

FOREIGN INVESTMENT IN CANADA: MINERALS ARE CRITICAL AND ANNUAL REPORT RELEASED

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Canada continues to be [open for business and welcomes foreign investment](#).^[1] However, the Government's approach to reviewing foreign investment is evolving, with an increased focus on national security concerns.

This policy evolution was articulated by the Minister of Innovation, Science and Industry (ISI) in his [November 2, 2022 statement](#) announcing the Government's decision to order three Chinese investors to divest their investments in three junior Canadian exploration companies, when he cautioned that "[w]hile Canada continues to welcome foreign direct investment, we will act decisively when investments threaten our national security and our critical minerals supply chains, both at home and abroad." The Minister emphasized that the Government is "determined to work with Canadian businesses to attract foreign direct investments from partners that share our interests and values".

Below we provide a brief overview of three key developments:

- Canada's evolving national security regime.
- Canada's new approach to reviewing investments in critical minerals (including the three recent divestiture orders noted above).
- The most recent annual report describing the Government's approach to enforcing the *Investment Canada Act* (ICA), Canada's federal legislation that regulates foreign direct investments into Canada.

1. The Investment Canada Act Framework

The ICA requires foreign investors that acquire control of Canadian businesses or that establish new Canadian businesses to file an administrative notification or, if certain financial thresholds are satisfied, an application for review.^[2] A foreign investor may not close a reviewable acquisition until the Minister under the ICA determines that the investment is of "net benefit" to Canada, based on six factors identified in the ICA.^[3]

The ICA also provides that all investments by foreign investors in Canada may be subject to a national security review at the discretion of the Government. This includes the acquisition of a minority, non-controlling interest in a Canadian business, the acquisition of an entity with operations in Canada or the establishment of a

Canadian business. The objective of a national security review is to assess whether an investment could be injurious to Canada's national security, in which case the Government may prohibit, or impose conditions on, the investment.

2. Canada's Evolving National Security Regime

Since the start of the pandemic, Canada has broadened its approach to national security reviews and demonstrated greater willingness to disclose its approach to national security reviews.

a) Heightened Scrutiny in the Pandemic

On April 18, 2020, the Government issued a [*Policy Statement on Foreign Investment Review and COVID-19*](#) (which remains in effect) advising that the national security powers in the ICA would be used to carefully scrutinize investments in health-related sectors as well as other sectors involved in the supply of critical goods and services. This policy broadened the historic approach to national security review in three key areas -- food, transportation and other critical supply chains -- each of which was identified as vitally important to the Government's response to the pandemic. The Government also recognized that some investments into Canada by state-owned enterprises (SOEs)^[4] may be motivated by non-commercial imperatives that could harm Canada's economic or national security interests. See [our earlier bulletin](#) on this policy.

b) Updated National Security Guidelines

On March 24, 2021, the Government updated its [*Guidelines on the National Security Review of Investments*](#) (National Security Guidelines), initially adopted in 2016, to (i) reinforce that all investments by SOEs (including private investors closely tied to foreign governments) will be subject to enhanced scrutiny, regardless of the value or size of the investment; and (ii) provide more detail regarding the factors considered in assessing whether an investment is likely to raise national security concerns — including the transfer of sensitive technology or know-how outside of Canada, the supply of critical goods and services to Canadians, the potential impact of the investment on the security of Canada's critical infrastructure, critical minerals and critical mineral supply chains, and sensitive personal data. See [our earlier bulletin](#) on the updated guidelines.

c) Policy Statement on Foreign Investment Review

On March 8, 2022, in response to the Russian invasion of Ukraine, the Government issued a [*Policy Statement on Foreign Investment Review and the Ukraine Crisis*](#), which provides: (i) investments subject to net benefit review by Russian investors will be found to be of net benefit to Canada only on an exceptional basis; and (ii) all other investments, regardless of value, that have "ties, direct or indirect, to an individual or entity associated with, controlled by or subject to influence by the Russian state", will support a finding that there are reasonable grounds to believe that the investment could be injurious to Canada's national security. See [our earlier bulletin](#)

on this policy.

d) *Review of Acquisition of Neo Lithium Corp.*

In January 2022, the Government permitted a Chinese SOE, Zijin Mining Group, to acquire Neo Lithium Corp, a Canadian listed and headquartered mining company, which only owned lithium assets outside of Canada, for approximately \$960 million.

This decision received significant criticism, including from the Standing Committee on Industry and Technology (INDU), which [issued a report on March 29, 2022](#) to the House of Commons, which, among other matters, called for greater transparency about the foreign investment review process. The [Government response tabled on June 22, 2022](#) set out details on the national security review process and acknowledges the need to find a balance between maintaining Canada's reputation as a place of investment while mitigating harms to Canada's national security and long-term national interests.^[5]

e) *ICA National Security Review Amendments*

On August 2, 2022, the [National Security Review of Investments Regulations](#) were amended to allow foreign investors to voluntarily file notifications in respect of investments in Canada that would otherwise not require notification (for example, acquisitions of a minority non-controlling interest in a Canadian business):

- Where a foreign investor makes a voluntary filing, the Government has 45 days to decide whether to engage the national security review regime.
- Where a foreign investor does not make such voluntary filing, the Government has up to [five years](#) from the closing of the investment to engage the national security regime.

3. New Approach to Critical Minerals

a) *New Critical Minerals Policy*

On October 28, 2022, concurrent with the release of the Annual Report (as described below), The Minister of ISI and the Minister of Natural Resources issued a statement announcing the adoption of the [Policy Regarding Foreign Investments from State-Owned Enterprises in Critical Minerals under the Investment Canada Act](#) (Critical Minerals Policy).

The Critical Minerals Policy begins with a statement recognizing that Canada's future prosperity and leadership with respect to emerging low-carbon and other technology sectors requires reliable market-based access to critical minerals across the value chain, and that critical minerals are vital inputs to defence and high technology industries. In this context, some investments into Canada by SOEs can be motivated by non-commercial imperatives that are contrary to Canada's interests, in particular, by non-likeminded governments.

In recognition of these concerns, the Critical Minerals Policy provides that:

- investments in critical minerals sectors by SOEs (including private investors assessed as being closely tied to, subject to influence from, or who could be compelled to comply with extrajudicial direction from foreign governments) that are subject to net benefit review will only be approved as a net benefit to Canada on exceptional basis, and
- all other investments in Canada's critical minerals sectors by SOEs (including private investors assessed as being closely tied to, subject to influence from, or who could be compelled to comply with extrajudicial direction from foreign governments) could constitute reasonable grounds for the Government to believe that the investment could be injurious to Canada's national security, regardless of the value of the transaction.

This policy is similar to the Government's approach in 2012 in connection with the then increased SOE interest in Canadian oil sands. Recognizing the significance of Canada's oil sands, most of which were owned by the private sector, the Government [warned](#) that "given the inherent risks posed by foreign SOE acquisitions in the Canadian oil sands the Minister ... will find the acquisition of control of a Canadian oil sands business by a foreign SOE to be net benefit to Canada on an exceptional basis only".[\[6\]](#)

b) [Government Orders Chinese Entities to Divest Interests in Exploration Companies](#)

On November 2, 2022, the Minister of ISI issued a [brief statement](#) announcing that the Government has conducted national security reviews of a "number of Canadian companies engaged in the critical minerals sector, including lithium" and, as a result, the Government made final orders that three Chinese-controlled investors divest their interests in three Canadian TSX Venture listed public companies with interests in lithium, as follows:

- Sinomine (Hong Kong) Rare Metals Resources Co., Limited (Sinomine) is required to divest its investment in Power Metals Corp. Sinomine acquired a 5.7% interest in Power Metals for \$1.5 million in January 2022 and entered into an offtake agreement in March 2022 for all of the lithium and tantalum produced at Power Metals' Case Lake property in Ontario (as long as Sinomine holds a 2.5% or greater interest in Power Metals – which would not be the case if the divestiture order is complied with). Both parties issued preliminary [press releases](#) in response to the divestiture order, with Power Metals' press release indicated that "Sinomine will respond to the Canadian government shortly as they look at the appeal process."
- Chengze Lithium International Limited (Chengze) is required to divest its investment in Lithium Chile Inc. Chengze acquired a 19.35% interest in Lithium Chile in May 2022 in exchange for \$27.9 million, an increase from 5.14%. It appears that all of Lithium Chile's properties are located outside of Canada, in Chile and Argentina. Both parties issued preliminary [press releases](#) in response to the divestiture order, with

Lithium Chile's press release indicating that "Chengze is reviewing the directions of the Order, and their legal options."

- Zangge Mining Investment (Chengdu) Co., Ltd. (Zangge) is required to divest its investment in Ultra Lithium Inc. Zangge acquired a 14.17% interest in Ultra Lithium for \$4.14 million in May 2022. It also entered into an agreement in June 2022 to pay US\$10 million to Ultra Lithium and invest US\$40 million in its lithium exploration project in Argentina for a 65% stake in its subsidiary that owns the Argentinian property, Ultra Argentina S.R.L. Each of Zangge and Ultra Lithium issued a preliminary [press release](#) in response to the divestiture order, with Ultra Lithium advising that the parties "have also mutually agreed to terminate the definitive agreement" for the lithium exploration project in Argentina, and that it "is assessing its legal and other options to preserve value for its shareholders".

The Minister's statement does not indicate the specific reasons for the orders, other than reaffirming that Canada's critical minerals are key to the future prosperity of Canada, and does not provide details of the divestiture orders.

There are several notable features arising from these parallel orders:

- While each of the three investors is a Chinese public company with its securities listed on the Shenzhen exchange, it appears that each investor may have been considered to be closely tied to, subject to influence from, or compellable to comply with extrajudicial direction from the People's Republic of China (PRC). While the Minister's statement contains no explicit allegation that these investors have any SOE connections, the statement includes a direct electronic hyperlink to the Critical Minerals Policy (described above), which only applies to SOEs and investors that could be influenced or compelled by foreign governments.
- None of the Chinese investors appear to have acquired "control" of the Canadian businesses (as that term is defined in the ICA), and none of the Chinese investors are *de facto* "control persons" of the Canadian companies (as that term is used in securities law to apply to holders of 20% or more of a public company).
- Each of the three Canadian companies is a TSX Venture Exchange listed junior mineral exploration company engaged in the exploration of lithium, with their projects in early exploration stages, and no commercial production. Thus the intervention is occurring at an early point in the development of any critical mineral deposit held by these entities.
- Two of the Canadian businesses' lithium assets are not even located in Canada: Lithium Chile has interests in exploratory stage lithium projects in Chile, and Ultra Lithium has interests in exploratory stage lithium projects in Argentina. This contrasts with the decision earlier in 2022 not to intervene in the acquisition by Zijin Mining of Neo Lithium which was developing a lithium project in Chile (see above). While the Government has taken action in relation to the shares of the Canadian parent company, a sale

by a Canadian company of assets located wholly outside of Canada would not otherwise trigger any review by the Government under the ICA.

- Divestiture orders for the sale of shares of public companies are unprecedented in Canada. These orders will require the Chinese investors to divest their shares within a confidential mandatory time period. While government policy typically is not focused on the negative impact on the value of the assets to be sold, a requirement that a shareholder sell a significant block of shares likely will have a negative impact on the trading price (i.e., a “fire sale”), which may not reflect the underlying value of the company or its project(s). The securities of junior TSX Venture issuers are often thinly traded and therefore are not able to absorb the rapid sale of a significant number of shares. Additionally, as junior exploration companies typically fund their operational expenses through equity financings, significant and unexpected downward changes in a share price can directly impact such companies’ ability to obtain financing on advantageous or market terms, resulting in increased costs to obtain financing for projects and increased shareholder dilution.
- These divestiture orders and the Critical Minerals Policy may deter the flow of capital to Canadian businesses engaged in exploration and mining projects for critical minerals from Chinese SOEs and investors that are closely tied to the PRC.
 - The Government has stated it “is determined to work with Canadian businesses to attract foreign direct investments from partners that share our interests and values ... [and] will continue to encourage and work with Canadian businesses that require investment capital, by helping to identify and find partnerships that will serve in the best interest of Canadian businesses, workers, and the economy.” The nature and extent of action by the Government to support early stage exploration companies (potentially including Power Metals, Ultra Lithium and Chile Lithium) remains to be seen.
 - New sources of foreign funding will be required to develop Canada’s critical minerals, including for both Canadian and international critical mineral assets held by Canadian companies. As a result, there may be new opportunities for foreign investors from Canada’s preferred trading partners to invest in these areas.
 - When entering into new equity financing, debt financing and other contractual arrangements such as joint ventures, Canadian companies in the critical minerals space will need to consider the origin of potential investors and whether there are any associated national security risks. In circumstances where an investor has close ties to an SOE or may be subject to SOE or PRC influence, Canadian counterparties are likely to consider negotiating more comprehensive risk-shifting contractual protections.

4. ICA Annual Report

On October 28, 2022, ISI released the [Annual Report: 2021-2022](#) (Annual Report), which provides a summary of the key policy developments, investment activities, and increasing focus on national security matters under the ICA during the fiscal year ended March 31, 2022.

a) [Filings and Net Benefit Reviews](#)

The 2021-22 year was characterized by a record number of filings under the ICA. The 1,255 filings represented an increase of 52% over 826 filings in 2020-2021, and 22% over the previous record of 1,032 filings in 2019-2020. This increase is consistent with the recovery of the Canadian and world economies, with [OECD data](#) indicating that foreign investment in Canada increased from US\$46.5B in 2019 to US\$98.3B in 2021.^[7]

Of the total number of investments for which filings were made in 2021-2022, the United States continues to be the largest source of investments (731 investments representing 58% of total filings), followed by the European Union (209 investments representing 17% of total filings), the United Kingdom (88 investments representing 7% of total filings), and China (including Hong Kong) (50 investments representing 7% of total filings).

Each of the eight investments subject to a net benefit review (i.e., <1% of the total investments) obtained the required approval by the Minister. These eight investments had an average enterprise value of \$3.9B. The average net benefit review took 88 days, which was slightly higher than the range in the previous five years of 72-85 days.

b) [National Security Reviews](#)

In the 2021-2022 year, 24 investment proposals were reviewed for national security concerns, which is the same number as 2020-2021. This represents a significant increase over each of 2019-2020 (10), 2018-2019 (9), and 2017-2018 (4). Of the 24 national security reviews in 2021-2022, 12 were subjected to the longer extended national security review process, which can lead to a final order blocking the investment or imposing conditions.

Of the 24 investment proposals, 16 (i.e., 67%) were permitted to proceed, seven were withdrawn, and one review was ongoing at year-end. These outcomes were broadly similar to 2020-2021, where 16 of 24 investments were permitted to proceed, five were withdrawn and three were subject to divestiture or blocking orders by the Government. These data reflect that more transactions are receiving in-depth scrutiny, but that a solid majority of transactions subject to national security reviews are cleared.

Of the 12 investment proposals subject to extended national security reviews in 2021-2022, six originated in China, four originated in Russia and one originated in each of Jordan and Finland. Of the four proposed investments withdrawn, two originated in China, and one originated in each of Russia and Jordan. The review that remains ongoing originated in China. This contrasts with 2020-2021, where of the 11 investment proposals

subject to an extended national security review that that year, seven originated in China, one originated in each of Russia, Taiwan, United Arab Emirates and the United Kingdom. Of these 11, four proposed investments were withdrawn (three originating in China and one originating in the United Kingdom), two were subject to divestiture (one each originating in China and the United Arab Emirates) and one was blocked (originating from China).

The industries in which the extended reviews were conducted in 2021-22 are diverse: metal ore mining, grocery stores, taxi & limousine service, support activities and water transportation, data processing, activities related to creditor intermediation, securities & commodities, computer systems, management scientific and tech consulting, scientific research, and other.

Of the 50 Chinese investments into Canada in 2021-22, only six investments (i.e., 12%) were subject to an extended review, and, of these six reviews, only two were withdrawn and one remains ongoing. These data show that there is a significant ongoing flow of investments into Canada from PRC/ Hong Kong, and only a few have been abandoned, blocked, divested or otherwise mitigated.

5. Conclusion

The Government's messaging has shifted, from an "open for business" policy to a more nuanced statement that Canada "continue[s] to welcome foreign direct investment" but that "Canada will act decisively when investments threaten our national security and our critical minerals supply chains".

The ICA review process will raise increasingly frequent and complex issues, with a strong focus on (i) investments by SOEs and private investors closely tied or subject to the influence of foreign governments, and (ii) a broader range of potentially sensitive sectors, including critical minerals, as well as health, artificial intelligence and other sensitive technologies, personal data, and critical infrastructure. The review of an investment may be affected by a variety of factors, including the ownership and control of the investor, the size of the Canadian business, the nature of the Canadian business's activities, and the proposed structure of the investment. Foreign investors should contact legal counsel early in the process to obtain strategic advice to identify and mitigate any risks that may arise in connection with such investment.

Please reach out to us or your usual McMillan contact if you have any questions about these developments or in connection with a new investment in Canada. We would be very pleased to explore with you any national security risk implications of transactions that you may be contemplating.

[1] See also, [Global Affairs Canada's Key Facts on Canada's Competitiveness for Foreign Direct Investment](#).

[2] For additional detail on when filing is required, see our [2022 Competition Act and Investment Canada Act Thresholds chart](#).

[3] There are certain rare cases where the application for review can be submitted post-closing, but in most cases, filing is required pre-closing and closing must wait until Ministerial approval is received.

[4] The definition of “state-owned enterprise” in the ICA is broad, and means: **(a)** the government of a foreign state, whether federal, state or local, or an agency of such a government; **(b)** an entity that is controlled or influenced, directly or indirectly, by a government or agency referred to in paragraph (a); or **(c)** an individual who is acting under the direction of a government or agency referred to in paragraph (a) or who is acting under the influence, directly or indirectly, of such a government or agency.

[5] Neo Lithium’s reserves will produce lithium carbonate rather than lithium hydroxide, and the end use limitations were taken into account in assessing national security risks ([as reported on here](#)).

[6] Also see the [Prime Minister’s statement in 2012](#) regarding foreign investment in Canada’s oil sands.

[7] Of the 1,255 filings submitted in 2021-2022, 1,247 filings were certified notifications (including 278 notifications in connection with establishing new businesses in Canada) and only eight filings were applications for review subject to net benefit review. This small number of acquisitions subject to net review is a consequence of the very high “enterprise value” thresholds that trigger a net benefit review for acquisitions by foreign investors controlled in countries that are strong trading partners of Canada, such as, among others: the United States; Mexico; members of the European Union; the United Kingdom; CPTPP countries such as Australia, Brunei, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam; and also Korea. These thresholds were initially established in 2009 and have been expanded in recent years. See our earlier [bulletin](#) on these review thresholds and an our [bulletin](#) setting out the 2022 review thresholds.

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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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