December 8, 2023

Proposed Guidance on ‘Foreign Entity of Concern’ Definition for DOE Battery Grants

BACKGROUND AND APPLICABILITY

On December 1, the U.S. Department of Energy (the “DOE”) released a notice of its proposed interpretation of the definition of “foreign entity of concern” (FEOC) under the Bipartisan Infrastructure Law (the “BIL”),[1] and a request for public comment on its proposed interpretation. The deadline for comments to the DOE’s proposed guidance is January 3, 2024. The proposed FEOC definition is of significance to participants across the battery supply chains of U.S. EV manufacturers and is relevant in two aspects:

First, DOE’s $6 billion Battery Materials Processing and Manufacturing grant program gives priority to applicants that will not use battery material supplied by or originating from a foreign entity of concern.[2] See our publication, dated, November 27, 2023, for more information on this grant program.[3]

Second, the $7,500 U.S. federal tax credit for new clean vehicles (EVs) under Internal Revenue Code Sec. 30D (which was amended and extended by the U.S. Inflation Reduction Act of 2022) is not available if the vehicle’s battery contains battery components manufactured, or assembled by a FEOC (for vehicles placed in service after December 31, 2023), or if the battery contains critical minerals extracted, processed, or recycled by a FEOC (for vehicles placed in service after December 31, 2024). The proposed regulations on Sec. 30D Excluded Entities published by the Department of the Treasury (the “Treasury”) and the Internal Revenue Service on December 4th reference the DOE definition of FEOC. See our publication, dated, April 5, 2023, for more information on the 30D tax credit.

PROPOSED FEOC DEFINITION

The statutory text provides that, among other criteria, a foreign entity is defined as a FEOC if it is “owned by, controlled by, or subject to the jurisdiction or direction of a government of a foreign country that is a covered nation.”[4] Covered nations include the Democratic People’s Republic of North Korea, the People’s Republic of China (the “PRC”), the Russian Federation, and the Islamic Republic of Iran.[5] In its guidance, the DOE proposes to clarify the term FEOC by providing interpretations of the statutory definition’s key terms, including the terms "owned by, controlled by, or subject to the jurisdiction or direction" and "government of a foreign country."

"Subject to the Jurisdiction"

The DOE proposes that a foreign entity is "subject to the jurisdiction" of a covered nation government if (i) the foreign entity is incorporated or domiciled in, or has its principal place of business in, a covered nation; or (ii) with respect to the critical minerals, components, or materials of a given battery, the foreign entity engages in the extraction, processing, or recycling of such critical minerals, the manufacturing or assembly of such components, or the processing of such materials, in a covered nation.[6]

For example, if an entity is incorporated or domiciled in, or has its principal place of business in the PRC, it is a FEOC. And even if an entity is not legally incorporated in the PRC, it could nevertheless be considered a FEOC with respect to the extraction, processing, or recycling of the relevant critical minerals or materials, or the manufacturing of battery components in the PRC.

"Owned By, Controlled By, or Subject to the Direction"

The DOE proposes that an entity is "owned by, controlled by, or subject to the direction" of another entity (including the government of a foreign country that is a covered nation) if (i) 25% or more of the entity's board seats, voting rights, or equity interest are cumulatively held by that other entity, whether directly or indirectly via one or more intermediate entities; or (ii) the entity has entered into a licensing arrangement or other contract with another entity (a contractor) that entitles that other entity to exercise effective control[7] over the extraction, processing, recycling, manufacturing, or assembly (collectively, "production") of the critical materials, battery components, or battery materials.

The DOE uses three scenarios to illustrate indirect control in a tiered ownership structure:

First, if Entity A (the government of a foreign country that is a covered nation) cumulatively holds 25% of Entity B's board seats, voting rights, or equity interest, then Entity A directly controls Entity B. If Entity B cumulatively holds 50% of Entity C's board seats, voting rights, or equity interest, then Entities B and C are treated as the same entity, and are both FEOCs.

Second, if Entity A (the government of a covered nation) cumulatively holds 50% of Entity B's board seats, voting rights, or equity interest, then Entity A is the direct controlling "parent" of Entity B. If Entity B cumulatively holds 25% of Entity C's board seats, voting rights, or equity interest, then Entity C is understood to be directly controlled by Entity B and indirectly controlled by Entity A. In that case, Entities B and C are both FEOCs.

Third, if Entity A (the government of a covered nation) cumulatively holds 25% of Entity B's board seats, voting rights, or equity interest, then Entity A directly controls Entity B. If Entity B cumulatively holds 40% of Entity C's board seats, voting rights, or equity interest, then Entity B directly controls Entity C. However, because Entity A does not hold 50% of the board seats, voting rights, or equity interest of Entity B, and Entity B does not hold 50% of the board seats, voting rights, or equity interest of Entity C, Entity A's indirect control of Entity C is calculated proportionally (25% x 40% = 10%). The 10% interest in Entity C is insufficient to meet the 25% threshold for control, and therefore, Entity C is not a FEOC via the indirect control of Entity A.

"Government of a Foreign Country"

The DOE's proposed interpretation of the term "government of a foreign country" includes local state-owned enterprises (SOEs) and separate legal entities that are organs of a state but where ownership may be unclear, such as a utility or public financial institution. This interpretation aligns with the definition of "foreign government" promulgated by the Treasury in its regulations implementing the CFIUS program.[8]

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ENDNOTES

1 Bipartisan Infrastructure Law, PUBL058.PS (congress.gov), enacted on November 15, 2021.

2 Sec. 40207(b)(2)(C)(V) of the BIL.

3 Other laws and government mandates need to be reviewed to determine if the proposed DOE definition of FEOC introduces incremental restrictions to foreign ownership in a supply chain or in production, such as President Biden's Executive Order 14083, dated, September 15, 2022, which identified advanced clean energy technology as a top area of focus of the Committee on Foreign Investment in the United States (CFIUS).

4 Sec. 40207(a)(5)(C) of the BIL.

5 As defined in 10 U.S. Code 2533c(d).

6 See DOE's 2023 Final Critical Materials List, What Are Critical Materials and Critical Minerals? | Department of Energy, and U.S. Geological Survey (USGS)'s 2022 Final List of Critical Minerals, issued February 24, 2022.

7 The proposed DOE guidance on FEOCs describes effective control as "the right of the [entity's] contractor in the contractual relationship to determine the quantity or timing of production, to determine which entities may purchase or use the output of production, or to restrict access to the site of production to the contractor's own personnel; or the exclusive right to maintain, repair, or operate equipment that is critical to production."

8 31 C.F.R. Part 800.221 on Foreign government.

Questions regarding the matters discussed in this publication may be directed to Inosi Nyatta, Isaac Wheeler, and Sam Saunders or any Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. Additional S&C resources about energy transition matters may be found here. This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice.