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Canada Enacts Significant Changes to its Foreign Investment Laws

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I. INTRODUCTION

A foreigner considering an investment in Canada might understandably be overwhelmed (and potentially deterred) by the complex regulatory framework governing the potential investment. In addition to the myriad of sector-specific restrictions on foreign ownership, such investments may also be subject to review under the *Competition Act* to ensure competition is not "lessened or prevented substantially" and a general review under the *Investment Canada Act* ("ICA") to ensure the investment is likely to be of "net benefit" to Canada.

In July 2007, the Government of Canada established the Competition Policy Review Panel ("Panel") to study and make recommendations on improving Canada's competitiveness in an increasingly global marketplace. In its final report titled *Compete to Win*, released on June 26, 2008, the Panel made a significant number of recommendations including amending the ICA and other legislation and changing how such legislation is administered. Among the Panel's recommendations were proposed amendments to the ICA to narrow its scope generally and the introduction of an explicit screening mechanism for investments raising national security concerns.

This article provides a brief overview of amendments to the ICA designed to implement the Panel's recommendations, and highlights some other recent developments in Canadian foreign investment law.

II. LIBERALIZED FOREIGN INVESTMENT REVIEW REGIME

A. Background

Since 1985, the *Investment Canada Act* ("ICA") has provided the statutory framework for regulating foreign investment into Canada.

Under the ICA, a non-Canadian that acquires control of a Canadian business will, unless a statutory exemption is available, be subject to either a (post-closing) notification requirement or, alternatively, a pre-completion review process where approval must be obtained before the non-Canadian may implement the investment. Such an acquisition is reviewable if the value of the assets of the Canadian business being acquired exceeds certain thresholds established in accordance with the ICA.

The applicable thresholds will vary depending on (i) the country in which the non-Canadian is ultimately controlled, (ii) the nature of the business carried on by the Canadian

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business being acquired, and (iii) whether the acquisition of control is direct or indirect. For example, an investor ultimately controlled in a World Trade Organization ("WTO") member state (a "WTO Investor") will be subject to much higher thresholds than a non-WTO Investor, reflecting Canada's obligations under the WTO. As such, a direct acquisition of control of a Canadian business by a WTO Investor would only be subject to review if the gross assets of the Canadian business being acquired had a book value in excess of C$299 million, as compared to $5 million for a non-WTO Investor. In addition, the special higher threshold does not apply to WTO Investors if the Canadian business carries on a "cultural business;" in those cases, the much lower non-WTO Investor thresholds prevail.

B. Amendments

On March 12, 2009, amendments to the ICA received Royal Assent, with some amendments coming into force right away while others have yet to be brought into force. A high-level summary of the amendments (both those currently in force and those not yet in force) follows:

- The threshold for review of a direct acquisition of a Canadian business (except for cultural businesses) by or from a WTO Investor will increase substantially from the current $299 million to $600 million immediately after this amendment comes into force, rising by a set amount annually over a six-year period to eventually reach $1 billion with annual adjustments thereafter. It is anticipated that the change in the review threshold will reduce the number of reviewable transactions, such that only the largest acquisitions by foreign investors will be subject to review under the ICA.
- The measurement standard will change from gross assets (book value) to "enterprise value" of the assets of the acquired business. "Enterprise value" is not defined in the ICA, but will be prescribed by regulation. Draft regulations were published in July 2009 and prompted extensive feedback from various stakeholders, particularly in relation to the proposed methodology for determining the "enterprise value" of a publicly traded company. Final regulations have not come into force.
- The $5 million review threshold previously applicable to the acquisition of direct control by WTO Investors of Canadian businesses engaged in the financial services, transportation services, or uranium production sectors has been eliminated and the general threshold now applies to direct acquisitions by WTO Investors of Canadian businesses in these sectors.
- Amendments designed to increase transparency require the Minister to provide reasons for any decision made that an investment is *not* likely to be of net benefit to Canada.

III. "NET BENEFIT REVIEW" TEST UNDER THE ICA

If a transaction is reviewable under the ICA, the non-Canadian investor must satisfy the Minister of Industry (the "Minister") that the acquisition is likely to be of "net benefit to Canada." With respect to a Canadian business that is considered to be carrying on a "cultural business" (for example, film, video, publishing, music, and broadcasting), the Minister of Canadian Heritage exercises a review function.

The ICA enumerates the factors to be taken into account by the Minister, where relevant, in the "net benefit" analysis, including:

a) the effect of the investment on the level and nature of economic activity in Canada, including the effects on: employment; resource processing, the utilization of parts, components, and services produced in Canada, and exports from Canada;

b) the degree and significance of participation by Canadians in the business;

c) the effect of the investment on productivity, industrial efficiency, technological development, product innovation, and product variety in Canada;

d) the effect of the investment on competition within any industry or industries in Canada;

e) the compatibility of the investment with national industrial, economic, and cultural policies enunciated by the federal government or legislature of any province likely to be significantly affected by the investment; and

f) the contribution of the investment to Canada's ability to compete in world markets.

As a condition of obtaining approval, the Minister will ordinarily require a foreign investor to provide written undertakings in respect of its plans for the Canadian business. Such undertakings typically involve commitments to maintain or grow levels of employment, capital investment, and R&D in Canada. Commitments to maintain certain levels of Canadian participation in the management of the Canadian business and to maintain its head office in Canada are also typically exacted from the foreign investor.

If the Minister is not satisfied that the acquisition is likely to be of "net benefit to Canada," then the acquirer may be prohibited from acquiring the Canadian business or, in the rare circumstance of a post-implementation review, the investor may be required to divest itself of its interest in the Canadian business.

In 2008, the Canadian government blocked the proposed acquisition of the space technology division of MacDonald, Dettwiler and Associates ("MDA"), a Vancouver-based company, by Alliant Techsystems Inc. ("Alliant"), a U.S.-based defense contractor. The proposed transaction contemplated the acquisition of the space-based radar systems, space robotics, satellite systems, and intelligence, surveillance, and reconnaissance capabilities of MDA. The Canadian company had developed the iconic Canadarm, and also owned and developed Radarsat-2, a unique surveillance satellite that was considered an essential tool in protecting Canada sovereignty, particularly over the vast Arctic waters.

Jurisdictional questions over the transfer of Radarsat-2 technology and uncertainty as to whether foreign ownership of the technology could result in the U.S. government preventing Alliant from delivering critical satellite date to the Canadian government were factors in the decision to block the transaction. No other acquisition has been blocked under the ICA. However, some potential investors have withdrawn proposed acquisitions before a potentially adverse decision was rendered.

IV. NEW NATIONAL SECURITY REVIEW PROCESS

The March 2009 amendments established a new review process for foreign investments that raise national security concerns. The ICA does not contain a definition of "national security," which may be understandable at the political level but injects significant Ministerial discretion and corresponding uncertainty into the investment review process.

Under the ICA, the Minister may initiate a review of an investment by a non-Canadian where the Minister has reasonable grounds to believe the investment could be "injurious to national security." Such a review is possible for foreign investments constituting less than an acquisition of control and regardless of financial thresholds. These provisions apply to a non-Canadian that acquires an interest in or establishes a Canadian business or, in certain circumstances, an entity carrying on all or part of its operations in Canada.

The ICA does not provide prospective foreign investors with any guidance as to what business activities are either "off limits" or are likely to trigger a national security review. Similarly, the legislation does not identify any factors to be considered by the government in assessing whether an investment may be injurious to national security. Questions remain, for example, as to whether a foreign investment in Canada's strategic assets—such as the energy and resource sectors, the technology, or aerospace sectors—would trigger a national security review.

The potential foreign takeover of Potash Corporation of Saskatchewan by BHP Billiton, announced on August 17, 2010, has raised the question of whether the government will take an expansive view of the national security review provisions under the ICA and use those provisions to block the acquisition of such strategic assets. (The proposed transaction, should it proceed, would be subject to a "net benefit review" under the ICA.) Since the amendments were made to the ICA in 2009, a national security review has not been triggered in connection with the acquisition by foreign investors of what one might regard as Canada's strategic assets, such as energy assets in the Oil Sands region or the technology assets of Nortel (in bankruptcy). The government has declined to use the national security provisions for what might be viewed as "protectionist" purposes.

The new national security review provisions may have been invoked in a case involving the proposed acquisition of a publicly-traded Canadian company, Forsys Metals Corp. ("Forsys"), a mineral exploration company with a uranium property close to production in Namibia, Africa. The proposed acquisition of Forsys by George Forrest International Afrique S.P.R.L ("GFI"), a Belgian company, was announced in November 2008. Subsequently, on August 19, 2009 Forsys announced that it had been provided with an unsolicited letter GFI had received from Industry Canada, stating that GFI was prohibited from implementing the investment pending further notice from Industry Canada. Published reports indicate that the proposed transaction was not subject to a net benefit review, since the value of the assets of Forsys fell below the then C$312 million threshold. Ultimately, Forsys announced its decision to terminate the proposed transaction, stating as a basis for doing so the failure of GFI to transfer funds in accordance with the transaction agreement. Neither Industry Canada nor the parties have disclosed the specific concerns of Industry Canada about GFI's proposed investment nor have any of them confirmed that the national security review process was invoked.

Even had the proposed transaction not been abandoned but was then blocked on the basis of the new national security review provisions, it is not clear that we would have learned very much about how the review process unfolded. The March 2009 amendments to the ICA require the Minister to give reasons for blocking a proposed transaction where the Minister is not satisfied that the investment is likely to be of net benefit to Canada. In contrast, where a proposed transaction is blocked following a national security review, this is not the case. It is perhaps understandable that matters that are determined to be potentially injurious to the national security of Canada would not be publicly discussed. That said, this further

emphasizes the significant Ministerial discretion and corresponding uncertainty that the national security provisions have introduced into the investment review process.

The ICA does not establish a pre-closing mechanism that would allow a foreign investor to voluntarily seek clearance of any national security review of a proposed investment in advance of closing.

The *National Security Review of Investments Regulations* prescribes timelines for completion of the steps involved in the national security review process, which could take up to 130 days. The timelines are as follows:

- Notification to the non-Canadian investor that a review of the investment has been ordered by the Governor in Council—within 45 days from the time that the Minister of Industry becomes aware of the investment (or within 70 days, where notice of a possible review was given to the investor within 45 days, giving cabinet a further 25 days to determine whether to order a review of the investment).
- Conduct of the review by the Minister in consultation with potentially 19 other governmental departments and agencies (such as the Department of National Defence, the Department of Foreign Affairs and International Trade, the Canadian Security Intelligence Service, the Department of Public Safety and Emergency Preparedness, and the Canada Border Services Agency) and providing a report and recommendations to the cabinet or, if satisfied that the proposed investment would not be injurious, to national security, sending a notice to the investor within 45 days from the date the Governor in Council ordered a review of the investment.
- The Governor in Council, on recommendation from the Minister, may order any measure it considers advisable to protect national security, including allowing the investment subject to undertakings or commitments given by the foreign investor, prohibiting the investment by a non-Canadian, or, if already implemented, ordering a divestiture of the acquired business—within 15 days from the date the Minister reported on the investment.

Guidelines on investments by state-owned enterprises issued in December 2007 continue in effect, subject to the new national security review.

V. NOTIFIABLE TRANSACTIONS—NEW INFORMATION REQUIREMENTS

Acquisitions of control of Canadian businesses by non-Canadians that are not otherwise reviewable and investments by non-Canadian to establish new Canadian businesses will be subject to the notification requirement under the ICA. In such circumstances, the ICA mandates that the foreign investor provides notification to the government within 30 days after implementation of the investment and supplies prescribed information about the investor and the Canadian business being acquired or established. Notification is essentially an administrative function and does not trigger an approval process.

The draft regulations published for comment in July 2009 indicate that the Canadian government will seek additional information from foreign investors submitting notification under the ICA, mainly to assess whether a national security review is required under the ICA. The new notification requirements, if registered, will require a foreign investor to provide disclosure of:

- the names of the members of the investor's board of directors;
- the investor's five highest paid officers;
- any person or entity that owns 10 percent or more of the investor's equity or voting rights;
- contact details for each of the above, including date of birth for the individuals identified;
- name(s) of any foreign state that has a direct or indirect foreign ownership in the investor; and
- the sources of funding for the investment.

All foreign investors will be required to make more detailed disclosures to the Canadian government about the investor's ultimate ownership and control. The regulations establishing the new information requirements for notifications have not come into force but are expected to be registered together with the regulations prescribing the methodology for determining the "enterprise value" of a Canadian business, as discussed above.

Significant changes to Canada's foreign investment laws have liberalized the foreign investment review regime but, at the same time, have introduced a new screening mechanism for investments raising national security concerns, which is not without its complexities. Early consultation with Canadian regulatory counsel and a well-thought out strategy will assist foreign investors in realizing their business objectives in Canada.