

Foreign Investment Review in Canada

The Impact of the COVID-19 Pandemic Thereon

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In March 2020, government authorities in Canada began implementing measures to deal with the impact of the COVID-19 pandemic (the “Pandemic”). In this article, we discuss the various policies adopted and measures taken to adapt Canadian foreign investment review law to the new realities imposed by the Pandemic. As will be seen, the Canadian government reacted to the Pandemic by broadening the scope of transactions that may give rise to issues, especially insofar as Canadian national security is concerned. As a result, foreign investors must be particularly alert to the potential impact of Canadian government review of their investments in Canada.

A. Overview

The *Investment Canada Act* (Canada) (the “ICA”) is the principal Canadian legislation governing the review of foreign investments in Canada. It is a federal statute and is administered and enforced by the Investment Review Division (“IRD”) of the Ministry of Innovation, Science and Economic Development (“ISED”).¹

The ICA authorizes the Canadian government to review certain investments by non-Canadians in Canadian businesses and, where considered appropriate, to prohibit these investments from proceeding, to order investments to be unwound or divestitures made, or to permit the investments to proceed subject to conditions or undertakings.

There are two aspects to ICA review:

- the “net benefit review” process, and
- the “national security review” process.

(i) Net Benefit Review

Pursuant to the net benefit review process, a non-Canadian acquiring acquire control of a Canadian business (including a business in Canada owned by a foreign entity), and whose acquisition exceeds certain thresholds, must satisfy the government that its investment will be of net benefit to Canada. These

reviews are typically required to take place pre-closing, and are typically completed within approximately 75 days of filing.

Although the ICA sets out various “net benefit” factors to be considered, the decision is largely discretionary and will depend on the type and quality of binding commitments (undertakings) that the non-Canadian investor is prepared to provide the Canadian government with respect to the Canadian business post-investment. Typical undertakings relate to the role of Canadian management; employment; and investments in the Canadian business, such as for capital expenditures and research and development. Virtually all transactions that are subject to net benefit review are approved on the basis of such undertakings

Because of recent increases to the relevant thresholds, only a very few foreign acquisitions of control are subject to full net benefit review in a given year. For example, in the most recent fiscal year for which statistics are available (April 1, 2019 to March 31, 2020), less than 1% of reportable transactions underwent a full net benefit review (nine in total). As for investments where net benefit review thresholds are not exceeded (the vast majority), investors are only required to submit a notice advising the government that the transaction has taken place (“ICA Notice”); they are not required to obtain government approval for the investment. Investors in these circumstances have the option of filing the ICA Notice either before closing or within 30 days following closing.

(ii) National Security Review

The ICA also authorizes the Canadian government to investigate if foreign investments are potentially injurious to Canadian national security interests. If the Canadian government finds that a transaction would be injurious to Canadian national security, it may prohibit the transaction, order it unwound (if already completed), or

¹ For a more detailed discussion of ICA review in Canada, see the Annual Report under the Investment Canada Act for fiscal year

2019/2020, [https://www.ic.gc.ca/eic/site/ica-lic.nsf/vwapi/2019-20AnnualReport_eng.pdf/\\$file/2019-20AnnualReport_eng.pdf](https://www.ic.gc.ca/eic/site/ica-lic.nsf/vwapi/2019-20AnnualReport_eng.pdf/$file/2019-20AnnualReport_eng.pdf).

require “mitigating” undertakings as a condition for approval.

In contrast to the net benefit review process, there are no thresholds for the national security review process. For example, the value of the target Canadian business is irrelevant and minority investments are also subject to review (not just acquisitions of control). The ICA also does not define what qualifies as a “national security” concern, leaving the government broad discretion to decide. In short, essentially every foreign investment is potentially subject to national security review.

There is also no separate application process for national security reviews. In cases where a filing must be made pursuant to the ICA’s net benefit review process, whether an application for review or an ICA Notice, it is the filing of these materials that triggers the national security review process. In cases where the ICA net benefit review process does not apply, e.g., where there is only a minority investment and not an acquisition of control, the national security review process is triggered by implementation of the investment, meaning that any review will take place post-closing.²

Once the national security review process is triggered, the Canadian government has an initial period of 45 days to decide if it will commence a formal review, which it can extend unilaterally by another 45 days (for a total of 90 day after filing). If the government decides to initiate a formal review (either after 45 or 90 days), the review can last at least another 110 days, subject to further extension. As such, national security reviews can take 200 days or more to be completed.³

There have been approximately 29 national security reviews commenced between 2009 (when the national security regime was enacted) and March 31, 2020 (the most recent timeframe for which statistics are available). The government has issued orders in 18 of these reviews; in seven of the remaining cases, the investor abandoned the transaction after the national security review was commenced, while the remaining four transactions were permitted to proceed without a remedy. In most of the 18 cases where an order was issued, the government required that the investment

either be blocked or unwound; there have only been four cases where an investment was allowed to proceed based on conditions imposed. It is also worth noting that 17 of the 29 reviews involved Chinese investors.⁴

A. Impact of the Pandemic

1. “Enhanced Scrutiny” and Extended Timelines

The Canadian government moved quite quickly – and substantively – to adjust its approach to foreign investment review in the wake of the Pandemic. Although no changes were made to applicable thresholds, the government announced in an April 2020 policy statement (the “Policy Statement”) that it would be applying “enhanced scrutiny” under the ICA to all “foreign direct investments of any value, controlling or non-controlling, in Canadian businesses that are related to public health or involved in the supply of critical goods and services to Canadians or the Government”. The government added that it would also apply “enhanced scrutiny” to all investments by foreign state-owned enterprises (“SOE’s”) or “private investors assessed as being closely tied to or subject to direction from foreign governments”. The Canadian government did not state expressly what it meant by “enhanced scrutiny” in this regard, but suggested that this could involve additional information requirements or extensions of timelines for review.⁵

The Policy Statement explained that the Canadian government’s new approach was necessary “to ensure that inbound investment does not introduce new risks to Canada’s economy or national security, including the health and safety of Canadians.” The Policy Statement specifically pointed to the concern that foreign investors might engage in “opportunistic behaviour” by snapping up Canadian businesses which had recently seen their valuations decline as a result of the Pandemic. The Policy Statement also expressed concern that foreign SOE’s “may be motivated by non-commercial imperatives that could harm Canada’s economic or national security interests”, e.g., by buying up Canadian companies and re-directing their production to the new “home jurisdiction.”

² The IRD will scan public sources and use other resources to identify minority investments that may be of concern, and then reach out to the investors for additional information.

³ According to the most recent government statistics, it took the Canadian government an average of 217 days to complete the national security reviews it conducted in fiscal 2019/2020.

⁴ In addition to the foregoing, at least one other transaction involving a Chinese investor was blocked in 2021, i.e., the proposed acquisition by

Shandong Gold Mining Co., Ltd. (a Chinese state-owned gold mining company) of TMAC Resources (a Canadian gold mining company operating in the Canadian North).

⁵ The Investment Review Division of Innovation, Science and Economic Development Canada, Ministerial Statement, “Policy Statement on Foreign Investment Review and COVID-19” (April 18, 2020), <https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81224.html>.

Following upon the Policy Statement's suggestion of extended timelines, the Canadian government passed legislation in July 2020 permitting the extension of certain legislative time limits, including those under the ICA. Pursuant to this authority, the government extended the timelines for the national security review process by as much as six months (subject to even further extensions on consent), meaning that the entire process could take up to 260 days to complete (or more).⁶ The amending legislation provided that these longer timelines would expire on December 31, 2020 unless otherwise extended. Fortunately they were not extended, and the pre-Pandemic national security review timelines again apply.

The other key question was how long the government would apply its "enhanced scrutiny" of foreign investments as set out in the Policy Statement. The Policy Statement said that its enhanced scrutiny would apply "until the economy recovers from the effects of the COVID-19 pandemic," which afforded the government considerable leeway to decide. In light of that, many observers believed that, whether formally or not, the government's temporary policy would likely become a fixed part of foreign investment review in Canada.

And that is effectively what happened.

In March 2021, the government issued revised "Guidelines on the National Security Review of Investments" (the "Revised Guidelines") outlining changes/clarifications to the government's approach to national security reviews.⁷ Among other things, the Revised Guidelines state that: all investments by foreign SOEs in Canadian businesses will now be subjected to "enhanced scrutiny" regardless of the value of the investment. The Revised Guidelines also re-emphasize that one of the factors the government will consider in determining whether a foreign investment constitutes a national security risk will be the impact on "the security of Canada's critical infrastructure," including infrastructure that is "essential to the health of

Canadians." The Revised Guidelines also clarify that, in considering whether a transaction will involve the transfer of "sensitive technology" outside of Canada (another form of national security risk), the government will include "medical technology" among its areas of concern.

In other words, the two key (but ostensibly temporary) aspects of the Policy Statement – i.e., an enhanced focus on investments by SOE's and on investments that impact the public health sector – are now enshrined by the Revised Guidelines as permanent elements of the Canadian national security review process going forward.⁸

2. Looking Ahead – Possible Future Amendments

The Pandemic has had the additional effect of generating new interest in foreign investment issues in Canada, and specifically whether the ICA regime should be made more robust.

Most notably in that regard, the House of Commons Standing Committee on Industry, Science and Technology initiated a study in June 2020 to determine if additional changes to the ICA are required, including in response to issues raised by the Pandemic. The committee issued its report in March 2021 with nine recommendations, some of which echo the concerns already seen in the Policy Statement and the Revised Guidelines.⁹ For example, the committee recommended that:

- a) the ICA thresholds for net benefit review be reviewed on an annual basis (currently only certain thresholds are subject to annual adjustment);
- b) all SOE investments, regardless of value, be reviewed under both the ICA's national security regime (as provided for in the Revised Guidelines) and the net benefit review regime (currently, only SOE investments exceeding a prescribed threshold are subject to net benefit review);

⁶ Government of Canada, "Temporary Extension of Certain Timelines in the National Security Review Process Due to COVID-19" (July 31, 2020), <https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81225.html>.

⁷ Government of Canada, "Guidelines on the National Security Review of Investments" (March 24, 2021), <https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81190.html>. The original Guidelines were issued in December 2016.

⁸ There were several other notable changes included in the Revised Guidelines. First, in addition to medical technology, the Revised Guidelines identify other sorts of technology as being "sensitive", including artificial intelligence, biotechnology, and space technology. Second, the Revised Guidelines provide additional examples of what constitutes "critical infrastructure" for national security review purposes,

including energy and utilities, finance, food, transportation, water and manufacturing. Third, the Revised Guidelines add two new areas of scrutiny for national security review: whether the transaction will impact the production of critical minerals and critical mineral supply chains, and whether the transaction will enable the foreign investor to access and exploit sensitive personal data. In truth, the addition of these two factors came as no surprise in that they had already arisen as issues of concern in prior national security reviews.

⁹ House of Commons, Report of the Standing Committee on Industry, Science and Technology, "The Investment Canada Act: Responding to the COVID-19 Pandemic and Facilitating Canada's Recovery" (March 2021), <https://www.ourcommons.ca/DocumentViewer/en/43-2/INDU/report-5/page-84#18>.

- c) the ICA be used to protect strategic sectors including, but not limited to, health, pharmaceuticals, agri-food, manufacturing, natural resources, and intangibles related to innovation, intellectual property, data and “expertise”;
- d) any Canadian business or entity holding a “sensitive asset” be required to notify the federal government 30 days before implementing the transfer of that asset to a non-Canadian entity;
- e) there be enhanced and mandatory cooperation between the IRD and Canada’s national security apparatus to analyze possible national security threats; and
- f) the government be required to explain the factors for decisions made under the ICA, and to make public any undertakings or conditions imposed on foreign investors as the basis for the approval of transactions.

In addition to the Parliamentary committee efforts, a federal government task force is currently leading an interdepartmental policy review examining if any additional measures are needed to ensure Canada’s continued ability to respond to economic-based threats to national security.¹⁰ The Pandemic was a significant impetus to this effort, as Canada’s national security establishment has expressed concerns that the “uncertain environment” created by the Pandemic is “ripe for exploitation by threat actors seeking to advance their own interests.” Specific concerns include the loss of sensitive goods, technology and intellectual property, the malicious use of sensitive personal information of Canadians, and compromised critical infrastructure.

Among the issues the task force is exploring is whether the ICA should be amended to help Canada better address economic-based threats to national security. The task force’s consultation process is focusing on three principal questions in that regard:

- a) should the ICA’s procedures be amended to increase the scope of transactions that are subject to mandatory pre-closing review?

b) are mitigation measures (e.g. undertakings) that permit a transaction to proceed subject to conditions effective in dealing with potential national security concerns?

- c) should the penalties for non-compliance with the ICA be increased?

It is anticipated that the task force will issue its report in the coming year.

II. IMPLICATIONS AND CONCLUSIONS

The Pandemic has had a profound effect on the application and enforcement of Canadian foreign investment review law, and proposed amendments to the ICA may make the situation even more complicated. This is particularly the case with respect to national security reviews, given that the process can be applied so broadly.¹¹ As a result, foreign parties considering investments in Canada must pay even more attention to the ICA’s national security review process in their transaction planning.¹² In certain cases, investors – and especially foreign SOEs - may be well-advised to engage with the authorities as far as possible in advance in order to clarify the regulatory risk they face. This could involve informal discussions with the IRD and other relevant government agencies. It could also involve adopting filing strategies that expedite the government’s assessment of their investments.¹³

For example, in cases where an investor is obliged to file an ICA Notice (discussed above), it is important that foreign investors consider if they will do so pre-closing or post-closing. Investors that are concerned about the prospect of a national security review are now frequently submitting the ICA Notice prior to closing, rather than waiting to do so until 30 days after closing (which had been the consistent practice before the national security regime was enacted). The objective is to permit the initial review period (of 45 to 90 days) to expire before the transaction is implemented, in order to see whether the government will either decide to allow the transaction to

¹⁰ Government of Canada, News Release, “Government of Canada expands work to address economic-based threats to national security” (May 27, 2021), <https://www.canada.ca/en/public-safety-canada/news/2021/05/government-of-canada-expands-work-to-address-economic-based-threats-to-national-security.html>.

¹¹ Statistics and details regarding national security reviews since the Pandemic started are not yet available, so it is not possible yet to measure if the Pandemic led to more national security reviews in areas that would not necessarily have been of concern previously. The only transaction blocked in the past year for which information is publicly available involved the proposed acquisition by a Chinese state-owned gold mining company (Shandong Gold Mining Co., Ltd.) of a Canadian gold mining company operating in the Canadian North (TMAC

Resources). That transaction likely would have been at risk even without the “enhanced scrutiny” of SOE investments precipitated by the Pandemic. That said, our firm has dealt with several cases where this “enhanced scrutiny” led to intensive and extended initial reviews of foreign investments that would not have raised issues pre-Pandemic (although fortunately did not culminate in the commencement of formal national security reviews).

¹² It would be a mistake to conclude that national security reviews are “just a problem” for Chinese investors. Although Chinese investments make up a majority of the transactions subjected to national security reviews so far, the gap is closing.

¹³ The IRD strongly encourages early engagement if there are any concerns that a transaction could raise national security concerns.

proceed without review or commence a full scale formal review. In other words, foreign investors are increasingly looking for clarity pre-closing rather than taking the risk that there could be a national security review post-closing. However, since there is no legal requirement in the ICA to file the ICA Notice pre-closing, vendors/targets sometimes object to this approach on the grounds that they should not be obliged to share in a regulatory risk that is not legislatively mandated. Vendors are also incentivized in these circumstances to include a “hell or high water” provision in the transaction agreement as a *quid pro quo* to ensure that investors will be obligated to do what they can to secure government approval.

Similarly, in cases where no net benefit review filing is required, e.g., in the case of a minority investment, foreign investors must consider if and how they will deal with the risk that a national security review may be triggered post-closing. For example, an investor may wish to consult with IRD informally before closing to assess whether there are any likely national security concerns that could be raised. In these circumstances, the IRD will not provide a formal or binding view, and will always caution that the statutory process will have to run its course regardless. That said, in our experience, it can be helpful to engage in this type of informal discussion and it is possible to get a relatively firm, albeit not 100% concrete, sense of whether issues are likely to be raised.

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