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Foreign investment review in Canada: Key issues in 2010

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Issues surrounding foreign investment in Canada continue to be at the forefront of the country's public policy agenda. Just recently, a new study was released dispelling (once again) the myth that foreign investment leads to the "hollowing out" of corporate Canada. It also has been reported that the Conservative minority government intends to make measures to improve Canada's ability to attract foreign investment one of the centrepieces of its legislative agenda for the coming year.

Here are some of the key developments governing foreign investment review to watch out for in 2010.

1. Will the *Investment Canada Act's* new national security review process make life tougher for non-Canadian investors?

Major changes to the *Investment Canada Act* ("ICA") were enacted in March 2009. Foremost among these changes was the establishment of a new "national security" review process, which arms the federal government with broad powers to prohibit or unwind foreign investments in Canada on the grounds that they "could be injurious to national security." The term "national security" was deliberately left undefined to allow the government maximum discretion. The government can also invoke the process before or after closing and without regard to the value of the investment or the level of interest acquired.

The new national security process appears to have prevented the completion of at least one transaction since it was enacted, namely, the proposed acquisition of Forsys Metals Corp. ("Forsys") by George Forrest International Afrique S.P.R.L. ("GFI").

According to reports, Forsys (a publicly-traded mineral exploration company with a uranium project in Namibia) terminated the proposed transaction after the Canadian government notified GFI that it was prohibited from implementing the investment pending further notice. Although the reason for the government's intervention was never made public, it is believed that its concerns related to potential "national security" issues revolving around GFI's potential acquisition of the Forsys uranium project, even though the project and deposits are not in Canada. In particular, there appear to have been concerns about certain of the countries from which GFI sought funding for the acquisition.

"National security" also became an issue in the proposed acquisition by Ericsson of Nortel's wireless unit, announced in July 2009. Ericsson, a Swedish telecom company, successfully bid for Nortel's wireless unit as part of an auction stemming out of Nortel's bankruptcy proceedings initiated in January 2009. Various parties, however, including RIM, argued that the federal government should prevent the sale because it would jeopardize Canada's national interests. Notwithstanding these protests, the federal government announced that it had "no grounds to believe that the transaction could be injurious to Canada's national security" and allowed the transaction to proceed. Still, the case demonstrates the extent to which a determined opponent can now appeal to "national security" concerns as an additional basis upon which to attack a proposed transaction.

Even after a year of experience, the new "national security" review process remains an unknown quantity for non-Canadian investors, particularly in view of the lack of transparency over what type of transactions the government is likely to review. It is to be hoped that 2010 will offer opportunities for greater clarification regarding the application of this process.

2. Will the *Investment Canada Act*'s revised review threshold's come into force?

The March 2009 amendments also changed one of the key tests governing when non-Canadian investments will be subject to review under the ICA. However, because related regulations are still in draft form, these amendments are not yet in force.

Currently, most direct acquisitions of a Canadian business by non-Canadian investors are subject to pre-closing review under the ICA if the book value of the assets of the Canadian business exceeds $299 million (this threshold is revised each year based on the change in Canada's GDP and in 2009 was $312 million). The same acquisitions will be reviewable under the incoming amendments if the "enterprise value" of the assets of the Canadian business is equal to or greater than (a) $600 million, in the case of investments made during the first two years after the amendments come into force; (b) $800 million, in the case of investments made during the third and fourth years after the amendments come into force; and (c) $1 billion, in the case of investments made between the fifth year after the amendments come into force and Dec. 31 of the sixth year after the amendments come into force. This threshold will thereafter be adjusted on an annual basis.

The government issued draft regulations in the summer of 2009 with its proposal on how to define “enterprise value” for these purposes. Specifically:

• In the case of an acquisition of control of a Canadian business which is publicly-traded, the "enterprise value" would be the “market capitalization” of the entity plus its liabilities minus its cash and cash equivalents. “Market capitalization” would be calculated on the basis of a prescribed formula based on the value of the company’s publicly traded shares over a specific period of time.

• In the case of an acquisition of control of a Canadian business which is not publicly-traded, or where the transaction involves an acquisition of all or substantially all of the assets of a Canadian business, the "enterprise value" would be the book value of the assets of the Canadian business as at the end of its last fiscal year, as reflected in its most recent annual financial statements.
The draft regulations were criticized on several grounds, including difficulties with the proposed formula for calculating “market capitalization.” Based on the delay in officially promulgating these regulations (which still remain in draft), it appears that at least some of these criticisms hit their mark. As a result, the proposed new threshold remains in limbo until a satisfactory definition for “enterprise value” is drafted. This is unfortunate because the new threshold was supposed to reduce the number of investments subject to ICA review.

3. Will the Canadian government prevail against US Steel for the alleged breach of *Investment Canada Act* undertakings?

The recession of 2009 forced the Canadian government to confront the difficult issue of how to enforce undertakings provided under the ICA in the context of global economic dislocation. The implications will continue to unfold in 2010.

The immediate focus will be on the Canadian government’s effort to enforce undertakings provided by US Steel in 2007 to obtain approval for its acquisition of Stelco that year. In the spring of 2009, US Steel shut down most of its Canadian operations. US Steel argued that it was justified in taking these measures because of the unique circumstances created by the global economic crisis. According to guidelines under the ICA, investors will not be held accountable for being unable to fulfill undertakings when this failure is "clearly the result of factors beyond the control of the investor/"

The Canadian government took a different view of US Steel's actions. In July 2009, the government filed an application with the Federal Court of Canada seeking an order requiring US Steel to increase its Canadian steel production, maintain employment levels in Canada, and pay a fine of CDN$10,000 per day for each day that it allegedly failed to comply with its undertakings. This marked the first time that the Canadian government had gone to court for such an order.

US Steel responded by not only denying that it had breached the ICA, but by challenging the constitutionality of the legislation itself. US Steel claimed that the ICA contravenes the Canadian Charter of Rights and Freedoms and the Bill of Rights by infringing the rights of non-Canadian investors to a fair hearing and the presumption of innocence.

Arguments in the constitutional challenge were heard by the Federal Court in January 2010. The outcome of the case will have a significant impact on the extent of any future enforcement actions under the ICA.

4. Telecommunications: Do changes to the foreign ownership restrictions lie ahead?

In November 2007, in an effort to bring more wireless competition to Canada, Industry Canada set aside 40 MHz of Advanced Wireless Services (AWS) spectrum for new entrants. Globalive Wireless Management Corp. ("Globalive") bid $442,099,000 in the AWS spectrum auction which took place over a two month period in the summer of 2008 and was provisionally awarded 30 spectrum licences by Industry Canada subject to compliance with the Radiocommunication Regulations which prohibits corporations that are not Canadian-owned and controlled from being eligible to hold a licence. On March 13, 2009, Industry Canada determined that Globalive satisfied the ownership and control criteria in the Radiocommunication Regulations.

However, in order to be eligible to operate as a telecommunications common carrier, licensees must also meet the ownership and control requirements of section 16 of the Telecommunications Act which, like the Radiocommunication Regulations, provide that the carrier must be a Canadian-owned and controlled corporation. On Oct. 30, 2009, following a rare public proceeding that included a two-day oral hearing, the CRTC determined that Globalive had not met the requirements of the Telecommunication Act's ownership and control regime and was therefore not eligible to operate as a telecommunications common carrier and provide wireless services in Canada.

The CRTC based this decision on its view that Globalive is controlled in fact by a non-Canadian, Orascom Telecom (an Egyptian-based telecommunications company). The CRTC pointed to various factors in support of this conclusion, including that Orascom Telecom holds 65% of Globalive's equity, is the principal source of Globalive's technical expertise, provides Globalive with access to an established wireless trademark and provides the vast majority of Globalive's debt financing. The CRTC was particularly concerned that Orascom held both 65% of Glovalive's equity and the vast majority of Globalive's debt, which represents most of Globalive's enterprise value.

On Dec. 10, 2009, the federal cabinet exercised its review powers over the CRTC and issued an order-in-council varying the CRTC decision and ruling that Globalive is a Canadian-owned and controlled company. This allowed Globalive to begin offering wireless service in Canada, which it has now done.

The order-in-council emphasized that "in varying the CRTC decision, the government is not removing, reducing, bending or creating an exception to Canadian ownership and control requirements in the telecommunications and broadcasting industries. The government's decision to vary is specific to the facts of this case."

Nonetheless, there continues to be speculation about whether the Globalive order-in-council portends an opening up of the Canadian telecom sector to greater foreign investment.

Recent news reports have fed that speculation, indicating that the government may announce some form of liberalization of the foreign ownership rules governing Canada's telecommunications sectors in the next budget or in the speech from the throne. These reports have not been officially confirmed, so it remains to be seen if the government truly has the appetite for such reform.

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