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Canada Lowers the Wall to Foreign Investment

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At a time when trade globalization is attracting new controversy, the Canadian government has taken steps to encourage increased foreign investment in Canada. These measures promise a more attractive and welcoming foreign investment climate.

First, the Canadian government has announced that one of the key thresholds under the *Investment Canada Act* (ICA) will be increased two years earlier than originally planned. The objective is to encourage more foreign investment by reducing the number of transactions subject to the ICA's "net benefit" review process.

Second, the Canadian government has announced plans to issue guidelines regarding the ICA's national security review process, which prohibits investments that are "injurious" to Canada's national security interests. The purpose of these guidelines is to inject greater transparency into the process, thereby alleviating the uncertainty and unease currently confronting foreign investors.

Finally, the Canadian government intends to liberalize foreign investment restrictions for Canadian airlines. Specifically, the government plans to permit non-Canadians to own up to a 49% voting interest in Canadian airlines, an increase from the current cap of 25%. The goal is to promote greater competition in Canada's airline industry by opening up additional sources of investment for new entrants.

Higher Net Benefit Review Threshold

Under the ICA, non-Canadians acquiring control of Canadian businesses may be obliged to obtain pre-closing approval from the Canadian government if certain financial thresholds are exceeded. In these circumstances, the non-Canadian investor is required to satisfy the government that its proposed acquisition is likely to be of net benefit to Canada.

The most commonly applied net benefit review threshold governs "direct" acquisitions of non-cultural Canadian businesses by (or from) non-Canadians who qualify as "WTO investors." Under current rules, investments of this nature are subject to review if the "enterprise value" of the assets of the Canadian business exceeds C\$600 million in value. The threshold was scheduled to increase to C\$800 million in 2017 and to C\$1 billion in 2019, when it would increase annually according to a prescribed indexing formula.

The concept of an escalating enterprise value threshold was introduced by the former Conservative government as part of its effort to gradually limit reviews under the ICA to very large transactions and a few other types of acquisitions: (i) acquisitions by non-WTO investors; (ii) acquisitions by foreign state-owned enterprises (SOEs); (iii) foreign acquisitions of Canadian "cultural" businesses; and (iv) foreign investments that raise "national security" concerns. The first three do not benefit from the higher enterprise value threshold and the fourth is governed by an entirely separate review process (discussed below).

On November 1, 2016, the current Liberal government announced in its Fall Economic Statement for 2016 that it intends to introduce legislation to implement the planned C\$1-billion threshold for direct WTO acquisitions two years earlier than originally planned. This decision to accelerate implementation of the C\$1 billion threshold is consistent with the government's overall stated objective of encouraging investments in Canada (both foreign and domestic) that will create new jobs and opportunities for Canadians.

The government's announcement came on the heels of another development that will also serve to modify the ICA's net benefit review process. On October 30, 2016, Canada signed a Comprehensive Economic and Trade Agreement with the European Union (CETA), which, among other things, will require Canada to increase the ICA net benefit review threshold to C\$1.5 billion for acquisitions of control by non-SOE investors from European Union member countries (as well as other countries entitled to "most-favoured nation" treatment

under Canada's current free trade agreements). Legislation is now before Parliament to implement the provisions of CETA into Canadian law (see Bill C-30).

Note that neither the new C\$1-billion threshold for direct WTO investments nor the CETA C\$1.5-billion threshold will apply to investments by non-WTO investors, to investments by foreign SOE investors (whether WTO or not), or to acquisitions of Canadian cultural businesses. These categories of investments will continue to be governed by lower (and in some cases, much lower) thresholds.

Even with the above carve-outs, it is certain that these changes to the ICA thresholds will reduce the number of foreign investments subject to ICA review. That number could diminish even further if the Trans-Pacific Partnership (TPP) is implemented, because it would raise the net benefit review threshold for investments from TPP member countries to C\$1.5 billion.

National Security Guidelines

The Fall Economic Statement's second important announcement in the foreign investment area states, "Before the end of 2016, the government will also publish guidelines under which investments are examined under national security provisions." According to the government, this "increased transparency will help investors better understand and navigate the review process, while ensuring the integrity of our national security processes is maintained."

Since the ICA's national security review was enacted in 2009, critics have complained about the lack of transparency that envelops the process. Just to cite a few of the more troublesome aspects, the ICA does not define what constitutes a "national security" interest, nor does it clarify when an investment could be "injurious" to such interests. And from a process perspective, no mechanism exists whereby an investor can apply for "clearance"; the authorities are often opaque and evasive about explaining concerns to the parties; and public disclosure of decisions (and reasons for those decisions) is virtually non-existent. As a result, even though only a few national security reviews have apparently been conducted since 2009 (reportedly fewer than 10), the shroud of secrecy surrounding the process has elevated the national security review issue into a major source of unease for many foreign investors.

It would be a welcome accomplishment if the proposed guidelines are truly useful in helping foreign investors (and counsel) understand what to expect from Canada's national security review process. We will be offering our assessment once the guidelines are released.

Changes to Foreign Ownership Rules Governing Airlines

In addition to the restrictions on foreign investment represented by the ICA review processes, certain sectors of the Canadian economy are subject to government-imposed limits on foreign ownership.

One of the more prominent examples is the airline industry, which is subject to a statutory cap of 25% on the foreign ownership of voting interests in Canadian airlines. This cap has been criticized as depriving potential new airlines of an important source of investment needed to establish themselves and remain viable competitors.

The Canadian government has now responded to these criticisms by reviving a Conservative proposal to raise the cap on foreign ownership of Canadian airlines to 49%, from 25% (although any individual foreign investor or investor group would be prohibited from owning a greater than 25% voting interest). As explained by Canada's Minister of Transport, the government's stated objective is to encourage more competition and lower fares through the creation of new, ultra-low-cost airlines in Canada. Indeed, as a sign of its commitment in this area, the government also announced that, even though amending legislation is expected in 2017, it will issue exemptions to two existing airline companies to allow them to immediately pursue increased foreign investment, with appropriate conditions.

While moving to liberalize current restrictions, the government has obviously decided not to cross the foreign ownership Rubicon by permitting non-Canadians to *control* Canadian airlines, either by owning a majority of voting interests or via "control in fact." It's open to question whether that day will ever come. What also remains to be seen is whether the government will eventually seek to liberalize foreign ownership restrictions governing other protected sectors of the Canadian economy, such as telecommunications and broadcasting.

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