

CANADA PROCEEDS WITH PROMISED CHANGES TO FOREIGN INVESTMENT REVIEW

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overview

The Canadian government's 2013 budget implementation bill (C-60) will enact a number of previously announced adjustments to the *Investment Canada Act* (ICA). The proposed amendments address three main areas:

- the long-awaited increases in the thresholds for review of most acquisitions to C\$1 billion in "enterprise value", phased-in over a four-year period;
- the manner in which state-owned enterprises (SOEs) will be defined and the introduction of additional "control in fact" tests for acquisitions by SOEs; and
- extensions to the timelines for national security reviews.

These amendments follow on the heel of the December 2012 revisions to the guidelines for assessing investments by SOEs (Revised SOE Guidelines). At the time, the government emphasized Canada's continuing openness to foreign investment generally and signalled these areas of further fine-tuning. It also approved two major SOE investments in the oil and gas sector, while noting that further investments by SOEs in the Western Canadian oil sands would likely be limited to joint ventures and minority interest transactions. (The Revised SOE Guidelines and the accompanying materials are more fully discussed in our [September 2012](#) and [December 2012](#) bulletins.)

The additional provisions addressing SOEs appear to be motivated by the government's concern that "[t]he larger purposes of state-owned enterprises may go well beyond the commercial objectives of privately owned companies."^[1] This attention to commercial objectives is reinforced in the Revised SOE Guidelines, which describe some of the factors the Minister will consider in his or her assessment, including:

- the investor's commitment to transparent and commercial operations;
- adherence to Canadian standards of corporate governance, laws and practices, including free market principles; and
- the likelihood that the acquiring SOE will operate on a commercial basis, including with respect to

exports, processing, employment of Canadians, R & D and innovation, and the level of capital expenditure to keep the Canadian business in a globally competitive position.

Neither these earlier revisions nor the Bill C-60 amendments will close the door on investments by SOEs, and they are more welcoming than ever to non-SOE investors. Notably, after the December 2012 announcements, a C\$2.2 billion shale gas joint venture between Encana Corp. and PetroChina Company Limited proceeded without ICA review. Under the transaction, PetroChina, a SOE subsidiary of China National Petroleum Corporation, obtained a 49.9% interest in the joint venture while Encana retained 50.1% ownership and will serve as operator of the joint venture.

thresholds for review

The Bill C-60 amendments will finally implement the substantial increases to the financial thresholds for review first proposed in June 2008, and approved in principle by the government in 2009. The standard threshold (for direct acquisitions involving investors or vendors controlled by citizens of WTO member countries) will be raised from C\$344 million in asset value to C\$600 million in enterprise value for two years, commencing the day that the amendments come into force. It will then rise to C\$800 million for the following two years before reaching C\$1 billion. The current thresholds are already high and we expect that relatively few transactions will be reviewable under the new thresholds.

The definition of "enterprise value" is still pending. The most recent draft regulations proposed to calculate "enterprise value" as market capitalization, plus liabilities, minus cash and cash equivalents in the case of a publicly traded entity carrying on business in Canada. In the case of a non-publicly traded Canadian business, the proposed enterprise value would equal the total acquisition value, plus the entity's total liabilities, minus cash and cash equivalents. There is no indication yet as to when the implementing regulations will be finalized or whether these definitions will be modified.

Investments in the cultural sector, as well as those by non-WTO investors, will continue to be subject to the C\$5 million asset value threshold (or C\$50 million for indirect acquisitions). Investments by SOEs (where the acquiror or vendor is from a WTO country) will continue to be subject to the existing C\$344 million review threshold (with annual indexing to reflect changes in Canada's GDP).

definition of "SOE"

Bill C-60 will broaden the definition of "SOE". As indicated in the Revised SOE Guidelines, a SOE would include an entity that is directly or indirectly controlled *or influenced* by a foreign government or agency. The SOE definition also includes the foreign government or agency itself, as well as an individual acting under the direction or influence of a foreign government or agency.

It is not yet clear what degree of influence by a foreign government or agency will be applied to the SOE determination. While "influence" is a broader concept than "control in fact", many of the same factual considerations will be relevant in making such assessments. The Investment Review Division of Industry Canada has already started using a structured list of questions to determine the degree of control or influence by a foreign state. Not surprisingly, the analysis considers share ownership by a foreign government, decision-making rights attached to these shares, and the powers to appoint senior management and nominate board members, among other things. Further clarification will be important, and we expect that in relatively short order there will be precedents or guidance demonstrating that the influence branch of the SOE definition will be applied in a responsible and workable manner.

"control in fact" tests for SOEs

Bill C-60 gives the Minister of Industry the ability to make determinations that:

- an entity is or is not controlled in fact by a SOE;
- there has or has not been an acquisition of control of a Canadian business by a SOE; and
- an entity which is otherwise Canadian-controlled is controlled in fact by a SOE.

These control in fact tests are not unique in foreign ownership reviews. The existing ICA status and acquisition of control rules focus heavily on ownership of voting shares, but also include a control in fact aspect in the "presumed control" provision. Currently, control is deemed to exist above 50% and not to exist below 33.33% of the voting shares of a corporation. Within the 33.33 – 50% shareholding range, control is presumed to exist unless it can be shown that the investor will not control the corporation in fact through ownership of voting shares.

Bill C-60 would give the Minister the ability to examine situations where a SOE has, or will acquire, less than one-third of the voting shares or interests, but has, or will acquire, control in fact over the entity. There is no prohibition against control in fact situations — the implication is simply that such investments (if they meet the financial thresholds) are subject to the standard net benefit to Canada test. Similarly, the Minister could determine that an apparently Canadian controlled entity is a "non Canadian" under the ICA if it is controlled in fact by a SOE. There are no immediate implications to such a determination, but it would mean that, if the Canadian-based entity decides to invest in another Canadian business, such a transaction could be reviewable under the ICA (assuming the financial review thresholds applicable to SOE transactions are met).

The Minister may request information in order to make control in fact determinations, and the investor will have the opportunity to make submissions regarding such determinations. The determinations may be made prospectively or with possible retroactive effect to the date of these amendments (which allows the Minister to

deal with situations that were not submitted by the parties in advance).

Similar control in fact provisions apply to acquisitions of cultural businesses and national security reviews under the ICA. In our experience, these issues require attention when potential transactions are being considered, but they rarely impede transactions. Control in fact provisions also exist in the broadcast, telecommunications and transportation sectors. In these areas, control in fact has been defined as the ability to determine strategic decision-making activities, or the ability to manage the day-to-day operations of an enterprise, whether this ability is exercised or not. Recent cases show that the government has not applied control in fact tests in a protectionist manner. Transactions are seldom rejected; instead, modest adjustments to governance structures are often made as part of the regulatory approval process. Most notably, when the Canadian Radio-television and Telecommunications Commission decided that a new wireless provider with foreign financial backing was "controlled in fact" by a non-Canadian, the federal Cabinet reversed the decision.^[2] This is consistent with the government's "open for business" approach.

We do not expect that the control in fact rules would be used in a protectionist manner in the SOE context any more than they have been in the cultural industry or national security contexts. Even if a control in fact determination is made, the main consequence for SOE investors is to be prepared to meet the net benefit test by demonstrating their commercial objectives and providing undertakings which are typically expected to include:

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

extension of timelines for national security reviews

Currently, national security reviews can take up to 135 days to complete if all possible phases are undertaken. Bill C-60 extends the deadlines for the Minister to take specific steps in relation to national security reviews to 30 days (instead of five days) after the expiry of each prescribed period. The new maximum timeline will be clarified when the implementing regulations are finalized. The amendments will also allow timelines to be extended by agreement between the Minister and the applicant (as is currently the case for standard net benefit reviews).

While the changes may increase the theoretical maximum length of national security reviews, the review powers have rarely been used and the timelines have not been excessively long compared to other regulatory review processes (e.g., the Committee on Foreign Investment in the United States, or second phase review

transactions by the competition agencies in Canada, the US or Europe). We expect that investors who engage proactively on potential national security issues will not encounter undue delays.

concluding observations

The Bill C-60 amendments do not represent a significant departure from Canada's openness to foreign investments. The increase in the review threshold to C\$1 billion in enterprise value underscores this orientation. The extended timelines for national security reviews provide the Minister with additional flexibility but will not necessarily be fully utilized, especially where the parties are addressing issues promptly. The control in fact provisions for SOEs are consistent with those applied in other foreign ownership contexts and there is no reason to expect that the government would employ the new provisions in a protectionist manner. The additional scrutiny appears to be driven by a desire to ensure that SOEs will be operating with a commercial orientation, and there remains significant scope for investment in Canada by SOEs who are prepared to do so. Investors and their advisors may need to take a more proactive and comprehensive approach to the foreign investment review process, but should not be discouraged from pursuing transactions in Canada.

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[1][ps2id id='1' target=''] See Stephen Harper, "Statement by the Prime Minister of Canada on foreign investment" (7 December 2012).

[2][ps2id id='2' target=''] See Order-in-Council PC-2009-2008 in connection with Globalive Wireless LP's bid for wireless spectrum licences.

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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