'TRICK OR TWEAK' – PROPOSED RELAXATION OF FOREIGN OWNERSHIP RESTRICTIONS

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The Federal Government gave first reading on May 16, 2017 to Bill C-49, an Act to amend the *Canada Transportation Act* (the "**CTA**") and other acts respecting transportation[1].

As the government announced previously, Bill C-49 proposes to allow increased ownership of voting interests in Canadian air services with non-Canadians being entitled to own up to 49% of the voting interests. Currently, Section 55(1) of the CTA defines "Canadian" 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."

Bill C-49 introduces an amendment to Section 55(1) that replaces the underlined words with the following:

> "(c) a corporation or 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 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;"

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 license is a "Canadian". Section 55(1) of the CTA provides a two-part ownership test for Canadian air services, the first part being the *de jure* test of percentage ownership of voting interests, and the second part being the *de facto* test of "control in fact". Bill C-49 changes the de jure test but makes no change in the *de facto* test.

Increasing the percentage of the aggregate voting interests that non-Canadians are permitted to own up to 49% may provide additional flexibility for Canadian air services to attract investment from non-Canadians provided those non-Canadian investors are completely unrelated and no single investor or any person with whom it has an affiliation hold more than 25% of the voting interests, directly or indirectly. Critically, however, Canadians must still retain 'control in fact' of air services. The Agency will consider a wide range of factors and make a subjective assessment of whether Canadians retain control in fact. The Agency has published a non-exhaustive list of factors it will consider that includes the following[2]:

- Risks and benefits
- Concentration of voting interests
- Board of Directors
- Officers
- Shareholder and Board of Directors' meetings
- Veto rights
- Security rights, options, and warrants
- Rights of first refusal / Pre-emptive rights
- Debt
- Guarantees
- Power to wind-up the company
- Lease of assets
- Financial strength and business activity
- Management agreements
- Operational or service agreements
- Charterer / air carrier relationship

It is important to recognize that the Agency's assessment need not be based on the actual exercise of control, but the potential ability to exercise of control, directly or indirectly. 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. Control in fact is determined based on an assessment of the ongoing power and ability, whether exercised or not, to determine or decide the strategic decision-making activities of an air carrier and the ability to manage its day-to-day operations.

Under the new regime, if non-Canadians hold up to 49% of the voting interests of a licensed Canadian air service, the Canadian licensee will still have to demonstrate, on an ongoing basis, that the non-Canadians are unaffiliated and are not acting, will not act, and cannot act, directly or indirectly, together to exercise control. Exactly how one will be able to demonstrate those facts to the satisfaction of the Agency remains to be seen.

We know that even in circumstances in which Canadians hold 75% of the voting interests, the Agency may be extremely skeptical that a non-Canadian holding the remaining 25% is not able to exercise control in fact. 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 the Canadian interests are held by more than one person. 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 proposed amendments would also likely not immediately reduce the foreign ownership restrictions for air carriers who obtained domestic licenses based in part on incorporation documents containing the current voting interest restrictions or subject to conditions relating to monitoring and filing periodic reports on foreign ownership of voting interests. Changes in these areas that are likely to affect a carrier's Canadian status would trigger the requirement to provide notice to the Agency and, potentially, further review of the carrier's continuing eligibility to hold a domestic license.

It is not clear whether the proposed amendment to the CTA effects a real substantive 'tweak' to the rules or whether the change is illusory and a 'trick'. The proposal in Bill C-49 may be of some assistance in allowing Canadian air carriers to obtain investment funds from non-Canadian sources, but the circumstances in which those investments can be implemented without running afoul of the control in fact test appear to be very limited.

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[1] Bill C-49 is subject to amendment as it proceeds through the parliamentary process and will not become effective until approved by Parliament and royal assent is given.[ps2id id='1' target='/]
[2] Canadian Transportation Agency, Interpretation Note: Control in Fact – October 5, 2015.[ps2id id='2' target='/]

A Cautionary Note