Nordic Newsletter

July 2023

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Editors' Note

Dear friends and colleagues,

Welcome to the inaugural edition of Covington & Burling's quarterly Nordic Newsletter. Our Nordic Newsletters will focus on recent legal developments that we believe are of interest to our Nordic clients and contacts doing business around the world. Over the years, Covington & Burling and its attorneys have advised numerous Nordic clients in connection with transactional, regulatory and litigation matters, as well as general counseling, with respect to their ongoing global operations. We will apply our experience and market knowledge of the Nordics to select the most relevant items for inclusion in our Nordic Newsletters and aim to provide you with only what we think is of real interest to you.

In this first newsletter, we included articles addressing recent developments in international trade, sanctions, foreign direct investment and ESG. Recently, a team of Covington experts from our trade/sanctions and foreign direct investment and CFIUS practices joined us for a week of meetings throughout the Nordics. We met with numerous clients and contacts in Oslo, Copenhagen, Helsinki, Stockholm and Gothenburg and fielded numerous questions arising from the growing regulatory concerns in those areas. Given the current state of global politics, ever-increasing regulation and a heightened focus on ESG best practices and compliance, we expect these subjects to continue to be of concern to our clients in the Nordics.

We are very excited about the opportunity to share this information with you. If you are not as excited as we are, feel free to unsubscribe by clicking here. Let us know if there are topics of interest you would like to hear more about in future editions of the newsletter.

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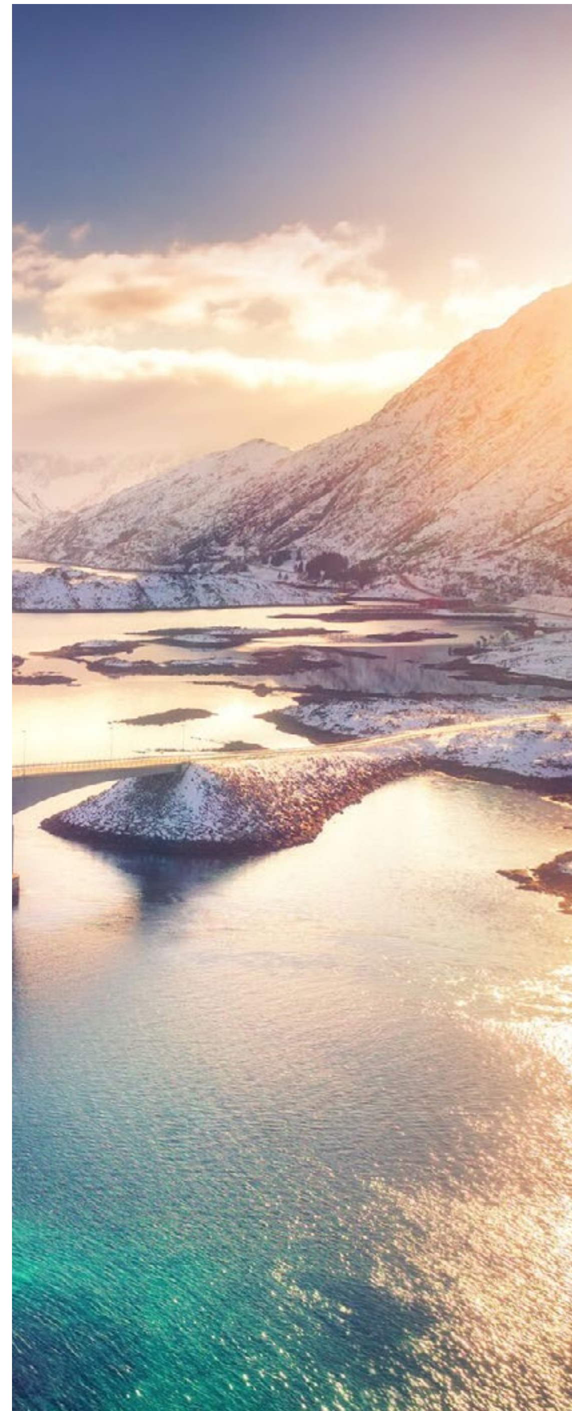

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The Green Claims Global Drive: Developments in the UK, US and EU

The Climate Crisis

CFIUS Issues Guidance On Disclosure of Information About Limited Partner Investors

Meet the Nordic Initiative: Mark Thompson

Who is Mark Thompson?

I am originally from the US, but moved from NY to London over 20 years ago.

Tell us about your legal practice…

I am head of the Firm's global Private Equity Practice and a member of the firm's Nordic Initiative.

Trends and recent developments in the region?

We are particularly busy representing funds on investments relating to the energy transition.

While private equity in general has been relatively slow over the last 12 months, energy transition investments around the globe have continued.

What do you like the most about advising Nordic-based clients?

I enjoy the direct, straight-forward responses of Nordic-based clients. Across the region, there is pragmatism to deal making which allows us to cut to the bottom line more easily in order to get a deal done.

Ideal Nordic holiday…

Summer on the coast (any of them!) with friends and a good bottle of wine.

Upcoming Event

Webinar: Global ESG Legal and Policy Trends and Implications for Businesses in the Nordics

Please Register Here

Thursday 14 September 2.30 - 3.30 CET

The global legal landscape regarding environmental, social and governance (ESG) issues is evolving rapidly. The landscape covers a broad range of topics – from human rights and climate impact, to sustainability marketing claims and diversity and inclusion. Companies need to understand how the new world of ESG impacts their business operations and value chains.

In this session, our leading ESG experts will provide a primer for companies on key trends emerging from the U.S., EU and other global markets and their relevance for businesses in the Nordics. We will discuss key legal and reputational risks and provide some practical pointers on preparing for and navigating the ESG storm.

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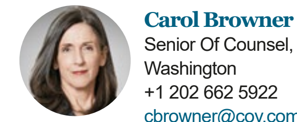

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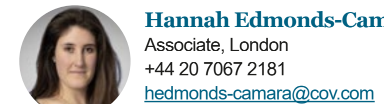

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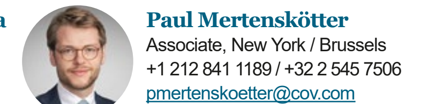

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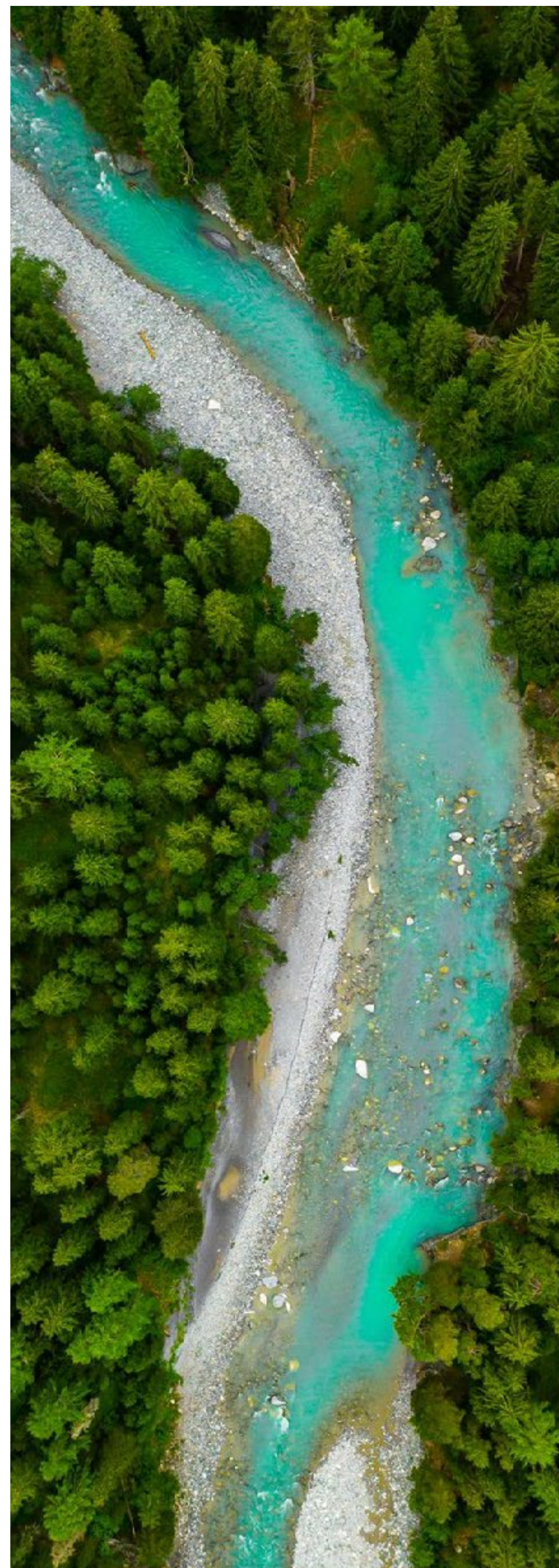
Transitioning to a Net-Zero Economy Thanks to Public Funding - What Nordic Companies Need to Know

As part of "A Green Deal Industrial Plan for the Net Zero Age", responding to the US Inflation Reduction Act (**"IRA"**) (see our alert), the European Commission (the **"Commission"**) adopted on 9 March 2023 its Temporary Crisis and Transition Framework for State Aid measures to support the economy following the aggression against Ukraine by Russia (the **"TCTF"**). The text amends the Temporary Crisis Framework last modified on 28 October 2022 (see our blog).

1. Investments
2. Rules
3. Dialogue



These are the three most important takeaways for Nordic companies about the TCTF:

1. To avoid that an investment be directed outside the European Economic Area (**"EEA"**), EU Member States may support investments in the manufacturing of relevant equipment for the transition towards a net-zero economy. These include batteries, solar panels, wind turbines, heat pumps, carbon capture usage and storage (**"CCUS"**), as well as the key components and critical raw materials necessary for their production. Member States may also grant aid matching foreign subsidies to support those investments, provided that they are located in the poorer areas of the EU. In addition, the possibility for EU countries to grant aid for accelerating the rollout of renewable energy covers any renewable technology even without any bidding process to select aided projects that are considered less mature. Also aid to decarbonize an industry, including through the use of renewable hydrogen-derived fuels, can now be granted more easily.

2. The TCTF is not a subsidy program, and it is up to EU Member States to provide public funding. The TCTF lays down the State aid rules that Member States have to comply with to preserve the internal market and avoid undue distortion of competition. These rules, aiming at responding to the US IRA and the aggression against Ukraine by Russia, are much less stringent than the generally applicable State aid rules and are therefore only available until the end of 2025.

3. Companies willing to benefit from State aid may need to enter into a dialogue with Member States to seek the introduction of relevant incentives. They must anyway comply with State aid rules to avoid illegal aid being reduced or subjected to reimbursement. Conversely, companies could complain against illegal aid conferring an unfair competitive advantage to their competitors to restore a level playing field.

1. New possibilities for Member States to grant State aid for the transition to a net-zero economy

Aid to cover investment costs for the production of relevant equipment for the transition towards a net-zero economy

Under general State aid rules, aid facilitating industrial production, cannot, in principle, be granted, except for initial investments in assisted areas (i.e. areas with low population density or abnormally poor) and under specific conditions. With the TCTF, EU Member States may grant aid for investments in the production of relevant equipment for the transition towards a net-zero economy (e.g. batteries, solar panels, wind turbines, heat-pumps, electrolysers, CCUS, key components and critical raw materials to produce such equipment). The following aid is now allowed:

- **"Anti-relocation" aid**, even outside assisted areas, up to 15% of the investment costs incurred (e.g. land, buildings, plant, machinery, patent rights), with a cap of €150 million. Some top-ups are allowed for investments in assisted areas (up to 20-35% with a maximum of €200-350 million, depending on whether the investment takes place in an area with low population density or in an abnormally poor area); and for aid in the form of tax advantages, loans or guarantees (+5%) or for small- (+20%) and medium-sized companies (+10%). Such aid must be part of a program applicable in a non-discriminatory basis to any applicant that fulfils the conditions.
- **Exceptionally, "matching" aid** on an individual basis, outside of any pre-defined program, to "match" a subsidy available for an equivalent investment outside the EEA, which includes the EU Member States, Norway, Lichtenstein and Iceland. The aid, however, cannot exceed the funding gap, that is the amount necessary to induce the company to locate the investment in the EEA. The investment must be fully located in an assisted area or partly in an assisted area but involving several EEA countries. The beneficiary must commit to use state-of-the art production technology from an environmental-emissions perspective and show that the aid does not create counter-cohesion effects, for instance if the project could have been located in an even poorer area of the EEA.

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For both anti-relocation aid and matching aid, the aid must be requested before the start of works and be granted by 31 December 2025 and the investment must be maintained in the area concerned for at least five years (or three years for small- and medium-sized enterprises) after completion of the investment. The risk that the investment would not take place in the EEA without the aid must be demonstrated as well as the absence of relocation of the investment within the EEA. The applicant to an aid program will also have to provide detailed information, notably on the investment, including its expected positive effects for the area concerned in terms of job creation, R&D activities, etc.

Aid to cover operating or investment costs for accelerating the rollout of renewable energy

The TCTF extends until 31 December 2025 the possibility for EU countries to grant aid to accelerate the rollout of renewable energy and energy storage. Member States may devise State aid programs accessible to eligible companies to support energy production from any renewable energy source as well as energy storage.

Renewable energy sources are defined in the Renewable Energy Directive and include wind, solar and geothermal energy, ambient energy, tide, wave and other ocean energy, hydropower, biomass, landfill gas, sewage treatment plant gas, biogas, renewable hydrogen and its derived fuels. Compliance with the "do not significant harm" principle must be ensured.

Support can be granted to a new or repowered installation, which must be completed and operational within 36 months except for offshore wind technologies.

Unless the power that the installation can produce is very low (e.g. for a company's own purposes), aid for investments in solar photovoltaic, wind and hydropower generation must in principle be determined through a competitive bidding process. Such process should lead to the bidder(s) requesting the lowest support to win the subsidisation contract.

In all other cases, the aid can be set administratively by the granting authority. In any event, overcompensation must be avoided, and the aid amount may not exceed the total investment costs or, if set administratively, 45% of those costs.

Aid for renewable-energy output could also be granted in the form of a two-way contract for difference of maximum 20 years, whereby the energy producer is guaranteed a minimum remuneration for the energy produced and the retrocession of revenues to the State when prices exceed a certain limit.

Similarly to investment aid, the amount of aid to support the production of electricity from solar photovoltaic, wind and hydropower is in principle determined after a competitive bidding process, except for small installations. In other cases, the strike price, which corresponds to the minimum remuneration, may be set administratively by the energy regulator to cover the producers' net costs and estimated WACC.

Aid for industry decarbonization through electrification or the use of renewable and electricity-based hydrogen and for energy efficiency measures

Under the general State aid rules, Member States are allowed to grant aid for an industry's decarbonization under certain conditions, and following, as a principle, a competitive bidding process to select the aid beneficiary.

To reduce dependency on fossil fuels imports, Member States may grant aid more easily under the TCTF to support substantial reductions (at least 40%) of greenhouse gas ("**GHG**") emissions from industrial activities currently relying on fossil fuels as energy source or feedstock, or of energy consumption in industrial activities and processes (at least 20%). Aid cannot be granted to merely comply with EU standards. Such aid must be made available under a program accessible to any company fulfilling the conditions.

Moreover, companies may not be granted individually more than 10% of the program's overall budget or € 200 million, whichever is lower.

The aid amount may be determined in three alternative ways: (i) by a competitive bidding process, (ii) up to 60% of investment costs for projects achieving substantial GHG reductions or 30% of investment costs for projects aiming at a reduction of energy consumption, or (iii) up to 40% of the eligible costs corresponding to the difference between the costs of the project and the cost savings or additional revenues, compared to the situation in the absence of the aid. Under the latter, some top-ups can apply for medium-sized companies (+10%), small sized companies (+20%) and for projects delivering reduction of GHG of at least 55% or of energy consumption of at least 25% compared to the situation prior to the investment (+15%). Decarbonization of industrial processes can be pursued through various technologies, including renewable hydrogen and hydrogen-derived fuels, provided hydrogen qualifies as renewable. Here again, the installation must be operational within 36 months.

2. Compliance with State aid rules

When deciding to grant State aid, Member States must comply with the State aid rules in place. State aid rules also apply in cases that are less obvious than direct grants. For instance, it has already been decided that the support distributed to producers of electricity from renewable energy sources by private companies through compulsory levies imposed on consumers constitutes a State aid.

Meaning that, unless the aid amount does not exceed a certain threshold, and subject to some detailed conditions, Member States must submit their project to grant State aid to the Commission for prior approval. For large investment projects for mass production of relevant equipment for the net-zero age, the aid amount cannot exceed a certain threshold which is set according to the disadvantaged area in which the investment takes place, with an absolute maximum of €57.75 million per company for the most disadvantaged areas. To support renewable energy, the maximum amount of aid may not exceed €30 million per company per project. Above these thresholds, Member States must notify their aid to the Commission, which will examine whether all conditions laid down in the TCTF are fulfilled.

It would also be possible for Member States to rely on more stringent State aid rules, such as the Regional aid guidelines and the Climate, Environment and Energy aid Guidelines. The aid intensity allowed is generally lower under those rules than under the TCTF.

Project developers could also seek public funding directly from the EU, which has a plethora of programs in place or in the making.

When granting funding, the EU is not subject to the State aid rules, but it must nevertheless comply with certain principles, such as the principle of equal treatment. Therefore, EU funding is often made available on the basis of calls for proposals.

3. How Nordic companies can take advantage of the TCTF?

Contrary to the US IRA, the TCTF does not create any overarching subsidy program, and each individual EU Member State remains competent to introduce State aid programs or to grant aid on an individual basis to particular companies. Member States may impose more conditions on beneficiaries than provided for in the TCTF.

Companies may play a role in adequately informing Member States about their market and their needs in order to scale up the production of renewable energy, energy storage and of relevant equipment for a net-zero economy. Although it pertains to the Member States to comply with State aid rules, consequences of non-compliance are mostly borne by State aid beneficiaries. For instance, Spain reviewed in 2013 its 2007 subsidy program for the production of electricity to comply with State aid rules, leading to smaller revenues for investors than initially projected.

To date, beneficiaries have been unsuccessful in obtaining damages from Member States for having granted illegal State aid. That puts a high burden on companies to ensure that the advantages they receive are legally compliant. By contrast, companies facing the unfair competition of their competitors due to illegal State aid received, may submit a complain to the Commission.

Covington combines the relevant State aid and regulatory expertise to identify opportunities of public funding or to explain to the authorities the needs to create such opportunities. Its multidisciplinary teams can assist companies at an early stage in structuring their projects to take advantage of those opportunities. Thanks to our State aid litigation expertise, we can also verify the legality and sustainability of public sources of funding as well as challenge unfair advantages granted to our clients' competitors.

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The Green Claims Global Drive: Developments in the UK, US and EU

The regulation of green claims — and enforcement against "greenwashing" — is developing quickly across the globe, particularly in the EU, the UK and the US. Now is a critical time for companies to get up to speed: authorities in all three jurisdictions are focusing more and more intently on this issue; company reputations will increasingly rise and fall with the strength of their green claims, and national regulators are set to get new powers (including the power to levy significant fines) to tackle companies found in breach. Here are some brief updates, and points of comparison between the regimes.

1. Scope and structure of regimes
2. Substantiation, qualification and extent of benefit
3. General or generic claims
4. Third party certification or eco labels
5. Verification
6. Enforcement

Summary of recent developments

The EU has proposed two Directives to modernize and harmonize the rules on green claims across the bloc — the "Greenwashing Directive" , and the "Green Claims Directive" (together, the **"EU Green Claims Proposals"**). The EU Green Claims Proposals are currently moving through the EU legislative process, and — if adopted — will need to be implemented nationally in EU Member States. In the UK, the Competition and Markets Authority (**"CMA"**) is conducting a sector by sector review of green claims, starting with the fashion and household essentials sectors. The CMA's review is the first concerted application of the CMA's 2021 Green Claims Code. Meanwhile the UK's Advertising Standards Authority continues to be very active in reviewing green claims. In the US, the US Federal Trade Commission (**"FTC"**) is reviewing its "Guides for the Use of Environmental Claims" (**"Green Guides"**), which was last updated in 2012.

Scope and structure of regimes

None of the proposed EU green claims rules, or existing UK or US rules, replace existing sector- or product-specific rules (e.g. eco labelling, packaging and waste disclosures in the EU and UK, or other federal, state or local laws in the US). The EU Green Claims Proposals set out precise and detailed legal requirements, while the UK and US rules are set out in guidance and examples. This may give UK and US authorities more flexibility than EU authorities when interpreting and applying the rules.

Substantiation, qualification and extent of benefit

All three jurisdictions require (or will require) companies to provide clear substantiating evidence for their claims, to qualify their claims where appropriate and to avoid making claims where the claimed environmental benefits are not substantial in the context of the overall life cycle or environmental impact of the product, brand or company. The EU Green Claims Proposals set out a specific, ten point methodological framework for substantiating green claims.

General or generic claims

All three jurisdictions take (or will take) a strong stance against overly broad, general or generic claims *(e.g. "green"* or *"eco friendly"*). The UK and US technically permit broad claims, but set such a high bar for substantiation that companies may struggle to make them. In contrast, the EU Green Claims Proposals specifically prohibits generic claims, unless the company making the claim can substantiate it by demonstrating excellent environmental performance against defined legislative or sector specific standards.

Third party certification or eco labels

Companies should avoid "self certifying" or using own brand eco labels. The EU Green Claims Proposals in particular will completely prohibit the display of sustainability labels that are not based on an independent, third party certification scheme or established by public authorities.

Verification

The EU Green Claims Proposals will require companies to submit their green claims to an EU Member State national authority for "verification" (i.e. a compliance check) before publishing the claims. The US and UK do not impose the same verification requirements.

Enforcement

The EU Green Claims Proposals will require Member States to provide for fines of up to 4% of national turnover for companies in breach of the rules. The US FTC has various investigative and civil enforcement powers, and is consulting on a new power to seek civil financial penalties. The UK's CMA has various investigative and civil enforcement powers, and the UK government plans to grant the CMA the power to issue fines of up to 10% of global turnover.

Businesses operating in any of the three jurisdictions should take the time to review their claims — and their processes for formulating and substantiating claims — and make sure they get a "green light" under the relevant rules. For more detail and points of comparison, please see our dedicated blog post, here.

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The Climate Crisis

A recent report by the World Meteorological Organisation makes for alarming reading. The report warns there is a 66% likelihood of exceeding the 1.5°C threshold in at least one year between 2023 and 2027 and notes that such a rapid change in global temperatures will take the world into 'uncharted territory', with an anticipated El Nino weather system likely to push already high temperatures even higher this year. Since we have already seen the impact of a 1.1°C rise, the conclusions of the WMO report are deeply uncomfortable. This article looks at some of the data which give context to the Report's conclusions.

1 Gas
2 Oil
3 Coal
4 Renewable Energy Push
5 The Worsening Climate
6 Conclusion

Gas

Russia is the world's largest natural gas exporter; the second-largest exporter of crude oil; and the third-largest producer of crude oil. The Russian invasion of Ukraine spooked global gas markets and pushed prices to record highs – the TTF European gas price peaked at a record €343/MWh in August (equivalent in oil terms to more than $500 a barrel). But as world gas markets have adjusted, the price has fallen – €75 per megawatt hour at the end of December and under €50/MWh by the end of April 2023.

Like global markets, the EU has demonstrated remarkable agility in its response to Russia's invasion. In 2020, Russia supplied nearly 43% of all EU energy imports. The EU set itself the target of reducing Russian gas imports to 55 bcm/year by March 2023 (down from 158 bcm in 2021). At the time, this seemed ambitious, but in the event, the EU easily exceeded that target and, by October 2022, the EU's Russian gas imports had fallen to 38 bcm (12 % of the EU's energy consumption).

Last spring, the EU required that Member States' winter storage be 90% full by the end of autumn. Again, at the time, that seemed a tough ask in the face of global constraints on alternative supplies. But in any event, the EU easily exceed the target, reaching 96% by the beginning of November 2022. A combination of factors means the outlook for the EU is more positive than expected:

- A mild winter meant the EU emerged with record high gas inventories (EU storage was 56% full);
- The success of demand-side efficiencies (the Commission set a cross-EU efficiency target of 15% reduction in demand: the EU reduced demand by an average 19%);
- Global gas markets have been nimble in responding to EU demand for non-Russian gas. New and alternative supplies flowed in from Norway, Qatar, the US and (importantly) Algeria through existing, but under-used pipelines and new LNG capacity;
- The EU has built new LNG infrastructure at record speed – with Germany opening its first LNG jetty in November 2022.

This positive combination of factors may continue. But there are risks – the EU will continue to seek to reduce its latent reliance on Russian gas by purchasing increased volumes of gas on the international markets – not only to run its industry and supply domestic demand, but also to fill its storage capacity. This competition risks pushing global gas prices up again as we move towards the northern hemisphere winter – notwithstanding new sources of supply.

Oil

Oil markets have also adjusted to the new normal. A barrel of oil cost $86 in Jan 2022, rising to $123 in June 2022 before falling to $83 in Feb 23 and around $75 now.

The IEA's most recent Oil Market Report predicted that daily oil demand would increase by 2 mb/d in 2023 to a record 101.9 mb/d. Non-OECD countries will account for 90% of that growth, whilst OECD countries saw two consecutive quarters of declining demand in Q4 2022 and Q1 2023. It is too early to say whether the OECD demand reduction is due to specific circumstances (warm winter, reduced demand) or is the first indication of the impact of the accelerated energy transition.

OPEC and Russian daily production cuts will remove nearly 1.7 mbd of production from the global market. Non-OPEC countries can replace around 1 mbd of that shortfall, but the US shale patch, traditionally the most price-responsive source of more output, is currently constrained by supply chain bottlenecks and higher costs.

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This means the market risks significant undersupply and a failure to meet the IEA's projected increase in global demand – a global shortfall which risks pushing crude and product prices up. This may accelerate the transition to renewables, which look cheaper and less volatile.

The EU's retreat from Russian gas and oil has not, however, led to a glut of stranded Russian hydrocarbons. Russia's March 2023 oil exports were its highest since April 2020, with total oil shipments reaching 8.1 mb/d and refined products climbing to 3.1 mb/d. This pushed Russian monthly revenues from oil export to $12.7 billion (still 43% lower than the previous year). Third countries have stepped into the European pull-back and purchased Russian hydrocarbons at a strong discount, giving their industry a short-run competitive advantage. In March, nearly 90% of Russian crude exports went to Russia and China – up from less than 25% in 2021 – contributing to Russia's record current-account surplus of $227 billion (though Russia's Urals costs $100/barrel to extract and Russia is currently only getting $50/barrel on sale).

Coal

One consequence of the increased global competition for gas has been heightened demand for coal as a cheap alternative. 2022 saw global consumption passing 8 billion tonnes for the first time. The IEA forecasts coal demand to remain at around this level until 2025 with slowing demand in mature markets offset by increasing demand in emerging markets and the world's three largest coal producers – China, India and Indonesia – matching or surpassing their 2022 production records in 2023.

President Xi Jinping's pledge that China would be carbon neutral by 2060 was backed-up by its last five-year plan, which placed a heavy emphasis on reducing the use of coal and developing alternative clean energy sources. Indeed, between 2010 and 2021, China's renewable generation increased by an average annual rate of 19.2%!

Notwithstanding this impressive progress, China does not appear to be on course to meet its emissions reduction target. The country still relies on coal for more than half of its energy consumption and the government approved more new coal power in the first three months of 2023 than in the whole of 2021 (20.45 GW of coal power, up from 8.63GW in the same period in 2022). In the whole of 2021, only 18GW of coal was approved.

However, despite these high prices and comfortable margins, there appears to be no sign of surging global investment in export-driven coal projects. This ray of hope perhaps reflects caution among international investors and mining companies about the longer-term prospects for coal.

Renewable energy push

European countries are now making huge efforts to strip hydrocarbons out of their energy systems. In January 2022, Germany purchased 55% of its gas; 50% of its coal; and 35% of its oil from Russia. Within three months, those figures had fallen to 40% gas, 24% coal and 25% oil. Germany has pledged to reduce its gas requirements to supply less than 10% of domestic consumption by 2024 and increase its energy provision from renewables from 42% to 80% by 2030. That is an ambitious target, not least since increased demand does not translate into a like-for-like increase in installed capacity. Meeting Germany's doubling of renewable energy provision will require a near-trebling in installed capacity – from 225 TWh in 2021 to over 600 TWh by 2030. But the economics are increasingly favourable. During the 2010s the levelised cost of solar, offshore wind and onshore wind fell by 87%, 62% and 56%, respectively. In 2015, UK winning bids for offshore wind farms were over $120 per MWh, far higher than the cost of fossil-fuel electricity: at a recent auction the average bid was $50 per MWh, roughly the level of average wholesale power prices. Solar and onshore wind are even less expensive. By 2030, it will be cheaper to build solar installations from scratch than operating fully depreciated fossil-fuel plants, and renewable cost curves still have some way to fall.

The Worsening Climate

The Sixth IPCC Report did little to brighten the mood. The past eight years have been the warmest on record, with extreme weather events expected to become more frequent and intense as climate change accelerates. Greenhouse gas emissions continued to rise in 2022 and temperatures have already increased by at least 1.1°C since pre-industrial times. Last year, China suffered its worst summer heatwave on record, rivers dried up across Europe (which experienced its second warmest year on record and hottest ever summer), the UK hit 40 degrees C for the first time ever and record forest fires devastated the US and Australia. The European Alps and Greenland suffered record ice losses.

The trend has continued this year, with record temperatures in Myanmar, India, China Thailand, Laos, Bangladesh and Japan and parts of South America. Southern Europe is experiencing its second major drought in less than a year. For 32 consecutive days in January and February no rain fell anywhere in France—the longest dry spell in winter since monitoring began in 1959.

A US National Oceanic and Atmospheric Administration report earlier this month found that temperatures in the world's oceans over a 42 day period were consistently higher than in any year since records began in 1981, leading scientists to conclude that this could indicate a tipping point and that the world might be reaching the limit of the oceans' capacity to absorb carbon dioxide.

These are not 'just' climate events, the economic impact is real. A dry spring will hit agriculture, exacerbating global grain and food shortages already under pressure and helping sustain inflation. Parts of Europe and China rely on waterways for the transport of commercial goods. If water levels are low, they may have to be closed to big barges, increasing transport costs. And low rainfall will reduce electricity production at Europe's hydroelectric and nuclear plants.

Conclusion

Energy transitions are normally slow – it took a century for crude oil to make up 25% of the world's primary energy source. And they are normally incomplete – new fuels reduce the proportion of the total demand that old fuels provide, but the total energy demand keeps increasing – between 1850 and 2000 global energy use increased by a factor of 15 and is currently increasing by around 2% per year.

But the urgency of the climate crisis means that this energy transition will need to be larger, quicker and more complete than any before it. To meet the Paris target of 1.5 degrees C, emissions must peak by 2025 and halve by 2030. Failure to meet those targets would mean that 8.8% of current farmland will be unproductive and one billion people will be at risk from coastal flooding by 2050.

Governments are legislating to force the pace of change. But they need to do more to set the policy signals to which the private sector can respond.

In 2020, governments collectively spent more than $400bn in direct support for fossil-fuel consumption: more than twice what they spend subsidising renewable production. Today's policies look likely to deliver a global temperature rise of close to 3°C by the end of the century.

In the next 30-50 years, 90% or more of the world's energy demand will need to be provided by renewable-energy sources. And continued human development means demand will keep increasing. There is a growing sense of urgency in the scale of renewable investment – IRENA calculated that global investment in energy transition technologies, including energy efficiency, reached $1.3 trillion in 2022 – a record. But it is not sufficient: to reach the Paris Goal, IRENA calculates that investment needs to be $5.2 trillion per year.

This sense of urgency adds to the pressure on COP28, taking place in Dubai at the end of the year, to deliver concrete outcomes and transforming it into one of the most important COPs to date.

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CFIUS Issues Guidance On Disclosure of Information About Limited Partner Investors and Application of Mandatory Filing Rules to Multi-stage Transactions

The U.S. Department of the Treasury (**"Treasury"**), in its capacity as chair of the Committee on Foreign Investment in the United States (**"CFIUS"**), recently posted two new frequently asked questions (**"FAQs"**) to CFIUS' website that have important implications for parties planning transactions subject to the CFIUS' jurisdiction.

1. CFIUS may require detailed information regarding all foreign persons involved directly or indirectly in a transaction, including limited partners in an investment fund.

2. CFIUS' newly issued guidance creates uncertainty regarding the timing for mandatory filings in multi-stage transactions.

First, CFIUS confirmed its recent practice of requiring detailed information on all direct or indirect foreign ownership involved in a transaction, including disclosure of all limited partners (or **"LPs"**) of an investment fund, without regard to any pre-existing agreements between the fund sponsor and investor regarding disclosure.

Second, CFIUS offered guidance regarding the meaning of "completion date" for purposes of when a mandatory filing must be submitted for a multi-stage transaction. The guidance could have broad implications, especially for some venture financing transactions, as it introduces uncertainty regarding the ability of investors to use a staged transaction to acquire an initial, passive equity interest prior to submitting a mandatory CFIUS filing with respect to a subsequent acquisition of control or certain non-passive rights. The new guidance seems at odds with language that appears in the preamble to the regulations implementing the Foreign Investment Risk Review Modernization Act of 2018 (**"FIRRMA"**), and the practice of transaction parties for the last several years. CFIUS did not provide any explanation for this change, which raises questions as to why CFIUS has issued the guidance now.

Each of these developments is discussed in more detail below.

1. CFIUS may require detailed information regarding all foreign persons involved directly or indirectly in a transaction, including limited partners in an investment fund.

Treasury published the following FAQ on May 11:

Does CFIUS require information on all foreign persons, such as limited partners in an investment fund, that would hold an interest in a U.S. business, whether directly or indirectly, as part of the transaction?

"In addition to the information required for submission of a complete filing with CFIUS, to facilitate its review, CFIUS through the Staff Chairperson may request follow-up information with respect to all foreign investors that are involved, directly or indirectly, in a transaction, including limited partners in an investment fund. Like other aspects of the CFIUS process, the scope of such a request depends on the facts and circumstances of each transaction. For example, CFIUS often requests identifying information for indirect foreign person investors, including limited partners, their jurisdiction(s) of organization, and ultimate ownership, among other information, regardless of any arrangements that may otherwise limit the disclosure of such foreign person's identity.

CFIUS may also request information with respect to any governance rights and other contractual rights that investors collectively or individually may have in an indirect or direct acquirer or the U.S. business to facilitate the CFIUS' review regarding jurisdictional or national security risk-related considerations. Such information is subject to the confidentiality protections afforded by statute.

The new FAQ reflects an evolution in the CFIUS' approach to disclosure of information about LPs. Historically, there were some circumstances—largely involving fund transactions from China—in which the CFIUS would insist on receiving information on all LPs, regardless of how small (from a percentage standpoint) and passive a particular LP interest was. However, by and large, well-known fund sponsors from allied countries have not generally been required to provide detailed information on all LPs in a fund. Instead, if the fund could demonstrate control by the general partner and that the LPs were geographically diverse and entirely passive, it often was the case that CFIUS would accept summary information on the composition of the LP base, or at least not require specific information on any LP that held less than a 5 percent indirect interest in the ultimate U.S. business. That approach has shifted, as reflected in this FAQ, and the purpose of the FAQ is to put fund sponsors on notice regarding the breadth and specificity of the information that CFIUS will now seek.

As set forth in the FAQ, CFIUS may now insist on detailed information regarding all LPs and other co-investors in a fund or other investment vehicle involved in a covered transaction, regardless of the fact that such LPs may be passive, financial investors. This will include, among other things:

- the identity of the LP;
- the LP's relative contribution of committed capital to the fund and transaction at issue (and therefore the relative ownership percentage);
- information regarding LPs' principal places of business and places of legal organization, as well as whether any LP is owned or controlled by a foreign government; and
- all documentation with the LP, including all side letters entered into with LPs, as well as all organizational and governance documents for the fund, regardless of whether any such documents are protected by confidentiality provisions negotiated between the fund sponsor and the LPs.

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That is, if a fund sponsor has made a commitment to keep confidential the identity of an LP or other information regarding the investment, CFIUS may insist on knowing that identity regardless of that contractual commitment. CFIUS will, however, keep that information confidential in CFIUS process (i.e., not make it publicly available), as required by statute.

Going forward, investors should anticipate these requests and be prepared to provide CFIUS with the requested information and documentation. Investors also should assume that CFIUS will press for such information and documentation regardless of any privately negotiated confidentiality provisions. To the extent possible, investors may wish to inform their LPs that such information and documentation may be required to be disclosed to CFIUS, and that a delay in or failure to disclose it to CFIUS could prejudice CFIUS' view of the investor. The best time to have these conversations with LPs is before a CFIUS filing is made, because once the transaction is under review, the parties will have only three days (or two, in the case of a declaration) to respond to a question set from CFIUS requesting information on the investor's LPs.

2. CFIUS' newly issued guidance creates uncertainty regarding the timing for mandatory filings in multi-stage transactions.

Treasury also published the following FAQ on May 11:

How does CFIUS determine the "completion date," in assessing when a mandatory filing should be submitted, where the foreign person first acquires equity interest but will not receive control or covered investment rights until after CFIUS' review?

"The 'completion date' is the earliest date upon which any ownership interest is conveyed, assigned, delivered, or otherwise transferred to a person [31 C.F.R. § 800.206]. In a transaction where the ownership interest is conveyed before the foreign person receives the corresponding rights, the 'completion date' is the earliest date upon which the foreign person acquired any of the equity interest. For example, if Company A acquired a 25 percent ownership interest in Company B on July 1, but its right to control Company B was deferred until after CFIUS reviews the transaction, the 'completion date' for the transaction is July 1. If the transaction is subject to the mandatory declaration requirement pursuant to 31 C.F.R. § 800.401, the latest date that the parties can file the transaction with CFIUS is June 1. Note that contingent equity interests are assessed separately under 31 C.F.R. § 800.207."

This new informal guidance is significant because it appears to suggest that parties cannot structure transactions such that the foreign investor provides a U.S. business with an injection of capital in exchange for a strictly passive and non-controlling equity interest, while agreeing that any subsequent receipt of equity or rights that would constitute a covered transaction and trigger a mandatory CFIUS filing will be subject to prior CFIUS approval. If that interpretation of the FAQ is accurate, then the FAQ would seem to be at odds with Treasury's own explanatory comments that accompanied the publication of the regulations that implemented FIRRMA and the CFIUS' practices in recent years.

FIRRMA, enacted in 2018, required for the first time certain transactions to be filed with CFIUS prior to consummation. Under the implementing regulations, in the event that a transaction would trigger a mandatory filing, the parties must submit a declaration or a notice to CFIUS "[t]hirty days before the completion date of the transaction." 31 C.F.R. § 800.401(g)(2). 31 C.F.R. § 800.206 in turn defines "completion date" as "the earliest date upon which any ownership interest, including a contingent equity interest, is conveyed, assigned, delivered, or otherwise transferred to a person, or a change in rights that could result in a covered control transaction or covered investment occurs."

When these rules were published in 2020, Treasury explained in its accompanying comments that the rules included a definition of "completion date" "to clarify that, in the event that a covered transaction will be effectuated through multiple or staged closing, the completion date is the earliest date on which any transfer of interest or change in rights that constitutes a covered transaction occurs." 85 Fed. Reg. 3112, 3114 (Jan. 17, 2020).

Transaction parties have generally interpreted this to mean that the filing must be submitted 30 days prior to the "transfer of interest or change in rights that constitutes a covered transaction." (Emphasis added.) In other words, the filing must be submitted 30 days before the date on which the foreign investor acquires either "control" of the U.S. business or any of the "covered investment" rights that would trigger a mandatory filing. However, the acquisition of a strictly passive, non-controlling interest would not trigger a mandatory filing—even if documented as part of a broader transaction—because it is not a "transfer of interest or change in rights that constitutes a covered transaction."

Thus, the preamble to the regulations seemed to communicate that parties could structure a transaction such that the foreign investor could first acquire a strictly passive and non-controlling equity interest in a U.S. business without a CFIUS filing. In turn, parties have routinely undertaken transactions where they have agreed that if the investor subsequently could acquire "control" of the U.S. business or non-passive rights enumerated in 31 C.F.R. § 800.211(b) (such as the right to appoint a member of the board), prior CFIUS approval would be contractually required if such subsequent transaction would trigger a mandatory filing. To our knowledge, CFIUS has not questioned parties' practices in structuring transactions in that manner until recently. The ability to undertake an initial, passive equity investment without triggering a CFIUS filing allowed foreign investors to provide U.S. businesses with immediate capital at critical junctures. At the same time, this approach also delayed a covered transaction until the parties had time to assemble a fulsome CFIUS filing, thereby ensuring that CFIUS would have the ability to review the transaction before the foreign person acquired any non-passive rights.

The FAQ, on the other hand, suggests that CFIUS may treat an initial passive minority investment that on its own would not be subject to CFIUS' jurisdiction as nonetheless subject to CFIUS' jurisdiction (and triggering a mandatory filing) if the foreign investor later also would—or could—acquire rights or interests that separately would constitute a covered transaction. If this is accurate, then even if an investment is "solely for purpose of passive investment" within the meaning of the regulations and outside of CFIUS' jurisdiction, if the transaction documents contemplate the foreign person—at any point in the future—possibly acquiring rights or interest that would trigger a mandatory filing, the parties would be required to file at least 30 days before the first share transfers, or risk civil penalties up to $250,000 or the value of the transaction. See 31 C.F.R. §§ 800.401(g)(2), 800.901(b).

It is not clear, however, how CFIUS will interpret this new FAQ in practice, and it creates ambiguity in numerous ways. For example:

- Is CFIUS now asserting it has jurisdiction to review an initial, strictly passive investment that does not confer control, if the parties then subsequently agree to undertake a controlling transaction? That would seem to be at odds with CFIUS' statutory and regulatory authority, but the only difference between that example and the example in the FAQ is whether the transaction is structured as one multi-stage transaction or two separate transactions. For example, if transaction A provides the foreign investor with a strictly passive and non-controlling stake in a business that produces a critical technology and, two years later, transaction B occurs, with transaction B conferring additional equity and a board seat (or other covered investment right), it is not clear, even under this FAQ, if CFIUS would retrospectively conclude that transaction A triggered a mandatory filing.
- It equally is unclear how CFIUS would treat a multi-stage transaction that contemplates an initially passive investment, followed by an acquisition of rights in a second stage when that later second stage is never completed. Consider, for example, a multi-stage transaction in which a foreign person agrees to acquire initially a strictly passive, non-controlling equity interest of 4.9 percent of the outstanding voting interest in a TID U.S. business that produces a critical technology that requires a U.S. government license to be exported to the foreign person. The foreign person also agrees that, if the U.S. business meets certain performance thresholds in the future, the foreign person will invest another 4.9 percent and acquire the right to appoint a board member. This second stage of the transaction (i.e., the additional 4.9 percent and the board appointment right), however, is subject to prior receipt of CFIUS approval. The U.S. business never meets the performance criteria to trigger the second stage of the investment, and the foreign person never acquires the board appointment right or the additional 4.9 percent interest. Under the FAQ, CFIUS appears to suggest that this transaction would need to be filed 30 days before any equity interest transfers (i.e., 30 days before the first stage), even if the second stage of the transaction never occurs and the foreign person never acquires the board appointment right—even though at no point under this example is the foreign person actually "afforded" a board right.

- The FAQ notes that contingent equity interests are addressed separately, but the FAQ raises the question of whether CFIUS will see the acquisition of a contingent equity interest that contemplates later acquisition of board or other covered investment rights (subject to prior CFIUS approval) as requiring a filing 30 days before acquisition of the contingent equity interest.

It is not clear why Treasury has now decided to issue this new FAQ on multi-stage transactions—particularly without reconciling it with the prior commentary issued in connection with the regulations—but we expect that this shift will make it harder for U.S. businesses, in certain circumstances, to receive crucial (and timely) injections of capital. This may be especially so for early stage companies that are involved with critical technologies, and therefore CFIUS' position is a curious one given that these are the exact types of companies that the Biden Administration otherwise has indicated it is paramount to nurture and grow in the United States.

If you have any questions concerning the material discussed in this client alert, please contact the members of our CFIUS practice.

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