



AUGUST 2010

UPDATE ON FOREIGN INVESTMENT IN CANADA

BY SANDY WALKER

Over the past year Canada has witnessed a number of significant developments in its foreign investment review process. In particular:

- the monetary threshold for review of foreign investments under the *Investment Canada Act* (the “ICA”) will be significantly increased;
- the Canadian Government established a regime to screen foreign investments based on national security concerns;
- several acquisitions by foreign state-owned investors were approved pursuant to guidelines applicable to such investors; and
- the Canadian Government filed its first lawsuit against a foreign investor for an alleged failure to comply with undertakings.

NEW THRESHOLD FOR REVIEW

Under the ICA, Canada’s federal Industry Minister is required to review and approve acquisitions of control of Canadian businesses that meet certain monetary thresholds if they are of “net benefit to Canada.” The new review threshold for direct acquisitions¹ of Canadian businesses not engaged in cultural activities² will be increased from CDN\$299 million in book value of the assets of the target Canadian business, to CDN\$600 million in its “enterprise value” (“EV”), once implementing regulations are in force. (If the regulations are implemented in 2010, the threshold will climb to

¹ A “direct acquisition” involves the direct acquisition of a Canadian entity (a corporation, trust, joint venture or partnership) or substantially all the assets of a Canadian business.

² A “cultural business” includes the publication, distribution or sale of books, magazines, newspapers, and the production, exhibition, distribution or sale of film and music recordings.

CDN\$800 million in 2012 and then to CDN\$1 billion in 2014.) Draft regulations issued by the Government in 2009 define EV, but are still under internal review following a public consultation period.

If the draft regulations are finalized as currently drafted, the review threshold would almost double for private company acquisitions and asset acquisitions, and would more than triple in four years. For investments in Canadian publicly traded entities, the revised review threshold is anticipated to capture fewer such transactions than previously.

NATIONAL SECURITY REVIEW PROCESS

Under the new national security regime, 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, Cabinet may order a divestiture.

Uncertain Scope of “National Security” Review

Foreign investors may be surprised to learn that the scope of “national security” is not defined nor are there plans to provide guidance. Without any criteria, Cabinet has wide discretion to determine the relevant risk factors. If guidance issued in respect of the U.S. national security review process (undertaken by the Committee on Foreign Investment in the U.S. (“CFIUS”)) is followed in Canada, targets in sectors such as critical infrastructure, critical technology and energy would merit closer scrutiny, as would investments by foreign government entities.

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 harbour for transactions that fall below the review threshold noted above, and minority investments are subject to review whether or not they constitute an acquisition of “control.”

Foreign investors into Canada may be concerned that there is no formal mechanism to obtain pre-clearance of these transactions on national security grounds. However, early submission of a filing (either an application for review or a notification) required under the general ICA provisions (*i.e.*, not related to national security) will trigger a 45-day period during which the Minister must give notice of a national security review or possible review. The only 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. If a national security review is invoked, investors can expect potentially significant delays, adding as much as 130 days (and possibly more) if the maximum prescribed periods are fully utilized.

An Assessment to Date

The national security review process has generated some anxiety among foreign investors but, in fact, the Government has not yet prohibited a transaction on national security grounds. It seems likely that the current Government's interpretation of "national security" will be more circumscribed than the broad range of industries potentially subject to review by CFIUS. Over the past year, the Government considered acquisitions in various Canadian sectors that could, in theory, have fallen within sensitive U.S. categories, including the acquisition of Canadian technology icon, Nortel, and energy (including oil sands) companies, without apparently requiring any mitigating measures by the acquirer. Moreover, there is little evidence that prior to the establishment of the national security regime, the Government had a frustrated desire to challenge numerous transactions. For example, Dubai Ports World's proposed acquisition of P&O's port services business in 2006 ignited a highly political debate in the U.S., but was quietly approved in Canada. Although national security review did not exist in 2006, the absence of specific statutory authority to block transactions on this basis did not prevent the Government from prohibiting ATK's proposed acquisition of MacDonald, Dettwiler and Associates Ltd. in 2008, for reasons that could be characterized as "national security" (among other rationales reported in the media, the protection of Canadian sovereignty in the Arctic) under the "net benefit" test.

With that said, Canadian politicians of all political stripes have, over the past few years, become more aware of the potential to use the ICA to political advantage. As a result, we may yet see "national security" concerns used to justify a review of a transaction that is unpopular and not otherwise reviewable under the "net benefit" approval process. Moreover, it should be noted that Industry Canada may have intervened on national

security grounds in a proposed transaction in 2009 involving the purchase by a Belgian company of a Canadian company, Forsys Metals Corp., whose only asset was a uranium project in Namibia. While there has been no public confirmation that national security was invoked, the parties were advised by Industry Canada not to close, pending further notice, despite the fact that the target appeared to fall below the review threshold under the ICA's "net benefit" review process. The parties ultimately abandoned the transaction and it is unclear whether a national security review was ever initiated.

In summary, given the potentially expansive boundaries of "national security," foreign investors contemplating investments in a sector potentially linked to national security should consult with legal counsel to consider early confidential discussions with the Canadian Government to assess and address any potential concerns.

ACQUISITIONS BY STATE-OWNED ENTERPRISES ("SOEs")

Industry Canada reviewed and approved a number of transactions in the past year where the investors were state-owned. These included: the acquisition of Nova Chemicals by International Petroleum Investment Company (owned by the Abu Dhabi government); Korea National Oil Corp.'s acquisition of Harvest Energy; PetroChina's acquisition of interests in two oil sands projects owned by Alberta Oil Sands Corp.; and Sinopec's acquisition of a company holding a 9% interest in oil sands producer, Syncrude Canada Ltd.

The minority (17%) 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.

The Ministerial approvals noted above confirm that the Government is not inherently hostile to state-owned acquirers. In addition, it is clear that the Government does not automatically presume that SOE investments raise national security concerns. Both of these developments should comfort SOEs wishing to invest in Canada.

SOE Guidelines

Reviewable transactions by state-owned investors are subject to Industry Canada's guidelines on the application of the "net benefit" test to SOEs (the "SOE Guidelines"). An SOE is defined as an enterprise "that is owned or controlled directly or indirectly by a foreign

government.” In addition to the general criteria (e.g., the impact of the investment on employment in Canada, on Canadian participation in senior management and on the level of capital expenditures in Canada), the SOE Guidelines outline two broad considerations the Government will consider in reviewing SOE investments: the SOE’s governance and commercial orientation. In particular, the Government will scrutinize whether the SOE adheres to Canadian standards of corporate governance, including the level of transparency and the presence of independent members of the board of directors and audit committees. With respect to the commercial orientation criterion, the Government will evaluate whether the SOE will operate the target Canadian business according to free market principles. It is highly likely that the Government will seek binding commitments or “undertakings” from the SOE acquirer in respect of corporate governance and commercial orientation.

serves as a reminder to foreign investors that the Canadian Government takes undertakings very seriously and monitors compliance.

CONTACT US

If you would like further information on any of the above issues, please contact [Sandy Walker](#) of our [National Competition | Antitrust Group](#).

COMPLIANCE WITH UNDERTAKINGS

For the first time in the history of the ICA, in July 2009, the Industry Minister sued an investor to enforce undertakings given in respect of a foreign investment. The Canadian Government applied for an order against U.S. Steel mandating compliance with “undertakings” made in respect of U.S. Steel’s acquisition of Stelco in 2007. The Government alleges that U.S. Steel failed to comply with its commitments relating to employment and production at its Canadian facilities. The Canadian Government has also requested that the court impose a fine of \$10,000 per day for the alleged breach of the undertakings. In response, U.S. Steel has taken the position that it has not breached its undertakings and that its inability to meet the undertakings was a result of factors beyond its control – a type of “force majeure” that Industry Canada has frequently accepted in the past to excuse non-compliance with undertakings.

While a significant development, there are reasons to believe that the facts in this case are extraordinary, and that such a response by the Canadian Government will remain exceptional. Nevertheless, the U.S. Steel case



FRASER MILNER CASGRAIN LLP

YOUR FUTURE IS OUR BUSINESS