

Recent Developments in National Security Reviews of Foreign Investments in Canada

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When assessing multi-jurisdictional pre-merger filing requirements, foreign lawyers should not overlook the potential need to submit a foreign investment review application in Canada. Recent changes to the *Investment Canada Act* to permit national security reviews have resulted in heightened interest in Canada's foreign investment review legislation, and have expanded the range of cross-border transactions that might require review.

Under the *Investment Canada Act*, a direct acquisition of control of a Canadian business is generally subject to review if the acquiror is not Canadian and the asset value of the Canadian business exceeds C\$312 million. (This asset-value test is expected to change in 2010 to a test based on enterprise value with a significantly higher threshold.) Following amendments enacted earlier this year, the Act now also provides for the review of any foreign investment that could be "injurious to national security," regardless of the asset or enterprise value of the Canadian business, its revenue levels or the percentage interest in the target that will be acquired.

The legislation does not define "national security" or provide a list of factors to consider in assessing whether a transaction may give rise to national security concerns. However, a national security assessment will consider (i) the activities of the Canadian business, in particular whether it has military or strategic importance, and (ii) the nature of the foreign person making the investment.

Although early experience with the new process is limited, a number of developments suggest that the Canadian government will use its power to initiate national security reviews sparingly, and only in connection with transactions that give rise to obvious concerns. Four of these developments are outlined below:

- First, China Investment Corporation's investment in Teck Resources earlier this year did not trigger a national security review, nor did China-based Jilin Jien Nickel's unsolicited bid in September to acquire control of the

nickel mining company Canadian Royalties. Although the Teck transaction involved the acquisition of a minority and non-controlling stake, both transactions support the view that, absent other factors, investments in the natural resources sector, even by state-owned enterprises (SOEs), will not generally trigger national security reviews. Conversely, transactions involving critical military or strategic resources, such as uranium, should be expected to involve a review.

- Second, the Canadian government recently declined to review Ericsson's acquisition of the majority of Nortel's North American wireless business. This was a positive early indication that the national security review process would not become politicized. The government declined to act despite intense media coverage, political scrutiny and popular pressure to review the transaction on national security grounds. Some competitors and opposition politicians asserted that next-generation wireless technology should remain in Canadian hands, and that a review was vital to determine whether the acquisition was in Canada's national interest. The Minister of Industry made it clear that the test assesses risk to national security, not national interest, and concluded that "there are no grounds to believe that this transaction could be injurious to Canada's national security."

- Third, the government has issued guidelines regarding how it will review investments by SOEs and sovereign wealth funds (SWFs) seeking to acquire control of a Canadian business. The guidelines make it clear that the issues regarding these investments are commercial orientation and corporate governance. Enforcement staff will not presume that an investment by an SOE or SWF will give rise to national security issues; in fact, the guidelines do not refer to "national security." Notably, International Petroleum Investment Corporation's acquisition of NOVA Chemicals last June, the first major acquisition by an SOE of a Canadian business, did not involve a national security review. Although this does not rule out the possibility that an investment by an SOE or SWF could give rise to national security concerns, the mere fact that an investor is an SOE or SWF is not, in itself, sufficient to trigger a national security review.

- Fourth, the government has repeatedly expressed its desire to attract foreign investment; therefore, commencing a national security investigation without good reason would send a conflicting and potentially damaging signal to foreign investors with respect to Canada's desire for such investment. Earlier this year, the Minister of Industry announced that he had no intention of using the *Investment Canada Act* to discourage foreign investment. On the contrary, he stated, "We are reducing the challenges currently facing international investors who want to invest here. This is critical, because international investment is vital to our country." Similarly, in the context of the CIC/Teck transaction, the Minister of Finance said that investments by state-owned Chinese companies are welcome as long as they are made on a commercial basis. According to a recent Bloomberg report, the Minister said that the *Investment Canada Act* "won't be an obstacle for future investments by the Chinese wealth fund." Notably, the Minister of Industry subsequently approved PetroChina International's investment in properties owned by Athabasca Oil Sands.

The Canadian government appears to have invoked its new national security power only once since the new rules came into force. In August, the government sent a notice to George Forrest International requiring it to supply information about its proposed acquisition of Forsys Metals, a natural resources company whose chief asset was an offshore uranium mining project. News reports speculated that the government requested information about the source of financing for the transaction. Shortly after the notice was received, the transaction was terminated for other reasons, and neither the government nor any of the parties involved have commented on the transaction. This case is interesting because it suggests that an assessment of the origin of an investment will go beyond the acquiror and include the buyer's sources of funding, presumably on the theory that a person or entity financing an acquisition may have the ability to exercise influence over the acquired business. It also highlighted that, as expected, uranium will be the one natural resource in which the government will normally take an interest, even if those assets are not in Canada.

Despite some uncertainty about the scope of the new national security review powers, it is clear that national security concerns are unlikely to play a material role in the vast majority of transactions. Early signs indicate that the Canadian government will use its powers sparingly and that it will not be unduly influenced by

popular opinion or motivated by a desire to advance broader national interests. However, assessing the likelihood of a Canadian national security review should be an important part of a multi-jurisdictional pre-merger review analysis.