Significant changes to Canadian foreign investment review

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There were several significant developments in foreign investment law in Canada in 2015. Chief among these was the change to the size of transactions that are now subject to the “net benefit” review test under the Investment Canada Act (ICA). Not only did the monetary threshold increase but also the basis on which the threshold is calculated changed from “book value” to “enterprise value.” As a result, certain transactions that were previously subject to review will no longer be reviewable, while at the same time, some that were not subject to review under the old threshold will now be subject to ICA scrutiny. Proposed increases to the review threshold are also contemplated under new trade agreements.

In addition, the regulatory burden on investments has increased, including more extensive information disclosure requirements for foreign investors in relation to non-reviewable acquisitions of control of Canadian businesses.

One of the most significant events in 2015 was the election of the new Liberal government. It remains to be seen whether this political shift will cause corresponding policy changes in the area of foreign investment regulation in 2016 and beyond.

THE CHANGES TO THE REVIEW THRESHOLD

Effective April 24, 2015, the threshold for determining whether net benefit review under the ICA is required for acquisitions or dispositions by entities owned by nationals of a World Trade Organization member state is $600 million based on enterprise value of the target business, rather than the former threshold of $369 million in book value of the assets of the target business. The threshold will increase to $800 million in 2017, then to $1 billion in 2019, after which it will be indexed annually. If the Canada-European Union Comprehensive Economic and Trade Agreement (CETA) or the Trans-Pacific Partnership (TPP) trade agreement comes into force within the next year or so, eligible investors will only be subject to investment review at a threshold of $1.5 billion – almost double the threshold that would otherwise apply ($800 million in 2017).

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The enterprise value threshold is calculated differently depending on the type of target business:

- **Direct acquisition of a publicly traded entity** – $600 million or more in enterprise value, based on the target’s market capitalization plus its total liabilities (excluding its operating liabilities), minus its cash and cash equivalents.

- **Direct acquisition of a privately held entity** – $600 million or more in enterprise value, based on the total acquisition value plus its total liabilities (excluding its operating liabilities), minus its cash and cash equivalents. If the investor is acquiring 100% of the voting interests, total acquisition value is the total consideration payable. Where the investor is acquiring less than 100% of the voting interests, total acquisition value is the aggregate of the consideration payable by the investor, the consideration payable by any other investors and the fair market value of any portion of the voting interests that are not being acquired.

- **Acquisition of assets** – $600 million or more in enterprise value, based on the total consideration payable, plus the liabilities that are assumed by the investor (other than operating liabilities), minus the cash and cash equivalents that are transferred to the investor.

However, a state-owned enterprise (SOE) investor is still subject to review based on the threshold of book value of assets of the Canadian business at $369 million (indexed annually). All cultural investments will continue to be reviewable if the book value of assets of the Canadian business exceeds $5 million.

### IMPLICATIONS OF THE MOVE TO ENTERPRISE VALUE

The change from an asset-based threshold to an enterprise value threshold has a number of important implications for foreign investors contemplating direct acquisitions of control of Canadian businesses:

- **Review of transactions involving targets with large enterprise value but low book value** – acquisitions of some businesses that would not have been subject to review based on the former threshold of $369 million in book value of assets may be reviewable because they exceed the $600 million enterprise value threshold.

- **Enterprise value can be tactically determined to affect reviewability of a transaction** – in private transactions the purchase price will be the key factor and could be structured with a view to reducing the enterprise value. In public transactions, a purchaser may be able to carefully time its offer to coincide with a low market capitalization that results in an enterprise value below $600 million.

- **Different treatment of SOEs and private investors** – a possible unintended consequence of the amendments is that a private sector investor may trigger a review as a result of the target’s enterprise value exceeding the $600 million threshold, but a SOE investor would not trigger a review if the book value of the target’s assets is below the $369 million asset value threshold that applies to SOE investors.

### NEW TRADE AGREEMENTS WITH IMPLICATIONS FOR THE ICA REVIEW THRESHOLD

The TPP trade agreement concluded in October 2015 proposes an increase in the ICA review threshold to $1.5 billion in enterprise value. Only investors who are nationals of an original signatory to the TPP, or entities controlled by nationals of those TPP parties, may benefit from the higher review threshold. SOE investors are not eligible for the higher threshold.
The $1.5 billion threshold will match the increase in the threshold proposed under the CETA concluded in 2014, which is still not yet in force. The higher threshold in CETA will apply to an acquisition of a Canadian enterprise by an EU investor that is not an SOE. The determination of whether the acquirer is an EU investor would be based on whether an EU national controls the acquirer in law, or in the absence of a majority ownership, whether EU nationals control the acquirer in fact such as through the ownership of voting interests or the nationality of members of the board of directors. Moreover, EU enterprises that are controlled by nationals from Canada’s existing free trade agreement partners (e.g., the United States) would also benefit from the higher threshold.

At this time, no in-force dates have been set for the TPP or CETA. Of the two, CETA is expected to be in force sooner.

NEW INFORMATION BURDEN

In addition to changes to the review thresholds, the new regulations impose revised disclosure requirements. A foreign investor is now required to provide significantly more information to the federal government regarding the investor, its business activities and shareholders than was previously the case. This information burden applies to notifications required to be filed for all acquisitions of control of Canadian businesses by non-Canadians that are not reviewable.

EXTENDED TIMELINE FOR NATIONAL SECURITY REVIEWS

Independent of the ICA net benefit review process, the ICA national security regime allows the federal government to review a broad range of foreign investments, including minority investments, on the basis that such investments could be “injurious to national security.” Effective March 25, 2015, the government’s maximum review period extended from 130 days to 200 days (or possibly longer upon the consent of the investor). There are still no published criteria for what kind of investment might be “injurious to national security,” nor are there publicly available statistics on enforcement of this aspect of the ICA. Anecdotally, national security issues seemed to arise with greater frequency in the last couple of years of the Conservative government.

REVIEW STATISTICS

The number of transactions subject to ministerial review and approval under the ICA remains small. For the year ended March 31, 2015, excluding national security reviews, 15 applications were reviewed and approved, up from 11 in 2013-14. The average review time was 75.3 days, up from 71.5 days in 2013-14. These investments totalled $21.78 billion in asset value, an increase of 41.2% compared to 2013-14. The number of national security reviews is unknown, but they are not uncommon.

NEW LIBERAL GOVERNMENT

The new Minister of Innovation, Science and Economic Development, the Honourable Navdeep Singh Bains, is responsible for approving large investments under the ICA and administering the ICA’s national security regime. The new minister has both academic and business experience. He was a visiting professor at Ryerson University’s Ted Rogers School of Management and holds an MBA with a specialization in Finance. He also holds a Certified Management Accountant qualification and worked for several years in accounting and financial analysis for the Ford Motor Company of Canada.
Will the new minister and the Liberal government adopt a different attitude to foreign investment?

Foreign investment was not a campaign issue during the 2015 federal election. The Liberal Party did not advocate changes to the ICA. The last Liberal government routinely allowed large takeovers even in the face of some populist concern at the time about the “hollowing out” of Canadian-controlled industries. Based on this track record, it is difficult to imagine this Liberal government being more critical of foreign investment than the former Conservative government, which turned down some high-profile proposals on “net benefit to Canada” and national security grounds. Indeed, given the weakness of the Canadian economy, the new government may be inclined to more quickly approve foreign investment that promises significant employment and capital investment.

It is too early to say what approach the Liberals will take. Will they administer the national security regime differently? How will they deal with the ICA policies that put investments by SOEs through the additional hurdles of demonstrating transparency and commercial orientation while all but prohibiting them from acquiring control of oil sands businesses?

The way these legislative and regulatory changes are put into practice over the years ahead will certainly have an impact on the foreign investment climate in Canada, though the extent and tenor of that impact remain to be seen.
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The enterprise value threshold is calculated differently depending on the type of target business:

- For non-Canadian targets (which are controlled by nationals of those countries’ existing free trade agreement partners, e.g., the United States or EU nationals), the threshold is based on the target’s enterprise value.
- For Canadian targets, the threshold is based on the book value of the assets of the target business.
- For state-owned enterprises controlled by nationals of those TPP partners, may benefit from the higher review threshold. Only investors who are nationals of an original signatory to the TPP, or the United States, are eligible for this benefit.

The threshold for foreign investors in relation to non-reviewable acquisitions of control of Canadian businesses has been increased from $230 million to $1.5 billion in enterprise value. Only investors who are nationals of an original signatory to the TPP or the United States are eligible for this benefit.

The effective April 24, 2015, the threshold for determining whether net benefit review under the ICA is payable, plus the liabilities that are assumed by the investor (other than operating liabilities), minus liabilities not being acquired. The threshold will increase to $800 million in 2017, then to $1 billion in 2019, after which it will be indexed annually. If the Canada-U.S. free trade agreement does not provide for an increase, it will continue to be reviewable if the book value of assets of the Canadian business exceeds $5 million. However, a state-owned enterprise (SOE) investor is still subject to review based on the threshold of book value.

The new version of the ICA now requires a review of the net benefit test for all transactions exceeding $1.5 billion in enterprise value, based on the total consideration paid, plus the liabilities that are assumed by the investor (other than operating liabilities), minus liabilities not being acquired. Transactions exceeding this threshold are subject to review if they are “injurious to national security,” nor are there publicly available statistics on enforcement of this aspect of national security.

The changes to the review threshold have been made to reflect the economic environment and the need to ensure that transactions of significant national security do not proceed without proper scrutiny. Proposed increases to the review threshold are also contemplated under new trade agreements.

One of the most significant events in 2015 was the election of the new Liberal government. It remains to be seen how the government will proceed with these changes to the ICA, and how it will use the new powers to ensure that transactions of significant national security do not proceed without proper scrutiny.

Significant changes to Canadian foreign investment law include:

- Increasing the financial threshold for net benefit review from $230 million to $1.5 billion in enterprise value, based on the total consideration paid, plus the liabilities that are assumed by the investor (other than operating liabilities), minus liabilities not being acquired.
- Introducing a review of the net benefit test for all transactions exceeding $1.5 billion in enterprise value, based on the total consideration paid, plus the liabilities that are assumed by the investor (other than operating liabilities), minus liabilities not being acquired.
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