MARCH 13, 2024

Canadian Government to Enhance Scrutiny of Foreign Investments in the Interactive Digital Media Sector

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The Canadian government recently issued two policy statements (IDM Statements) affirming that it will enhance its scrutiny under the *Investment Canada Act* (ICA) of foreign investments in the Canadian Interactive Digital Media (IDM) sector. One of the statements sets out the government's position with respect to net benefit reviews under the ICA (IDM Net Benefit Statement), and the other concerns ICA national security reviews (IDM National Security Statement). The Minister of Innovation, Science and Industry and the Minister of Canadian Heritage also issued a joint statement further commenting on these new policies affecting IDM (Joint IDM Statement).

The IDM Statements, which were issued on March 1, 2024, reflect a general shift to greater rigour in net benefit and national security reviews of investments in specific sectors (such as critical minerals) or in respect of investments by state-owned and other investors from hostile jurisdictions—which in practice to date has largely meant China or Russia. As such, they highlight the need for non-Canadian investors to consider the national security and cultural net benefit review implications of their IDM investments in Canada at an early stage.

What Is IDM?

IDM is broadly defined in the Policies as "digital content and/or an environment in which users can actively participate or that facilitates collaborative participation among multiple users for the purposes of entertainment, information or education, and [which is] commonly delivered via the Internet, mobile networks, gaming consoles or media storage devices."

Examples of IDM business activities listed in the IDM Statements include personal computer (PC) gaming, console gaming, cloud gaming, mobile gaming, and products involving immersive technology or augmented reality. However, on their face, the IDM Statements appear to apply more broadly to include technology platforms and mobile apps that can be used for entertainment, education, training, and e-commerce such as social media.

Net Benefit Review

Foreign investors proposing an acquisition or other investment that is subject to an ICA net benefit review must satisfy the Canadian government that the proposed investment is likely to be of net benefit to Canada. This often requires that the investor provide certain binding undertakings regarding the operation of the target Canadian business after the implementation of the investment. For more details on ICA net benefit reviews, see our publication Doing Business in Canada.

Given the inclusion of audio and video content, the Canadian government has generally treated IDM as a "cultural" activity for the purposes of net benefit reviews under the ICA where the Canadian business itself engages in these cultural business activities. Net benefit reviews of investments in cultural businesses are conducted by the Department of Canadian Heritage (Heritage Canada).

The Canadian government's position is not free from dispute, however, since the types of business activities characterized as IDM are not expressly referenced in the ICA. The issue is of importance because investments in cultural businesses are subject to much lower review thresholds. In addition, even where foreign investments in Canadian cultural businesses fall below mandatory review thresholds, the government can still order net benefit reviews on public interest grounds.

With the growing importance of IDM to the Canadian economy in recent years, it is our experience that the Canadian government has generally subjected foreign investments in Canadian IDM businesses to more vigorous net benefit reviews. The government has now confirmed and clarified this approach in the IDM Net Benefit Statement. As set out in that statement (and in the Joint IDM Statement), the government's principal concerns are to ensure "the continued expression of Canadian voices and stories reflective of Canadian values" and the creation and retention of distinct Canadian-owned and -created intellectual property (IP). (The government's concerns about retaining Canadian-developed IP in Canada go beyond IDM and apply generally).

Here are some key points from the IDM Net Benefit Statement:

Factors considered. Factors that will be examined to determine whether a proposed foreign investment in the Canadian IDM sector would be of net benefit to Canada include the following:

- the extent to which a foreign state is likely to exercise direct or indirect operational and strategic control over the Canadian business as a result of the transaction;
- the nature of any intellectual property owned or created by the Canadian business to be acquired;
- the degree of competition in the relevant business, and the potential for significant concentration of foreign ownership as a result of the transaction;
- the corporate governance and reporting structure of the foreign enterprise, including whether it adheres to Canadian standards of corporate governance and to Canadian laws and practices, including free market principles, in its Canadian operations; and
- whether the Canadian business to be acquired is likely to continue to operate on a commercial basis.

Stringent undertakings. Foreign investments in Canadian IDM businesses "will likely be subject to stringent undertakings" in order to secure net benefit approval, especially if these businesses create or own IP or create content reflecting Canadian "values," "voices" and "stories."

Creative independence. These types of investments may require undertakings directed at ensuring the "creative independence" of the Canadian business, robust corporate governance and transparency in decision-making, and ongoing reporting, auditing and rights of inspection.

In addition, the Joint IDM Statement notes that investors may also have to agree to commit to undertakings for a longer period of time than the norm, particularly with respect to creative independence, corporate governance and transparency. This could mean undertakings of five years of duration rather than the more typical three years.

National Security Review

Recent years have witnessed an upsurge in national security concerns relating to foreign investments in IDM. The principal concerns revolve around foreign access to the sensitive personal information of Canadians and the use of IDM by foreign states to manipulate information and disseminate propaganda. (Again, access to personal information is an issue of broader national security concern not just limited to IDM).

The IDM National Security Statement focuses specifically on the potential negative effects of investments by "state-sponsored or state-influenced actors" in the Canadian IDM sector, particularly if the states involved are hostile to Canada's national security interests. According to the statement, all such investments (regardless of value or whether they are minority acquisitions) will be subject to "enhanced scrutiny" under the ICA's national security provisions.

The concept of "enhanced scrutiny" is unclear but does not mean that every transaction subject to such scrutiny will be blocked. Rather, the statement signals an increased likelihood of a more probing initial examination and greater risk that the government will conduct a full scale national security review of such an investment, which can significantly extend transaction timelines.

The IDM National Security Statement also sets out factors that the Canadian government will consider in deciding whether to commence a national security review of a foreign investment in a Canadian business involved in IDM products, such as

- the reach and audience of the product's content;
- whether the products have online elements (such as in-game chat logs, in-game purchases, microphone/camera access);
- the nature and extent of the investor's ties to a foreign government;
- whether the Canadian business is likely to be used as a vehicle by a foreign state to propagate disinformation or censor information in a manner that is inconsistent with Canadian rights and values through the investment;
- the composition of the board of directors of the Canadian business; and
- the degree of control or influence the investor would likely exert on the Canadian business, including its product's content.

Given the stakes involved, which could include the Canadian government blocking or unwinding the investment, the IDM National Security Statement also strongly recommends that foreign investors consult the government in advance regarding their investment plans in the IDM sector.

Implications

The IDM Statements do not impose a blanket prohibition on foreign investment in Canadian IDM businesses. In other contexts, for example, the Canadian government has stated that certain types of ICA approvals will be provided only in "extraordinary circumstances." That is not the case here.

Indeed, the Statements affirm that Canada remains open to foreign investment in the sector, albeit with a preference for investments from states that are not considered hostile to Canadian interests. Even with that caution, however, it should be kept in mind that decisions under the ICA are highly discretionary and the outcome of a net benefit or national security review of any given investment will depend on the particular circumstances.

That said, the Statements highlight the need for non-Canadian investors to consider the national security and cultural net benefit review implications of their IDM investments in Canada at an early stage. They also provide some degree of greater transparency into the types of factors and considerations that will inform the government's reviews of these investments. Investors can use these insights to help formulate their transactions and regulatory strategies, including whether to engage with regulators prior to closing, even where not legally obliged to do so.

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