high-profile public transactions have been blocked, abandoned, or delayed due to CFIUS concerns.

In November 2017, a bipartisan group of members of congress proposed new legislation to address perceived inadequacies in CFIUS's ability to tackle foreign investment risks. Following seven public hearings on the CFIUS process and several turns of draft legislation, the final text of FIRRMA was agreed in late July, and subsequently included in the NDAA for President Trump's signature. Most provisions of the Act have delayed applicability, pending the adoption of new regulations.

We discuss below three key impacts that FIRRMA will have on infrastructure investment and offer related takeaways.

1. FIRRMA makes many minority infrastructure investments by foreign investors newly subject to CFIUS's jurisdiction.

CFIUS's legal jurisdiction has historically been limited to transactions that result in a foreign person acquiring "control" of a US business. FIRRMA shifts CFIUS's jurisdictional focus to make "critical infrastructure" investments that are "non-passive" reviewable by CFIUS, lowering the threshold of rights or influence that a foreign investor could possess without triggering CFIUS's jurisdiction. Indicia of non-passivity include, but are not limited to, board observer rights and certain information rights, and can attach to an investment of any size.

Importantly, "critical infrastructure" is broadly construed: the term may include many US companies operating in the energy, transportation, communications, utilities, and water and wastewater systems sectors. And, the target company in question may be positioned at any point in the value chain as an owner, operator, manufacturer, supplier, or service provider to critical infrastructure.

In practice, CFIUS has been keenly interested in formally reviewing a wide variety of infrastructure investments (e.g. oil and gas pipelines, data centres, water treatment plants, telecom assets, power grid assets, mining companies) given the potentially sweeping adverse impacts that sabotage or disruption of such assets could have.

Following the implementation of FIRRMA's regulations, the advisability or necessity of notifying CFIUS will be a question for most, if not all, foreign investments in US infrastructure, regardless of the size of a foreign investor's equity check.

2. FIRRMA authorises CFIUS to review "greenfield" transactions involving the purchase of vacant real estate.

FIRRMA provides that the purchase, lease, or concession by or to a foreign person of real estate in close proximity to US military or other installations or facilities that are sensitive for national security reasons will be subject to CFIUS's jurisdiction.

In assessing whether such a transaction will be subject to its jurisdiction, CFIUS will look at the extent to which the transaction could expose "national security activities" conducted at the site in question

as well as whether the foreign investor could gather information on any activities at the site (i.e. not only those activities relating to national security).

The inclusion of greenfield investments in CFIUS's jurisdiction follows concerns that its member agencies did not have a streamlined and consistent process to evaluate the potential national security risks of an asset's proximity to sensitive sites.

As the Trump administration has advocated for greenfield foreign investments in US infrastructure as a key component of its domestic economic policy package, the expansion of CFIUS's jurisdiction relating to real estate will make it highly relevant for foreign investors considering new US infrastructure opportunities.

Foreign investors considering new infrastructure projects should undertake a rigorous "co-location" assessment of the land to be used for the project to determine its proximity to potentially sensitive sites. Because the most sensitive US government sites are not widely known, early assistance from experienced CFIUS counsel is critical to ensure appropriate identification and mitigation of potential risks.

3. Certain infrastructure investments will trigger mandatory notifications to CFIUS.

The CFIUS review process has historically been initiated voluntarily by parties to a transaction, absent an agency request to file on a non-notified transaction. FIRRMA makes certain infrastructure investments subject to mandatory notification requirements. Specifically, FIRRMA will require transaction parties to submit "light" notifications ("declarations") of transactions that will result in the acquisition of a "substantial interest" in US "critical infrastructure" companies by a foreign person in which a foreign government holds a "substantial interest."

Declarations must be submitted at least 30 days in advance of the closing of a transaction, which may effectively prevent transaction parties from structuring their deal as a simultaneous sign-and-close if regulations do not permit parties to file a declaration without a signed agreement.

The requirement to file declarations remains subject to important clarifications in FIRRMA's implementing regulations, including with respect to potential exemptions for investors from US allies. However, it may have an outsized impact on public pension funds, sovereign wealth funds, and other investment vehicles affiliated – formally or informally – with foreign governments.

Mandatory notification requirements will affect both the competitive positions of foreign investors subject to the requirements as well as timing and certainty considerations for sellers. All other things being equal, investors required to submit declarations for infrastructure investments may be at a comparative disadvantage in competitive contexts. Sellers will likewise need to ensure their due diligence appropriately surfaces potential declaration requirements early in the deal process.

Planning for the future

While the ultimate impacts of FIRRMA will not be clear until after regulations are implemented, investors and companies should ensure that CFIUS considerations are considered in the early stages of transaction planning.

Private equity sponsors must assess how capital raised in the near term could be subject to FIRRMA's provisions upon deployment. Moreover, sellers should carefully evaluate the relevance of CFIUS to potential exits, including how FIRRMA may affect the universe of suitable and realistic buyers for a company.

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