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Canadian National Security Reviews: 10 Takeaways

INTRODUCTION

Canada, like many other countries, has adopted a regime for reviewing foreign investment. The regime was established in the 1970's as an express response to concerns about perceived American domination of the Canadian economy. In 1985 the regime was significantly transformed, becoming much less protectionist in tone and substance. While the system was originally designed to protect against foreign control, it is now transforming, primarily, into a national security review mechanism, like the CFIUS system in the United States.[1] In this brief we provide an overview of the Canadian national security review system and some practical tips for navigating through it.

DECREASED GENERAL FOREIGN INVESTMENT REVIEW CONCERN

The first significant point to note with respect to developments in Canada is that the review system under the *Investment Canada Act* (ICA) has been amended to intentionally remove the vast majority of foreign investments from the traditional review. That traditional review is focused on whether such an investment provides a 'net benefit' to Canada. While all acquisitions of Canadian businesses by entities controlled by foreign persons must be notified to the Investment Canada authorities, only those exceeding certain

[1] The system also has a fairly robust set of provisions dealing with protection of "cultural" industries, which is outside the focus of this Brief.

thresholds require approval, and those approval thresholds have increased markedly.

In 2015 the mechanism for determining the value of transactions subject to review was switched from an asset value (at least for most transactions) to an enterprise value (except for acquisitions by non-WTO investors or State Owned Enterprise (SOE) investors and acquisitions of "cultural" businesses) and the threshold went from C$369 million in asset value to C$600 million in enterprise value. Subsequently due to a scheduled ramp up, due to inflationary increases, and due to free trade agreements (including those with EU members, the United States, Mexico, the CPTPP members, as well as others), the enterprise value threshold has risen to C$1.568 billion for trade agreement investors and C$1.045 billion for WTO non trade agreement investors. These thresholds will continue to increase annually based on Canada's annual nominal GDP growth rate.

The result has been that a significant number of transactions have been removed from the traditional 'net benefit' review. For the most recent year for which statistics are available, 10 transactions met the threshold and applied for review, as opposed to 22 the year before. Consequently, for truly large transactions review as to whether a transaction is of net benefit to Canada will continue to be required, but the vast majority of transactions now fall beneath the review thresholds. The opposite is true with regard to National Security Reviews.

MORE NATIONAL SECURITY ISSUES

Before 2009 there was very little expressed concern in Canada with respect to national security issues in foreign investment. One transaction, the proposed acquisition of MacDonald Dettwiler and Associates' geospatial division by a major U.S. defence contractor, Alliant Techsystems, may have been blocked on national security grounds under the general "net benefit to Canada" test. Beyond that, little if anything is known and little concern was evidenced with respect to the national security issue.

In 2009, however, an express power to review transactions respecting their implications for national security was enacted. In

this brief we provide a quick overview of the key considerations as well as some practical suggestions.

KEY TAKEAWAYS

1. **What level of control is necessary?**

Answer: No control is necessary - any investment by a non-Canadian in a Canadian business (including acquisition of an interest in an existing Canadian business or establishment of a new Canadian business) may be reviewed on national security grounds if it is thought to be problematic. So, when involved in sensitive industries or transactions involving sensitive investors (discussed below) proceed at your own risk. No transaction is too small to escape potential challenge, and no equity holding is too minimal if it is something that could give rise to a national security concern.

2. **What types of deals get reviewed?**

Answer: The guidance document issued by the Investment Canada authorities indicate that transactions involving Canada's defence capabilities and interests, sensitive technologies, critical infrastructure (such as telecommunications, pipelines, electricity generation or transmission), foreign intelligence and activities of illicit actors (such as terrorist groups or organized crime) are most likely to attract scrutiny. The national security interest may also involve "co-location" concerns, i.e., proximity to sensitive sites. Based on media reports in 2015, a proposed investment by a Chinese SOE to build a fire alarm production facility was blocked on national security grounds due to its proximity to a Canadian Space Agency facility.

3. **Transactions involving Investors from which Countries are most likely to get closer scrutiny?**

Answer: Unambiguously China and Russia top this list. Of those transactions which were reviewed and either blocked, allowed subject to conditions, or were withdrawn because of the challenge, between 2012 and 2018 (15 transactions in total), all but 3 involved China or Russia. Of the 3 which did not involve China or Russia it is understood that Chinese or Russian interests were involved with two of those three investors. In addition to investors from China and

Russia, anecdotal evidence suggests that there is a reasonably high sensitivity to investors from certain Middle Eastern jurisdictions.

4. **Are SOE Investors Special?**

Answer: Yes. State-Owned Enterprise (SOE) investors are special. As a general matter under the *Investment Canada Act*, SOE's attract greater scrutiny and lower thresholds. With respect to national security, the issue tends to be whether SOE investors from certain jurisdictions are likely to be thought of as true arms of the state, as opposed to more traditional pension fund type SOE investors. Certainly, as a practical matter, Investment Canada authorities are very interested in who SOE investors are and how they are controlled.

5. **Are Private Equity Investors An Issue?**

Answer: Private equity investors are not an issue *per se*. However Investment Canada authorities are increasingly interested in understanding who the major beneficial owners are in private equity funds, despite *de jure* control by fund management. Investment Canada authorities will pay particular attention to investment by funds where a significant percentage of the funds are held by investors from jurisdictions which attract greater scrutiny.

6. **How can you minimize risk?**

Answer: Inevitably, an investment which is in a sensitive business and/or by firms from sensitive jurisdictions will attract interest. The best way to minimize risk is to recognize proactively when you have an investment of that sort, consider what the sensitive issues are and whether there are steps that can be taken to reduce the risk. For instance, in private equity investments the decision may be taken to restrict investment from certain jurisdictions and to give careful thought to who will sit on the board of directors of controlling corporations.

Another practical step which can be taken, to avoid confusion and delay where an investment is occurring in a sensitive sector, is to meet in advance or at the time of notification with the Investment Canada authorities to make sure that they are fully aware of the

investment and understand the arguments as to why it is not problematic. The Investment Canada authorities welcome these meetings, and, anecdotally, such meetings have proved successful in reducing or eliminating reviews where the facts support that conclusion.

7. **How can you know ahead of time if there is a problem?**

Answer: File early. Because national security reviews can occur in any transaction, whether or not it exceeds the thresholds for the traditional 'net benefit' review, it is not necessary that there be a filing before the transaction closes. The *Investment Canada Act* only requires that a notification filing occur within 30 days post-closing, and no filing at all is required if there is no acquisition of control. However the fact that a transaction did not have to be notified, or notified in advance, does not mean it will not be subject to a national security review. The problem in that case for the purchaser is that the transaction may be subject to review post-closing, at which time the vendor, having received its money, is no longer interested in the issue and the full risk falls on the purchaser. Vendors may be happy with this outcome but most purchasers are not. As a practical matter in most transactions where there is thought to be a potential national security review risk, purchasers will insist that an *Investment Canada Act* notice be filed more than 45 days pre-closing and that there be a condition that the 45 day period expire without notification that there may be a national security review.

8. **What timelines apply to reviews?**

Answer: The national security process starts when the Investment Canada authorities receive the investor's notification (or application if the transaction exceeds the applicable "net benefit" threshold) of the transaction as required under the *Investment Canada Act*, or when the transaction closes in the case of minority investments which do not require notification. The authorities have 45 days, which can be extended for a further 45 days by giving notice to the investor, to conduct an initial triage review. If the Investment Canada authorities have national security concerns following this review, they may begin a full in-depth review by issuing an order for review. If the authorities issue a notice to extend the initial triage review or an

order for a full in-depth review, the investor cannot close the transaction (if it is not already closed) unless and until it is cleared by the authorities to do so. The full in-depth review may take up to 90 days (with potential further extension with consent of the investor). If the national security concerns remain at the end of in-depth review, the matter will be referred to the Canadian Federal Cabinet, which has a further 20 days to make its final determination. Therefore, the entire process can take up to 200 days (or longer with the investor's consent).

Timeline for National Security Review

Review Step	Length of Time
Filing of Investment Canada Act notification or application, or closing of the acquisition (in the case of a minority acquisition)	Day 0
National Security authorities engage in initial triage review, and may order a full in-depth review	45 days (90 days if a notice to extend the initial trial review is issued)
National Security authorities engage in full in-depth review, and may refer the matter to the Federal Cabinet	45 days (90 days if a notice to extend the in-depth review is issued) >90 days (with agreement of the investor)
Federal Cabinet considers the matter and make final decision to block, approve or impose conditions	20 days

9. **What are the possible outcomes of a national security review?**

Answer: At the end of a national security review, the Federal Cabinet has broad powers to require the investor to take measures to

address the national security concerns. This may include: blocking a proposed transaction, permitting the closing of the transaction if certain conditions are met, or requiring the investor to unwind the transaction if it already closed. If a transaction is subject to a full in-depth review, it is highly unlikely for the transaction to be later cleared without conditions. In the 15 transactions subject to a full in-depth review between 2012 and 2018, four were blocked, four were allowed to close with conditions, five were ordered to be unwound, and the parties abandoned the transactions in the remaining two.

10. **Do Canadian authorities speak with their friends respecting national security reviews?**

Answer: Yes. Canada's authorities speak with their colleagues elsewhere, particularly with CFIUS and other members of the "five eyes" community. So, like with merger review, consistency in the story is important when dealing with various agencies. If one of Canada's security friends has a concern with the transaction, that may be problematic for the deal. On the other hand, if authorities elsewhere tell their Canadian cousins that they are not concerned, then that will generally militate in favour of Canadian approval. There may, of course, be particular Canadian issues which apply, even if there are no concerns elsewhere, but all things being equal, it helps.

CONCLUSION

As noted at the outset, the *Investment Canada Act* has undergone a shift in emphasis over the last half dozen years. Thresholds have been raised and "net benefit" reviews are less frequent than they were in the past. There is a sense that the Investment Canada authorities are more interested in supporting capital investment in Canada, even in relatively large transactions which are subject to review.

By contrast, National Security Reviews, which did not exist prior to the last decade, have become an increasing concern with respect to sensitive sectors and investors from sensitive jurisdictions. The issue has become a significant one for counsel planning transactions. We hope that the checklist in this Brief is of some high level assistance at early transaction planning stages.

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a cautionary note