

GOVERNMENT OF CANADA PROVIDES VALUABLE GUIDANCE ON NATIONAL SECURITY REVIEW OF FOREIGN INVESTMENT IN CANADA

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Introduction

The Canadian Government has issued important new National Security Guidelines which will “provide greater certainty to companies looking to investment in Canada while maintaining the integrity of the national security review process”.^[1]

In 2009, the Government of Canada [made significant changes](#) to the *Investment Canada Act*^[2] (ICA), including introducing a new mechanism to review investments that could be “injurious to national security”. To date, only five transactions have been blocked or subject to divestiture pursuant to the national security review provisions and two more were subject to conditions imposed by the Government of Canada before implementation. However, there was little guidance on what types of investments might be “injurious to national security” and foreign investors had been left with some uncertainty as to whether their transactions might be delayed or even prohibited by such a review.

The Government announced in its [Fall Economic Statement](#) of November 1, 2016 that it would be publishing guidelines (the “Guidelines”) on what types of investments are examined under national security reviews. The [Guidelines](#) were published on December 19, 2016.^[3] In the accompanying [announcement](#),^[4] the Government emphasized that the Guidelines are designed to attract investment and ensure greater transparency.

The Guidelines set out a list of factors that the Government considers when determining whether to initiate a national security review. Those factors address defence, critical infrastructure, goods and services, and intelligence capabilities. The inclusion of “critical infrastructure” is consistent with the approach taken by the Committee on Foreign Investment in the United States (CFIUS), which also treats critical infrastructure as a key factor in national security reviews.^[5]

Background

Subject to limited exceptions, the ICA requires non-Canadian investors (foreign companies and foreign-

controlled companies) to provide a notification under the ICA (or submit an application for review under the ICA's separate "net benefit" review procedure) each time that they acquire control of a Canadian business or establish a new Canadian business. While no notification is required under the ICA for non-controlling investments, such investments are nonetheless subject to the ICA's national security regime. Once an application or notification has been certified by the Department of Innovation, Science and Economic Development (ISED) as complete (or once an investment has been implemented, for investments that are not notifiable or reviewable), the Government has 45 days under the ICA in which it can either order a national security review or inform the investor that a national security review is being considered. For an in-depth discussion of the national security review process and the timelines associated with a national security review, please see our 2015 [bulletin](#) describing amendments to the ICA and its regulations.

Since the introduction of the national security provisions to the ICA in 2009, eight national security reviews have been ordered by Cabinet, resulting in seven Orders-in-Council. The Orders have imposed a range of measures, with the most significant being disallowing the proposed investment.^[6]

Most recently, in July 2015, the Government ordered a Chinese-controlled investor, O-Net Communications Holdings Limited (O-Net), to divest control of a Canadian business that specializes in fiber components and modules as a result of a national security review. In November 2016, following a court challenge by O-Net based on procedural fairness and following negotiations between the parties, the Government consented to (a) the Federal Court setting aside Cabinet's initial divestiture order, and (b) initiating a new national security review of this acquisition of control.^[7]

The Guidelines

The Guidelines provide helpful information to investors by outlining the Canadian national security review process, including, most critically, the factors that the Government takes into account when determining whether a particular investment poses a national security risk.

Types of Information that the Government Considers

The Guidelines emphasize that determining whether there should be a national security review is a highly fact-specific inquiry. The Government reviews "the nature of the asset or business activities and the parties, including the potential for third-party influence, involved in the transaction".^[8] The Guidelines emphasize that this fact-specific inquiry may incorporate the review of "sensitive information" as defined under section 38 of the *Canada Evidence Act*:

sensitive information means information relating to international relations or national defence or national security that is in the possession of the Government of Canada, whether originating from inside

or outside Canada, and is of a type that the Government of Canada is taking measures to safeguard.^[9]

The Non-Exhaustive Enumerated Factors for Making National Security Determinations

The Guidelines provide a non-exhaustive list of factors that the Government may take into account when making national security determinations under the ICA:^[10]

- (i) The potential effects of the investment on Canada's defence capabilities and interests;
- (ii) The potential effects of the investment on the transfer of sensitive technology or know-how outside of Canada;
- (iii) Involvement in the research, manufacture or sale of goods/technology identified in section 35 of the *Defence Production Act*;^[11]
- (iv) The potential impact of the investment on the security of Canada's critical infrastructure;
- (v) The potential impact of the investment on the supply of critical goods and services to Canadians, or the supply of goods and services to the Government of Canada;
- (vi) The potential of the investment to enable foreign surveillance or espionage;
- (vii) The potential of the investment to hinder current or future intelligence or law enforcement operations;
- (viii) The potential impact of the investment on Canada's international interests, including foreign relationships; and
- (ix) The potential of the investment to involve or facilitate the activities of illicit actors, such as terrorists, terrorist organizations or organized crime.

The Guidelines do not set out the relative weight of these factors or explain precisely how they are considered in the context of a national security review. However, we note that “critical infrastructure” has become a major component of CFIUS national security reviews in the United States, and it would not be unexpected to see a similar approach develop in Canada. Critical infrastructure refers to processes, systems, facilities, technologies, networks, assets and services essential to the health, safety, security or economic well-being of Canadians and the effective functioning of government.^[12] This is potentially a broad range of activity. However, national security concerns should only emerge where the combined nature of the specific assets / businesses in question, and the identity of the investor or persons influencing it, give rise to some actual security risks.

Pre-Filing Dialogue

Finally the Guidelines outline the willingness of the Investment Review Division (IRD) of ISED to meet with prospective investors to discuss their investment projects during the development stage:

Accordingly, investors are encouraged, particularly in cases where the factors listed in paragraph 6 of these Guidelines may be present, to contact the Investment Review Division at the earliest stages of the development of their investment projects to discuss their investment and, where applicable, to file a notification or an application for net benefit review at least 45 days prior to planned implementation.

...

In all cases, Investment Review Division officials are ready to meet with investors about their investment projects. Such consultations may facilitate assessments under Part IV.1 [national security] and clarify information requirements that might be useful in the course of assessments.[13]

Internal Reporting Requirement

In addition to announcing the Guidelines, ISED simultaneously announced that the Government plans to introduce amendments to the ICA that will require annual reporting on the administration of the ICA's national security provisions. This will add helpful transparency for foreign investors.

Conclusion

The Guidelines represent a potentially meaningful shift in the Government's approach to national security reviews that should be welcomed by the investment community. The increased openness and transparency should assist foreign investors in obtaining clarity as to whether their transactions may become subject to the national security regime and how best to handle transactions that may raise such issues. While by its nature such reviews are based on specific circumstances, and while issues related to national security have inherent sensitivity with respect to confidentiality, the issuance of the Guidelines is a significant positive step, and another clear indication that Canada remains open to and welcoming of foreign investment.

by Neil Campbell, James Musgrove, François Tougas, Joshua Chad and Josh Freedman, Student-at-Law

[1] Innovation, Science and Economic Development Canada, "Attracting global investments to develop world-class companies", News Release (December 19, 2016), available online:

<www.news.gc.ca/web/article-en.do?nid=1171529>.

[2] *Investment Canada Act*, RSC 1985, c 28 (1st Supp), s 25.1.

[3] Innovation, Science and Economic Development Canada, "Guidelines on the National Security Review of Investments", Guidelines Document (December 19, 2016), available online:

<<http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81190.html>>.

[4] Innovation, Science and Economic Development Canada, “Attracting global investments to develop world-class companies”, News Release (December 19, 2016), available online:

<www.news.gc.ca/web/article-en.do?nid=1171529>.

[5] U.S. Department of the Treasury, “Guidance Concerning the National Security Review Conducted by CFIUS” (8 December 2008), 73 Fed. Reg. 74567, available online:

<www.treasury.gov/resource-center/international/foreign-investment/Documents/CFIUSGuidance.pdf>.

[6] Innovation, Science and Economic Development Canada, 2015-16 Annual Report on the Investment Canada Act (August 2016) at 1, available online: <www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_1k81188.html>.

[7] Julius Melnitzer, “Feds agree to new national security review for foreign businessman” (22 November 2016), Lexpert Online, available online:

<www.lexpert.ca/article/feds-agree-to-new-national-security-review-for-foreign-businessman>.

[8] *Guidelines* at para 6.

[9] *Canada Evidence Act*, RSC 1985, c C-5, s 38.

[10] *Guidelines* at para 6.

[11] *Defence Production Act*, RSC 1985, c D-1. Section 35 of the *Defence Production Act* refers to “controlled goods”. Controlled goods are defined in a schedule to the act to include, among many other items, specific firearms, vehicles designed for military use, and rockets and other explosive devices.

[12] The *Guidelines* identify the [National Strategy for Critical Infrastructure and Action Plan for Critical Infrastructure as a reference for additional information on Canada' critical infrastructure](#). This strategy document (that was first published by Public Safety Canada in 2009) lists ten critical infrastructure sectors in Canada: (i) energy and utilities; (ii) finance; (iii) food; (iv) transportation; (v) government; (vi) information and communication technology; (vii) health; (viii) water; (ix) safety; and (x) manufacturing.

[13] *Guidelines* at paras 8, 10.

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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