Canada adopts significant changes to foreign investment review framework

Antitrust Update

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On 24 April 2015, the Canadian government adopted regulations that significantly affect the foreign investment review framework. With the exception of cultural businesses and investments by foreign state-owned enterprises (SOE), the changes affect foreign investments in all sectors of the economy. Notably, the pre-merger review and national security provisions in the Investment Canada Act (ICA) (described below) apply in addition to the merger control provisions set out in the Competition Act, which should also be reviewed in advance of a merger transaction affecting Canada.

The new regulations implement the long anticipated changes to the existing thresholds that trigger a net benefit review under the ICA. For investments by World Trade Organization (WTO) private-sector investors, the basis of the net benefit review threshold has changed from the “book value” of the target Canadian business’s assets to the “enterprise value.” The new threshold amount is CA$600 million. This is expected to result in the review of fewer foreign investment proposals to determine whether they are likely to be of net benefit to Canada.

However, foreign SOE will continue to be subject to the existing standard for the net benefit review threshold, specifically, the book value of the target Canadian business’s assets. This is in line with the Canadian government’s policy on SOE and will allow greater scrutiny of investments made by foreign SOE in sectors of the Canadian economy. Investors from non-WTO member countries and foreign investments in Canadian “cultural businesses” will also continue to be subject to the existing net benefit review threshold.

The new regulations also increase significantly the information required from foreign investors, even where there is no net benefit review, in order to provide Canadian security and intelligence agencies with more information about investors and their investments. This change aligns with the Canadian government’s authority to conduct a national security review of a foreign investment, where it determines whether an investment could be injurious to national security. Increasingly, such national security reviews are being undertaken. The new regulations have increased the timeline for completing such reviews from 130 days to 200 days.

This bulletin provides an overview of the foreign investment landscape in Canada, and the key aspects of the new regulations. All amounts are stated in Canadian dollars.

Overview of foreign investment in Canada

The acquisition of control of a Canadian business or the establishment of a new business by a foreign investor in Canada requires compliance with the ICA and its regulations. In some instances, the ICA deems the acquisition of a minority interest in a Canadian business by a non-Canadian investor to be an acquisition of control. Foreign
investment proposals require an analysis to determine whether the foreign investor requires a pre-closing approval from the Canadian government.

Monetary thresholds prescribed under the ICA are used to determine whether an investment proposal by a non-Canadian will be reviewed by the Canadian government to assess whether it is likely to be of “net benefit to Canada.” All other acquisitions of control of a Canadian business and the establishment of new businesses in Canada by a foreign investor require that a notification be given to the Canadian government within thirty days of closing or, in the case of a new business, its establishment.

In addition to the net benefit review process, the ICA contains national security provisions, which permit the Canadian government to review investments that could be injurious to national security. The federal Cabinet may impose any measures that it considers advisable to protect national security. The ICA does not define “national security”, which injects significant discretion and corresponding uncertainty into this aspect of the investment review process. Foreign investments constituting the acquisition of a minority holding in a Canadian business or resulting in the establishment of a new Canadian business, or even a foreign entity carrying the national security provisions. There are no monetary thresholds for national security reviews, which may be initiated after a transaction has been completed or an investment has been implemented.

**New net benefit review threshold**

Monetary thresholds prescribed under the ICA are used to determine whether investment proposals by foreign investors will be reviewed by the Canadian government to assess whether they are likely to be of net benefit to Canada. Under the predecessor law, a direct acquisition of control of a Canadian business (either a share acquisition or an asset acquisition) by a non-Canadian WTO investor was generally subject to a net benefit review if the “book value” of the assets of the Canadian business exceeded CA$369 million.

As of 24 April 2015, the threshold determination is based on the “enterprise value” of the Canadian business. A net benefit review will generally be required if the enterprise value of the target Canadian business’s assets is CA$600 million or more. The threshold will be increased to CA$800 million in two years, to CA$1 billion two years later and thereafter, indexed annually to reflect changes in Canada’s gross domestic product (GDP).

The regulations set out a detailed formula to determine “enterprise value.” Generally, the calculation will be as follows:

- For publicly traded companies, the enterprise value of the assets of the Canadian business is equal to the market capitalization of the entity plus its liabilities (other than operating liabilities) minus its cash and cash equivalents.
- For private companies, the enterprise value of the assets of the Canadian business is equal to the total acquisition value, plus its liabilities (other than its operating liabilities) minus its cash and cash equivalents.
- For an asset acquisition, the enterprise value of the assets of the Canadian business is equal to the total acquisition value, plus its liabilities (other than its operating liabilities) minus its cash and cash equivalents.

The enterprise value is determined based on the date of filing. The formula for calculating the enterprise value and in turn, determining whether a pre-closing approval from the Minister of Industry is required, is complex and should be reviewed to properly assess the foreign investor’s obligations under the ICA.

**State-owned enterprises**

The Canadian government continues to review investments by foreign SOE under the rules that existed before 24 April 2015. Under the ICA, an SOE is broadly defined and includes not only entities that are owned by a foreign state, but also entities that are directly or indirectly owned, controlled or influenced by a foreign government. Foreign SOE investment proposals are assessed using more extensive factors to determine whether they are likely to be of net benefit to Canada, including whether the target Canadian business would be operated on a commercial basis.

The CA$369 million threshold, based on the book value of the Canadian business’s assets, will continue to apply to investments by SOE. The asset value threshold will continue to be indexed annually to reflect changes in Canada’s
nominal GDP.

**Other investments excluded from new “enterprise value” rules**

The existing book value threshold also continues to apply:

i. in the case of non-WTO investors, unless the Canadian business is controlled by a WTO investor immediately prior to the implementation of the investment or

ii. where the foreign investment is in a “cultural business”, a term that is broadly defined in the ICA. In these cases, the thresholds for review remain at CA$5 million and CA$50 million in book value for direct and indirect investments, respectively.

**New disclosure requirements**

Where the thresholds are not exceeded and an investment proposal is not subject to a net benefit review, the non-Canadian investor must nevertheless notify the Canadian government of the investment and file a notification in the prescribed form. Such notification must be given within thirty days of closing. Under the new regulations, foreign investors are required to provide significantly more information when completing the notification form, even where there is no net benefit review.

Among the new informational requirements, foreign investors will have to identify:

1. the names of board members
2. the investor’s five highest paid officers
3. any person or entity that own 10 percent of the investor’s equity or voting interests
4. whether the investor is owned, controlled or influenced, directly or indirectly, by a foreign government and
5. sources of funding for the investment.

Additionally, investors must furnish a copy of the purchase and sale agreement or if not available, a description of the principal terms and conditions, including the estimated total purchase price for the Canadian business. The government will use this information to determine whether the foreign investment should be reviewed under the national security provisions of the ICA.

Significantly more informational requirements have also been added to the application for review form, which applies when the foreign investment proposal is subject to the net benefit review assessment. This information will be used to determine whether the government will also initiate a national security review of the proposed foreign investment.

**Establishment of new Canadian business**

It should be noted that where a foreign investor establishes a new Canadian business, there is a requirement to file a notification form with the Canadian government. The new regulations require significantly more disclosure of information about investors and their investments. Such foreign investments are also subject to the national security provisions.

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