



Regulation of Foreign Investment



1. Overview

Foreign investment in Canada is regulated by the federal *Investment Canada Act (ICA)*. Its purpose is to encourage foreign investment on terms that are beneficial to Canada.

While the ICA is primarily administered by Industry Canada, the Department of Canadian Heritage administers the ICA in relation to defined “cultural businesses,” which will be discussed later in this section. In general, the acquisition of

control of an existing Canadian business or the establishment of a new Canadian business by a foreign investor is subject to notification or review.

Notification is a simple process involving completion of a prescribed form to provide basic information about the foreign investor and the Canadian business. It is not an impediment to the closing of an acquisition. In fact, since it can be submitted within 30 days of closing, it is usually submitted after closing.

Where review is required, the foreign investor must submit more detailed information about itself and the Canadian business before closing, including its detailed plans for the Canadian business, and may only complete the proposed investment if the Minister of Industry or the Minister of Canadian Heritage, as applicable, determines it to be of “net benefit to Canada.”

Whether the investment is reviewable or merely notifiable depends on a combination of the following factors:

- The value of the assets of the Canadian business;
- Whether the investor is controlled by residents of a World Trade Organization (WTO) member state;
- Whether the Canadian target carries on a defined cultural business; and
- Whether the investment is to be effected directly, through the acquisition of a Canadian business, or indirectly, through the acquisition of a foreign business of which the Canadian business is a subsidiary.

Certain transactions involving foreign investors are exempt from the provisions of the ICA, such as internal corporate reorganizations that involve no change of ultimate control, realization of security held by a foreign entity on Canadian assets, bona fide estate transfers

and acquisitions of control of Canadian businesses subject to review under other Canadian legislation, such as the *Bank Act* (Canada).

2. Canadian Business

A business is deemed Canadian when it has:

- A place of business in Canada;
- One or more individuals in Canada who are employed in connection with (but not necessarily by) the business; and
- Assets in Canada that are used to carry on the business.

3. Foreign Investor

A foreign investor is essentially a non-Canadian.

With respect to individuals, a Canadian is a Canadian citizen or, subject to certain qualifications, a permanent resident of Canada within the meaning of Canada’s immigration legislation.

With respect to a business undertaking, including one owned by a government, the undertaking is considered Canadian if it is Canadian-controlled. Provisions relating to Canadian control are detailed and complex, but generally:

- If one Canadian, or two or more Canadian members of a voting group, owns a majority of the voting interests of an entity, the entity is Canadian-controlled;

- Conversely, if one non-Canadian, or two or more non-Canadian members of a voting group, owns a majority of the voting interests of an entity, the entity is not Canadian-controlled;
- With respect to a widely held public company that is not controlled in fact through the ownership of voting shares, the corporation is deemed to be Canadian-controlled if at least two-thirds of the board of directors is Canadian.

4. Acquisition of Control

The ICA contains detailed and complex provisions relating to the acquisition of control of a Canadian business by a foreign investor. To summarize:

- The acquisition of a majority of a corporation's voting shares is deemed to be an acquisition of control;
- The acquisition of less than a majority but more than one-third of a corporation's voting shares is considered an acquisition of control, unless it can be established that the acquiring party will not have control in fact of the corporation. For example, a 40 per cent acquisition would not result in control if another shareholder owned the other 60 per cent and there is no shareholders' agreement that limits the larger shareholder's rights.
- The acquisition of less than one-third of a corporation's voting shares is not deemed an acquisition of control unless it can be established that the acquiring party will have control in fact of the corporation. For example, a 30 per cent acquisition of the voting shares of a publicly traded corporation that is otherwise widely held is not considered an acquisition of control.

5. Review Thresholds

Thresholds differ depending on the characteristics of the investor and the investment in question. If the review thresholds are not exceeded, the investment is subject to the simple notification procedure previously described.

a. Direct Investment by a WTO Resident Investor in a Non-cultural Business

The proposed direct acquisition of a Canadian business by an investor that is a resident of a WTO member is reviewable if the book value of the assets of the Canadian business, as stated on its financial statements at the end of its most recently completed fiscal year, exceeds \$312 million.¹ A lower threshold applies if the Canadian business is engaged in cultural business activities (discussed below).

It should be noted that in early 2009, the government announced its intention to replace the book-value threshold with a much higher threshold based on enterprise value. When it takes effect, the enterprise-value threshold will be set initially at \$600 million and then incrementally increased to \$1 billion over the next few years, with further increases contemplated after that. At the time of the government's announcement, the transition was expected to occur fairly quickly. However, it has been delayed, apparently over problems relating to the development of a user-friendly formula for determining the enterprise value of publicly traded corporations. It is not known when the transition will occur.

b. Direct Investment by a WTO Resident Investor in a Cultural Business

The proposed direct acquisition of a Canadian cultural business by an investor that is a resident of a WTO member is reviewable if the book value of the assets of the Canadian business exceeds \$5 million.

Cultural businesses include:

- The publication, distribution or sale of books, magazines, periodicals or newspapers in print or machine-

¹ The figure of \$312 million applied in 2011. It is adjusted annually based on the change in Canada's GDP.

readable form, but not including the sole activity of printing or typesetting books, magazines, periodicals or newspapers;

- The production, distribution, sale or exhibition of film or video recordings;
- The production, distribution, sale or exhibition of audio or video music recordings;
- The publication, distribution or sale of music in print or machine-readable form; and
- Radio communications 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.

The ICA does not provide an exemption for *de minimis* involvement in a cultural business. Even if a Canadian business is primarily involved in non-cultural business activities, a minimal involvement in cultural business activities will trigger the review obligation if the \$5-million threshold is exceeded.

When review is required in respect of a proposed acquisition of a Canadian business that involves both non-cultural and cultural business activities, applications for review must be submitted to Industry Canada (in respect of the non-cultural aspects of the business) and the Department of Canadian Heritage (in respect of the cultural aspects of the business).

c. Indirect Investment by a WTO Resident Investor

Indirect investments by WTO resident investors are not reviewable unless they involve the acquisition of a Canadian cultural business, in which case the \$5-million threshold applies.

It should be noted that structuring a transaction for the purpose of avoiding review (e.g., incorporating a corporation outside of Canada, the sole assets of which are the shares of the Canadian corporation, and then purchasing the shares of the foreign corporation) is not permissible.

d. Direct Investments by a Non-WTO Investor

A proposed direct acquisition of a Canadian business by an investor that is not a resident of a WTO member is reviewable if the book value of the assets of the Canadian business exceeds \$5 million, regardless of whether the Canadian business is engaged in non-cultural or cultural business activities.

e. Indirect Investment by a Non-WTO Investor

The proposed indirect acquisition of a Canadian business by an investor that is not a resident of a WTO member is reviewable if:

- The book value of the assets of the Canadian business exceeds \$50 million; or
- The book value of the assets of the Canadian business exceeds \$5 million and the value of the assets of the Canadian business represents more than 50 per cent of the value of the assets of the target's entire international business.

As with indirect acquisitions by residents of a WTO member, the \$5-million threshold also applies if the Canadian business is engaged in cultural business activities.

f. Discretionary Powers

In addition to reviews that result from the application of the above-listed rules, the government has other discretionary powers to order a review. For example:

- The government can review any investment that “could be injurious to national security”; and
- With respect to most types of cultural businesses, the government can:
 - Elect to review the acquisition of control of an existing business or the establishment of a new Canadian business within 21 days of receiving the foreign investor's notification; or
 - Deem a business that carries on or proposes to carry on any such business to be non-Canada-

dian on the basis that the business is controlled in fact by one or more non-Canadians.

6. Review

Where review is required, the foreign investor submits an Application for Review and may not complete the proposed investment until the Minister of Industry and/or Minister of Canadian Heritage, as applicable, has determined it to be of “net benefit to Canada.”

In the application, detailed information is required about the foreign investor, the Canadian business and the foreign investor’s plans for the Canadian business.

To determine whether the proposed investment is likely to be of net benefit to Canada, the government considers factors including:

- The effect of the investment on the level and nature of economic activity in Canada, including its effect on employment; resource processing; the utilization of parts, components and services produced in Canada; and exports from Canada;
- The degree and significance of participation by Canadians in the business;
- The effect on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;
- The effect on competition within any industry in Canada;
- Compatibility with national industrial, economic and cultural policies; and
- Its contribution to Canada’s ability to compete in world markets.

In considering these factors, the Minister of Industry or the Minister of Canadian Heritage, or both as applicable, consults with other relevant federal government departments as well as the governments of affected provinces, which are typically provinces in which the

Canadian business has assets or employees.

A determination of net benefit to Canada is usually based on undertakings made by the foreign investor in relation to the factors outlined above. Undertakings are legally binding commitments made by a foreign investor that typically remain in effect for three to five years and are subject to compliance reviews and audits over that time. In our experience, the government is most concerned with: securing undertakings that relate to specific levels of employment in Canada, the inclusion of Canadians in management positions, capital investment in the Canadian business and further development in Canada of Canadian-sourced technology. However, the specific focus of the undertakings varies depending on the nature of the business.

a. Timing

The ICA provides the Minister of Industry and/or Minister of Canadian Heritage, as applicable, with 45 days to determine whether a proposed investment would be of net benefit to Canada, along with a unilateral right to extend the review period by an additional 30 days. Additional extensions require the agreement of the foreign investor, without which the applicable Minister would likely reject the investment. In our experience, it is not uncommon for the review of large and complex transactions with significant political overtones to extend beyond 75 days.

b. Possible Outcomes

The government may either approve the proposed investment or reject it. Almost all proposed investments are ultimately approved based on undertakings negotiated between the investor and the government.

The only application that has been formally rejected was Alliant Techsystems’ proposed acquisition of MacDonald, Dettwiler and Associates’ Information Systems and Geospatial Service Operations division. The transaction would have involved the sale of satellite technology to a U.S.-controlled corporation. The development of this technology had been heavily subsidized by Canadian taxpayers, and the Canadian government consid-

ered it essential to the surveillance of Canada's vast northern territory, due in part to its ability to obtain images through cloud cover.

In late 2010, BHP Billiton withdrew its take-over bid for Potash Corporation of Saskatchewan after the government indicated that it would reject BHP Billiton's application.

In early 2011, there was a great deal of media speculation as to whether the government would approve the London Stock Exchange's proposed acquisition of Canada's TMX Group. In this case, the government did not have to decide, as the deal fell apart when it became clear that the required majority of TMX Group's shareholders was not going to support it.

An unknown number of other applications may have been withdrawn before an adverse decision was rendered. For transactions that could raise significant political concerns, foreign investors should not underestimate the importance of an effective government-relations strategy.

c. Fee

There is no filing fee for either an application for review or a notification.

7. National Security

In early 2009, the ICA was amended to provide the government with the right to review any investment that "could be injurious to national security." This right not only applies to the acquisition of control of existing Canadian businesses, but also to minority investments, internal reorganizations and the establishment of new Canadian businesses. It can also apply to investments in businesses with tenuous links to Canada, as a review can be ordered in respect of an investment in a business if "any part" of its operations is in Canada. There is no minimum investment size below which a review on national security grounds may not be ordered, and the government has provided no guidance as to what kind of investment constitutes a threat to

national security. The national security provision empowers the government to prohibit any proposed investment, impose conditions on its completion or require divestiture of a completed investment.

The degree of power and discretion afforded by the national security provision caused a great deal of angst among potential foreign investors when it was added to the ICA. However, experience to date suggests that the government has used the power very conservatively.

While full information about the use of the power is not publicly available, it appears that it may have been used only once, possibly contributing to the termination of George Forrest International Afrique's (GFI) proposed acquisition of Forsys Metals (Forsys).

Forsys is a mineral exploration company, the shares of which trade on the Toronto Stock Exchange. One of its projects is a uranium deposit in Namibia. Media coverage suggested that the Iranian government could possibly be one of the sources of GFI's funding. The Canadian government has not received significant criticism for blocking a transaction that could have resulted in the Iranian government acquiring some form of an interest in a uranium deposit, even if the deposit in question was located in Africa and Forsys itself did not appear to have any mineral projects in Canada.

The conservative use of the national security review power is not surprising, as its arbitrary or unreasonable use would likely discourage foreign investment that is critical to the Canadian economy, which the ICA is intended to encourage. It is worth noting that, in the same round of amendments that added the national security review power to the ICA, other amendments were made that were intended to liberalize foreign investment, including the elimination of three sensitive sectors (leaving cultural businesses as the only remaining sensitive sector) and the planned substantial increase in the review threshold for direct investments by residents of WTO members. On balance, the amendments were intended to increase foreign investment in Canada, not decrease it.

The biggest risk to foreign investors posed by the national security review power relates to transactions that do not exceed the applicable mandatory review threshold. As these deals can be completed before being notified, it is possible that the government could conduct a review and order divestiture after closing. Given that the government may not commence a national security-related review more than 45 days after receiving an investor's notification, foreign investors have a means to address this risk. Where a proposed transaction could possibly raise national security-related concerns given the nature of the acquired Canadian business and/or the foreign investor, the investor can submit a notification more than 45 days before closing and include a closing condition in the purchase agreement that either no national security review shall have been commenced or any such review that is commenced shall have been concluded on terms satisfactory to the investor.

8. State-owned Enterprises

In late 2007, the government issued guidelines to clarify how the “net benefit to Canada” test will be applied in the context of proposed investments by foreign state-owned enterprises (SOEs). The purpose of the guidelines is to ensure that the acquired Canadian business will continue to be operated on a commercial basis with transparent corporate governance and reporting requirements, rather than to serve the non-commercial, political objectives of a foreign state.

Factors to be considered are the nature and extent of control of the SOE by its government; the corporate-governance, operating and reporting practices of the SOE; and whether the acquired Canadian business would retain the ability to operate on a commercial basis. The guidelines provide a non-exhaustive list of undertakings that SOEs may offer to demonstrate net benefit to Canada. These include the appointment of Canadians to boards of directors, employing Canadians in senior management positions, the incorporation of a company in Canada and the listing of shares on a Canadian stock exchange.

9. Sector-specific Legislation

In addition to the general ICA process, various federal and provincial statutes place additional restrictions on foreign ownership in specific industries.



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