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"Special" Treatment: State-Owned Enterprises Under Canada's Foreign Investment and Competition Laws

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I. INTRODUCTION

Canada, like the United Kingdom and the United States, has witnessed a sharp decline in state ownership in the past few decades. However, investment by foreign state investors in Canada in recent years—in effect a foreign "nationalization"—has represented an interesting and significant deviation from this trend, particularly in the natural resources sector. Such investment has not gone unnoticed: the acquisition of Canadian resource companies by foreign state-owned enterprises ("SOEs") and sovereign wealth funds ("SWFs") has become the subject of heated political debate and extensive press attention in Canada over the last few years including the acquisition by Chinese SOE, CNOOC, of Canadian oil company, Nexen in 2013. (For convenience, SOEs and SWFs will be referred to collectively in this paper as "SOEs.")

This wave of foreign state ownership has been remarkable not only because of the state status of the acquirers but also because the sources of foreign direct investment in Canada are no longer limited to Western countries (particularly the United States) but include a growing number of emerging economies such as China, Malaysia, Korea, Russia, Singapore and the Middle Eastern oil states.[2]. As illustrated in Table 1, which lists recent SOE investments in Canada (see Appendix A), investment by SOEs in Canada has focused primarily on natural resources and, in particular, oil and gas.

Also of note is that Chinese investment has expanded dramatically: cumulative foreign direct investment into Canada from China (both state and non-state) was U.S. $10.7 billion at the end of 2011, an increase of 3500 percent in the last decade.[3] From 2011 to 2012, Chinese investment in Canada doubled to reach U.S. $21.3 billion, $15.2 billion of which can be attributed to the CNOOC-Nexen deal.[4]

SOEs are also investing in related industries, moving up the energy sector's "value chain;"[5] for example, PetroChina had expressed interest in building Enbridge's Northern

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[2] *See*, *The Visible Hand, Special Report on State Capitalism*, 402 (8768) THE ECONOMIST (January 21, 2012) ("The Economist 2012 SOE Report") which notes that "the 13 biggest oil firms, which between them have a grip on more than three-quarters of the world's oil reserves, are all state-backed." In addition, "three Chinese state-owned companies rank among the world's ten biggest companies by revenue, against only two European ones."

[3] Foreign Affairs and International Trade Canada, "Canada-China Economic Complementarities Study," http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/china-chine/study-comp-etude.aspx?view=d#exec.

[4] *See* KPMG, *The Dream Goes On: Rethinking China's Globalization* (May 2013).

[5] *See* Nathan Vanderklippe, *China Moving Up Canada's energy value chain*, GLOBE AND MAIL (June 18, 2012), *available at* http://www.theglobeandmail.com/report-on-business/industry-news/energy-and-resources/china-moving-up-canadas-energy-value-chain/article4106346/

Gateway pipeline to transport Canadian oil to the west coast of Canada. It is also noteworthy that Chinese companies have increasingly invested in Canadian companies with assets in Canada rather than Canadian companies with assets outside of Canada (e.g., China National Petroleum Corporation's acquisition of PetroKazakhstan in 2005).

The sometimes nationalist response by Canadians[6] to SOE investments is in part a response to already existing concerns about foreign investment. These concerns rose to a fevered pitch in the wake of a spate of foreign (non-SOE) takeovers of Canadian icons beginning in the mid 2000s with the acquisitions of companies such as mining company Inco, aluminum producer Alcan, natural resources giant Falconbridge, and retailer Hudson's Bay Company (founded in 1670 in Canada). The loss of head office jobs (the so-called "hollowing out" of corporate Canada) and the elimination of Canadian companies as national champions were key themes of critics of these investments.

II. MERGER CONTROL AUTHORITIES—COMPETITION BUREAU AND INDUSTRY CANADA

The two main regulatory authorities that review SOE acquisitions in Canada are the Competition Bureau which enforces merger control under the Competition Act (the "CA") and the federal Department of Industry ("Industry Canada")—more specifically, the Investment Review Division—which administers and enforces Canada's foreign investment review legislation, the Investment Canada Act (the "ICA").[7] With the increase in SOE investments over the past several years, both authorities have scrambled to develop responses to some of the specific issues raised by such investments. As discussed in greater detail below, the Competition Bureau has recently formulated a provisional response while the Canadian Government has articulated a more restrictive SOE policy and buttressed this with amendments to the ICA.

III. BRIEF BACKGROUND ON SOES

While SOEs have been around for many decades, they became the focus of public discourse beginning in the mid 2000s as they shifted a proportion of their investments from lower return bonds and treasury bills of Western countries to higher yielding equity investments and strategic assets. Moreover, SOEs have increasingly been from emerging economies that have accumulated foreign exchange reserves through trade surpluses (*e.g.* countries such as China).

SOEs may be distinguished from private companies on several dimensions from their governance structure and objectives to their operating principles. In 2005, the OECD recognized the special factors that characterize state owners and create unique challenges for them and for the countries in which they make investments:

> A major challenge is to find a balance between the state's responsibility for actively exercising its ownership functions, such as the nomination and election of the board, while at the same time refraining from imposing undue political interference in the management of the company. Another important challenge is to ensure that there is a level-playing field in markets where private sector

[6] A poll by Abacus Data in September 2012 showed that 69 percent of Canadians were opposed to the proposed acquisition of Nexen by CNOOC. *See* abacusdata.ca/2012/09/20/energy-politics-nexen-cnooc-and-china/.

[7] The Department of Canadian Heritage is responsible for the administration of the ICA in respect of cultural businesses.

companies can compete with enterprises and that governments do not distort competition in the way they use their regulatory or supervisory powers.[8]

Not surprisingly, SOEs are not a homogeneous group. Some, such as the Norwegian fund, will not buy more than 5 percent of any one company while others are willing to take bigger stakes in companies and expect to import expertise through their investments. Moreover, as is apparent from Table 1, SOEs are often from non-OECD countries (*i.e.*, more recently developed or developing countries) where state ownership is a dominant feature of the economy, particularly in critical sectors such as energy, transport and telecom.[9]

In addition, some SOEs may not necessarily operate according to the commercial principles and dictates of private-sector companies, and the home countries in question may not be democratic or capitalist. In other words, the home countries of the SOEs may have different political, cultural, and economic institutions and SOEs, accordingly, represent a heterogeneous group.

IV. MERGER CONTROL OF SOE TRANSACTIONS UNDER THE COMPETITION ACT

A. Background on the Competition Act

Under the CA, parties to a transaction involving the acquisition of assets of an operating business; of the voting shares of a corporation; or of interests in a combination, an amalgamation, or the formation of a combination may be subject to the CA's premerger notification regime. In addition, the Commissioner of Competition (the "Commissioner"), who is the head of the Competition Bureau (the "Bureau"), may review and challenge any "merger" before the Competition Tribunal. A "merger" is defined to include not only acquisitions of control but also acquisitions of a significant interest in a business.[10] The following section provides a brief overview of the CA's premerger notification process as well as the substantive merger review process.

B. Premerger Notification and Merger Review

Premerger notification is required under Part IX of the CA when certain monetary thresholds are exceeded. There are three notification thresholds[11] applicable to an acquisition of voting shares of a corporation under the CA, all of which must be exceeded for the transaction to be notifiable:

- Size of the Parties: The parties to the transaction (who are the buyer and the target corporation in a share acquisition), together with the affiliates of each of them,

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[8] *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, OECD 2005 at 3 [*OECD Governance*].

[9] The Economist 2012 SOE Report, *supra* note 2 at 4, notes that at June 2011, the highest shares of national/state-controlled companies in the emerging market by industry sector are, in descending order, energy, utilities, telecommunication services, financials, and industrials.

[10] Section 91 of the CA defines a "merger" as "the acquisition or establishment, direct or indirect, by one or more persons, whether by purchase or lease of shares or assets, by amalgamation or by combination or otherwise, of control over or significant interest in the whole or a part of a business of a competitor, supplier, customer or other person."

[11] All thresholds in the CA are determined with reference to the most recent audited financial statements of the target company, adjusted, as necessary, to reflect subsequent significant non-ordinary course events or transactions.

collectively have assets (book value) in Canada or annual gross revenues from sales in, from, or into Canada that exceed CDN $400 million.

- Size of the Transaction: The aggregate book value of the assets in Canada owned directly or indirectly by the target corporation **or** the annual gross revenues from sales in or from Canada generated from those assets in Canada must exceed CDN $82 million.
- Shareholding Threshold: As a result of the proposed acquisition, the purchaser will hold more than 20 percent of the voting shares of a publicly traded corporation (or more than 35 percent of a privately held company) or if the purchaser already holds more than 20 percent of the voting shares of a public company (35 percent of a private corporation), it would hold more than 50 percent of the voting shares as a result of the proposed acquisition.

Where a proposed transaction meets the notification thresholds under the CA, each of the parties is required to file a notification with the Commissioner. This filing commences a 30-day statutory waiting period within which the parties are prohibited from closing the transaction, unless the requirement to notify is waived or the waiting period is terminated by the issuance of an Advance Ruling Certificate (an "ARC") or a no-action letter. The Commissioner may within the initial 30-day waiting period issue a "supplemental information request" ("SIR") for additional information and documents, in which case a new 30-day waiting period will commence following compliance with the SIR. SIRs are requested only where a matter raises significant competition concerns.

In addition to, or in lieu of, compliance with the CA's premerger notification provisions, the parties have the option of requesting **positive clearance** in the form of an ARC or a no-action letter, and do make such requests in almost all notifiable transactions (to shape the Bureau's assessment of a transaction). The request for an ARC or no-action letter is in the form of a letter to the Commissioner and contains a competitive impact analysis of the transaction. If granted, an ARC exempts the parties from any premerger notification obligation or terminates the statutory waiting period if a premerger notification has been filed and the waiting period is still running. An ARC also precludes the Commissioner from challenging a completed transaction provided the parties have disclosed all material facts and the transaction is completed within one year of the date on which the ARC is issued.

An ARC will only be issued in the clearest of circumstances where the Commissioner is of the view that the transaction is not likely to substantially prevent or lessen competition (*e.g.*, where there is no, or only minimal, overlap in the businesses of the buyer and the target). Even if an ARC request is denied, the Commissioner may issue a no-action letter stating that he does not at that time intend to challenge the transaction.

The differences between an ARC and a no-action letter are that a no-action letter (i) preserves the Commissioner's right to challenge the transaction within one year of closing, and (ii) absent an explicit waiver of the obligation to notify (which waiver is routinely granted), does not exempt parties from the premerger notification obligation. It is highly unusual for a transaction to be challenged post-closing following issuance of an unqualified no-action letter, and parties regularly close their transactions with comfort on the basis of such clearance.

Whether or not a transaction is notifiable, it may be subject to challenge by the Commissioner before the Competition Tribunal on the grounds that it will likely cause a substantial lessening or prevention of competition. In making this determination, the Commissioner will consider a number of factors, including the extent of any competitive overlap between the businesses of the parties and, with respect to products that overlap, the presence of effective competitors, the parties' and competitors' market shares, and any barriers to entry (among other things).

C. Application of the Competition Act to SOE Acquisitions

The nationality of the parties to a transaction is not a relevant factor in merger control under the CA. Nor is a party's state-owned status. Nevertheless, the Competition Bureau has reviewed a number of SOE transactions, many in the natural resources sector, over the past several years. The Bureau has not issued definitive guidance on SOE-related issues with the result that its views may well continue to evolve. Nevertheless, the following section summarizes the Bureau's current, provisional approach to the substantive review of SOE transactions as well as premerger notification.

D. Substantive Review of SOE Transactions

The Competition Bureau has reviewed numerous SOE transactions. As many of these have occurred in the oil and gas sector—often production assets—none has raised serious substantive competition issues as of yet. Nevertheless, as SOE investments grow in natural resource sectors and expand beyond such sectors, future SOE transactions may generate significant competition issues.

Such an outcome is much more likely if the Competition Bureau were to regard all SOEs owned by the same foreign government as under common control for purposes of its substantive competition analysis. In fact, the Competition Bureau has likened its treatment of SOEs to how it treats private equity funds that are controlled by a common management firm. As a result, the Bureau has taken the position that it may not provide positive clearance in the form of an ARC or a no-action letter if it does not receive detailed information regarding all of the foreign government's (including its affiliates) investments in Canada (down to a 10 percent interest).[12] Not surprisingly, this could create difficulties for certain SOEs that do not have access to detailed information about the businesses of entities that they may regard as competitors.

The concern raised by the Bureau's demand for extensive information (on 10 percent and greater investments of other SOEs owned by the same home state as the acquiring party SOE) is mitigated somewhat by the fact that the Bureau is only interested in the holdings of other SOEs in industries related to the target business. For example, if the business to be acquired is engaged in the oil and gas sector, the Bureau will not be interested SOEs operating in an unrelated sector (*e.g.* air transportation), although the Bureau might find investments in vertically related sectors such as pipelines to be relevant.

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[12] If the SOE believes there are impediments to obtaining the relevant information, the SOE must advise if there exist alternative means for the Bureau to obtain the information.

Where the SOE is unable to provide sufficient information about other SOEs' holdings in Canada, the transaction may have to proceed to closing without receiving positive clearance (*i.e.*, an Advance Ruling Certificate or a no-action letter) unless the Bureau accepts that such information is not relevant. In such instances, the parties will have to take comfort from the Bureau's failure to bring an injunction prohibiting closing of the transaction and the parties' own assessment of the likelihood for any challenge to the transaction.

A more appropriate response from the Bureau would be to issue a no-action letter if it does not intend to challenge the transaction (the Bureau remains free under the CA to oppose the transaction within one year). Such an approach would permit the acquiring SOE to obtain some reassurance and would also ensure that a standard closing condition (an ARC or a no-action letter) in a purchase and sale agreement could be fulfilled.

E. Premerger Notification Issues Arising for SOEs

The sovereign status of the investor may also be relevant in respect of premerger notification. In particular, a significant issue is whether other SOEs owned by the same home state are technically "affiliates" for premerger notification purposes under the CA.

The Competition Bureau has provisionally (for the past few years) adopted the position that the term "person" for the purposes of premerger notification section of the CA does not include a foreign government.[13] As a result, SOEs owned by the foreign government that are not within the party SOE's corporate chain of control below the parent state are not currently considered "affiliates" for purposes of premerger notification.

The Bureau's position is significant and advantageous for SOE acquirers for two reasons. First, all parties to notifiable transactions must submit certain required information regarding all affiliates in the same or related (vertically or horizontally) businesses. This requirement could be very difficult for SOE parties to meet given that other SOEs may be unwilling to share such competitively sensitive information (e.g., customer information) with entities they regard as competitors. If information about such SOEs were required, the merging parties would not be able to trigger the 30-day statutory waiting period. If the parties have also not received positive clearance from the Commissioner in the form of an Advance Ruling Certificate or a "no-action" letter (see above discussion), then they would not be in a legal position to close.

Fortunately, because the Competition Bureau's interpretation of "affiliate" does not include affiliates who are in different chains of control under the foreign government, the likelihood of an SOE party being unable to provide information relating to affiliates with assets in the same business in Canada may be reduced. This assessment is predicated on the assumption that SOEs that compete with the SOE party are less likely to be held within the same corporate grouping below the foreign government. Where this assumption does not hold, the SOE party may try to convince the Bureau that the SOEs about which information is sought are marketplace rivals, and that the SOE party has complied with CA requirements on the basis that information

[13] Note that the CA specifically addresses this issue for corporations controlled by the Canadian sovereign, whether at the federal or provincial level, stating, "one corporation is not affiliated with another corporation by reason only of the fact that both corporations are controlled by Her Majesty in right of Canada or a province, as the case may be."

regarding its "affiliates" is not "reasonably obtainable" by the SOE party (a ground for failing to supply certain information that must be set out in a declaration under oath or solemn affirmation attached to the notification filing). However, the Commissioner might well not accept this position.

SOEs that might otherwise be considered "affiliates" may also be omitted from the filing if they could not reasonably be considered relevant to the Commissioner's assessment of whether the proposed transaction would be likely to prevent or lessen competition substantially. As a result, no information would need to be included in a premerger notification relating to SOEs engaged in a sector that is unrelated vertically or horizontally to the acquiring SOE's overlapping business with the target. This "relevancy" screen is a standard exemption and may be helpful for SOE parties .

Second, the Bureau's provisional approach regarding SOE affiliates means that fewer SOEs must be included when calculating the size of parties' threshold ($400 million).[14] This is advantageous for SOEs that have limited assets in Canada because the transaction may not, as a result, be notifiable.

V. REVIEW OF SOE TRANSACTIONS UNDER THE INVESTMENT CANADA ACT

As with all investments by foreigners, SOE investments may be subject to review under the *Investment Canada Act* (the "ICA"). SOEs are currently subject to the same review threshold as non-SOEs (although they will not be once amendments to the ICA are implemented—see discussion below); but, since 2007, reviewable investments have been assessed on the basis of two additional criteria not applicable to non-SOE investors—commercial orientation and corporate governance—under the "net benefit to Canada" test.

In the past year, the Canadian Government announced that it will scrutinize SOE investments more closely and in June 2013 amended the ICA to permit the review of SOE acquisitions that might otherwise not be reviewable under the general ICA rules and to broaden the definition of an SOE to include "influence," not just ownership, by a foreign government. In addition, although it approved CNOOC's acquisition of Nexen in December 2012, the Government indicated it would prohibit further acquisitions of control of Canadian oil sands businesses by SOEs save on an exceptional basis.[15] The Government has also revised its guidelines on how it will review investments by SOEs, although its 2007 guidelines remain largely intact.

[14] Even if the Bureau took the position that all entities owned by the same foreign state are affiliates, not all SOEs would be equally affected. In particular, some SOEs might not be considered to be controlled by a foreign state under the CA "control" rules and therefore might not be affiliated with other SOEs owned by that state. For example, unlike for Canadian government entities, the CA does not recognize that an SOE might not have share capital. Accordingly, SOEs without share capital or otherwise not meeting the definition of control in the CA might not be considered to be controlled by the home state and therefore affiliated with other SOEs owned by that state.

[15] Note that only reviewable transactions are subject to this prohibition.

A. Background on the ICA

1. The ICA Review Process

Subject to certain exemptions, every acquisition of control by a non-Canadian of a Canadian business requires either notification (essentially a post-closing administrative formality) or detailed review and pre-closing ministerial approval under the ICA. The test for approval is whether the transaction will be of "net benefit to Canada."

Direct acquisitions[16] of control by World Trade Organization ("WTO") investors trigger a pre-closing approval requirement if the review threshold is exceeded. (Indirect acquisitions, *i.e.*, the purchase of a foreign corporation that owns a Canadian entity, are generally not reviewable, subject to exceptions for the purchase of a cultural business or non-WTO transactions.) The current review threshold is a book value of assets of the target of CD $354 million or more (as reflected in the audited financial statements for the most recently completed fiscal year prior to closing). A WTO investor is a purchaser that is controlled ultimately by nationals of a WTO member country.[17]

The review threshold will be changed following issuance of a regulation implementing a new review threshold (established in 2009 amendments to the ICA) of $600 million in "enterprise value" ("EV") of the target Canadian business; this threshold will rise to $800 million within two years and to $1 billion within four years. Based on previous drafts of the regulation, EV for a public company will likely be defined in relation to its market capitalization over a defined period plus liabilities minus cash; for share acquisitions of private companies or asset purchases, EV will likely be defined in relation to the purchase price plus liabilities minus cash. (As will be discussed in greater detail below, the EV threshold will not apply where the acquirer is an SOE investor as a result of amendments to the ICA in June 2013.)

If a transaction is reviewable, it must be approved by the Minister of Industry prior to closing. An application for review triggers a 45-day initial review period which can be unilaterally extended by Industry Canada for a further 30 days. Any further extensions must be made with the consent of the acquirer. (Such consent is generally forthcoming as Ministerial approval may otherwise be withheld.)

The determination of whether a transaction meets the "net benefit to Canada" test is largely based on economic factors relating to the impact of the investment on the following, among others: the level of employment, capital expenditures, the locus of head office functions, participation of Canadians in senior management, innovation, technology transfer, and the level of exports. However, the statutory factors include "the compatibility of the investment with

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[16] Direct acquisitions may be by way of acquisition of the shares of a Canadian corporation or of interests in a Canadian partnership or through the acquisition of substantially all the assets of a business in Canada.

[17] A corporation is WTO-controlled if the corporation is not controlled in fact through share ownership (*i.e.*, a widely held company) and at least two-thirds of the board of directors are WTO citizens. Note that even if the purchaser is not a WTO investor, the higher review threshold of $354 million also applies if the Canadian target business is currently controlled by a WTO investor; for this purpose, however, Canada is not considered a "WTO" country. That is, if a non-WTO investor acquires a Canadian-controlled corporation, the current review threshold is $5 million in book value of assets. (However, there are very few non-WTO investors given the inclusiveness of the WTO membership roster.)

national industrial, economic and cultural policies, taking into consideration industrial, economic and cultural policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the investment." The open-ended nature of this factor gives the Government broad latitude to invoke unspecified policies to justify the "net benefit" decision and accordingly permits decisions that may be politically motivated.

Investors typically are required to make certain commitments (called "undertakings") to the Canadian government in order to obtain ministerial approval. These undertakings are generally for a three-year duration but may be five years for very large transactions and, in certain instances, will operate indefinitely.

2. National Security Review Process

In 2009, the Canadian Government introduced a national security screening process into the ICA. The federal Cabinet may prohibit or attach conditions to a foreign investment in an existing Canadian business, or the establishment of a new Canadian business, if such investment would be "injurious" to Canada's "national security." If the investment has already been completed, the Cabinet may order a divestiture.

The scope of "national security" is not defined nor has the government issued any guidance. Without any criteria identified under the act, the federal Cabinet has wide discretion to determine the relevant risk factors. Note that guidance issued in respect of the U.S. national security review process (undertaken by the Committee on Foreign Investment in the United States or CFIUS) identifies targets in sectors such as critical infrastructure, critical technology, and energy as meriting closer scrutiny.

In addition, national security review applies to a much broader scope of transactions than the general "net benefit" review process. For example, there is no safe harbor for transactions that fall below the "net benefit" review threshold noted above, and minority investments are subject to review whether or not they constitute an acquisition of "control."

While there is no formal mechanism to obtain pre-clearance of these transactions on national security grounds, early submission of a filing (either an application for review or a notification) under the general ICA provisions (*i.e.*, those not related to national security) will trigger a 45-day period following which the Minister must send a notice of an order for national security review or during which the Minister must send a notice of possible review. Parties to a transaction would be well-advised to provide for leeway of several days (*e.g.*, five days) in addition to the 45-day period to provide for the receipt of such notice. If such a notice has not been received, the parties can close, reassured that the transaction will not be challenged.[18] The exception is minority investments that do not represent an acquisition of control, in which case the Minister has 45 days from closing to give notice of a review or possible review. If a national security review is invoked, investors can expect potentially significant delays, adding as much as

[18] Note, however, that with the new rules on SOE investments, it is possible that the Government might determine that an investor is an SOE post closing and could then require the filing of an application for review on the basis that control in fact was acquired even if no such control would be found under the generally applied (to non-SOEs) presumptions and rules. The characterization of the investor as an SOE could also potentially trigger a national security review.

130 days (and possibly more, once all of the 2013 amendments are in force) if the maximum prescribed periods are fully utilized.

The national security review process generated some anxiety among foreign investors at its introduction but it was only in October 2013 that the Government first (at least publicly) prohibited a transaction on national security grounds.[19] With that said, as noted below, Canadian politicians and interested "stakeholders" have over the past few years become more aware of the potential to use the ICA to political advantage. As a result, it is possible that "national security" concerns could be used to justify the review of a transaction that is unpopular and not otherwise reviewable under the "net benefit" approval process.

In addition, while a national security review is not likely to apply in most circumstances, foreign investors need to include on their checklists consideration of whether there is any potential for national security issues to arise. Concerns could relate to the target's sector (*e.g.*, critical technology or infrastructure, defense industry and inputs to the defense industry), and/or to the investor (*e.g.*, is it associated with organized crime?).

3. BHP Billton's Bid for Potash Corp. of Saskatchewan in 2010

Most "net benefit" reviews under the ICA are relatively routine processes that pose no threat to transaction completion (although they may extend deal timelines). However, the Government's rejection of the proposed acquisition by BHP Billiton ("BHP") of Potash Corp. of Saskatchewan ("PotashCorp") (the "Potash decision") in 2010 signaled that the review process can become highly politicized and result in unpredictable and adverse outcomes for transactions.[20]

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[19] On October 7, the Industry Minister announced that he was not approving Egyptian-controlled Accelero Capital Holding's purchase of MTS' Allstream Division—the wireline enterprise services division of Manitoba Telecom Services Inc.—on national security grounds. The reasons for the Minister's decision in the Accelero/Allstream case were only hinted at. In his press release, the Minister noted that "MTS Allstream operates a national fibre optic network that provides critical telecommunications services to businesses and governments, including the Government of Canada."

Allstream's press release underlines the significant degree to which the parties made efforts to meet the "net benefit to Canada" test—offering commitments including a plan to invest $300 million over the next three years—and Accelero reportedly sought to assuage government concerns about national security, including offering not to supply the Canadian government and committing not to buy from Chinese manufacturer, Huawei. The press release also makes it clear that the parties were taken by surprise and puzzled by the rejection on national security grounds, underlining the lack of communication by the government as to the nature of the threat it identified.

Industry Canada also issued a notice of review on national security grounds in a proposed transaction in 2009 involving the purchase by a Belgian company (George Forrest International Afrique SPRL) of a Canadian company, Forsys Metals Corp., whose only asset was a uranium project in Namibia. The parties ultimately abandoned the transaction. There have been a few other transactions that have been reviewed on national security grounds (including (reportedly) the acquisition of control of wireless carrier Wind Mobile) but relatively little information is available about these.

[20] Note that the Canadian Government did not issue a final rejection of BHP's proposed acquisition of potashcorp as BHP withdrew its bid, stating "the minister of industry would have required additional undertakings beyond those BHP billiton had already offered which would have conflicted with bhp billiton's business strategy and been counter to creating shareholder value." *See* Helia Ebrahimi, *BHP Billiton blasts Canadian government as it pulls $38bn potashcorp bid*, THE TELEGRAPH (November 15, 2010), *available at*

The Potash decision was only the second time in the history of the ICA that a foreign investment outside of the cultural sector was turned down, and resulted in the parties abandoning the transaction.[21] While the government issued no decision, from statements made publicly, the Minister of Industry was apparently not satisfied that BHP was prepared to make sufficient commitments in respect of capital expenditures or PotashCorp's membership in Canpotex.[22] At the time, the Minister of Agriculture also referred to potash as a "strategic resource," raising the question whether Canada viewed certain industries as "strategic" and too important to Canada's national interests to be owned by foreigners.

Despite these apparent concerns, the most widely accepted explanation for the Government's rejection of the bid was the political and populist reaction against the deal led by the Premier of Saskatchewan (the province in which most of PotashCorp's assets are located). The Premier's objections included concerns over a significant reduction in tax revenues and foreign ownership of a "strategic" resource. Significantly, the bid was hostile and the minority status of the reigning Conservative government made it vulnerable to a potential loss of Parliamentary seats in Saskatchewan and elsewhere in Canada.

The absence of official reasons for the Potash decision fostered a sense of anxiety and concern about Canada's openness to foreign investment.[23] It also offered several lessons to foreign investors including SOEs prospecting for Canadian investments:

1. It underlined the importance of early consultation with various influential stakeholders, including the governments of the provinces in which the target business is located, to communicate a coherent and credible story about the positive impact of the investment in Canada.
2. It demonstrated that the timing of an acquisition is critical: launching a bid at a time when the federal government or the relevant provincial governments are politically vulnerable (just prior to an election or when the government is in a minority position) increases the risk of a rejection.
3. Pursuing a hostile takeover adds uncertainty given that a Canadian target corporation generally will have stronger relationships with the Government than the foreign acquirer.

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http://www.telegraph.co.uk/finance/newsbysector/industry/mining/8133214/bhp-billiton-blasts-canadian-government-as-it-pulls-38bn-potashcorp-bid.html.

[21] In the first, Alliant TechSystems' proposed acquisition of the geospatial business of MacDonald Dettwiler and Associates was rejected under the "net benefit" test in 2008 partly on the basis of apparent national security concerns (no official reasons for the decision were given by the government). The national security review process was not yet in place.

[22] *See* Cassandra Kyle, *BHP Billiton withdraws potash bid, citing 'net-benefit' bar*, POSTMEDIA NEWS (Nov. 15, 2010), *available at* www.canada.com/news/Billiton+withdraws+potash+citing+benefit/3827505/story.html.

[23] BHP offered commitments that were significant and in some respects, unprecedented, including foregoing tax benefits to which it was entitled in Saskatchewan, remaining a member of the Canpotex potash export consortium for five years, and establishing its global headquarters in Saskatoon. BHP also offered a U.S. $250 million performance bond to the government to backstop its undertakings, likely to allay public concerns about compliance with undertakings.

4. Wary foreign investors may wish to avoid the ICA "net benefit" review process altogether by considering alternatives to acquiring a controlling stake in a Canadian target such as "off-take agreements" in the resource sector.[24]

The Potash decision did not reflect a sea-change in Canada's openness to foreign investment. Indeed, in the more than three years since the decision, there has been no final rejection of a foreign investment under the "net benefit to Canada" test. Nevertheless, while most recognize that a review under the ICA will not constitute a roadblock to completion of a transaction, in those few deals involving Canadian icons or sensitive sectors (the category for which is neither defined nor closed), the ability to close cannot be absolutely guaranteed. In the case of an SOE acquirer, such concerns may well be heightened as illustrated by the public reaction to the recent CNOOC/Nexen deal and the Canadian Government's articulation of a new policy towards SOEs in 2012 and amendments to the ICA in 2013 (discussed below).

B. ICA Review of SOE Transactions—Background

1. 2007 SOE Guidelines

In 2007, Industry Canada issued guidelines on how it would review investments by state-owned investors (the "2007 SOE Guidelines") that exceed the review thresholds.[25] The release of the guidelines followed a tide of takeovers of Canadian marquee companies by non-SOEs as well as an increasing recognition that SOEs were becoming significant players in Canadian investments (beginning with Chinese SOE Minmetals' aborted attempt to take over Noranda Inc. in the fall of 2004). There were a number of concerns expressed about SOEs, including the opaque nature of their organizations, unfair advantages in acquiring businesses (having deep pockets and access to non-commercial credit terms), and the possibility of SOEs pursuing non-business objectives of the home state such as the strategic hoarding of resources (rather than development) and funneling resources to the home country of the SOE.

The 2007 SOE Guidelines defined an SOE as an enterprise that is owned or controlled directly or indirectly by a foreign government.[26] In addition, the guidelines set out two factors (beyond the typical "net benefit" factors) that the Government would consider in reviewing SOE investments: corporate governance and commercial orientation.

a. Corporate Governance

The 2007 SOE Guidelines state that the Government will examine whether the non-Canadian investor adheres to Canadian standards of corporate governance (including, for example, commitments to transparency and disclosure, independent members of the board of directors, independent audit committees, and equitable treatment of shareholders), and to Canadian laws and practices. The examination will also cover how and the extent to which the non-Canadian is owned or controlled by a state.

The requirement for Canadian standards of corporate governance merits some comment. The rationale for requiring independent directors is likely an attempt to ensure that the Canadian

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[24] Off-take agreements entitle the investor to a share of production.

[25] The guidelines do not apply to transactions under the review threshold.

[26] As noted below, "SOE" is more broadly defined now to include "influence."

business is governed by an entity with directors at arm's length from the SOE's home country. With respect to how the state controls the investing entity, the actual mechanisms of control may be opaque to an outsider or the formal mechanisms may not reflect how control is actually held.

One way to address corporate governance concerns is a public listing of the company on an exchange with significant transparency requirements, such as the New York Stock Exchange. Indeed, a requirement to maintain an exchange listing may be requested as a way to meet corporate governance standards. Absent such a public listing, the Government may demand detailed commitments relating to transparency.

b. Commercial Orientation

In assessing the commercial orientation of the SOE, the 2007 SOE Guidelines stated that the Minister will assess whether the target Canadian business will continue to have the ability to operate on a commercial basis regarding:

- where to export;
- where to process;
- the participation of Canadians in its operations in Canada and elsewhere;
- support of on-going innovation, research, and development; and
- the appropriate level of capital expenditures to maintain the Canadian business in a globally competitive position.

The first factor highlights a potential concern that the SOE might simply wish to funnel Canadian natural resources to its home state, rather than supplying market-based customers. With respect to processing, the concern is that processing would be moved offshore to increase employment and economic activity in the home state of the SOE, rather than processing in Canada.

As with corporate governance, the concern that the target Canadian business will be operated according to non-market dictates could be allayed significantly if the SOE is listed on a recognized stock exchange given the transparency and accountability requirements of certain stock exchange rules. (Note that not all stock exchanges would meet this requirement.)

c. Undertakings

Finally, the 2007 SOE Guidelines outline the types of binding commitments or undertakings that may be required to ensure that SOE investments result in a net benefit to Canada. These include:

- commitments to appoint Canadians as independent directors,
- the employment of Canadians in senior management,
- the incorporation of the target business in Canada, and
- the listing of shares of the acquiring company or the target Canadian business on a Canadian stock exchange.

It is significant to note that certain undertakings by SOEs may well exceed the normal three to five year commitments given by non-state foreign investors.

2. Summary of SOE Reviews to Date

The Canadian government has reviewed and approved numerous transactions involving an SOE.[27] These include: the acquisition of Chinese SOE, CNOOC, of Nexen (2013); the acquisition of Progress Energy by Malaysian SOE Petronas (2012); Sinopec's acquisition of Daylight Energy (2011); the acquisition of Opti-Canada acquisition by CNOOC (2011); Sinopec's acquisition from ConocoPhillips Co. of a company holding a 9 percent interest in oil sands producer, Syncrude Canada Ltd. (2010); PetroChina's acquisition of interests in two oil sands projects owned by Athabasca Oil Sands Corp. (2010); the acquisition of Nova Chemicals by International Petroleum Investment Company (owned by the Abu Dhabi government) (2009); Korea National Oil Corp.'s acquisition of Harvest Energy (2009); China Investment Corp.'s acquisition of a 45 percent stake in an oil sands joint venture with PennWest (2009); and the acquisition by a subsidiary of publicly listed Abu Dhabi National Energy Company PJSC (TAQA), of PrimeWest Energy Trust (2008).[28]

The Ministerial approvals noted above have demonstrated that SOE transactions have in the past been seen as beneficial to Canada. This is not surprising given that Canada is a small country with vast natural resources and needs foreign capital to develop its resources. The recent prominence of Chinese SOEs as investors in Canada is also noteworthy and reflects the warming of relations between Canada and China that began with Prime Minister Harper's 2009 visit to China and has continued through numerous meetings between the Prime Minister and other Cabinet ministers and their Chinese counterparts.

The approvals are also significant in that SOE investments do not appear to have raised national security concerns (although such concerns have no doubt been canvassed). Nevertheless, at the same time as the CNOOC/Nexen transaction was approved, the Canadian Government announced its new policy towards SOEs, including a prohibition of reviewable acquisitions of control of Canadian businesses in the oil sands and a heightened level of scrutiny of SOE investments in the Canadian economy generally.

C. The CNOOC/Nexen Deal—A Pivotal Transaction

The ICA approval process for CNOOC's acquisition of Nexen illustrates the significant degree of politicization that may accompany the review of a high profile acquisition by an SOE in the resource sector. A key theme is the extent to which the net benefit review process morphed into a much broader economic and political debate about the Canada-China relationship, a challenge that would not be faced by a private sector foreign investor.

As noted above, while the statutory factors the Industry Minister must consider in making the "net benefit to Canada" generally relate to economic, objective factors such as employment, level of capital expenditures, and the locus of head office functions, the Minister may also take into account "national industrial, economic and cultural policies," as well as

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[27] The minority (17 percent) investment by China Investment Corp. in Teck Resources in July 2009 was not subject to "net benefit" review because it did not constitute an acquisition of control.

[28] *See* http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aUazXOsVZ1GM.

provincial policies in those same areas. This category represents a very large "black box" of unspecified policies that can be used to justify a range of diverse outcomes for a proposed transaction. As the discussion of the CNOOC/Nexen transaction below illustrates, the Canadian Government struggled to balance its concern to maintain Canada's open investment climate, while at the same time responding to the larger political dynamics at play.

During the review period for the transaction, there was a steady torrent of press reports covering every angle of the CNOOC/Nexen acquisition and the highest level of government officials, including Prime Minister Harper, were involved in approving the deal. Prior to granting approval, Prime Minister Harper noted that the Government would determine whether the deal was not just of "net benefit" to Canada but also whether it was in the "long term interest" of Canada.[29] Although there had been suggestions that national security would be a consideration, it does not appear that there was a national security review. The parties also made a filing under the U.S. national security legislation (the *Foreign Investment and National Security Act* of 2007) enforced by the Committee on Foreign Investment in the United States.

One of the major criticisms of the transaction was that China would not allow a comparable transaction by a Canadian investor in China.[30] This concern for reciprocity was repeatedly noted by critics of the deal who argued that the ICA test of "net benefit to Canada" should require a condition that China open its door to Canadian investment in the same sector. Others opposed such conditionality. According to liberal economic orthodoxy, even unilateral action to eliminate obstacles is considered beneficial for the liberalizing country. In addition, some commentators noted that Nexen had been "for sale" for a long time and that no Canadian company had been willing to buy it.[31] Nevertheless, the "reciprocity" argument had some traction with the public and the Canadian government undoubtedly felt the pressure to obtain significant commitments (falling short of reciprocal access) from CNOOC.

Another criticism of the CNOOC/Nexen transaction alleged that the net benefit to Canada was questionable because state-owned investors do not historically run companies in the most efficient way. Indeed, as noted above, Canada had in the past few decades privatized a number of crown corporations (including PetroCanada) in recognition of this view. Canadian economist Jack Mintz argued: "Unless a government wishes its state-owned enterprises to operate strictly according to commercial criteria, a takeover of a private company by an SOE could result in the target performing less efficiently since other criteria besides value maximization undermine profitability and productivity." Moreover, Mintz noted that the playing field for bidders was not level as SOE acquirers have advantages (including tax exempt status and cheap credit) that mean that the winning bid is not based on economics and is, therefore, not the

[29] *See* James *Waterman, How to Buy a Canadian Oil Company, CNOOC's bid to acquire Nexen gets political,* PIPELINE NEWS NORTH, *available at* http://www.pipelinenewsnorth.ca/article/20120912/PIPELINE0118/309129999/-1/pipeline/how-to-buy-a-canadian-oil-company

[30] *See* Jeffrey Simpson, *What if Nexen coveted CNOOC?*, GLOBE AND MAIL (September 29, 2012), *available at* http://www.theglobeandmail.com/commentary/what-if-nexen-coveted-cnooc/article4575332/.

[31] *See* Sophie Cousineau, *The price that China must pay to win Nexen*, GLOBE AND MAIL (September 29, 2012) *available at* http://www.theglobeandmail.com/report-on-business/industry-news/energy-and-resources/the-price-china-must-pay-to-win-nexen/article4576200/.

bid that maximizes the economic advantages to the target company (including replacing existing management with better management). Accordingly, he proposed addressing this issue by limiting state ownership to 30 percent of voting shares as is done with pension plans.[32]

Despite these public criticisms of the CNOOC bid, a number of factors militated in favor of government approval of the transaction. First, CNOOC positioned the transaction in a favorable light by communicating publicly its willingness to make significant commitments, including:

- Establishing Calgary as CNOOC's North and Central American headquarters, which will manage Nexen's global operations and CNOOC's existing operations in the region (comprising approximately U.S. $8 billion of CNOOC's existing assets);
- Intending to retain Nexen's current management team and employees;
- Enhancing capital expenditures on Nexen's assets;
- Intending to list CNOOC Limited shares on the TSX; and
- Enhancing community and social commitments.[33]

These commitments corresponded closely to the 2007 SOE Guidelines described above, and their communication at the time of announcing the transaction reflected CNOOC's appreciation of the political nature of the Investment Canada approval process.

Second, the Canadian Government had been making considerable efforts to promote trade and investment with China as witnessed by Prime Minister Harper's visits to China in December 2009 and February 2012 as well as the conclusion of the Foreign Investment Promotion and Protection Agreement ("FIPA") with China in September 2012.[34] A rejection of CNOOC's bid would have seriously undermined the rapprochement Canada has sought with China and jeopardize future trade and investment between the countries.

Moreover, Prime Minister Harper indicated that Canada must accept the differences between the two countries' economies: "We can't make it a prerequisite of doing business that they've got to become just like us. We do have to factor in our differences and factor in those differences in pursuing ultimately what our best interests are within a relationship that has to be mutually beneficial."[35]

[32] Jack Mintz, *Jack Mintz: Limit State Takeovers*, *available at* http://opinion.financialpost.com/2012/07/24/jack-mintz-limit-state-takeovers/.

[33] *See* the CNOOC press release, *CNOOC Limited Enters into Definitive Agreement to Acquire Nexen Inc.*, July 23, 2012, *available at* http://www.cnoocltd.com/encnoocltd/newszx/news/2012/2062.shtml.

[34] *See* Bill Curry & Shawn McCarthy, *Tories quietly table Canada-China investment treaty*, GLOBE AND MAIL, (September 28, 2012) at p. A11, *available at* http://www.theglobeandmail.com/news/politics/tories-quietly-table-canada-china-investment-treaty/article4573635/.

[35] *See* Shawn McCarthy & Andy Hoffman, *Harper promises playbook for foreign takeovers*, GLOBE AND MAIL, (September 7, 2012), *available at* http://www.theglobeandmail.com/report-on-business/industry-news/energy-and-resources/harper-promises-playbook-for-foreign-takeovers/article4525220/

D. Approval of CNOOC/Nexen and Revised SOE Policy (2012)

Canada ultimately approved the CNOOC/Nexen deal in December 2012—more than four months after it was announced. At the same time, the Prime Minister announced a new and more stringent policy framework for the review of SOE investments in Canada. The new policy reflects limits to the Government's tolerance for significant foreign government ownership in the Canadian economy and in the oil sands. The highlights of the Government's December 2012 announcement are:

- Further acquisitions of control of a Canadian oil sands business would be prohibited under the "net benefit to Canada" test absent "exceptional circumstances." (Note that this only applies to reviewable transactions.) Apart from the obvious impact of decreasing investment in the oil sands, the prohibition casts doubt on whether certain provisions in existing SOE joint ventures in the oil sands can be implemented. For example, could an SOE's right of first refusal in a joint venture agreement be exercised if this resulted in the SOE acquiring control? Such an issue would have repercussions on oil sands joint ventures formed after the prohibition; an SOE taking a minority position in an oil sands joint venture would need to have minority partner protections but the range of such protections would be constrained by the prohibition on acquisitions of control. As a consequence, SOEs may be unwilling to make even a minority investment in the oil sands or may only be willing to buy at a discount.
- Scrutiny of SOE investments would be intensified, especially in sectors where SOE influence in a particular industry is deemed significant.
- Revisions to the SOE guidelines would underscore that SOEs are expected to be transparent, constrain state influence, and operate according to free market principles. (See the revised guidelines in Appendix B.) Note that the main criteria in the guidelines continue to be the SOE's commercial orientation and whether it meets Canadian standards of corporate governance.[36]
- The definition of SOEs would be broadened to include companies that were influenced by foreign governments. (See discussion below.)

E. June 2013 SOE Amendments to the ICA

In June 2013, the Canadian Government passed amendments to the ICA implementing its new approach towards SOEs and lengthening the maximum amount of time for a national security review. (Not all of these amendments are yet in force.)

For the following reasons the amendments to the ICA will almost certainly result in more SOE investments being subject to pre-closing Ministerial approval on the basis of "net benefit to Canada:"

[36] The 2012 SOE guidelines add that adherence to Canadian laws includes adherence to free market principles and that in examining the extent to which the non-Canadian is owned or controlled by a state, the influence of the state on the conduct and operations of the SOE will be examined. In addition, the impact of the investment on productivity and industrial efficiency in Canada is an additional consideration in determining the SOE satisfies the commercial orientation requirement.

- While the ICA review requirement only applies to acquisitions of control of Canadian businesses, and the rules for determining whether an acquisition of control has occurred are set out in the ICA, the amendments enable the Minister to make SOE investments subject to review if he finds "control in fact"—even if the application of the ICA's general rules would lead to the conclusion that no acquisition of control has occurred.
- The uncertainty generated by this Ministerial discretion is exacerbated by the potentially very broad scope of the term "SOE" which has been expanded beyond entities that are controlled by foreign governments to include those that are "influenced" by such governments.
- SOEs will not benefit from the increase in the generally applicable review threshold, which is set to rise dramatically over the next few years. The likely result is that SOE investments will be subject to more reviews than would otherwise be the case.

1. Broader Ministerial Discretion to Subject SOE Transactions to Review

The amendments may significantly increase the number of SOE investments requiring Ministerial approval by permitting the responsible Minister to avoid the general ICA rules and presumptions:

- **Defining when an acquisition of control occurs**. The ICA general rules establish presumptions regarding when control is acquired. For example, they state that the acquisition of less than one-third of the voting shares of a corporation, or of less than a majority of the economic interests of a partnership, is deemed not to be an acquisition of control. If there is no acquisition of control, there is no requirement for a "net benefit" review under the ICA. For an SOE, these rules need not be applied if the Minister concludes based on "any information and evidence" made available to him that the SOE will acquire control in fact.
- **Determining whether one entity is controlled by another**. The ICA sets out general rules and presumptions regarding when control exists. However, the amendment would permit the Minister to go beyond those rules in assessing whether an SOE controls another entity in fact, thus creating some uncertainty about whether such an entity would be considered an SOE when it made an acquisition.
- **Determining whether an investor is Canadian or not**. The ICA establishes rules to determine the Canadian status of an investor. As a result of the amendment, an entity that would otherwise be considered Canadian-controlled may be judged to be an SOE if the Minister concludes that it is controlled in fact by an SOE. The consequence is that if such an entity pursued an acquisition of a Canadian business, it would be subject to the SOE review threshold and Ministerial discretion on whether it was acquiring control in fact.

The repercussions of bypassing the normal presumptions and rules on these points could be significant for an SOE investor. As an assessment of "control in fact" can be relatively subjective and depend on a detailed analysis of the terms of the investment, it may be unclear—especially early in the deal process—whether the SOE investment is an acquisition of control in fact under the ICA and therefore potentially reviewable. Moreover, the Government has no plans

to issue guidance on how it will apply a "control in fact" test, although this phrase has been interpreted in the context of cultural business reviews under the ICA and in other legislation including transportation, telecommunications, and tax laws.

Finally, a determination that the investor is an SOE, or that an SOE controls or has acquired control of a Canadian business can be made retroactive to April 29, 2013. This retroactivity raises the risk that an investor will have to seek Ministerial approval under the "net benefit" test or be subject to national security review post-closing where the parties concluded pre-closing that there was no acquisition of control by an SOE (*e.g.,* because the investment involved a minority interest) or that the investor was not an SOE. To address this uncertainty, an investor may, in the appropriate circumstances, wish to consult early on with the Government. However, it should be noted that the Minister is not required under s. 37 of the ICA to provide a formal, written opinion on this issue but may choose to do so.

2. Expanded Scope of an SOE

The definition of an SOE has been amended to include not only the government of a foreign state or agency of such government and an entity that is controlled, directly or indirectly, by such a government, but also an entity that is influenced, directly or indirectly, by a foreign government. The definition of an SOE has also been expanded to capture individuals acting under the direction of a foreign government or under the direct or indirect influence of a foreign government.

The Government has indicated there is no plan for guidance on the term "influence." It is possible that the Government will feel constrained not to interpret this phrase too broadly as there may be a risk of a backlash against Canadian pension funds and other quasi-public Canadian entities in foreign countries. Nevertheless, it is unclear in any given situation where the Government will choose to draw the line with respect to, for example, the degree of foreign government representation on boards or senior management links to government officials when determining whether an entity is "influenced" by a foreign government.

It is also worth noting that the Government may be in a better position to identify state involvement once it has finalized a draft regulation establishing new information requirements for notification filings and applications for review. The draft regulation would require information from investors respecting any level of direct or indirect state ownership (including the nature and extent of the state's interest in the investor), sources of funding for the investment, and the names of the members of the investors' board of directors and the five highest paid officers.[37]

3. SOE Review Threshold

SOEs will not benefit from the planned increase to the current review threshold. At present, the review threshold for direct acquisitions of Canadian businesses by foreign investors controlled by nationals of WTO countries is CD $354 million in the book value of the target Canadian business. Non-SOEs will in the future face a review threshold based on the target's

[37] *See* draft *Regulations Amending the Investment Canada Regulations* at http://www.gazette.gc.ca/rp-pr/p1/2012/2012-06-02/html/reg1-eng.html.

enterprise value; the threshold will be $600 million when implemented, rising to $800,000 in two years and then to $1 billion four years later. As noted above, the meaning of "enterprise value" will be defined by regulation; draft regulations to date have defined EV for public companies as market capitalization plus liabilities minus cash, while EV for private companies relates to purchase price plus liabilities minus cash.

The likely outcome of differentiating between SOEs and non-SOEs in the review threshold is that more SOE transactions will be subject to review relative to non-SOE transactions, although this is not necessarily the case. For example, for Canadian businesses that are engaged in industries where book values may be lower relative to EV (*e.g.,* information technology companies), it is possible that an SOE investment might be below the book value review threshold while a non-SOE investment would exceed the enterprise value threshold for the same target. This would advantage the SOE investor relative to the non-SOE in a bidding process for the Canadian target business—a curious result that is at odds with the Government's objective to require more scrutiny of SOE investments.

4. Longer Timelines for National Security

The amendments also extend the maximum timelines for national security review (though these amendments are not in force at the time of writing) and extend the date following the conclusion of a national security review by which the Minister has to provide the "net benefit" ruling. The implications of these extensions are unlikely to be serious for most transactions given that in the four years since national security has been introduced, there have been very few reviews. Nevertheless, for those that are subject to national security review, deal timelines could be extended significantly.

VI. CONCLUSION

Given its own relatively small pool of domestic capital, Canada relies on foreign investment. SOEs are major players in global business and capital markets and have the financial resources and appetite to invest (especially in natural resources but also in other sectors). In this context, it is important that the rules for SOE investment in Canada are clear and predictable in their application. Both the Competition Bureau and Industry Canada have taken steps in this direction over the past few years, although the Bureau has characterized its approach as provisional and the Government's revised foreign investment review policy has generated uncertainties for SOE investments.

The Competition Bureau's recently articulated approach to premerger notification for SOEs makes it easier for SOEs to file a complete notification, although potential pitfalls still exist for some SOEs. However, the Bureau's approach to substantive reviews of SOE transactions (requiring information relating to any SOE of a foreign government in a similar or vertically related business to the party SOE) does not take into account that some SOEs may legitimately be unable to provide information about such entities. In such scenarios, where the Competition Bureau has sufficient information to conclude that it will close its file on a matter, there is a strong argument that it should be willing to provide SOE investors with the comfort of a "no-action" letter indicating that it has no current intention to challenge the proposed transaction.

The Canadian Government has articulated a revised approach to SOEs over the past year by announcing its (restrictive) policy towards oil sands investments by SOEs and by

underscoring its intention to scrutinize SOE investments closely. In this environment, significant uncertainties remain for SOE investors. The CNOOC/Nexen transaction demonstrated the particular susceptibility of SOE transactions to generate political controversy and therefore be more unpredictable in their outcome than a similar investment by a foreign non-state acquirer (where the focus of concern would be largely on the target investment and not the nature of the investor). In addition, while the Canadian Government has given notice that acquisitions of control of Canadian oil sands businesses will in general be prohibited, it has not addressed the circumstances which would lead it to grant exemptions from this policy.

Finally, the broadened discretion of the Minister to determine the reviewability of an investment and to define an SOE more expansively also generates anxiety for SOEs (or would-be SOEs) looking to invest in Canada and even for SOEs (or would-be SOEs) who already have made investments in Canada.

A number of commentators are of the view that Canada's restrictive policy on SOEs investing in the oil sands has deterred SOE investors and hurt the Canadian economy.[38] While it is likely that the lower rate of investment by SOEs relates to a number of factors including lower commodity prices, the Canadian Government could take steps to blunt the negative repercussions. First, it could offer guidance on when it might provide exemptions from the prohibition on SOEs acquiring control of oil sands assets and on how broadly it will interpret "SOEs." Second, the Government should convincingly telegraph the message that while the Canadian Government will review SOE investments to ensure net benefit to Canada, SOE investors are welcome in all other sectors of the Canadian economy.

[38] *Foreign takeover limits scaring away investors, says Prentice*, CBC (October 1, 2013) at http://www.cbc.ca/news/business/foreign-takeover-limits-scaring-away-investors-says-prentice-1.1874507. *See also* Rebecca Penty & Andrew Mayeda, *Oil Sands Deals Dive as State Firms Scrutinized*, BLOOMBERG (September 30, 2013), *available at* http://www.bloomberg.com/news/2013-09-30/oil-sands-deals-dive-as-state-firms-scrutinized.html.

APPENDIX A.

TABLE 1: Selected Recent SOE Investments in Canada

SOE/SWF	Canadian Target	Year of Investment
China National Offshore Oil Company ("CNOOC")	Nexen Inc. ("Nexen")	2013
Petronas (Malaysia)	Progress Energy Resources Corp.	2012
Sinopec (China)	Daylight Energy	2011
CNOOC (China)	Opti-Canada	2011
Sinopec (China)	9% stake in Syncrude Canada Ltd. (vendor = ConocoPhillips Co.)	2010
PetroChina (China)	Athabasca Oil Sands Corp.	2010
China Investment Corp. (China)	45% stake in PennWest	2009
Korea National Oil Corp. (Korea)	Harvest Energy	2009
International Petroleum Investment Company (Abu Dhabi)	Nova Chemicals	2009
Abu Dhabi National Energy Company PJSC ("TAQA") (Abu Dhabi)	PrimeWest Energy Trust	2008

APPENDIX B

REVISED SOE GUIDELINES

Guidelines—Investment by state-owned enterprises—Net benefit assessment[39]

The following guidelines are issued by the Minister responsible for the administration of the *Investment Canada Act* (the "Act"), under the authority of section 38 of the Act, to inform investors of certain procedures that will be followed in the administration of the review and monitoring provisions of the Act where the investors are state-owned enterprises (SOEs).

Recognizing that increased capital and technology would benefit Canada, the purpose of the Act is "to encourage investment in Canada by Canadians and non-Canadians that contributes to economic growth and employment opportunities and to provide for the review of significant investments in Canada by non-Canadians in order to ensure such benefit to Canada."

For the purposes of these guidelines, an SOE is an enterprise that is owned, controlled or influenced, directly or indirectly by a foreign government.

As currently required by the *Investment Canada Regulations*, in their applications for review, non-Canadian investors, including SOEs, are required to identify their controller, including any direct or indirect state ownership or control.

It is the policy of the Government of Canada to ensure that the governance and commercial orientation of SOEs are considered in determining whether reviewable acquisitions of control in Canada by the SOE are of net benefit to Canada. In doing so, investors will be expected to address in their plans and undertakings, the inherent characteristics of SOEs, specifically that they are susceptible to state influence. Investors will also need to demonstrate their strong commitment to transparent and commercial operations.

The Minister will apply the principles already embedded in the Act to determine whether a reviewable acquisition of control by a non-Canadian who is an SOE is of net benefit to Canada. Under the Act, the burden of proof is on foreign investors to demonstrate to the satisfaction of the Minister that proposed investments are likely to be of net benefit to Canada.

When assessing whether such acquisitions of control are of net benefit to Canada, the Minister will examine, as part of the assessment of the factors enumerated in section 20 of the Act, the corporate governance and reporting structure of the non-Canadian. This examination will include whether the non-Canadian adheres to Canadian standards of corporate governance (including, for example, commitments to transparency and disclosure, independent members of the board of directors, independent audit committees and equitable treatment of shareholders), and to Canadian laws and practices, including adherence to free market principles. The Minister will assess the effect of the investment on the level and nature of economic activity in Canada, including the effect on employment, production and capital levels in Canada. The examination will also cover how and the extent to which the non-Canadian is owned, controlled by a state or its conduct and operations are influenced by a state.

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[39] *Available at* http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#state-owned.

Furthermore, the Minister will assess whether a Canadian business to be acquired by a non-Canadian that is an SOE will likely operate on a commercial basis, including with regard to:

- where to export;
- where to process;
- the participation of Canadians in its operations in Canada and elsewhere;
- the impact of the investment on productivity and industrial efficiency in Canada;
- support of on-going innovation, research and development in Canada; and
- the appropriate level of capital expenditures to maintain the Canadian business in a globally competitive position.

Specific undertakings related to these issues may assist to supplement a non-Canadian's plans for the Canadian business. Examples of undertakings that have been used in the past and could be used in the future, include, among other undertakings, the appointment of Canadians as independent directors on the board of directors, the employment of Canadians in senior management positions, the incorporation of the business in Canada, and the listing of shares of the acquiring company or the Canadian business being acquired on a Canadian stock exchange. Appropriate monitoring will be conducted in accordance with the ICA.