MODERNIZATION OF THE *INVESTMENT CANADA ACT* IS UNDERWAY

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On December 7, 2022, the Canadian federal government introduced Bill C-34, *An Act to amend the Investment Canada Act*, to modernize Canada's foreign investment review law, the Investment Canada Act (ICA). Bill C-34 is intended to align Canada's approach to national security reviews of inbound foreign investments with the foreign investment review regimes of its allies in the UK and the US, with a particular focus on investments in sensitive sectors of the economy. The Bill follows a directive in the Prime Minister's December 2021 Mandate Letter to the Minister of Innovation, Science and Industry to "strengthen the national security review process and better identify and mitigate economic security threats from foreign investment."

Below we outline the key implications for Canadian businesses, their shareholders and non-Canadian investors followed by a discussion of the changes to the ICA contemplated by Bill C-34.

The Bill will be studied in Committee over the next couple of months, with passage into law, with or without amendment, anticipated as early as the spring of 2023. As part of this process, the government is expected to make regulations identifying sensitive sectors that will trigger an enhanced review process and additional procedural elements, and publish further guidance with the objective of increasing transparency and investor certainty.

KEY IMPLICATIONS FOR BUSINESS

Under the current legal framework, non-Canadian investors may invest in Canadian businesses without providing any notice to the government, so long as the investor does not acquire control of the Canadian business. This will change once Bill C-34 becomes law. Once in force, a non-Canadian investor will be required to make a pre-closing filing with the Canadian government in respect of a proposed investment in a sensitive sector that may impact Canada's national or economic security. By requiring a pre-closing filing, the government is seeking to limit any potential harm to national security prior to closing of the investment.

This pre-closing filing requirement, along with the proposed increased penalties, signal the government's commitment to using the ICA to mitigate security risks associated with foreign ownership over technologies and other strategic assets by non-Canadian investors, including in particular investors with ties to non-aligned

countries. We expect these amendments could act as a significant deterrent to foreign investment in sensitive sectors, particularly businesses seeking to sell minority interests through equity financing activities (including non-voting equity raises, which are not currently subject to any pre-closing filing requirements).

The Bill also alters the rules governing the disclosure of evidence during a judicial review proceeding significantly in the government's favour. In a recent white paper by McMillan lawyers Joshua Krane, Stephen Wortley and Connor Campbell, the authors proposed that the government should consider adopting an amicus framework for the communication of national security information. We will see if such a proposal finds its way into the judicial process as investors consider challenging national security reviews.

PROPOSED UPDATES TO THE INVESTMENT CANADA ACT

1. New pre-closing filing requirement for investments in prescribed businesses activities that may raise national security concerns

A non-Canadian investor is required to notify the Canadian government when acquiring control of a Canadian business or when establishing a new Canadian business. The investor can notify the government before closing or up to 30 days after closing. Investors also have the ability to notify non-controlling investments voluntarily. The submission of a notification commences a 45-day period during which time the Minister can initiate a national security review process.

The proposed amendments will require a non-Canadian investor to make a pre-closing filing in respect of an acquisition, in whole or in part, of a Canadian business engaged in a prescribed business activity, if the non-Canadian (i) could gain access to material non-public technical information or material assets, and (ii) would have the power to appoint or nominate any person who has the capacity to direct the business and affairs of the business, or prescribe special rights with respect to the business. The investor may not close the investment until the review period has lapsed or any national security concerns have been resolved.

The government has not yet defined the prescribed business activities, the types of non-public technical information and the types of material assets that would trigger a mandatory pre-closing filing. The government plans to introduce regulations to this effect after the passage of Bill C-34.

We anticipate that the new regulations will capture the categories of investment that are already subject to enhanced scrutiny under existing guidelines. These categories include: investments by Chinese and Russian investors, investments in critical minerals, and investments that relate to sensitive sectors and technologies such as aerospace, defence, artificial intelligence, biotechnology, energy generation, medical technology, and the supply of critical goods and services, to name a few.

2. Increased penalties for non-compliance

The proposed amendments will increase the costs of non-compliance by raising the penalties from $10,000/day to $25,000/day and introducing a new discretionary penalty of the greater of $500,000 or an amount set out in the regulations.

While the Minister has not historically relied on the use of penalties to ensure compliance, the increased penalties, along with the new pre-closing notice requirements, may act as an additional deterrent for Canadian businesses involved in sensitive sectors of the economy and their shareholders who are considering a transaction with non-Canadian investors, including in particular investors from non-aligned countries.

3. New ministerial authority to impose interim conditions during a national security review

The proposed amendments will provide the Minister with the authority to impose interim conditions while a national security review is ongoing. The Minister can exercise this power after consulting the Minister of Public Safety and Emergency Preparedness, if the Minister is satisfied that interim conditions are necessary to protect national security (e.g., limit the investor's access to critical technologies during the review period).

This authority would arguably allow the Minister to tailor an interim order to particular circumstances based on the nature of the Canadian business and the specific national security concerns associated with an investment in that Canadian business. However, the exercise of these powers could lead to delays in closing the acquisition or an investor abandoning a proposed investment. Additionally, this power creates information asymmetry between the investor and other bidders (if any) and the Canadian business; potentially skewing the allocation of risk between the parties, reducing the bargaining power for the investor, and decreasing the purchase price for the Canadian business.

4. New ministerial authority to accept undertakings to mitigate national security risk

The amendments will permit non-Canadian investors to make representations and submit binding undertakings directly to the Minister to address national security concerns in respect of an investment, and allow the Minister to resolve a national security review on the basis of such negotiated undertakings, instead of having to go to Cabinet.

This change would align the negotiation process with how the Minister currently negotiates undertakings with investors during economic or "net benefit" reviews under the ICA and make the negotiation process more efficient.

5. Improved information-sharing with international counterparts

The ICA currently includes a blanket privilege over information provided to the Canadian government in respect of an investment. The proposed amendments would curtail that privilege and allow the Minister to

share information about an investment with a foreign state or agency for the purposes of national security reviews under the ICA, with the objective of facilitating international cooperation between governments.

6. New rules for disclosure and evidence during a judicial review proceeding

The proposed amendments would permit judges, on the request of the Minister, to consider sensitive information as part of a judicial review of a decision made under the national security provisions of the ICA without disclosing such information to the public, including to the investor and its counsel. The judge would be permitted to proceed with this confidential process if, in the judge's opinion, disclosure of the purported sensitive information would be injurious to international relations, national defence or national security, or would endanger the safety of any person.

Notwithstanding such limitations, the amendments require that the investor be provided with a summary of information to allow the investor to remain reasonably informed of the government's case. The summary would not include anything that, in the judge's opinion, would be injurious to international relations, national defence or national security, or would endanger the safety of any person if disclosed. The amendments also require that the judge provide the investor with an opportunity to be heard.

Absent an amicus process, the amount of judicial discretion in withholding certain information could severely hamper an investor's ability to demonstrate that a national security order was unreasonable or an abuse of process.

RENEWED FOCUS ON NATIONAL SECURITY

Bill C-34 is the latest step in a series of policy, regulatory and legislative measures that have increased the degree of scrutiny placed on inbound investments since the onset of the COVID-19 pandemic:

- In April 2020, at the beginning of the COVID-19 pandemic, Innovation, Science and Economic Development Canada (ISED) announced "enhanced scrutiny" of foreign investments in Canadian businesses related to public health or involved in the supply of "critical goods and services".
- In March 2021, ISED revised its national security guidelines to (1) recognize that state-owned or influenced investors will be subject to enhanced scrutiny; (2) include a detailed list of industries and business activities of national security concern; and (3) identify investments providing access to sensitive personal data as an area of concern.
- In March 2022, following Russia's invasion of Ukraine, ISED announced that investments in Canada of any size by Russian investors would provide reasonable grounds for a national security review.
- In October 2022, the government introduced a new policy regarding investments in Canada's critical minerals sector from state-owned enterprises and subsequently announced divestitures of three

investments by Chinese investors in Canadian critical minerals businesses.

- In November 2022, the government published Canada's Indo-Pacific Strategy. As part of this strategy, the government indicated that updates to the ICA will be an important tool to protect intellectual property and Canadian research as China becomes as an "increasingly disruptive global power".

The proposed amendments to the ICA are the next step in an attempt by the Canadian government to monitor and control inbound investments in critical technologies and assets by non-Canadian investors, including in particular investors from non-aligned countries. Once these amendments become law, the government will need to promulgate regulations to identify the "prescribed business sectors" in issue and provide information about the pre-closing notification and timing requirements. Accordingly, the ultimate approach that the government will take and the corresponding risks faced by non-Canadian investors remain undefined.

In the interim, all non-Canadian investors wishing to invest in Canadian businesses in sectors that may raise national security concerns should consult with counsel to consider risks, transaction structures and filing strategies.

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.

by Beth Riley, Joshua Chad, Joshua Krane and Hannah Johnson

A Cautionary Note