

CANADA MAKES CHANGES TO INVESTMENT CANADA REGIME

Posted on December 11, 2012

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On December 7, 2012, Industry Canada released widely anticipated revisions to guidelines^[1] on the review of proposed investments by foreign state-owned enterprises (SOEs) under the *Investment Canada Act* (ICA). At the same time, the Prime Minister provided additional comments about the government's proposed approach in a companion speech and the Minister of Industry approved two significant SOE acquisitions of Canadian businesses in the oil and gas sector: *China National Offshore Oil Company (CNOOC) / Nexen Inc.* and *Petroliam Nasional Berhad (Petronas) / Progress Energy Ltd.*

the Investment Canada Act

Recognizing that increased capital and technology would benefit Canada, the purpose of the ICA 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." The ICA applies when a non-Canadian acquires control of an existing Canadian business or commences a new business activity in Canada. Such transactions must either be notified to Industry Canada^[2] or, if significant financial thresholds are exceeded, be submitted for "net benefit to Canada" review. While review thresholds vary depending on the country of origin of the investor, the form of investment and the type of business conducted by the target company, the monetary threshold that typically applies is C\$330 million in asset value for direct non-cultural investments by investors from WTO countries.

previous SOE guidelines

In 2007, Industry Canada published guidelines which indicated that an SOE's governance and commercial orientation would be considered in determining whether a proposed investment is of net benefit to Canada. In addition to the general net benefit factors, these SOE guidelines stated that investors would be expected to:

- adhere to Canadian standards of corporate governance;
- adhere to Canadian laws and practices; and
- ensure that the target continued to have the ability to operate on a commercial basis regarding exports, processing, employment of Canadians, development of innovations, and the level of capital expenditures

to maintain the Canadian business in a globally competitive position.

the revised SOE guidelines

The 2012 SOE guidelines confirm or refine many of the factors noted in the previous SOE guidelines. The SOE's reporting and governance structure, commitment to transparency and to operating on a commercial basis, and willingness to proactively provide undertakings in respect of such matters will continue to be important. More specifically, the Minister will typically expect undertakings concerning:

- the appointment of Canadians as independent directors;
- the employment of Canadians in senior management positions;
- incorporation of the business in Canada; and/or
- listing of shares of the acquiring company or the Canadian target on a Canadian exchange.

The most notable change in the revised guidelines is that the definition of an SOE has been expanded to include enterprises that are directly or indirectly "influenced", rather than simply "controlled", by a foreign state. In addition, the nature and extent of the control or influence that a subject SOE is expected to exert over the proposed target and relevant industry post-transaction will be important factors.

national security review timelines

Although no specifics were provided, the Prime Minister expressed an intention to amend the ICA to provide the Minister of Industry with the flexibility to extend the time period for national security reviews in SOE cases under "exceptional circumstances". Under the ICA, the Minister may initiate a review of a transaction upon determining that it may be injurious to national security (although such reviews have been extremely rare to date). A review on national security grounds may be initiated regardless of a transaction's size, the nationality of the investor or whether the deal involves an acquisition of control or merely of a minority interest. To date, no guidance has been provided as to the types of transactions that may be injurious to national security.

ICA review thresholds

The revised SOE guidelines were accompanied by a statement that the government intends to proceed with previously announced increases of the threshold for review of most acquisitions of control of Canadian businesses. The monetary threshold for direct acquisitions of control by investors from WTO countries will be increased from C\$330 million in "asset value" to C\$1 billion in "enterprise value" over a four year period. However, in order to facilitate continuing attention to SOE issues, proposed investments by SOEs will continue to be subject to the existing C\$330 million review threshold (subject to annual adjustment to reflect changes in Canada's GDP).

the Petronas / Progress Energy and CNOOC / Nexen transactions

The announcement of the revised SOE guidelines coincided with the government's announced approval of two controversial acquisitions by foreign SOEs in the oil and gas sector: the C\$5.3 billion acquisition of Progress Energy Corp. by Malaysian state-owned oil company Petronas; and the largest foreign investment by a Chinese SOE to date, the C\$15 billion acquisition by CNOOC of Nexen Inc.

The Petronas investment was initially rejected by Industry Canada, subject to an invitation to the investor to resubmit their application. This occurred because the Minister asked Petronas for an extension for the review which Petronas declined. Although the undertakings given by Petronas have not been made public, the resubmitted application reportedly included a proposed new governance structure.^[3]

The review period of the CNOOC transaction was extended twice by Industry Canada, likely due to the size and scope of the transaction, the fact that it involved oil and gas interests and the existence of a parallel review in the United States.^[4] It appears that CNOOC's undertakings included keeping Nexen's head office in Calgary, seeking a listing on the Toronto Stock Exchange and agreeing to place some C\$8 billion of its assets under the control of Nexen's management in Canada.^[5]

Canada effectively "grandfathered" the CNOOC and Petronas deals under the previous SOE guidelines. While the Prime Minister emphasized that Canada "will maintain an open, market-based approach to foreign investment," new SOE acquisitions of controlling interests in Canadian oil sands businesses will be found to be of net benefit "on an exceptional basis only." Acquisitions by private investors will still be possible under the regular net benefit review process and acquisitions of minority interests, including joint ventures, will continue to be welcomed and assessed on a case-by-case basis. The decision not to "change the rules in the middle of the game" by applying new rules to existing applications is another reflection of the government's efforts to create a favourable climate for inbound investment.

concluding observations

The December 7, 2012 announcements highlight three critical issues relating to Canada's foreign investment policy:

- Most importantly, the government is maintaining a policy of welcoming foreign investment. The vast majority of investments into Canada occur without any significant government oversight. Since the ICA was enacted in 1985, the Canadian government has approved approximately 18,700 transactions. In 2011, there were 649 direct and indirect acquisitions and investments, with 96.8% of these occurring via notifications and only 3.2% requiring review and approval.^[6] Very few transactions have been rejected. The approval of the *CNOOC / Nexen and Petronas / Progress Energy* transactions, despite their difficulty

and sensitivity, underscore this reality.

- Second, investments by SOEs will be subject to enhanced scrutiny. The Prime Minister was clear that the efforts Canada has made to emphasize market principles and replace Canadian state involvement in the economy should not be undermined by investments by foreign SOEs. That said, the revised SOE guidelines are helpful in providing greater transparency and improved guidance on the governance and free market requirements which will need to be met.
- Finally, foreign investments in the oil sands sector will need to be structured with private capital holding control. However, SOEs will have significant scope to participate through acquisitions of minority interests and joint ventures.

In summary, the publication of revised foreign investment review process guidelines applicable to SOEs which stress the importance of free market principles and industrial efficiency in the "net benefit" analysis should be welcome news to the international investment community. The overall tone of the revised guidelines, coupled with the clearance of the *CNOOC / Nexen and Petronas / Progress Energy* transactions, are consistent with the government's track record in seeking to liberalize investment and trade including through bilateral investment/agreements as well as the ICA review regime.^[7] The clear message is that Canada is open for business.

by Neil Campbell, James Musgrove, Stephen Wortley, Martin Masse, Devin Anderson

[1] See [online](#).

[2] Investments involving Canadian cultural industries such as music, book and magazine publishing and distribution must be notified to the Department of Heritage, either alone (if the investment is entirely of a cultural nature) or concurrently with an Industry Canada filing (when only part of the investment is cultural).

[3] See for example "Progress Shares Rise on Reports Petronas Has Resubmitted Takeover Bid to Ottawa" *The Canadian Press* (16 November 2012).

[4] Nexen has offshore interests in the United States which have resulted in the transaction being scrutinized by the U.S. Committee on Foreign Investment.

[5] See [Nexen, News Release: CNOOC Limited Enters Into Definitive Agreement to Acquire Nexen Inc.](#)

[6] See "Canada: Investment Regulations", *EIU ViewsWire* (8 November 2012) at 1.

[7] See for example [Canada continues to welcome foreign investment with Investment Canada Act changes](#).

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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