AMENDING THE INVESTMENT CANADA ACT: AN ASSESSMENT OF THE GOVERNMENT'S RESPONSE TO THE WILSON REPORT

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Introduction

On February 6, 2009, the Government introduced Bill C-10, the *Budget Implementation Act, 2009*. Tucked into the back of that bill were the most significant changes to the *Investment Canada Act* (the "ICA") in over two decades. The bill became law on March 12, 2009.

Background

The amendments to the ICA represent in large part the Government's response to the report of the blue-ribbon Competition Policy Review Panel (known as the "Wilson Panel" after its chair and referred to in the paper as either the Wilson Panel or the "Panel", with the report being referred to as the "Wilson Report").

The Wilson Panel was appointed in July 2007 amid a public hue and cry relating to the "hollowing out" of corporate Canada following the high profile takeovers of Canadian icons such as Alcan and Falconbridge. Its mandate was to review Canada's competition and foreign investment policies with a view to enhancing Canada's competitiveness in an increasingly global marketplace. The Panel issued its report, *Compete to Win*,[1] to the federal Industry Minister on June 26, 2008. The report was wide-ranging, canvassing issues from education, immigration, taxation and securities regulation to specific proposals to amend Canada's competition and foreign investment review laws. In particular, the Panel's recommendations aimed to eliminate legal, regulatory and policy impediments to competition and enhance conditions necessary to enable Canadian companies to compete more effectively internationally.

The Panel's proposals on foreign investment review generally favoured a more streamlined and narrower review process. Nevertheless, the Panel did not adhere to a strict ideology of completely unfettered investment liberalization. For example, the Panel did not support the wholesale elimination of the federal Government's general power under the ICA to review foreign investment in any sector. Moreover, it conditioned further liberalization in ownership in certain sectors (for example, uranium) on the offer of reciprocal liberalization by other countries.[2]

The Wilson Report's recommendations on the ICA carried considerable weight with the federal Government that appointed it, but, as discussed below, not all of these recommendations were implemented in the amendments that were passed on March 12, 2009. This paper, originally intended as a summary of the principal recommendations of the Wilson Report relating to foreign investment review, was overtaken by the introduction and passage of Bill C-10 and has

accordingly been revised to provide an assessment of how responsive the Government has been to the Wilson Report.

Proposals to Amend the *Investment Canada Act* – Non-Cultural Businesses

A. Raise the ICA Review Threshold

The Panel

The Panel rejected the OECD's assessment that Canada has the most restrictive barriers to foreign direct investment among industrialized countries, suggesting instead that Canada's foreign investment review process is simply more explicit and visible than in most countries which have informal means of discouraging foreign investment.[3] Nevertheless, the Panel proposed significant amendments to the ICA on the basis that there had been no policy review of the ICA in more than 20 years and to rectify the perception that Canada does not fully welcome foreign investment.

Despite the Panel's belief that the review process under the ICA contributed to the perception that Canada is too restrictive towards foreign investors, it was not willing to eliminate reviews. The Panel did not expressly state why it would retain a review process, although it may have wanted Canada to retain some bargaining leverage against other countries' restrictions on investments. Moreover, the Panel noted that under NAFTA and other international treaties, Canada may only narrow the application of the ICA, not broaden it (without significant negotiations with its trading partners), and arguably this constraint would make it very difficult for Canada to reinstate foreign investment restrictions in the future should this be judged desirable.[4]

While not eliminating foreign investment review, the Panel advocated raising the threshold for review from (the 2008 level of) $295 million in book value of assets of the Canadian target to $1 billion in the enterprise value of the business, except for cultural businesses. The Panel's stated rationale was two-fold: to narrow the scope for intervention and to recognize that, except in certain circumstances, foreign investment is beneficial to Canada.

Bill C-10

Following the lead of the Wilson Report, one of the key changes in the amendments is that the threshold for review of direct acquisitions of control by WTO-member[5] based investors will increase from (the 2009 level of) $312 million in book value of assets to C$600 million, based on the "enterprise value" of the Canadian business, for the first two years following passage of the bill, to C$800 million for the two years following, and to C$1 billion for another two years, to be indexed according to inflation thereafter.

This amendment will in all likelihood decrease the number of transactions that would be subject to review. Nevertheless, the amount of the decrease and the degree to which the amendments will streamline the foreign investment review process will depend on how regulations regarding "enterprise value" are drafted, in particular, what the constituent elements of "enterprise value" are and how it will compare to book value. There will be challenges in defining "enterprise value" in a predictable, fair and clear fashion. For example, the purchase price may be dependent upon the investor's share price (if part of the consideration is the investor's shares) which, in the current volatile market, could fluctuate wildly, or may not be determined until shortly before closing or even after closing (as often occurs when there is a post closing purchase price adjustment based on the earnings of the target business). Without clear rules on how to calculate enterprise value, an investor may have some difficulty determining whether the review threshold is exceeded sufficiently in advance of the closing date to secure the necessary approval. Accordingly, the Government will need to ensure that implementing regulations address these different scenarios in a comprehensive way.[6]

Finally, while the proposed increase in the review threshold from $312 million in book value to $1 billion in "enterprise value" will likely significantly reduce the number of transactions that are subject to review, the impact may vary according to economic sector. As the Panel noted, sectors dependent on knowledge and services (that is, dependent on people, know-how and intellectual property) will likely be assigned greater value in relative terms under an enterprise value standard because a book value of assets measurement does not tend to adequately recognize intangible assets .[7]

B. Eliminate Sensitive Sector Thresholds (except Culture)

The Panel

The Panel recommended the elimination of the very low threshold ($5 million in book value of assets) currently applicable to targets in the so-called sensitive sectors of uranium production, non-federally regulated financial services and transportation services,[8] but not cultural businesses. The Panel saw no compelling reason to differentiate investments in these sectors from others given the "broad array of other industry specific regulation as well as the forthcoming national security safeguards on foreign investment" .[9]

Bill C-10

The Government has followed the Wilson Report and has eliminated the so-called "sensitive sectors" except for cultural businesses. This amendment also remedies the over-reach of the ICA to situations where the acquisition involves a Canadian target that falls below the general review threshold ($312 million) but above the very low sensitive sector threshold ($5 million) and was subjected to review even though the target's engagement in sensitive sector activity is purely ancillary or incidental to its principal business. (For example, a target business was

characterized as a "transportation business" where it transported its own goods to its customers but on the return leg of the journey carried third party goods to earn some minimal revenue to offset costs.)

An additional consequence of eliminating the three sensitive sectors is that indirect acquisitions (that is, the acquisition of a Canadian entity through the acquisition of a non-Canadian parent corporation) will only be reviewable in a limited number of situations: in the case of acquisitions of Canadian businesses engaged in cultural activities and in the event that neither the vendor nor the purchaser is a WTO investor.[10] This will be welcome news for foreign investors acquiring foreign corporations.

C. Reverse Onus of Proof

The Panel

Under the ICA, the investor must demonstrate to the responsible Minister that the proposed investment will result in a "net benefit to Canada". The Panel recommended both "reversing the onus" so that the Minister would have the burden of establishing that a transaction should be disallowed and raising the standard for rejection of a deal by the Minister to "contrary to Canada's national interest". By only permitting disallowance of an investment where the Minister could demonstrate that the investment would be injurious to Canada's national interest, the Government would be signalling a welcoming tone for foreign investment.

According to the Panel, it would be harder for a transaction to be against the "national interest" test than it would be to meet the "net benefit" test. The implication of this recommendation would be that the review process would be less onerous for investors and fewer undertakings by investors would likely be required (although the concept of "national interest" might be sufficiently vague and malleable that a more protectionist Minister could find harm at a relatively low threshold).

Bill C-10

The reversal of onus proposal was not included in the current round of amendments and the "net benefit to Canada" test has been retained. It is not clear whether the Government's decision not to follow the Wilson Report recommendation resulted from a concern that a new standard for review (national interest versus net benefit to Canada) might be difficult to implement and create additional uncertainty in the process or whether the reversal of onus might have placed too onerous a burden on the Minister.

D. No Distinction between WTO and non-WTO Investors

The Panel

The Panel advocated that the higher review threshold also apply to investors from the handful of countries that are not members of the WTO (for example, Russia). The current review threshold for such investors (if the seller is also not a WTO investor or is a Canadian) is $5 million in book value of the target's assets for direct acquisitions and $50 million for indirect acquisitions.

Bill C-10

Bill C-10 does not eliminate the distinction between WTO and non-WTO investors, with the result that direct acquisitions where neither the vendor nor the investor is controlled by nationals of a WTO country, will be subject to the lower $5 million (in book value of assets) review threshold for direct acquisitions and $50 million review threshold for indirect acquisitions. These thresholds have not changed since the ICA was introduced in 1985 – more than two decades ago.

The Panel's recommendation to treat WTO and non-WTO investors alike was sensible as government resources should not be expended on transactions of only minor importance to the Canadian economy. Moreover, to the extent that the Canadian Government has particular concerns about investments by certain countries, it is likely that such concerns would relate to national security and therefore could be addressed through the national security test.

E. Eliminate the Requirement to Notify

The Panel

The Panel recommended the elimination of the requirement to notify transactions that fall below the review threshold. While the notification form is generally easy to complete and can be filed post closing, in certain instances it may require significant resources to determine questions that appear relatively straightforward in the first instance (e.g., the country of ultimate control of the investor where the ownership structure is complex and multinational).

Bill C-10

Bill C-10 does not eliminate the requirement to notify transactions that are not reviewable and thus the ICA will continue to impose a filing obligation on investors making small investments in Canada. This is unfortunate, as the Panel's recommendation would have dispensed with an administrative formality with little obvious benefit to Canada.

F. Enhance Transparency and Predictability

The Panel

The Panel acknowledged that the lack of transparency and predictability in the ICA process is a frequently voiced criticism.[11] The Panel noted that currently it can take longer to obtain a binding ministerial opinion interpreting the application of the ICA to a particular set of facts than to conduct a review under the ICA. To address these issues, the Panel proposed to enhance transparency and predictability in the enforcement of the ICA through a number of means, including: increasing the use of guidelines and other advisory materials "to provide information concerning the review process, explain the basis for making decisions under the Act, and clarify interpretations by Industry Canada or the Department of Canadian Heritage regarding its application".[12] In addition, the Panel proposed requiring ministers to report publicly on the disallowance of a transaction and give reasons for disallowance as well as mandating ministers to produce an annual report. Such annual report would give reasons for any disallowance, disclose new policies or guidelines and describe undertakings offered by investors (while respecting confidentiality concerns). Finally, the Panel recommended that "in appropriate cases", ministers should provide binding opinions and less formal advice to parties regarding actual transactions "on a timely basis" [13]

Bill C-10

The Government has moved to enhance transparency in the ICA process, although the extent of the improvement that will be achieved may only be modest given relatively weak statutory requirements. The amendments add three provisions that may assist investors. First, there is a new requirement that Industry Canada submit a report on the administration of the ICA to the Minister annually (aside from the national security provision). While this provision may permit greater scrutiny of how the ICA is being enforced, the amendment does not elaborate on what information must be provided in the annual report. The Wilson Panel had recommended that the "report should be required to provide sufficient detail to allow the Canadian public to assess whether the Act is meeting its objective of ensuring that foreign investment proposals are not contrary to Canada's national interests" [14] Second, on the question of Canadian status under the ICA, Bill C-10 requires that the Minister provide an opinion no later than 45 days after the Minister has received sufficient information to issue such an opinion. This is a positive development as it ensures greater timeliness in the provision of opinions. The same 45 day period applies with respect to ministerial opinions on the applicability of the ICA or the regulations. However, the Minister is not required to provide an opinion and, as a result, an investor cannot count upon the expedited receipt of a Ministerial opinion regarding questions other than Canadian status. Third, the Minister is required to provide reasons for a disallowance of an investment and is permitted, though not required, to provide reasons for the approval of an investment.

G. Notably Absent from the Panel Report and Bill C-10

A significant issue that is not addressed by the Wilson Report is the jurisdiction of the Minister to review transactions that have only a tenuous connection to Canada. While the ICA does require that there be an acquisition of a "Canadian business", Industry Canada's interpretation of this term has varied significantly in recent years. For example, a mining company whose primary connection to Canada is a listing on a Canadian exchange but whose revenue-generating operations are entirely based in a foreign country will generally constitute a "Canadian business". If a transaction involving such a business is reviewable, the same test for approval (i.e., net benefit to Canada) applies as would apply to the acquisition of a target whose entire business is situated in Canada.[15] For Canada to avoid being perceived as overly zealous in its regulation of foreign investment, the application of the ICA to businesses which do not have any substantial presence in Canada should be re-considered.

Recommendations on the Application of the *Investment Canada Act* to Cultural Activities

The Panel

In the cultural business sector, the Panel noted the far-reaching application of the ICA and that "greater openness to two-way trade, foreign investment and talent would increase competitive intensity and ultimately ensure the long-term vitality of Canadian cultural businesses"[16]. The Panel was critical of numerous aspects of the review process by the Department of Canadian Heritage ("Heritage"), including:

- the overreach of the current review process to activities and transactions of minimal cultural significance. In this regard, the Panel doubted that a review is needed where the cultural activities of a commercial nature are only ancillary, recommending a *de minimis* exemption based on revenues from the cultural activities of the target business (less than the lesser of $10 million or 10% of gross revenues of the overall business).[17] (As there is currently no exemption, gift stores and drug stores that have magazine and book racks, even to a limited extent, are considered cultural businesses.);

- a lack of clarity on the meaning of cultural products. The Panel stated that Heritage should distinguish between cultural products that involve creation and distribution and those activities that are incidental to commercial activities. For example, the Panel noted that telephone directories and technical manuals should not be viewed as cultural products;

- adverse incentives and impacts on the ability to raise capital and enhance competition in cultural sectors. For example, Heritage policies prohibit the sale of Canadian owned book publishing or film distribution businesses to foreigners. The Panel doubted that

this prohibition should apply to capture investments in targets that publish almost no Canadian authors, sell most of their books outside Canada and have no printing or distribution within Canada.[18] It should be noted that such prohibitions also have the effect of limiting the number of possible purchasers of such businesses to Canadians only, thus circumscribing the ability of Canadian owners to maximize the value of their business at the end of their business careers (for a forward-thinking investor, such prohibitions also act as a disincentive to invest in the first place); and

- the low threshold for review (at $5 million in gross assets). The Panel observed that not only was the threshold very low but also that it could be immaterial as a decision can be made to review a transaction involving a target with less than this amount in assets. Nevertheless, the Panel did not feel it had sufficient evidence before it to recommend a new review threshold for cultural businesses.

Finally, as it did in respect of its proposals relating to non-cultural businesses, the Panel recommended that the Minister of Canadian Heritage should improve transparency through: increased use of guidelines and other advisory materials; requiring the Minister to report on disallowances of any transaction and produce an annual report to Parliament on the operation of the ICA; and providing binding opinions and less formal advice to parties regarding prospective investments in a timely manner. More broadly, the Panel recommended that cultural industry policies be reviewed every five years with advice from different stakeholders and that the first review should consider both increasing the review threshold and the desirability of reviews of new cultural businesses established by foreign investors.

Bill C-10

Bill C-10 does not address the acquisition of cultural businesses and, in particular, permits the continued review of businesses that are primarily non-cultural if they have even a minimal cultural dimension. The Government's failure to address the flaws identified by the Panel in the cultural investment review process is unfortunately a missed opportunity, given the infrequency of legislative reform in this area.

National Security

The Panel

Although the Panel's mandate did not include consideration of a national security test for foreign investment review, the Panel supported the stated intention of the Government to consider the establishment of a new review requirement for transactions that raise national security concerns and suggested a process similar to that used by the U.S. Government. Similarly, the Panel welcomed the Government's recently issued guidelines on the application of the ICA to

state-owned enterprises. (Interestingly, with the increase in the review threshold to $1 billion in enterprise value, only very significant investments by SOEs will be caught by the guidelines.)

Bill C-10

While the ICA does not currently provide for the review of foreign investments on national security grounds, Bill C-10 establishes a national security review process in the ICA.

The salient elements of the national security review are:

Potentially Broad Scope of "National Security"

There is no definition of "national security" in the proposed amendments nor is there an illustrative list of potential national security concerns. While the reluctance to provide a specific definition that would fetter the discretion of the Minister is understandable, the potential breadth of national security will mean unpredictability for foreign investors. By contrast, in the U.S., there is an illustrative list of factors that may be considered in determining whether a national security risk exists.[19] Aside from the more obvious matters relating to national defence, this list includes national security-related effects on U.S. critical technologies, critical infrastructure such as major energy assets, as well as long term requirements for sources of energy and raw materials.[20] In addition, the Committee on Foreign Investment in the United States (CFIUS) has released guidelines which outline how the Government scrutinizes not only the business that is the subject of the investment (the vulnerability) but also the potential threat represented by the investor.

Power to Prohibit or Authorize subject to Conditions

The federal Cabinet is empowered to prohibit closing of the investment, authorize the investment on condition that the non-Canadian investor provide written undertakings to the Government or implement the investment on terms and conditions contained in the order, or require the divestiture of the Canadian business.

No Safe Harbour and No Requirement of Control

In contrast to the general provisions of the ICA, there is no minimum review threshold with the result that transactions involving very small targets are potentially reviewable. Similarly, national security screening applies whether or not control has been acquired. This is a significant and worrisome aspect of the proposed amendments and is in contrast to national security review in the U.S. which requires that the foreign investor acquire control (although, even in the U.S., there is no "bright-line" test to determine whether a transaction results in foreign control[21]).

Weak Connection to Canada Sufficient

While the general ICA rules require the acquisition of a Canadian business with its three defining elements (assets in Canada, individuals employed in connection with the business and a place of business in Canada), the national security review process does not require that all of these three elements be present. In particular, national security applies to a target entity carrying on all or any part of its operations in Canada where the entity has any of: a place of operations in Canada, an individual(s) employed or self-employed in connection with the entity's operations or assets in Canada used in carrying on the entity's operations. In addition, the national security review process applies to an entity that does not meet the definition of a "business" (e.g., a mineral exploration company). As a result, the scope of national security is potentially very wide and can involve transactions with tenuous connections to Canada.

No Separate National Security Notification Process

There is no formal process established to notify the Government pre-closing if ministerial approval is not otherwise required. In such an instance, the investor may only learn that the transaction is subject to national security review following closing upon receipt of notice from the Minister. Investors may be well-advised to seek early counsel from Industry Canada in respect of transactions that may potentially raise national security issues.

Potential Delay

As many timelines in the national security review process are not set out in the amendment but are to be prescribed by regulation, there is clearly potential for the national security review process to delay significantly the closing of a transaction.

Retroactive Application

The national security review screening procedure applies retroactively to transactions closed between February 6, 2009 (the date that the bill was introduced) and Royal Assent.

Conclusion

With Bill C-10, the Government has chosen to implement some of the key recommendations of the Wilson Panel and foreign investors into Canada will in general benefit from less intervention because of the new review thresholds and the elimination of the sensitive sectors (except culture). At the same time, the bill reflects a stronger Government focus on investments that may harm Canadian national security. The question that investors may well ask is whether this new focus reflects a desire to facilitate greater protectionism in a potentially broad array of circumstances or whether national security will be narrowly construed as the Industry Minister has suggested.[22] The answer is difficult to prejudge with any certainty and could change as Governments do. The concept of "national security" is very subjective and susceptible to expansive interpretation, with

the result that the screening process could become politicized in the hands of a government that is not firmly committed to a liberal foreign investment regime. In order to address the uncertainty that a national security review process introduces, a foreign investor proposing to acquire a business with potential national security concerns would need to consider developing a pro-active government and public relations strategy to minimize the likelihood that the Government would take action to prohibit or restrict its investment. Such a strategy would need to anticipate and be sensitive to changes in the Canadian political and economic climate that could alter the dynamics of how national security is perceived.[23]

Notes

* Sandra Walker is Chair of the Foreign Investment Review Committee of the Competition Law Section of the Canadian Bar Association.

1 Available at http://www.ic.gc.ca/eic/site/cprp-gepmc.nsf/eng/h_00040.html.

2 The Panel acknowledged the debate over the "hollowing out" of corporate Canada and its own concern over foreign takeovers of notable Canadian companies but concludes that overall the "data indicate that the share of assets in Canada's non-financial industries under foreign control has not changed noticeably in recent years" Moreover, while recognizing the loss of a number of leading companies in recent years, the Panel noted a number of "growing Canadian champions" and rejects interfering with "the natural rhythm of creative destruction and renewal" Rather, the Panel identified the creation of a supportive policy and legal framework and a "more ambitious mindset" as the means to enhance the prospects for potential Canadian champions. In concluding this, the Panel clearly placed its confidence in a liberal investment environment as the means by which Canada will achieve growth and prosperity.

3 Wilson Report at 29.

4 See Wilson Report at 33.

5 "WTO" refers to the World Trade Organization.

6 The U.S. pre-merger antitrust filing regime under the Hart-Scott-Rodino Act uses concepts such as fair market value and acquisition price to determine notifiability under that statute but has detailed rules on when and how the different methods of valuation should be used.

7 Wilson Report at 31.

8 The Panel notes that foreign investment involving federally regulated financial services businesses (regulated under the Bank Act and the Insurance Companies Act) is exempt from review under the ICA.

9 Wilson Report at 32.

10 However, note that the national security process also applies to an indirect acquisition.

11 At present the volume of published resources relating to the interpretation and application of the ICA is woefully inadequate, given the more than two decades of experience with this statute. While Industry Canada currently has four interpretation notes and five guidelines, no interpretations or reasoned decisions have been issued or even summarized by Industry Canada in the context of actual cases before those departments in over twenty years. As a result, practitioners regularly resort to summaries of Industry Canada decisions made in the mid-1980s.

12 Wilson Report at 33.

13 Wilson Report at 37.

14 Wilson Report at 33.

15 In some respects, it may be less difficult to meet the test where the Canadian business has only minimal connections to Canada because the transaction will likely only have negligible adverse impacts which require offsetting by positive effects. On the other hand, the very fact that the target has little connection to Canada may make it challenging for the acquirer to demonstrate any positive effects on Canada.

16 Wilson Report at 34.

17 Wilson Report at 37.

18 Wilson Report at 36.

19 See Department of the Treasury, Guidance Concerning the National Security Review Conducted by the

Committee on Foreign Investment in the United States, available at http://www.gpoaccess.gov/fr/.

[20] In 2008 there was the first rejection of a transaction under the ICA by the Minister of Industry. ATK's acquisition of MDA raised some unique issues: extensive government funding of MDA and MDA's ownership of space technology including Radarsat 2.

[21] See CFIUS Reform: Final Regulations Issued on November 14, 2008 at http://www.treas.gov/offices / international-affairs/ cfius/docs/Summary-FinalRegs.pdf.

[22] Tony Clement, "How Canada can compete in tough times", National Post, March 3, 2009 at A13.

[23] For instance, it is not inconceivable that at some point a Canadian Government could use "national security" as the justification for limiting foreign investment in certain natural resources (from oil and gas to water) in the event of a severe restriction on the supply of such resources. Clearly, the CFIUS process contemplates such a possibility as the illustrative list of national security factors includes long term U.S. requirements for sources of supply of raw materials and resources. At the same time, if there were a serious shortage of a particular resource, it is likely that other policy instruments than foreign investment review would be used to ensure adequate provision of such resources for Canada.