FOREIGN INVESTMENT

Foreign Investment Review in Canada: a Primer on the Investment Canada Act

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Introduction

Most non-Canadian companies thinking about acquisitions in Canada are aware that their transactions may be subject to the notification and substantive review provisions of the *Competition Act*. However, it often comes as a rude surprise to foreign acquirors that they also must contend with the *Investment Canada Act* ("ICA"), Canada's foreign investment review legislation. Indeed, some foreign acquirors learn to their dismay that it is ICA approval, rather than clearance under the *Competition Act*, which can prove to be more time-consuming to obtain.

The costs of ICA approval can be significant as well. In a recent acquisition, for example, the foreign investor was obliged to provide an extensive series of undertakings in order to secure ICA approval, including: agreeing to pursue over $1.4 billion (Cdn.) in major infrastructure projects; committing to various additional capital expenditures; maintaining the Canadian business's corporate offices in Canada along with significant resident Canadian management; adding two Canadian citizens to its board of directors; conducting a comprehensive feasibility analysis of potential projects in Canada; and increasing existing levels of support to local communities.

Key Aspects

Given the potential impact of the ICA, set out below are some of the key aspects of this legislation that non-Canadians should be familiar with when contemplating a potential acquisition in Canada.

When Does the ICA Apply? – The ICA applies whenever a "non-Canadian" (i) establishes a new "Canadian business;" or (ii) acquires "control" of an existing Canadian business.

- The rules for determining "Canadian" versus "non-Canadian" status can be complex. Briefly, however, an individual is a "Canadian" if he or she is a Canadian citizen or, in some circumstances, a permanent resident of Canada. A corporation is a "Canadian" if the ultimate controlling shareholders are "Canadians." In the case of a widely-held corporation, the determination is based upon the citizenship or permanent resident status of the members of the board of directors. In that case, at least 2/3 of the board must be comprised of "Canadians" for the corporation to be considered "Canadian." (There are similar "status" rules for partnerships and trusts.)
- The acquisition of a majority (over 50%) of the voting interests of an entity is deemed to be an acquisition of control as is the acquisition of all or substantially all of the business's assets. In the case of entities other than corporations, the acquisition of less than a majority interest (50% or less) is deemed not to be an acquisition of control. The rules for corporations are more complex: an acquisition of less than a majority but more than 1/3 of the voting interests of a corporation is presumed to be an acquisition of control unless it can be established that this in fact will not be the case; however, an acquisition of less than 1/3 of the voting interests of a corporation is deemed not to be an acquisition of control.
- A "business" is defined to include any undertaking or enterprise capable of generating revenue and carried on in anticipation of profit. To be a "Canadian" business, there must be (a) a place of business in Canada; (b) an individual or individuals who are employed or self-employed in connection with the business; and (c) assets in Canada used in carrying on the business. Note that a "Canadian business" need not be controlled by Canadians – the acquisition of a foreign-controlled business operating in Canada is also subject to the ICA. In addition, a

business need not be carried out entirely in Canada to qualify as "Canadian."

Who Is Responsible for Administering the ICA? – Principal responsibility for administering the ICA belongs to the federal Minister of Industry. However, the acquisition of a Canadian business that qualifies as a "cultural business" falls under the jurisdiction of the federal Minister of Canadian Heritage.

- A "cultural business" includes a business that carries on (i) the publication, distribution or sale of books, magazines, periodicals or newspapers; (ii) the production, distribution, sale or exhibition of film or video products; (iii) the production, distribution, sale or exhibition of audio or video music recordings; (iv) the publication, distribution or sale of music; or (v) any radio, television and cable television broadcasting undertakings, any satellite programming and broadcast network services or any other radio communications to the public.
- There is no *de minimis* exception to the determination of whether a business carries on a "cultural business." Thus, a company which primarily carries on non-cultural activities will still be considered to be engaged in a cultural business even if its cultural activities represent only a small part of the total business. In the latter circumstances, filings may have to be made with the appropriate officials in both Ministries.
- There are a number of special rules relating to cultural businesses. For example, the Minister may deem there to have been an acquisition of "control" of a Canadian cultural business even if the general criteria for establishing "control" are not met. Similarly, the Minister may decide to review the acquisition of a cultural business even if the relevant thresholds are not met. There are also specific (and restrictive) policies relating to acquisitions of certain cultural businesses, for example, book publishing and film distribution.

When Are Review and Approval Required? – If an acquisition governed by the ICA exceeds certain financial thresholds, it will be subject to review and approval by the responsible Minister. If the relevant thresholds are not exceeded, the only requirement is to submit a notification containing basic information about the foreign investor and the acquired Canadian business within 30 days of closing. Investments to establish a new Canadian business (other than cultural businesses) are not subject to review – the only requirement is to submit a notification.

- The thresholds for reviewable acquisitions are based on the aggregate book value of the assets of the Canadian business and of all other Canadian entities controlled by the business. Note that this calculation is not limited to assets in Canada.
- The relevant thresholds vary depending upon a number of considerations, including:
  - is the "investor" or the Canadian business being acquired ultimately controlled by "WTO Investors" (i.e., nationals of a country (other than Canada) that is a member of the World Trade Organization or by an entity that itself qualifies as a WTO Investor);
  - is the acquisition of control "direct" or "indirect" (an "indirect" acquisition being defined as one in which the investor is acquiring a foreign entity that controls the Canadian business and where the asset value of the Canadian business represents less than 50% of the total value of the transaction); and
  - is the Canadian business engaged in certain prescribed industries (cultural business, transportation services, financial services or uranium mining).
- Summarized briefly, an application for review will be required in the following circumstances:

  (i) Where either the acquiring party is a "WTO Investor" or the Canadian business being acquired is controlled by a "WTO Investor:"

  - a "direct" acquisition will be reviewable if the value of the assets of the Canadian business being acquired, and of all other assets in Canada the control of which is being acquired, exceeds $265 million (Cdn.),[1] unless the Canadian

[1] This is the threshold for 2006. It is adjusted annually.

business is engaged in one of the prescribed industries referred to above, in which case a direct acquisition will be reviewable if the relevant asset value exceeds $5 million (Cdn.);

- an "indirect" acquisition will not be reviewable but will be subject to notification only, unless the Canadian business is engaged in one of the prescribed industries referred to above and the relevant asset value exceeds $50 million (Cdn.).[2]

(ii) Where no "WTO investor" is involved as the acquiring party or vendor:

- a "direct" acquisition will be reviewable if the value of the relevant assets involved exceeds $5 million (Cdn.);
- an "indirect" acquisition will be reviewable if the value of the relevant assets involved exceeds $50 million (Cdn.).

What Is the Standard Used to Evaluate a Transaction Subject to Review? – If an acquisition is subject to review, the Minister must be satisfied that it is likely to be of "net benefit" to Canada in order to grant approval to proceed.

- Among the relevant factors that the Minister will assess in determining "net benefit" are: the effect of the investment on economic activity and employment in Canada; the degree and significance of continued Canadian participation in the business; the compatibility with "national, industrial, economic and cultural policies;" the contribution to Canada's ability to compete globally; and the effect on competition domestically (the Competition Bureau will be consulted on this issue).
- Federal ministries with a potential interest in the transaction will be consulted as part of the review process. In addition, the views of each province in which the Canadian business has at least 10 employees will be solicited. The province of Quebec is the most active participant in this latter process and will often seek undertakings to benefit employees, suppliers and economic activity in that province. Other provinces tend to become involved only sporadically (e.g., if a key industry is at issue), if at all.

What Are the Timing Considerations for ICA Reviews? – The Minister has 45 days following receipt of a completed application for review to either approve or deny the application or to extend the review period for an additional 30 days (for a total of 75 days from the start of the process). If the Minister still requires more time at the end of that extended 75-day period to complete his or her review, the investor's consent must be obtained for any further extension (which has no set limit).

- Most transactions are reviewed within the initial 45-day period (or perhaps a slightly extended period beyond that), although there are cases involving particularly sensitive transactions where the review process took several months to complete.
- A key consideration for investors in terms of timing is whether the "net benefit" review is to take place before or after closing. In the case of "direct" acquisitions, investors are generally obliged to submit their applications for review and obtain the Minister's approval before they may complete the acquisition. In contrast, the review process for "indirect" acquisitions takes place following closing (although investors are entitled to file prior to closing should they choose to do so).

What Are the Potential Remedies/ Sanctions Under the ICA? – Transactions are rarely denied approval under the ICA's "net benefit" test. However, it is now common for the Minister to extract undertakings from acquiring parties as a condition for approval.

- Undertakings generally extend for 3-5 years and involve commitments with respect to matters such as capital expenditures; investment in research and development; minimum employment levels

[2] The officials responsible for administering the ICA take the position that an "indirect" transaction involving WTO investors qualifies as such even if the asset value of the Canadian business being acquired exceeds 50% of the asset value of the total transaction. This does not apply, however, if the transaction involves one of the prescribed industries referred to above. When that is the case, and the asset value of the Canadian business exceeds 50% of the total value of the transaction, the transaction will be regarded as a "direct" acquisition and the $5 million threshold will apply.

(which can be a touchy issue if downsizing is anticipated); Canadian participation in management; location of the head office; purchases from Canadian suppliers; and, where cultural businesses are involved, various types of support (usually financial) for the "Canadian cultural community."

- There are also a number of sanctions available to the Minister in the event of non-compliance with the ICA. Examples of non-compliance include if the investor (i) fails to file a required notification or application for review; (ii) implements an investment without the necessary approval or that has been prohibited; (iii) does not divest as required; or (iv) does not comply with an undertaking. It must be noted, however, that sanctions for non-compliance have rarely, if ever, been resorted to in practice.

Possible Developments

According to recent press reports, Canada's current Industry Minister, Maxime Bernier, is considering a review of the ICA that would liberalize even further the rules governing foreign investment in Canada. The one exception would be to include specific powers for the Minister to review (and block) transactions on national security grounds. Concerns about providing for national security review under the ICA surfaced in 2005 when state-owned China Minmetals Corp. sought to acquire Noranda Inc., a major producer of base metals. The Minmetals transaction did not proceed, but the former Liberal government introduced proposed amendments to the ICA to ensure that the Minister would be able to review transactions on national security grounds. The Liberals were defeated before these amendments could be passed, but it appears that the minority Conservative government intends to proceed with similar legislation. This would put Canada in line with other major trading partners, such as the United States, that also permit the screening of foreign investments for reasons of national security.