FOREIGN INVESTMENT LAW & NATIONAL SECURITY

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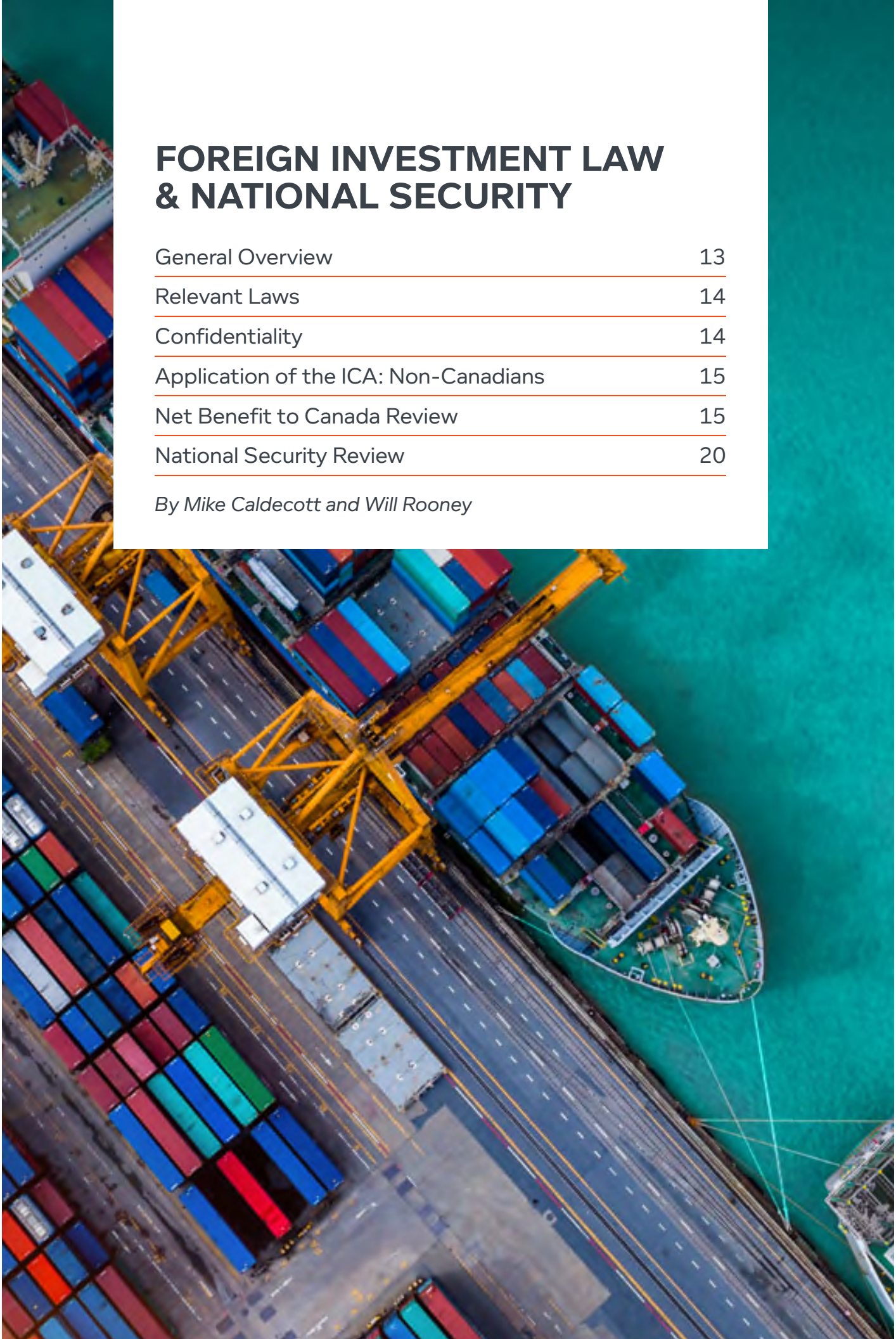

FOREIGN INVESTMENT LAW & NATIONAL SECURITY

General Overview

Canada's foreign investment review regime is set out in the *Investment Canada Act* (ICA). There are two separate processes contemplated by the ICA: (i) economic and/or cultural review of specified investments ("net benefit regime"), which is a mandatory and suspensory review process required for investments that exceed certain prescribed financial thresholds. Where the thresholds are not exceeded, an investment may still be subject to a technical notification requirement under the net benefit regime, and (ii) national security review.

THERE ARE TWO DIFFERENT ENFORCEMENT REGIMES CONTEMPLATED BY THE ICA: (I) REVIEW OF SPECIFIED INVESTMENTS FOR THEIR NET BENEFIT TO CANADA, AND (II) NATIONAL SECURITY REVIEW.

The ICA net benefit regime applies whenever a non-Canadian investor: (i) acquires control of a Canadian business; or (ii) establishes a new Canadian business, whereas the ICA national security regime applies to any investment (including minority investments) into entities carrying on all or any part of its operations in Canada.

The ICA's suspensory net benefit provisions are triggered where certain investments by a non-Canadian in a Canadian business surpass specified thresholds. These thresholds vary depending on the identity of the investor and if the Canadian business is engaged in cultural activities as defined in the ICA (in the latter case, the applicable thresholds are significantly lower).

Where a qualifying investment is not subject to suspensory net benefit review, the investor will be required to submit a **technical notification**, which applies to all direct and indirect acquisitions of control of Canadian businesses (and the establishment of a new Canadian business). This process requires the filing of a relatively short information form either before or within 30 days after completion of the transaction.

The ICA's **national security** provisions have the broadest scope. The ICA provides the Canadian government with the power to review any equity or asset investment by a non-Canadian (including non-controlling interests) involving a Canadian entity on national security grounds.

Transactions can be approved (with or without conditions), blocked or unwound by the government. The ICA's national security provisions apply to acquisitions of entities that do not constitute "Canadian businesses" and most corporate reorganizations (even where there is no change in ultimate control).

Importantly, investments by investors whom the Canadian government considers foreign State-Owned Enterprises (SOEs) — and those into entities active in Canada that operate in certain, more sensitive sectors — receive special attention under the ICA and related policy documents.

Legislative amendments with respect to the ICA's national security regime have been introduced to the federal Parliament that would change many aspects of the current regime. These possible amendments, which are not anticipated to be enacted before Q1 2024 at the earliest, are discussed further below.

Relevant Laws

The ICA is the only federal foreign investment law of general application in Canada. The ICA is supported by two relevant sets of regulations: the *Investment Canada Regulations* (SOR/85-611) and the *National Security Review of Investments Regulations* (SOR/2009-271).

In addition to the ICA's framework, certain statutory provisions restrict foreign investment and ownership in specific areas, including the financial services, air transportation, and broadcasting and telecommunications sectors. There are also foreign investment disincentives for media (including film) and publishing.

Separately, the *Competition Act* (Canada) also regulates investments with a nexus to Canada. Compliance with provisions of the ICA does not bar review or action by Canada's Competition Bureau under the merger provisions of the *Competition Act*. See **Competition Law**. Additionally, investments in transportation businesses that raise public interest issues that exceed the *Competition Act*'s pre-merger notification thresholds may also be subject to the *Canada Transportation Act*'s pre-closing review.

Confidentiality

Information submitted under the ICA is treated as confidential and, subject to narrow exceptions, will not be disclosed to the public. Such

information is exempt from *Access to Information Act* requests.

Information provided by an investor can be shared with other investigating agencies within Canada. However, in general, information provided in the context of an investment review is protected from disclosure to other government agencies unless necessary for the purposes of the administration and enforcement of the ICA.

In the context of a national security review, the government may communicate with prescribed investigative bodies, who may themselves disclose the information to others for the purposes of that agency's investigation. The government also shares information with foreign agencies conducting parallel national security investigations. Typically such co-ordination can be expected with Canada's close allies (e.g., the "Five Eyes" countries).

Application of the ICA: Non-Canadians

The ICA applies only to investments proposed or implemented by non-Canadians. If the investor's ultimate controller is a Canadian, the ICA does not apply. A 'Canadian' is defined as: (i) a Canadian citizen or permanent resident; (ii) the Canadian government (including agencies and provincial or local governments); or (iii) a Canadian-controlled entity (based on the nationality of the person or persons that ultimately control the investor).

Net Benefit to Canada Review

Application: Acquisition of Control of a Canadian Business

As noted above, certain investments that meet prescribed thresholds are subject to mandatory and suspensory review under the net benefit regime. The net benefit regime captures acquisitions of control of a Canadian business.

THE "NET BENEFIT" REVIEW THRESHOLD CHANGES IF THE INVESTOR IS A STATE-OWNED ENTERPRISE.

An **acquisition** can occur in one of three forms, in each case by a non-Canadian: (a) the acquisition of voting shares of a corporation incorporated in Canada; (b) the acquisition of voting interests of a non-share capital corporation, partnership, trust or joint venture carrying on that business, or (c) the acquisition of substantially all of the assets used to carry on that business).

A **Canadian business** is defined as a business carried on in Canada that (a) has a place of business in Canada; (b) employs persons in Canada in connection with the business; and (c) uses assets in Canada to carry on the business.

Non-Cultural Review

Direct acquisitions of control of a Canadian business that is not a cultural business (as defined in the next subsection) are subject to a review as to whether the transaction is of net benefit to Canada, if certain financial thresholds are met. For such transactions, review and approval of the investment by the Minister of Innovation, Science and Industry must occur before the transaction can close. Indirect acquisitions of a non-cultural Canadian business, on the other hand, are subject only to a technical notification, which can be made before or within 30 days after closing.

The threshold to trigger review for an acquisition of a non-cultural Canadian business depends on the identity of the investor. The threshold for a "trade agreement investor" (a person or entity from countries with which Canada has specified trade agreements) is higher than that for a "WTO Investor" (a person or entity from countries, other than Canada, that are members of the World Trade Organization). The thresholds, calculated using book values based on the most recent audited financial statements, are:

— C$1.931 billion (2023) in enterprise value of the target where the acquiror, or the target is a non-SOE "trade agreement investor," (e.g. from the United States or the European Union) or

— C$1.287 billion (2023) in enterprise value of the target where the non-SOE acquiror or target are controlled in other WTO member states (such as investors controlled in China).

The net benefit review threshold changes if the investor is a SOE. Investments by entities ultimately controlled by an SOE are subject to review where the book value of the assets of the Canadian business is C$512million (2023) or more.

The definition of a SOE under the ICA is broad. A SOE is defined to include an entity controlled or influenced, directly or indirectly, by a government or agency of a foreign state. In addition to this flexible

definition, the Minister of Innovation, Science and Industry has the power to retroactively determine that an entity is controlled in fact by a SOE, as well as to determine retroactively whether there has been an acquisition of control in fact by a SOE.

Cultural Review

The ICA provides a parallel net benefit review regime to investments involving businesses with a nexus to Canadian "cultural heritage and national identity." This includes book publishing, magazine and newspaper publishing, film production and distribution, music production and distribution, television, and radio. The Canadian government has interpreted this term broadly, including other activities that are not listed but analogous, such as video games, the exhibition of video content on online media and other digital activities.

Unlike non-cultural net benefit review, the review of a cultural business has both a broader scope and lower thresholds. Where a non-Canadian seeks to acquire control of a Canadian cultural business, directly or indirectly, review and approval by the Minister of Canadian Heritage is required provided the following thresholds (calculated using book values based on the most recent audited financial statements) are met:

— Where there is a direct acquisition of control of a Canadian cultural business (i.e., the target transacting entity is Canadian-domiciled), the book value of the assets of the Canadian business is C$5 million or more.

— Where there is an indirect acquisition of control of a Canadian business if either: (i) the Canadian business has assets of C$50 million or more in value; or (ii) the Canadian business represents more than 50% of the assets of the acquired group of entities and the Canadian business has assets of C$5 million or more in value.

Direct acquisitions of a cultural business that exceed the applicable threshold must be reviewed and approved prior to closing. For indirect acquisitions, the transaction can be reviewed and approved on a post-closing basis.

Note, even if an acquisition or establishment of a cultural business does not trigger the review threshold, Federal Cabinet may, nonetheless, order a review if it considers it to be in the public interest.

Procedure and Substantive Review

Where an investment is subject to net benefit review, the investor must submit an application for review to the relevant Minister (for cultural business, the Minister of Canadian Heritage, and for non-cultural businesses, the Minister of Innovation, Science and Industry). The application contains two basic elements:

— Basic information set out in the application form (i.e., background on the investor, its ultimate controller and the Canadian business being acquired); and

— a detailed business plan for the Canadian business post-merger that covers topics relevant to Canada's economic interest, including: employment, Canadian representation in management, the business' presence in Canada, continued investment in the Canadian business, and R&D.

Typically, the business plan will make reference to the historical performance of the Canadian business as a reference point for the relevant Minister to assess the investor's proposal.

Clearance under the net benefit review regime requires the relevant Minister to be satisfied, or deemed to be satisfied, that the investment "is likely to be of net benefit to Canada."

In determining "net benefit to Canada," the relevant Minister must consider:

— the effect of the investment on the level and nature of economic activity in Canada;

— the degree and significance of participation by Canadians in the Canadian business and the industry of which it forms a part;

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

— the effect of the investment on competition within an industry in Canada;

— the compatibility of the investment with national industrial, economic and cultural policies; and

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

In the context of cultural investment review, the relevant Minister must take into account the goal of the Department of Canadian Heritage to promote Canadian content across various forms of media.

Where a net benefit review is triggered, the relevant Minister has until 45 days after the complete application is received to determine whether the investment is likely to be of net benefit to Canada. The relevant Minister may, and typically does, unilaterally extend their review by 30 calendar days. Further extensions can, and very often do, occur with the consent of the investor.

For this reason, timelines for net benefit reviews can be protracted. In 2021-2022 (the most recent year for which data was available), eight non-cultural businesses were subject to review. The average assessment time was 88 days. In 2019-2020 (the most recent year for which data is available), five cultural investments were subject to automatic review by the Department of Canadian Heritage. The average assessment time for applications for review was 143 days.

If the relevant Minister initially decides that the investment will not be of net benefit to Canada, the non-Canadian will be given an opportunity to make representations and submit undertakings with respect to the investment with a view to satisfying these requirements. In most net benefit reviews, the investor will be required to provide binding undertakings to the relevant Minister, typically relating to domestic economic factors like employment in Canada, capex spending in Canada, maintaining Canadians in leadership positions and retaining Canadian IP rights.

THE CANADIAN GOVERNMENT HAS ALSO ISSUED GUIDELINES FOR THE REVIEW OF INVESTMENTS BY FOREIGN STATE-OWNED ENTERPRISES.

SOE Investments

The Canadian government has promulgated a number of policy statements that specifically apply to SOEs. Some are sector specific. Government policy statements explain that investments by SOEs in the oil sands or in critical minerals will only rarely be found to be of net benefit to Canada. Other guidance relates to the identity of the investor. Specifically, the *Policy Statement on Foreign Investment Review and the Ukraine Crisis* states that investments by Russian SOEs will be found to be of net benefit to Canada on an "exceptional basis only."

Apart from this specific guidance, Canadian government has also issued general guidelines for the review of investments by SOEs. The guidelines articulate specific factors that the relevant Minister will examine as part of his or her assessment of the net benefit factors listed above. The guidelines reflect the potential concerns the relevant Minister may have regarding the "governance and commercial orientation of the SOE." The relevant Minister will examine:

— The corporate governance and reporting structure of the SOE, including whether it adheres to Canadian standards of corporate governance. This includes commitments to transparency and disclosure, independent members of the board of directors, an independent audit committee, equitable treatment of shareholders and adherence to Canadian laws and practices.

— Whether the Canadian business to be acquired by the SOE will continue to have the ability to operate on a commercial basis and specify a number of important indications. These include where exports go, where processing takes place, the participation of Canadians in the operations and the level of capital expenditures to maintain the Canadian business.

A SOE can therefore anticipate that it may be required to provide undertakings beyond those normally expected of a non-SOE in order to secure approval by the relevant Minister. Indeed, the Canadian government will expect that a SOE investor address its inherent characteristics (specifically that it is susceptible to state influence) in its plans for the Canadian business to be acquired and related undertakings.

National Security Review

The Canadian government has the authority to review all proposed investments (regardless of size and whether control was acquired) that involve a non-Canadian where the responsible Minister has "reasonable grounds to believe that an investment by a non-Canadian could be injurious to national security."

For notifiable investments, the Canadian government has jurisdiction to initiate review the proposed transaction from any time that it becomes aware of the investment up until 45 days after receipt of a complete notification by the investor. For investments that are not subject to mandatory notification, the Canadian government's jurisdiction to review

an investment on national security grounds expires five years after the implementation of the investment (unless the investment is voluntarily notified by the investor, which shortens this timeline to 45 days).

A national security review can occur — on the government's initiative — before or after closing. Where a review is commenced prior to closing, there is suspensory effect (i.e., the investor cannot close the transaction until the national security review is complete). A national security review proceeds in several phases and may take up to 200 days (or longer, subject to any agreed-on extensions). In broad strokes, the review proceeds as follows:

— **Notice of Review.** The responsible Minister can issue a notice to the investor that a national security order may be made to obtain an addition 45 days to decide whether to launch a national security review.

— **Formal National Security Review.** If the responsible Minister has reasonable grounds to believe that the investment could be injurious to national security, the responsible Minister may refer the matter to Federal Cabinet for an order initiating a formal national security review, extending the review by another 45 days. This review period may be extended without the investor's consent by a further 45 days. Subsequent extensions of 45 days require the investor's consent (which in practice is not usually withheld).

— **Ultimate Determination from Federal Cabinet.** At the end of the review period, the responsible Minister can refer the matter to Federal Cabinet along with a recommendation. Federal Cabinet has 20 days to decide whether to approve the investment (with or without conditions) or prohibit the transaction (if pre-closing), or require the investor to divest itself of the Canadian business (if post-closing).

When to Notify: Mandatory Filings

As noted above, the Canadian government's jurisdiction to review an investment on national security grounds expires either: (i) five years after the implementation of the investment (where the investment is not notifiable); or (ii) 45 days after the responsible Minister becomes aware of the transaction or is deemed to become aware of the transaction by virtue of receipt of a complete "notification."

As a notification can be submitted either before or after closing, the choice of when to file is a key strategic decision. The commencement of

the national security review process is suspensory; an investor cannot close a transaction if there is a review ongoing. Typically, where there is national security risk, filing prior to closing is more buyer-friendly, since it will crystallize the possibility of intervention prior to the buyer taking ownership of the target. By contrast, sellers generally prefer to file a notification after closing, to avoid having to participate in any ensuing national security review.

That said, the Canadian government does not currently have the ability to impose interim conditions on the investor (i.e. limiting the ability of the investor to integrate and run the target business as it wishes pending the outcome of the review). Therefore, after closing, the purchaser will have full enjoyment of the business until a final determination is made with respect to the national security review. For this reason, where there is little or no national security risk, it is often preferable to the buyer to notify after closing.

Whether to Notify: Voluntary Filings

There are numerous investments that do not require review or notification under the net benefit regime but which are subject to the jurisdiction of the national security regime. For that category of investments, the investor must choose whether to pursue "voluntary notification."

Voluntary notification provides investors with the ability to avoid timing uncertainty. Without notification, the responsible Minister will have five years post-closing to challenge the investment. Submitting a voluntary notification limits the responsible Minister to 45 days to decide whether or not to begin a national security review. Provided this timeline is built into the relevant transaction documentation, the investor can crystallize any possible national security risk in Canada by filing on a voluntary basis with sufficient time to enable the 45-day intervention period to expire.

National Security: Substantive Assessment

There is no definition of what constitutes "injurious to national security" under the ICA. However, certain industries are likely to attract greater scrutiny. Businesses with exposure to technology, critical infrastructure, essential products and services, critical minerals, defence, and/or Canadians' sensitive personal data all raise greater risk of national security review. The Canadian government's *Guidelines on the National Security Review of Investments*, updated in 2021, includes a non-

exhaustive list of activities that may relate to national security. Although these guidelines provide some insight as to when a national security review may occur, there are notable gaps and foreign investors often receive limited transparency during the national security review process. If the Canadian government believes that a transaction may be injurious to national security, the transaction can be blocked, subjected to conditions, or, if already implemented, subjected to remedies, which can include divestiture.

Government data published in 2022 covering reviews in 2021-2022 year showed the highest ever number of national security reviews. While the responsible Minister issued the same number of national security "notices" (used by the government to extend the time available to consider whether a full national security review is warranted) as in the previous year (24 in total), they issued the highest number of national security review orders yet (12). Put differently, 50% of notices resulted in an extended national security review (which can last for 200 days or more). Of these 12 extended reviews, four investors originated from Russia, and six from China. Despite the presence of investors from higher-risk jurisdictions in these cases, the final outcomes of the 12 extended national security reviews were more permissive than in prior years. Seven of the 12 were cleared unconditionally; and only four were abandoned (likely pre-empting a prohibition or divestiture order).

Special Considerations for SOEs

Consistent with the guidance on SOEs that applies to the net benefit regime, guidance on national security specifically addresses SOEs. In general, investments by SOEs are subjected to enhanced scrutiny under the national security regime, particularly in respect of investors from non-allied jurisdictions.

Moreover, parallel subject-matter-specific and investor-specific considerations also apply to SOEs under the national security regime, similar to those that apply under the net benefit regime. Investments by SOEs in critical minerals are more likely to be subjected to "heightened" national security scrutiny, as will investments by Russian SOEs.

Anticipated Amendments to National Security Review

On December 7, 2022, a series of proposed amendments were introduced by the federal government for debate by Canada's House of Commons.

The amendments, if passed, will make a series of significant changes to Canada's national security regime. There is currently no specific timeline for their coming into force, but at the time of publication, they are not anticipated to be enacted until the first half of 2024. Specifically, they will add:

— **Interim Conditions.** The ability for the responsible Minister to impose conditions on the investor pending the completion of the national security review process.

— **Mandatory Pre-Implementation Notification for Specified Investments.** For investments in prescribed industries (a term yet to be defined, but likely to include more sensitive business sectors) where the investment could result in the investor obtaining access to specified information and where the acquisition entitles the purchaser to certain rights, mandatory notification prior to implementation would be required.

— **Conditional Approval by the Minister.** Under the present national security regime, binding undertakings can only be imposed on the investor via an order from federal Cabinet. The new amendments would allow the Minister to conditionally approve investments, subject to binding undertakings. This would remove the need for the Minister to seek Cabinet input in respect of a final national security decision in cases where they consider mitigation to be appropriate to resolve the identified concerns.

Investors are advised to seek counsel's advice to ensure they remain abreast of the latest developments in Canada's national security regime.

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