

# Canada: Open for Investment

Regulatory Update

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In the last year, Canada has continued to signal its openness to foreign investments, including investments by Chinese and other foreign SOEs in Canada's important oil and gas and chemicals sectors. This was to be expected in light of Canada's historic receptiveness to foreign investment and as a result of the overall policy signals from the government. These developments occurred in the midst of changes to Canada's legislative structure for reviewing foreign investments which raised certain thresholds for economic transaction reviews but also raised some potentially complex issues in relation to a new law on national security.

In March 2009, the Canadian Government passed Bill C-10 which, among other things:

- > introduced a national security screening mechanism for foreign investments into Canada;
- > raised the economic review thresholds for foreign investments under the *Investment Canada Act* (ICA) (subject to the yet-to-occur implementation regulation); and
- > enacted the National Security Regulations which establish timelines for national security reviews.

Canada also raised the size-of-transaction test in the Competition Act (CA) to CDN\$70 million (the CDN\$400 million size-of-parties test was not changed).

Foreign investors will no doubt welcome the overall expected reduction in investment reviews under the ICA, when the changes to the economic review thresholds come into force, as well as the increase in the CA's size-of-transaction threshold. However, some investors may have concerns regarding the uncertain prospects of a national security review under the ICA. State-owned investors may also be sensitive to the Canadian Government's increased focus on SOE investments.

### INVESTMENT CANADA ACT

The most significant change to the ICA is the establishment of a national security review process as this has triggered concern about whether the new law, which is very broad, will be applied only in rare cases. Also, due to the lack of a voluntary clearance mechanism, investors may be forced to assume some degree of post-closing risk.

### National Security Review Process

A national security review may be launched where the Government regards a foreign investment as potentially "injurious to national security". If it concludes that there is such a threat, the Government can prohibit or attach conditions to a foreign investment, whether an investment in an existing Canadian business or the establishment of a new Canadian business). If the investment is already completed, the Government's powers include the ability to order the divestiture of a Canadian business. It is important to note that this mechanism for national security review is

separate from the existing economic review process that, if the applicable threshold is met, requires Ministerial approval of foreign acquisitions of control of Canadian businesses on the basis that they are of “net benefit to Canada”.

### **Issues**

The national security amendments to the ICA raise a number of issues, including the following.

#### **■ National Security is Undefined**

The ICA does not define “national security”. The Government has not provided any meaningful guidance on the factors it will consider when determining whether there is a national security issue. The concern that national security will be interpreted expansively (beyond obvious defence-related concerns) is heightened by the large and varied group of governmental departments and agencies listed in the National Security Review of Investments Regulations (the “National Security Regulations”) including the Department of Canadian Heritage, the Department of Natural Resources, the Department of Transport, the Canada Revenue Agency, the Department of Public Works and Governmental Services and the Department of Finance, in addition to the more obvious agencies such as the Department of National Defence and the Canadian Security Intelligence Service.

#### **■ Small Transactions and Other Investments are Subject to the New Law**

Unlike the case in economic reviews under the ICA, the new national security review law applies to minority investments. Under the new law, the government may order a review if the business in question carries on any part of its operations in Canada and has any of: a place of operations in Canada; one or more individuals who are employed or self-employed in connection with the operations; or assets in Canada used in carrying on the operations.

#### **■ No Process for Voluntary Pre-Clearance**

The ICA does not provide a pre-clearance process for national security issues. However, in some cases the National Security Regulations provide for a statutory limitation on the Minister’s ability to act after a certain date. In some cases it may be possible to have the limitation period expire before closing. If this is not possible, there will be some (in most cases minimal) risk of a post-closing national security review and remedies including divestiture

#### **■ State-Owned Enterprises (SOEs)**

It is generally thought that the genesis of the national security law was the proposed acquisition of Canadian nickel miner Noranda Inc. by China Minmetals in 2004. Although that transaction did not proceed, it did generate debate about the role of national security considerations under the ICA.

In December 2007 the government issued guidelines on how it will apply the “net benefit to Canada” test to investments by SOEs that were being reviewed under the economic review provisions of the ICA (not the new national security law that was not then in force). In addition to the factors that the Minister of Industry typically considers in deciding whether to approve reviewable investments, the SOE Guidelines indicate that the governance and commercial orientation of SOEs will be considered.

With respect to governance, the SOE Guidelines state that the SOE’s adherence to Canadian standards of corporate governance will be assessed, including any commitments to transparency and disclosure, independent directors, audit committees and equitable treatment of shareholders, as well as compliance with Canadian laws and practices. The Minister will also consider how and to what extent the investor is controlled by a state.

With respect to the commercial orientation, the SOE Guidelines state that the following will be relevant: (i) destinations of exports from Canada, (ii) whether processing will occur in Canada or elsewhere, (iii) the extent of participation of Canadians in Canadian and foreign operations (iv) the support of on-going innovation, research and development; and (v) planned capital expenditures in Canada.

Finally, the SOE Guidelines outline the types of binding commitments or undertakings an SOE may be required to provide to pass the “net benefit” test. While many of these include commitments required by any foreign purchaser, of particular interest is the potential requirement to list the shares of the acquiring company or the target Canadian business on a Canadian stock exchange.

### ***Mitigating Considerations***

Despite the uncertainty generated by the introduction of the national security review process in Canada, foreign investors should in most cases not be overly concerned for a number of reasons.

#### **■ No National Security Reviews to Date**

There has apparently not been even one national security review since the new law came into force a year ago. Moreover, even under the “net benefit to Canada” test that is applicable to economic reviews, there has only been one non-cultural investment rejected in the quarter century since the ICA came into force (the ATK MDA aerospace transaction).

#### **■ Canada has an Open Economy**

Canada’s economy has historically been open to foreign investment. In 2009 (not a particularly active year for global foreign investment) 22 transactions were approved by the Minister of Industry under the economic review provisions of the ICA including three significant investments by SOEs: (i) China National Petroleum Corporation’s acquisition of control of Athabasca Oil Sands Corp, (ii) Korea National Oil Corporation’s acquisition of Harvest Energy Trust and (iii) Abu Dubai’s International Petroleum Investment Co’s acquisition of NOVA Chemicals Corporation. Also, China Investment Corporation’s acquisition of a 17% interest in Teck Resources Limited was successfully completed in 2009.

### ***New Threshold for Economic Reviews***

As noted above, under the ICA, the Industry Minister is required to approve acquisitions of control of Canadian businesses that meet certain monetary thresholds on the basis that they are of “net benefit to Canada”. The new World Trade Organization (“WTO”) review threshold for direct acquisitions<sup>1</sup> of Canadian businesses (that are not engaged in cultural activities) under the ICA will (when implementing regulations come into force) be increased from the current CDN\$299 million of assets to CDN\$600 million in “enterprise value” (to be defined in the implementing regulations). The new enterprise value review threshold will gradually increase to CDN\$1 billion over the next several years. It is anticipated that this will result in a significant reduction in the number of foreign investments that are subject to economic review under the ICA.

### ***Compliance with ICA Undertakings***

Foreign investors are generally required to give legally binding undertakings regarding various aspects of the Canadian business (e.g., employment levels, capex and R&D expenditures) that will run for 3 – 5 years after closing. Issues regarding compliance with undertakings are generally resolved through discussions with the Investment Review Division and, potentially, agreed remedial

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<sup>1</sup> A direct acquisition is the acquisition of substantially all the assets of a Canadian business or of the voting interests of an entity in Canada that carries on a Canadian business. By contrast, an indirect acquisition is the acquisition of the voting shares of a non-Canadian corporation that controls, directly or indirectly, an entity in Canada carrying on a Canadian business.

action. However, undertakings to the Canadian Government may be enforced through the courts in extreme cases.

For the first time in the history of the *Investment Canada Act*, the Industry Minister has brought judicial proceedings to enforce undertakings. In July 2009, the Minister announced that he had commenced a court application against United States Steel Corporation and US Steel Canada Inc. (collectively, “US Steel”) for an order mandating compliance with two undertakings given in respect of US Steel’s acquisition of Stelco Inc. (Stelco) in the fall of 2007.<sup>2</sup> US Steel has taken the position that it has not breached the undertakings and that its inability to meet the undertakings was a result of factors beyond its control. While this development is significant, there are reasons to believe that the facts in this case are extraordinary and that the Government will not be taking such action on a regular basis. Nevertheless, the US Steel serves as a reminder that the Government takes compliance with its undertakings seriously and will closely monitor an investor’s progress in fulfilling its undertakings.

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<sup>2</sup> In its application, the Government alleges that US Steel has failed to comply with its commitments to the Canadian Government in respect of employment and production at its Canadian facilities and did not remedy such defaults or explain them to the Minister’s satisfaction in response to the Minister’s demand letter. The Government has also requested that the court impose a fine of \$10,000 per day for the alleged breach of the undertakings.