THE LAWYERS WEEKLY

Canada's new foreign investment review standard raises concerns

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May 15 2009 issue

Canada recently adopted a new review standard for foreign investments affecting national security — but the discretionary nature of the review and the potential for arbitrary enforcement may make Canada look hostile to foreign investment.

(Gerald Bustamante / Images.com)

The Australian example

Earlier this year, the Australian government blocked a US$1.8 billion deal involving the proposed takeover by China Minmetals Group of Oz Minerals Ltd. China Minmetals is a Chinese state-controlled company engaged in the production and trading of metals and minerals, including coppers, aluminum, tungsten, tin, antimony, lead, zinc and nickel. It is also the largest iron and steel trader in China. Oz Minerals is Australia's third largest mining company and the world's second largest producer of zinc. It also produces copper, gold, lead and silver. Oz was seeking outside investment in order to meet its debt obligations.

According to Australia's treasurer, Wayne Swan, the proposed China Minmetals acquisition was denied approval on national security grounds. There was nothing particularly sensitive about Oz's operations in and of themselves. Rather, the Australian government was concerned that one of Oz's copper and gold mines was near a weapons testing site in Southern Australia that, in the words of the Australian treasurer, "makes a unique and sensitive contribution to Australian defence."

Apparently, the mere proximity of a Chinese-owned mine to the weapons testing site was a sufficient basis to kill the deal. (In late April, a revised deal between China Minmetals and Oz Minerals that excluded the acquisition of the mine near the weapons testing site was approved by the Australian government.)

The Australian government's decision was made pursuant to its authority under the *Foreign Acquisitions and Takeovers Act 1975* and came against the backdrop of substantial public opposition to investment in Australia by Chinese state-owned enterprises. The Australian government's interpretation of "national security" may be aggressive, but it is only one example in a growing list of steps taken by various governments to regulate and limit the scope of foreign investment in their jurisdictions, particularly by so-called SOEs (state-owned enterprises).

Canada's review process

So, could the same thing happen in Canada? In a word — yes.

Like Australia, Canada has a statutory regime in place to review foreign investments in the country, the *Investment Canada Act*. Pursuant to the Act, foreign investors acquiring control of Canadian businesses (or establishing new businesses in Canada) must notify the Canadian government and, in certain cases, obtain approval before they can implement their investments.

Until recently, the Act did not contain a specific process to review foreign investments on national security grounds. The Canadian government saw the lack of an express national security review power to be an important gap in its authority, leaving it out of step with other countries such as the U.S. (However, the absence of an express national security review power did not preclude the Canadian government from blocking the proposed acquisition in 2008 of a Canadian satellite company by a U.S. investor because of concerns about the impact it would have on Canada's ability to assert sovereignty over territories in the Arctic.)

In March 2009, amendments to the Act were enacted to address the perceived gap by creating a new review process for investments that "could be injurious to national security." If, following review, the government is satisfied that the investment could indeed be injurious to national security, it can take any measures that it considers advisable, including the outright prohibition of a proposed investment or forced divestiture in the case of a completed investment.

The discretionary nature of the Act's new national security review provisions, and the potential for arbitrary enforcement, has introduced significant uncertainty into the potential application of the Act to foreign investments in Canada (see sidebar). This uncertainty is unhelpful in the current environment and must be remedied if Canada is to avoid acquiring the reputation of being hostile to foreign investment.

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National security review process concerns

Given the potentially severe consequences, there are a number of very serious concerns about the *Investment Canada Act*'s new national security review process:

- The term "national security" has been deliberately left undefined to allow the government the widest possible discretion. For example, it is not limited to defence-related concerns, but could be easily applied to broader economic and social issues.
- The threshold for government intervention is low — "could be injurious to national security." This could easily lend itself to the type of broad interpretation seen in the Oz Minerals case in Australia.
- There are no monetary thresholds that must be exceeded to trigger a national security review.
- Unlike the normal review process under the Act, there does not have to be an "acquisition of control" of a Canadian business to trigger national security review. Instead, the standard has been relaxed such that a national security review could occur even where there has been a minority investment that does not even transfer de facto control.
- The time frame within which the review must take place has not been prescribed (as it is in normal review under the Act).
- The government may review a transaction on national security grounds even after it has closed, and there is no process for investors to request pre-closing approval in order to obtain comfort. Investors must wait until notified by the government that their transactions are under review, which could happen pre or post-closing.