CANADA'S EXPANDING APPROACH TO NATIONAL SECURITY IN FOREIGN INVESTMENT REVIEWS

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Canada's Expanding Approach to National Security in Foreign Investment Reviews

By Neil Campbell & Joshua Chad

The primary focus of Canada's review of foreign investments has shifted from an assessment of an investment's economic benefits in Canada to an assessment of national security risks. The range of potential national security concerns has broadened beyond traditional areas such as national defense, terrorism, and organized crime, to include the potential use of artificial intelligence, advanced technologies, critical supply chains or sensitive personal data to harm Canada's security. Procedurally, most national security reviews are initiated following a non-Canadian investor submitting the standard notification required to be filed after acquisition of control of a Canadian business, and extending this process to minority investments could reduce the uncertainty that currently applies to such transactions

I. INTRODUCTION

Canada has been reviewing foreign investments for half a century, but its focus over the past decade has shifted from an economic assessment of benefits to Canada towards national security issues. The range of potential national security concerns continues to expand, but an improved process is needed for the potential review of non-notifiable transactions.

II. CANADA'S FOREIGN INVESTMENT REVIEW REGIME

Canada's primary legislation regulating foreign investment is the *Investment Canada Act* ("ICA").[2] It sets out notification and review/approval requirements governing investments by non-Canadians to acquire existing Canadian businesses or to establish new Canadian businesses.

The ICA replaced Canada's *Foreign Investment Review Act*[3] ("FIRA") in 1985. FIRA was enacted in response to nationalist fears about foreign investment in the early 1970s and had a strong protectionist orientation.[4] It subjected investments to acquire Canadian businesses above relatively low financial thresholds to pre-closing reviews in order to confirm that the transactions were of "significant benefit" to Canada.

The enactment of the ICA by a new Conservative Government in 1985 represented a major policy shift, signaling that Canada was "open for business" and wanted to encourage additional investment from non-Canadians.[5] It was followed by negotiation of the *Canada-United States Free Trade Agreement* and numerous other deregulation and trade liberalization initiatives.

The ICA raised the pre-closing review thresholds significantly, with the Government estimating that only 10 percent of investments previously reviewed under FIRA would be reviewed under the ICA.[6] A post-closing notification requirement allowed the Government to maintain visibility on smaller transactions that would not longer be reviewable. In addition, the "significant benefit to Canada" test was replaced with a less demanding "net benefit to Canada" test.

After an in-depth study in 2008,[7] Canada proceeded with further modernization and liberalization. Since 2009, the review thresholds for investors from countries with which Canada has bilateral or regional trade agreements, as well as those from WTO member countries, have been raised to the point that there are now only a handful of "net benefit" reviews annually.[8] However, the trade agreement commitments all contain exceptions that preserve Canada's ability to take action to review and block or remedy investments that give rise to national security concerns.

The ICA was amended in 2009 to establish a formal national security regime.[9] It enables the Government to review most types of foreign investment on national security grounds - including minority shareholding investments (which currently are not subject to net benefit review or the regular post-closing notification requirement) as well as any acquisitions or establishments of Canadian businesses that are not subject to net benefit review.

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2 RSC 1985, c 28 (1st Supp). There are also foreign ownership limitations in a variety of regulated sectors including financial services, telecommunications/broadcasting and aviation. For more detailed descriptions, see N. Campbell and R. Wisner, *International Protection of Foreign Investment*, 2nd ed. (2019, looseleaf).

3 SC 1973-74, c 46 at s 2.

4 See, for example, Barry J O'Sullivan, "*Canada's Foreign Investment Review Act Revisited*," Fordham International Law Journal, Vol 4, Issue 1 (1980); Article 8.

5 See, for example, John L. Ross and David A. Rubin, Q.C., "*Investment Canada Act: A New Regime for Foreign Investment in Canada*," Commercial Law Journal, Vol 91, Issue 1 (1986) 141 at pp 141-142.

6 George Glover, Douglas New and Marc Lacourciere, "*The Investment Canada Act: A New Approach to the Regulation of Foreign Investment in Canada, Business Law*, Vol. 41 (1985) 83 at 98.

7 Competition Policy Review Panel, Compete to Win: Final Report (2008).

8 ICA, ss 14, 14.1. The threshold for direct acquisitions by trade agreement investors in 2021 is C$1.565 billion (enterprise value or asset value of the Canadian business being acquired), and the threshold for WTO investors is C$1.043 billion. Indirect acquisitions of control (i.e. acquisition of a foreign corporation with a Canadian subsidiary) by such investors are not reviewable. A lower threshold of C$415 million applies if the investor is a state-owned enterprise and the investment is a direct acquisition (indirect acquisitions by state-owned Enterprises from WTO member countries are not reviewable). For investments in the cultural sector, as well as investments by investors that are not controlled by citizens or governments of WTO member countries, the pre-2009 thresholds of C$5 million (direct acquisitions) and C$50 million (indirect acquisitions) continue to apply.

9 ICA, Part IV.1.

III. THE RISE TO PROMINENCE OF NATIONAL SECURITY REVIEWS

Unlike the mandatory "significant benefit" reviews under FIRA and "net benefit" reviews under the ICA, national security reviews are discretionary. They can occur either before or after an investment is implemented.

When national security reviews were first introduced, there was limited guidance about the situations that would likely raise national security concerns, how the review process would play out, and how the risks related to a national security review could be managed by transaction parties and their advisors.

Over time, the Government has provided more extensive guidance on what types of investments and situations might trigger national security issues. While the initial focus of the regime was on military/defense, terrorism and organized crime concerns, the potential for state-enterprises to engage in activities that do not reflect ordinary commercial operations soon emerged as another area of significant scrutiny. Guidelines were issued to indicate how such issues would be addressed in an application for review under the net benefit test,[10] but in some circumstances SOE activities and relationships may generate national security reviews irrespective of whether or not a net benefit review is under way.

More recently, the Government issued a policy statement in April 2020 expanding the use of national security reviews in response to the coronavirus pandemic.[11] The policy statement indicated that controlling as well as non-controlling investments in the health sector and in critical supply chains would potentially be scrutinized, regardless of the source of the investment.

This policy change remains in effect, and was reinforced and further extended by a March 2021 update to the Government's *Guidelines on the National Security Review of Investments*. The expanded guidance identified artificial intelligence and several other advanced "sensitive technologies," critical minerals and mineral supply chains, and access to sensitive personal data as additional areas of focus.[12]

IV. THE CONNECTION BETWEEN NOTIFICATIONS AND NATIONAL SECURITY

The ICA notification requirement for non-reviewable investments to acquire or establish a Canadian business provided a simple and convenient mechanism to enable the Government to conduct initial screening for transactions that might warrant a national security review.[13] The ICA regulations and notification forms were amended to require provision of various information that is useful for initial screening, including more details about investors, their officers and directors, persons controlling the investors, and possible involvement of state-owned enterprises.

Procedurally, the existence of the notification requirement allowed the national security regime to utilize a 45-day limitation period (after receipt of a complete notification) in which the Government may either commence a national security review or issue a notice indicating that it needs an additional 45 day period to determine whether to do so.[14] These are reasonable and clear time periods that reduce uncertainty for transaction parties while incentivizing the Government to complete the initial screening processes expeditiously.

According to the most recent annual report on the operation of the ICA, for the year ended March 31, 2019, the power to extend the initial screening period by 45 days was exercised 9 times. National security reviews were commenced for less than 1 percent (7 / 962 investment filings) of foreign investments.[15] While data for the years ending March 2020 and 2021 may be expected to show some increases, the Government has exercised the power to conduct lengthy and in-depth reviews sparingly.

10 Innovation, Science and Economic Development Canada, *Guidelines - Investment by State-Owned Enterprises - Net Benefit Assessment*, https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2.

11 Innovation, Science and Economic Development Canada, *Policy Statement Regarding Foreign Investment Review and Covid-19*, April 18, 2020, https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81224.html.

12 Innovation, Science and Economic Development 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.

13 It is assumed that parties will comply with the notification requirement, although there are no penalties for failure to do so unless and until the authorities have issued a demand that non-compliance be remedied and the investor has not responded with the requisite filing.

14 ICA, ss 25.2, 25.3.

15 Innovation, Science and Economic Development Canada, *Investment Canada Act – Annual Report for 2018-19*, https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk81126.html#Toc528931168.

Notifications under the ICA normally are filed within the 30-day period after closing of an acquisition or the establishment of a new business. This results in any national security review being undertaken post-closing, with the investor bearing the possible risks of divestiture or mitigation orders.[16]

To address such risks, an investor may decide to submit its ICA notification pre-closing (assuming the acquiree/vendor agree to allow such a step). The Government has encouraged this approach for pre-closing determination of whether national security concerns exist. As long as the investor allows more than 45 days between the notification date and the proposed closing date, and as long as the Government does not issue an extension notice or commence a national security review within the 45-day limitation period, the national security review risk is eliminated. However, if the Government does issue an extension or commence a review, the parties cannot complete the transaction until approval is obtained. This no-close review period may run for up to 200 days or more for a full national security review process.

The practical solution developed by foreign investment review lawyers and the Government works reasonably well for notifiable transactions. The transaction parties can choose whether to shift from post-closing to pre-closing review risks and manage their transaction timelines and risk allocations accordingly.

V. NATIONAL SECURITY REVIEWS OF NON-NOTIFIABLE TRANSACTIONS

In addition to notifiable acquisitions of control or the establishment of Canadian businesses, the ICA allows the Government to conduct a national security review of investments "to acquire, in whole or in part, or to establish an entity carrying on all or any part of its operations in Canada," as long as the entity has a place of operations in Canada, any individuals in Canada who are employed or self-employed in connection with its operations, or assets used to carry operations in Canada.[17] The submission of a notification form does not provide a trigger for the initial screening of such transactions for possible national security issues. Nor does it provide a starting point for the limitation period in which such decisions must be made. Instead, the 45-day period runs from the transaction closing date.

This regime is sub-optimal for the Government because it does not ensure that the investment review and national security authorities have awareness about transactions, or it may leave them with insufficient time to conduct screening in situations where they only become aware of a potential transaction towards the end of the 45-day period after closing. In either case, they do not have the information that would be contained in a completed notification form as a starting point for their screening activities.

This regime is also sub-optimal for private parties. They do not have the ability to trigger the start and end of the limitation period in which a pre-closing national security review would be initiated. The inability to obtain such certainty also reduces the incentive for voluntary engagement with the Government regarding potential issues that could be addressed pre-closing.

The latter concern might be addressable by way of changes to the *National Security Review of Investments Regulations*.[18] However, an amendment to the ICA would be needed if the Government wants to ensure that it has full visibility regarding the types of foreign investment activity that currently are not subject to notification requirements.

16 ICA, s 25.4.

17 ICA, s 25.1(c).

18 SOR/2009-271. Even though there is no statutory obligation to file notifications for these types of transactions, the limitation period could be structured as the earlier of; the date on which the investor voluntarily provides the complete and certified information that would be contained in a notification, or 45 days after closing.

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