"FACTS MATTER" – DESPITE AMENDMENTS TO THE FOREIGN OWNERSHIP RESTRICTIONS FOR CANADIAN AIR CARRIERS, 'CONTROL IN FACT' IS STILL THE RULE

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Following its introduction on May 16, 2017 as Bill C-49, an Act to amend the *Canada Transportation Act* (the "**CTA**") the *Transportation Modernization Act* (Canada) (the "**TMA**") finally received Royal Assent on May 23, 2018.

Ostensibly the TMA eases foreign investment restrictions applicable to Canadian air carriers by permitting persons who are neither Canadian citizens nor permanent residents of Canada to now own up to 49% of the voting interests of Canadian air carriers. Previously, Section 55(1) of the CTA defined "Canadian" (including individuals, corporation and other entities) to mean:

> "... a Canadian citizen or a permanent resident within the meaning of subsection 2(1) of the *Immigration and Refugee Protection Act*, a government in Canada or an agent of such a government or a corporation or other entity that is incorporated or formed under the laws of Canada or a province, that is controlled in fact by Canadians and of which at least seventy-five per cent, or such lesser percentage as the Governor in Council may by regulation specify, of the voting interests are owned and controlled by Canadians;" [*emphasis added*]

As a result, the CTA imposed a two part test to determine Canadian ownership of an air carrier:

i. 75% of the voting interests had to be held by Canadians (the *de jure* test); and
ii. the entity had to be controlled in fact by Canadians (the *de facto* test).

It is important to recognize that the two part test had to be satisfied at all times on an ongoing basis. The TMA does not change that requirement.

Section 15 of the TMA amends the *de jure* test in Section 55(1) of the CTA by replacing the underlined words above with the following:

> "... at least 51% of the voting interests are owned and controlled by Canadians and where

i. no more than 25% of the voting interests are owned directly or indirectly by any single non-Canadian, either individually or in affiliation with another person, and
ii. no more than 25% of the voting interests are owned by one or more non-Canadians authorized to provide an air service in any jurisdiction, either individually or in affiliation with another person;"

On the surface, this amendment would appear to be a material relaxation in the restrictions by allowing non-Canadians to own up to 49% of the voting interests in a Canadian air service. But not so fast. As before, no single non-Canadian can own, either individually or together with another person, more than 25% of the voting interests. As well, a new restriction has been added such that no more than 25% of the voting interests can be owned by one or more non-Canadians who are authorized, either individually or in affiliation with any other person, to provide an air service in any jurisdiction. This new restriction will impose an important limitation on Canadian carriers seeking investment from non-Canadians who have experience in the industry as persons who are authorized air service operators either in Canada or elsewhere.

More importantly, beyond the *de jure* test, the overriding *de facto* control test remains. The *de facto* test means that, regardless of the percentage of voting interests owned by non-Canadians, even if significantly less than 25%, the carrier might not be considered to be "Canadian". As the saying goes, 'facts matter' and, in this case, it the crucial question is still who in fact controls the corporation or entity.

Section 61(a)(i) of the CTA requires that an applicant for a licence to operate a domestic air service in Canada must demonstrate to the satisfaction of the Canadian Transportation Agency (the "**Agency**") that the licensee is a "Canadian". In other words, the Agency must be persuaded on the facts that the both the *de jure* and the *de facto* test is satisfied. An applicant must present evidence to demonstrate that the owners of voting interests in the air carrier are "Canadian". With the amendments in the TMA, that means being able to show not only that 51% of the holders of voting interests are "Canadian", but that no one non-Canadian holds more than 25% and that, if non-Canadians hold more than 25% in aggregate, no affiliation exist between or among those persons.

The more challenging hurdle is the *de facto* test. The Agency must be satisfied that the Canadians holding 51% or more of the voting interests can and will actually exercise control in all circumstances. In this regard, the Agency will consider a wide range of factors and make a subjective assessment of whether Canadians retain control in fact. The Agency has long recognized that business decisions can be influenced in various ways by minority interests, by financial institutions, by key suppliers and by senior employees or officers. In this regard, the Agency has published a very wide ranging but non-exhaustive list of factors it will consider.[1]

Among other things, the Agency will examine the composition of the Board of Directors, the existence and scope of veto rights in shareholder agreements or debt instruments, rights of first refusal or pre-emptive rights,

the existence of debt or guarantees and the rights of debt holders and guarantors, the provisions of leases and operational agreements and the overall financial strength of the carrier. The essence of these factors is to assess whether there is any mechanism, direct or indirect, actual or theoretical, by which control might be influenced in any possible circumstance. Furthermore, it is critical to recognize that the Agency's assessment need not be based on the actual exercise of control, but on the potential ability of one or more non-Canadians to exercise or influence control, directly or indirectly.

Given the amendments in the TMA, it is particularly relevant to note that the Agency will consider the concentration of voting interests – are the majority Canadian voting interests held narrowly by one person or cohesive group, or more broadly among a diverse group? If the latter, are there any circumstances in which one or more of the Canadians might collaborate with a non-Canadian to exercise or influence control? The Agency will want to be satisfied that the Canadian majority will, at all times and in all circumstances, act together to maintain control. Among other things, the carrier must be able to show that a non-Canadian investor is not affiliated with any other person (including a Canadian) such that they are not acting, will not act, and cannot act, directly or indirectly, together to exercise control.

The TMA changes none of this. Historically, we know that even when Canadians held 75% of the voting interests, the Agency could be extremely skeptical that a non-Canadian holding the remaining 25% was in fact not in a position to exercise control. Against that background, one can readily imagine that the Agency will have a hard time concluding that control in fact resides with Canadians if Canadians hold only a bare majority of voting interests at 51%, particularly if a single non-Canadian holds 25% of the voting interests and the Canadian interests are more widely held. In that circumstance, it seems clear that the licensee will have to go to extraordinary lengths to persuade the Agency that there is no possibility that one or more Canadians will collaborate, directly or indirectly, in any instance with non-Canadians to make or influence key business decisions.

The TMA will provide some additional flexibility to Canadian carriers to raise funds from non-Canadians, but they will need to be extremely cautious that any new investment from foreign sources is not connected, directly or indirectly, with any other non-Canadian investment in the business – and that all non-Canadian investors remain independent of one another. Ultimately, it will be the facts that will matter and the question of control in fact remains the critical test.

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[1] Canadian Transportation Agency, Interpretation Note: Control in Fact – October 5, 2015. As of the date of this publication, this Interpretation Note has not been updated to reflect the amendments in the TMA.

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.