

CANADIAN BUSINESS LAW



**INVESTMENT
CANADA ACT** **FAQ**
Q: Is Canada still open to foreign direct investment?

A: Absolutely. Although a recent high profile transaction received a heightened level of public and political attention, and there is also some uncertainty whether there may be a general policy and/or legislative change on the horizon, there is no doubt that the Canadian government is generally supportive of foreign direct investment. Since the *Investment Canada Act* (the "ICA") came into force a quarter of a century ago, over 99% of reviewable transactions have been approved. As discussed in more detail below, only two transactions were rejected and they each had unique circumstances.

Q: How does the ICA work?

A: The ICA has three distinct processes applicable to foreign direct investment in Canada: notifications, economic reviews under the "net benefit" to Canada test, and national security reviews. A notification is a very simple filing that is often made after closing, when a non-Canadian investor acquires control of a Canadian business or commences a new business. No governmental approval is required for notifications.

An economic review under the "net benefit to Canada" test is required in certain cases when a non-Canadian investor acquires control of a Canadian business, and certain thresholds are exceeded. Reviewable investments in Canadian businesses generally require ministerial approval before closing.

A national security review may be required where the government believes that there are reasonable grounds to believe that an investment may be injurious to national security. If the process is initiated by the government, governmental approval must be obtained. National security reviews are expected to be rare.

Q: What is the trigger for an ICA notification?

A: A notification is required where there is an acquisition of control of a Canadian business by

a non-Canadian, and where the thresholds for an economic review are not met. A Canadian business exists where the target business has: (i) a place of business in Canada, (ii) individual(s) in Canada who are employed or self-employed in connection with the business and (iii) assets in Canada used in carrying on the business. Generally, the Canadian business test is easily met. Notifications are also required when new Canadian businesses are established by a non-Canadian.

Q: What is the trigger for an ICA economic review?

A: There must be an acquisition of control of a Canadian business by a non-Canadian in one of the ways specified in the statute and an asset value threshold must be exceeded. In the case of buyers who qualify as "WTO Investors" under the ICA the threshold for 2010 is exceeded where the Canadian business has assets with a book value greater than CDN\$299 million (unless a cultural business is involved). There are technical issues associated with measuring asset values that are beyond the scope of this FAQ.

Q: Wasn't the ICA amended to increase the threshold and bring in a new "enterprise value" test?

A: Yes, but implementing regulations have not been enacted and the process currently appears to have stalled.

Q: Are there exemptions from review requirements?

A: There are a number of exemptions. The most important exemption is for an indirect acquisition of a Canadian business by a WTO investor (i.e., acquisition of control of the offshore parent corporation of a Canadian corporation). Although the test is complex, a WTO investor is most commonly found to exist where an entity is controlled by persons who are residents of one or more states that are members of the World Trade Organization.

Q: What if there is only a head office and perhaps a stock exchange listing in Canada and the operating assets are located outside of the country?

A: Generally speaking, this fact is insufficient to exempt a transaction from a review, if otherwise required. Even if all operations are offshore, the existence of the Canadian head office will usually be sufficient to constitute a “Canadian business” under the ICA.

Q: Are there sensitive sectors?

A: The recent amendments to the ICA regarding sensitive sectors have come into force. There is now just one sensitive sector: cultural businesses. Substantially lower thresholds for review apply to acquisitions of control of a Canadian cultural business.

Q: What is a cultural business?

A: The ICA treats a Canadian business as a cultural business if it engages in any of the following activities:

- (a) the publication, distribution or sale of books, magazines, periodicals or newspapers in print or machine readable form, other than the sole activity of printing or typesetting of books, magazines, periodicals or newspapers,
- (b) the production, distribution, sale or exhibition of film or video recordings,
- (c) the production, distribution, sale or exhibition of audio or video music recordings,
- (d) the publication, distribution or sale of music in print or machine readable form, or
- (e) radio communication in which the transmissions are intended for direct reception by the general public, any radio, television and cable television broadcasting undertakings and any satellite programming and broadcast network services.

Q: What if the business is only involved in cultural products to a *de minimis* extent?

A: There is no *de minimis* exemption, in the view of Heritage Canada, the department responsible for administering the ICA provisions in respect of cultural businesses.

Q: Are there special issues for cultural products?

A: Yes, there are a number of unique cultural considerations. The review threshold drops in most cases to CDN\$5 million (book value of assets). In some cases reviews can be ordered where the asset value is below CDN\$5 million. Also, Heritage Canada conducts the review of acquisitions of cultural businesses. Policy considerations of Heritage Canada may play a role in the review. Transactions involving certain cultural sectors are

subject to policies that acquisitions will not be approved except in certain cases. The policies are not always applied.

Q: What must be done to get approval if an economic or cultural review is required?

A: An application for review must be filed with the applicable governmental agency. The application must explain the purchaser’s plans for the business in detail. In many cases it will be necessary to give the Canadian government legally binding undertakings regarding the future operation of the business.

Q: What kinds of undertakings must be given?

A: This varies with the circumstances of each transaction. Generally speaking, undertakings cover employment levels (number of persons), capital expenditure and research and development expenditure levels, the preservation of a Canadian head office, the role of Canadians in senior management and the board of directors, and a wide range of other factors. Undertakings usually run for three to five years after closing.

Q: What is the test for approval?

A: The Minister must determine that the transaction will likely be of net benefit to Canada.

Q: Is the approval process onerous?

A: The process may initially be concerning to foreign investors who are unfamiliar with it. However, the government agency conducting the review has extensive experience and will endeavour to reach an outcome that is acceptable to the investor while still providing a sufficient basis for the Minister to properly approve transactions. As discussed in this FAQ, high profile transactions are likely to experience a much higher degree of scrutiny.

Q: Is the review process public?

A: No. At present the investment review process is conducted in strict confidence as required by the ICA. It is important to note that it is common on more significant transactions for the investor (at the request of the government), or the government in some cases, to issue a press release at the end of the process that discloses information regarding the main elements of the undertakings given by the investor. It is also of note that a private member’s bill to remove confidentiality protections for undertakings and parts of the enforcement process was introduced in Parliament in March 2010. However, this bill has not passed first reading and it is unclear whether it will ever become law. More recently, following the decision on the PotashCorp matter discussed below,

the House of Commons unanimously passed a non-binding motion that the ICA review process be more open, collaborative and finally accountable to communities affected by these decisions.

Q: How long does a review take?

A: A typical review usually takes 60 – 75 days, but this varies depending on the circumstances.

Q: Are there special rules applicable to state-owned enterprises (“SOEs”)?

A: SOE investments are reviewed according to the same factors that apply to private investors. That said, the government has issued guidance as to particular issues it will consider when reviewing SOE transactions. In short, the Minister will need to be satisfied as to the commercial orientation of the investor and that its governance structure meets commonly accepted business norms. Undertakings may be required to address these issues.

Q: Has the government approved SOE investments in the past?

A: Yes. A number of such investments have been approved including by Chinese, Korean, European and Middle Eastern SOEs.

Q: Which transactions have been rejected under the ICA?

A: There have been two rejections to date. The first, in 2008, was in respect of the proposed acquisition by a United States defence company, Alliant Techsystems Inc., of the space business of MacDonald, Dettwiler & Associates Ltd. That business developed and operated the Radarsat satellite program, as well as the robotic arm attached to NASA’s space shuttle.

The second rejection, in November 2010, was in respect of the proposed acquisition of Potash Corporation of Saskatchewan Inc. (“PotashCorp”) by BHP Billiton Plc. There was strenuous objection to the acquisition by the province of Saskatchewan where most of PotashCorp’s mines are located, echoed by other provincial governments, as well as from other stakeholders. The Minister of Industry issued a press release on November 3, 2010 that referred to a notice that he had sent to BHP to the effect that he was not, at that time, satisfied that the proposed transaction was likely to be of net benefit to Canada and informed BHP that it had 30 days to make any additional representations and undertakings it deemed appropriate. Ten days later, the Minister issued a press release stating that he had been informed that BHP Billiton had withdrawn its application for review and that this terminated the ICA review process. The Minister

stated that Canada welcomed foreign investment as being in the best interests of Canada for all the benefits it brings, including new ideas, sources of capital, and job creation. However, in the case of this particular acquisition the Minister determined that three of the criteria specified in the ICA were not satisfied, in particular, the criteria relating to Canada’s ability to compete in world markets, productivity, efficiency and innovation in Canada, and the country’s overall level of economic activity.

Q: Do politics play a role under the ICA?

A: In some cases politics may be very important. Although the factors to be considered by the Minister are specified in the ICA, they are often very broad. For example, one of the specified factors is the compatibility of the investment with national industrial, economic and cultural policies. The Minister therefore has considerable discretion when making decisions about particular investments. Also of note is that there is consultation with other federal governmental departments and affected provincial governments. Individuals and organizations may make submissions to the government. In recent years, the ICA process has received a higher degree of political prominence, which places the Minister under a higher degree of scrutiny. Some transactions have been the subject of political debate in Parliament. However, the Minister and his staff can be expected to take care to exercise their responsibilities within the requirements of the ICA.

Q: What is the role of governmental relations and public relations advisors?

A: In many cases, significant governmental relations and public relations efforts will not be required. However, for transactions that may raise politically sensitive issues, GR and PR strategies and implementation are essential. An early assessment (well before public announcement) of political risk should be made. It is often appropriate to make courtesy calls and meet with key municipal, provincial and federal officials, in order to introduce the investor and explain the rationale. Engaging with such officials at the earliest possible date often allows any concerns to be raised and addressed on a constructive basis. In these cases ongoing monitoring of the political and public reaction to a transaction is very important.

Q: How does the national security review process work?

A: There are a number of steps, but in essence the ICA allows the government to initiate a review where there are reasonable grounds to believe that an investment may be injurious to national security. Unlike the economic review provisions, there does not have to be

an acquisition of control of a Canadian business. Once commenced, a transaction may not be completed until approval is obtained. Closed transactions are subject to remedies including divestiture orders.

Q: Is there a voluntary filing process to deal with national security issues?

A: No. However, in some cases it is possible to provide the government with notice of the transaction before closing and obtain the benefit of a statutory prohibition on a review, once applicable time periods have expired.

Q: Have any national security review processes been commenced?

A: We are aware of only one such case. A national security notice of a potential review was issued in respect of the proposed acquisition by George Forrest International Afrique S.P.R.L. ("GFI") of Forsys Metals Corp ("Forsys"). Forsys owned uranium exploration and development properties in Namibia, which were not in production. The transaction did not complete. It does not appear that a full national review was ever commenced.

Q: Is there a process to enforce undertakings?

A: Yes. The ICA has an enforcement provision. Remedies include fines and divestment of the acquired business. The Attorney General of Canada ("AGC") has commenced proceedings against US Steel in relation to undertakings it gave when it acquired Stelco. The AGC alleged that US Steel has breached undertakings related to production and employment levels. US Steel is vigorously defending the proceeding and is, among other things, arguing that the global downturn is a critical factor that must be considered when assessing compliance. US Steel has also brought a constitutional challenge regarding the ICA enforcement provision. Although its challenge was dismissed at the trial level, US Steel is pursuing an appeal.

Q: Are changes expected to the ICA and related policy?

A: Yes, although it is difficult to predict the details. The Minister is expected to provide further guidance about the government's current views on foreign investment in the near future. It is likely that Parliament and the Industry Committee will consider amendments to the ICA, including amendments to make more of the process open to the public. It is also worth noting that some amendments made in 2009 to move from an asset value test to an enterprise value test and to increase the review threshold from the current CDN\$299 million (the threshold for 2010) to CDN\$600 million have not yet come into force due to the lack of implementing regulations. It is unclear at this time whether these amendments will ever come into force.

Q: Is the current climate favourable for foreign investment in Canada?

A: While there has been more public scrutiny and political debate of a few high-profile transactions in recent years, the Canadian government has repeatedly and clearly stated that in general it is strongly supportive of foreign direct investment in Canada. In the wake of the PotashCorp decision it can be expected that there will be further formal and informal guidance from the government as to the review process. There may also be amendments to the ICA with particular emphasis on transparency and enforcement. Early assessment of ICA issues is essential for the development of a successful strategy to obtain approval.

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