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Canadian Government Clarifies Policy on Foreign Investments by State-Owned Enterprises

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On December 7, 2012, the Canadian government released a policy statement and revised guidelines for investments by foreign state-owned enterprises (SOEs) that are subject to a net benefit review under the *Investment Canada Act* (ICA).

The government also announced that the Minister of Industry had approved investments by CNOOC Limited, a Chinese SOE, to acquire Nexen Inc., and by Petronas, a Malaysian SOE, to acquire Progress Energy Resources Corp. However, details of undertakings provided by CNOOC Limited and Petronas to obtain these approvals were not announced.

Background: *Investment Canada Act* Reviews

A direct acquisition by a non-Canadian of control of a Canadian business that surpasses a prescribed financial threshold (currently assets with a book value of more than C\$330 million) cannot be completed until and unless the foreign investor satisfies the Minister of Industry that the transaction is likely to be of net benefit to Canada. Traditionally, foreign investors have satisfied the net benefit requirement by providing undertakings that address factors such as employment, capital expenditures, research and development, and participation of Canadians in the management of the Canadian and global operations of the acquired business.

In the case of investments by SOEs, pursuant to guidelines issued in 2007, the Minister has also considered the corporate governance and reporting structure of the SOE to assess whether Canadian standards of transparency and independence of board members and auditors, for example, are maintained. The Minister has also assessed whether post-acquisition the Canadian business will continue to operate on a commercial basis. The guidelines suggested that the listing of shares of the acquiring company, or the Canadian business being acquired, on a Canadian stock exchange is an example of how an SOE could enhance an ICA application in this regard, as the Canadian business would be subject to the requirements for public companies in respect of governance, audits, disclosure and financial reporting.

The ICA has a separate review mechanism, introduced in 2009, for investments that raise national security concerns. Such reviews can be initiated with respect to a wide range of investments, including investments that are below the general net benefit review thresholds.

SOE Policy Statement and Guidelines

The policy statement and revised SOE guidelines released on December 7, 2012 establish the following framework for reviewing proposed investments in Canadian businesses by foreign SOEs:

- Foreign investors will continue to have the burden of proof to satisfy the Minister that a particular investment is likely to be of net benefit to Canada.
- SOE investments will continue to be evaluated on a case-by-case basis, but investments by foreign SOEs to acquire control of a Canadian oil sands business will be found to be of net benefit only in exceptional circumstances – non-controlling minority interests in Canadian businesses proposed by foreign SOEs will continue to be welcome.
- In assessing the net benefit of an SOE investment, the Minister will examine:
 - the extent to which a foreign state is likely to exercise control or influence over the entity acquiring the Canadian business – an important revision to the SOE guidelines is the expansion of the definition of an SOE to include, in addition to entities that are owned or controlled by a foreign government, entities that are merely influenced, directly or indirectly, by a foreign government;
 - the degree of control or influence an SOE would likely exert on the Canadian business that is being acquired and on the industry in which the Canadian business operates. Where, due to a high concentration of ownership, a small number of acquisitions of control by SOEs could undermine the private sector orientation of an industry, and consequently subject an industrial sector to an inordinate amount of foreign state influence, the government will act to safeguard Canadian interests;
 - the corporate governance and reporting structure of the foreign SOE, including whether it adheres to Canadian standards of corporate governance and to Canadian laws and practices, including free market principles;
 - whether the Canadian business to be acquired by the foreign SOE is likely to operate on a commercial basis, including with regard to where products will be exported or processed, the participation of Canadians in its operations in Canada and elsewhere, the impact of the investment on productivity and industrial efficiency in Canada, support of ongoing innovation, research and development in Canada, and appropriate levels of capital expenditures to maintain the Canadian business in a globally competitive position; and
 - specific undertakings offered by the foreign SOE to address the above-noted issues, including, for instance, the appointment of Canadians as independent directors of the Canadian business, the employment of Canadians in senior management positions, the incorporation of the business in Canada and the listing of shares of the acquiring company or the Canadian business being acquired on a Canadian stock exchange.
- While the government will be progressively [increasing the review threshold under the ICA](#) to C\$1 billion in enterprise value, investments by SOEs will continue to be subject to

the existing review threshold of C\$330 million in asset value, adjusted annually to reflect the change in nominal gross domestic product in the previous year.

SOEs and National Security

In conjunction with the new SOE guidance, the government announced that it will propose amendments to enable the Minister to extend the time available to conduct national security reviews of proposed foreign investments, although such extensions would be used only in exceptional circumstances. Prime Minister Stephen Harper stated in response to questions from reporters that, while national security issues were considered in respect of the CNOOC and Petronas transactions, neither transaction raised national security concerns.

However, SOE investors in particular should consider whether a proposed acquisition could conceivably raise any national security issues and, if so, whether they could be addressed by undertakings. For example, we are aware of a proposed acquisition of a Canadian software company (apparently well below the ICA net benefit review threshold) by a foreign investor with links to Chinese SOEs that was abandoned earlier this year because of a letter received from the Investment Review Division of Industry Canada relating to national security considerations.

Implications

Key implications of these developments include:

- The current government is clearly reluctant to change its policies on ICA review in the midst of an ICA review of a particular transaction. The government recognizes the importance to investors of providing some degree of predictability.
- The government has imposed a strict limit on any future attempts by foreign SOEs to acquire controlling interests in the Canadian oil sands, while also signalling that the same principle could be applied to limit aggregate SOE investment in other sectors. In particular, the Minister may find that a proposed SOE investment is not likely to be of net benefit to Canada if it would result in such a degree of aggregate state control that the sector may cease to be driven by a private sector commercial orientation. It remains to be seen what aggregate SOE control thresholds might trigger such a concern.
- Acquisitions by SOEs of less than a controlling interest in an entity active in the oil sands (or other sectors) will not likely raise the same level of concern, if they even require an ICA review. (One example of such a reviewable investment might be an acquisition of an entity that in turn controls only a minority stake in an oil sands developer.)
- The proposal to retain the current C\$330 million asset value review threshold for SOE investments, even when the general review threshold increases to a \$1 billion enterprise value threshold, may result in relatively more SOE investments continuing to be subject to ICA reviews, although in a particular case an entity's asset value may be considerably lower than its enterprise value.
- The new broader definition of an SOE in the government's guidelines may create significant uncertainty as to when the lower review threshold and the new SOE policy framework will apply.

- It does not appear that the government will saddle the review of a particular SOE investment with a requirement that the controlling State provide reciprocal investment rights for Canadian firms seeking to invest in that country.
- Each SOE investment subject to ICA review will be considered on its own merits. ICA reviews of particular proposed SOE transactions may still attract significant media and political attention and controversy. National or regional issues, such as those that appear to have led to the withholding of ICA approval for BHP Billiton's proposed acquisition of Potash Corporation in 2010, can still arise for a given transaction, whether or not an SOE is involved. Accordingly, careful planning with both legal counsel and government relations advisors is required for any ICA review of an SOE transaction.

The official media release of the Government of Canada, with links to the relevant statements and guidelines on the review of foreign SOE transactions under the ICA, is available online at <http://news.gc.ca/web/article-eng.do?nid=711489>.

See [here](#) for background on the CNOOC and Petronas transactions.

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