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Foreign Investment Bulletin

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Canada's Use of its National Security Power

The Government of Canada's decision to reject the proposed acquisition of Aecon, a major Canadian construction services firm, by China Communications Construction Company International Holding Limited. ("**CCCI**"), while significant, does not reflect a broader protectionist orientation or a retreat from Canada's general openness to foreign investment and trade. In our view, there are three main conclusions to be drawn from the Government's decisions in recent years under the *Investment Canada Act* ("**ICA**"). First, intervention in foreign investment transactions is exceedingly rare – each case stands on its own with the Government doing a careful case-by-case review of transactions which raise national security issues. Second, there is no indication that the Canadian process is being applied in a protectionist or political manner. Finally, parties seeking to undertake foreign investment transactions need to develop comprehensive legal and government relations assessments and strategies to deal with the possibility of reviews under the ICA, but there is no reason to regard Canada as riskier than other jurisdictions which have the power to conduct national security reviews.

The National Security Framework

Canada was a relative late-comer to national security review of foreign investments; the Government was not given such powers until 2009. The ICA allows the Government to initiate national security reviews within 45 days of becoming aware of any type of full or partial acquisition of a Canadian business or an investment in

Canada by a foreign company, individual or government.[1] A multi-step process allows information to be gathered from Canada's security agencies and other government departments, as well as from the parties. At the conclusion of the review, the federal cabinet may approve a transaction unconditionally, condition approval upon "mitigation measures", prohibit a proposed transaction or order a divestiture in respect of a completed transaction.[2]

The Aecon Decision

The Aecon transaction was announced in October 2017 and was followed by considerable media coverage regarding potential national security issues in relation to Aecon's work involving nuclear power facilities, hydroelectric facilities, oil and gas facilities and pipelines, transportation projects, telecom infrastructure, military housing and training facilities, and mining projects. In guidelines that were released in late 2016 (described in more detail below), the impact of a foreign investment on "critical infrastructure" is identified as a factor that the Government may consider when analyzing national security issues. Ten critical infrastructure segments have been identified, including the energy and utilities, transportation, and information and communication technology sectors in which Aecon is active.[3]

As is usual in national security reviews, detailed reasons for decisions are not published, primarily due to confidentiality restrictions and national security sensitivities. However, the Minister of Innovation, Science and Economic Development, Navdeep Bains, stated that:

> *As is always the case, we listened to the advice of our national security agencies throughout the multi-step national security review process under the Investment Canada Act. Based on their findings, in order to protect national security, we ordered CCCI not to implement the proposed investment. Our government is open to*

[1] Technically, at the 45 day mark, the Government may choose to commence a national security review or to inform an investor that it is considering initiating a national security review, which provides the Government with an additional 45 days to determine whether a national security review is warranted.

[2] A more detailed commentary on the national security framework is provided in our September 2017 Bulletin on the 2016-17 *Investment Canada Act* Annual Report.

[3] Public Safety Canada, "National Strategy for Critical Infrastructure" (2009).

international investment that creates jobs and increases prosperity, but not at the expense of national security.[4]

I'm confident that we'll continue to work together. We want to pursue strong economic ties with China and we'll continue to engage them on a range of files.... We're also very clear that we're open for trade, we're open for investment, but not at the expense of national security.[5]

The Government's Track Record

Since taking office in the fall of 2015, the Trudeau Government has continued to pursue bilateral and multilateral trade and investment agreements to diversify Canada's economic base. Most notably, the Comprehensive Economic and Trade Agreement with the European Union ("**CETA**") and the proposed Comprehensive and Progressive Agreement for Trans-Pacific Partnership ("**CPTPP**"), which has been tweaked after the United States' decision not to participate, contain extensive provisions which protect and promote foreign investment.[6] Canada's CETA concessions included a massive increase of the review thresholds under the ICA to an acquiree enterprise value of C$1.5 billion.[7] The Trudeau Government also unilaterally accelerated the phase-in of a higher C$1 billion review threshold for investors from other WTO countries almost two years ahead of schedule.[8] These changes have significantly reduced the number of transactions that are subject to "net benefit" reviews under the ICA. In the year ended March 2018, there were only nine net benefit reviews,[9] compared with an average of 16 per year in the prior five years.[10]

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[4] Innovation, Science and Economic Development Canada, "Minister Bains Statement on CCCI's Proposed Acquisition of Aecon" (2018-05-23).

[5] CBC, "Canada Still Wants to Work with China Despite Blocked Aecon Takeover: Bains" (2018-05-24).

[6] For an in-depth discussion of these trade agreements, see our January 2018 Bulletin on CPTPP and our October 2013 Bulletin and January 2018 Bulletin on CETA.

[7] This threshold also became applicable to several other countries including the U.S. pursuant to "most-favoured-nation" provisions in various trade agreements including NAFTA.

[8] See our March 2017 Bulletin on merger review threshold increases.

[9] As calculated based on the Government of Canada's "Listing of Completed Applications for Review and Notifications".

[10] Innovation, Science and Economic Development Canada, "Annual Report; 2016-2017", Report (31 August 2017). These data exclude reviews of cultural businesses, which are subject to very low thresholds.

CCCI is a state-owned enterprise ("**SOE**") for purposes of the ICA. The Trudeau Government, like the predecessor Harper Government, has not raised SOE thresholds other than through an annual inflation-related adjustment. The current threshold for WTO SOE investors is an acquiree book value of assets in Canada of C$398 million. The Trudeau Government continues to follow the guidelines for investments by SOEs that were released in 2012.[11] Of note, one of Minister Bains' first decisions under the ICA was approving the acquisition of control of the former Canadian Wheat Board (now G3 Canada Limited) by a Saudi Arabian SOE (the Saudi Agricultural and Livestock Investment Company).[12]

Canada is not alone in considering the possible national security implications of investments by SOEs. In the U.S., new legislation is being considered that, among other amendments, proposes to require CFIUS notifications to be filed in respect of any transaction in which a foreign government has a 25% interest in the investor making the acquisition.[13] Similarly, the European Parliament is close to finalizing a proposal that would broaden the powers of the European Commission to scrutinize foreign investments amid concerns about Chinese acquisitions, including by SOEs.[14]

With respect to China, Canada has had a bilateral investment treaty in place since 2014.[15] Canada and China have also been exploring the possibility of entering into free trade negotiations, although both have obviously been focusing much more extensively on the uncertainty in their trading relationships with the US over the past year and a half. Canada has continued to be very open to inbound investment from China, including in sensitive sectors that potentially may raise national security issues.

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[11] Government of Canada, "Statement Regarding Investment by Foreign State-Owned Enterprises" (2012-12-07).

[12] Government of Canada, "Decisions — January 2016" (Modified – 2016-02-22).

[13] David McLaughlin and Saleha Mohsin, "Foreign Dealmakers Would Face Tougher Security Reviews Under U.S. Bill" (2017-11-08), Bloomberg.

[14] Noah Barkin and Philip Blenkinsop, "With eye on China, EU Parliament pushes tougher line on investments" (2018-05-23), Reuters.

[15] See our September 2014 Bulletin on this treaty coming into force.

Since the Trudeau Government came to power in late 2015 until March 2018 (the most recent month with available statistics), there have been 82 investments from China and Hong Kong subject to review or notification under the ICA:[16]

	China	Hong Kong	Total
Net Benefit Review and Approval	4	5	**9**
Notification – Acquisition	31	16	**47**
Notification – New Business	12	14	**26**
Total	**47**	**35**	**82**

All the net benefit reviews received approval. Notably, the Trudeau Government considered whether to conduct a formal national security review of the Hytera/Norsat transaction and determined that this was not warranted.[17] It also settled the judicial review proceeding that was initiated by O-Net Communications in respect of the Harper Government's order that it divest its acquisition of ITF Technologies and then conducted a fresh review and approved the transaction.[18]

The National Security Review Process

Canada was criticized, with some justification, for lack of clarity regarding national security reviews between 2009-2015. However, in its 2016 Fall Economic Statement, the Trudeau Government committed to publishing guidelines on the types of investments that are examined under national security reviews. The Guidelines on the National Security Review of Investments (the "**Guidelines**") were issued on December 19, 2016.[19] The accompanying announcement

[16] These data exclude investments related to cultural businesses.

[17] Joanna Smith, "'Some Baloney' in PM's Claim Hytera went through National Security Review" (15 June 2017), CTV News.

[18] Steven Chase, "Liberal green light for Chinese takeover deal a turning point for Canada: experts" (28 March 2017), The Globe and Mail.

[19] Innovation, Science and Economic Development Canada, "Guidelines on the National Security Review of Investments", Guidelines Document (December 19, 2016).

emphasized that the Guidelines are designed to help attract investment into Canada and to ensure greater transparency.[20]

The Guidelines set out a list of factors that the Government considers when determining whether to conduct a national security review. Those factors include defence, critical infrastructure, the impact on the supply of critical goods and services to Canadians and the Government of Canada, and intelligence capabilities.[21] The inclusion of "critical infrastructure" is consistent with the approach taken by CFIUS, which also treats critical infrastructure as a key factor in national security reviews.[22]

The Guidelines also reflect the change in practice of Canada's Investment Review Division to permit early consultations with the Government to discuss proposed transactions. The Guidelines indicate that the Government is receptive to, and in fact encourages, investors that are considering implementing proposed investments with potential national security concerns to reach out to the Investment Review Division at an early stage to allow for constructive engagement with the Government on any such concerns.[23]

The Trudeau Government has also begun reporting on the results of national security reviews. The 2016-2017 annual report on the administration of the *Investment Canada Act* (the "**2017 Annual Report**") provided the first meaningful reporting on the use of the national security provisions.[24] The report noted that the most common factors that have given rise to national security issues in Canada were the potential for transfer of sensitive dual-use technology or know-how outside of Canada, the potential to negatively impact the supply of critical services to Canadians or the Government, and the potential to enable foreign surveillance or

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[20] Innovation, Science and Economic Development Canada, "Attracting global investments to develop world-class companies", News Release (December 19, 2016).

[21] For more information, please see our January 2017 Bulletin that discusses the Guidelines.

[22] U.S. Department of the Treasury, "Guidance Concerning the National Security Review Conducted by CFIUS" (8 December 2008), 73 Fed. Reg. 74567.

[23] See paragraphs 8 and 10 of the Guidelines.

[24] See Innovation, Science and Economic Development at 10 above.

espionage.[25] An average of about 2.5 transactions per year have been subject to a remedial order or abandoned as a result of national security reviews.[26] This represents less than 0.5% of the average of 673 ICA notifications per year during this time.[27]

Concluding Observations

Canadian Government intervention in foreign investment transactions is rare. There does not appear to be any indication that the Canadian process is being applied in a protectionist or political manner. While thorough legal and government relations assessments will be important in order to develop approaches for dealing with the possibility of regulatory reviews under the ICA, we do not consider Canada to be riskier than other jurisdictions which have the power to conduct national security reviews.

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[25] For more information on this national security guidance, please see our September 2017 Bulletin that discusses the 2017 Annual Report.

[26] From April 2012-March 2017 (5 fiscal years), 3 transactions were blocked, 5 required divestitures, 4 had conditions imposed, and 1 was abandoned. Technically, the O-Net transaction discussed above that was blocked and then subsequently approved is counted twice, once as a blocked transaction and once as approved with conditions.

[27] By comparison, under the CFIUS national security review process in the United States, over the most recent 5 year period available (2011-2015), an average of 12 transactions per year were subject to remedies or were abandoned. CFIUS notices were withdrawn during the CFIUS review phase in 12 cases, an additional 49 were withdrawn during the CFIUS investigation phase, and 1 transaction was subject to a Presidential Determination. The Committee on Foreign Investment in the United States, "Annual Report to Congress; Report Period: CY 2015" (2017-09), US Department of Treasury.