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Foreign Investment in Canada: Focus on national security and liberalization of the net benefit regime

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Introduction

It was an eventful 2018 for foreign investment review in Canada. Canada's national security regime took centre stage as a result of the Canadian government's decision to block the proposed takeover of construction firm Aecon Group Inc. by a Chinese acquiror under the national security regime. Meanwhile, liberalization of Canada's long-standing net benefit regime continued.

National security regime

The highlight of 2018 was the Canadian government's decision to block the proposed takeover of construction firm Aecon Group Inc. (Aecon) by China Communications Construction Company International Holding Limited (CCCI) on the basis that the transaction would be injurious to Canada's national security. This was only the third transaction formally blocked under Canada's national security regime and the first transaction blocked by the Liberal government.

CCCI's proposed acquisition of Aecon was announced on October 26, 2017, and quickly became the subject of debate in Canada. It was reported that Aecon's involvement in the construction of nuclear power stations, military facilities and communications infrastructure prompted concerns about the Chinese government indirectly acquiring control of Aecon. An order for a full national security review was issued in early 2018 and, on May 23, 2018, the government announced its decision to block the transaction. Predictably, other than advising that the decision was based on advice of Canada's security and intelligence agencies, no reasons were given in the official announcement (for more information on the decision, please refer to our Osler Update: "Proposed acquisition of Aecon by CCCI blocked on national security grounds.")

The Aecon decision is a significant development. However, this decision does not signal a change in Canada's overall approach to welcoming foreign investment.

While the Canadian government has the authority to scrutinize any foreign investment in Canada, regardless of size, that may be "injurious to national security," to date, the federal government has exercised its national security review power judiciously. The statistics released by the Department of Innovation, Science and Economic Development (ISED) for its fiscal year April 1, 2017 to March 31, 2018 indicate that of the 742 investments subject to mandatory notification or review during this period

- only four investments received notice that a potential national security review order was being issued;
- of these four investments, only two investments were subject to a formal order for national security review, as one investment was abandoned upon receipt of the notice and the government determined not to proceed with the issuance of a formal order with respect to the other; and
- of the two investments subject to formal orders, one investment was abandoned and the other one, CCCI – Aecon, was blocked by the government.

While each investment requires a fact-specific analysis, the *Guidelines on the National Security Review of Investments under the Investment Canada Act* (Guidelines) issued in 2016 provide useful insight into the factors the government considers when assessing whether an investment poses a national security risk. The Guidelines indicate that the nature of the asset or business activities and the parties (including the potential for third-party influence) involved in the transaction will be considered. The Guidelines provide a list of nine non-exhaustive factors considered in the assessment, including the effects of the investment on Canada's defence capabilities and interests and intelligence activities; the transfer of sensitive technology or know-how outside of Canada; the effects on the security of Canada's critical infrastructure and the supply of critical goods and services; and the potential of the investment to enable foreign surveillance or espionage.

The Guidelines make it clear that the focus of Canada's national security assessment is on national security as opposed to economic security. In 2018, the Canadian government reiterated this point forcefully in response to President Trump's actions to impose tariffs on steel and aluminum from its allies, including Canada and the European Union, contending that their exports threatened the national security of the United States.

The Guidelines also recommend that parties take steps both formally and informally to proactively identify national security considerations at an early stage of transaction planning and to engage in early filing and consultation with the government. In this regard, Osler's experience suggests that Canadian businesses are more frequently approaching ISED for early informal views on whether potential foreign investors are likely to raise national security concerns and that ISED welcomes such inquiries, informally screening such potential investments relatively quickly in co-operation with Canada's national security agencies and providing informal guidance.

While orders for a formal national security review remain the exception, ISED has been candid in advising stakeholders that if a formal national security review is ordered, the review will take at least 200 days. To state the obvious, not many deals can withstand such a long period of uncertainty. In addition, while the statute does allow for measures short of blocking the investment, or in the case of a completed investment, divestiture, it appears that such mitigation measures are falling out of favour in the United States for a range of reasons, all of which may equally apply in Canada. Based on the July 2018 report of the U.S. Government Accountability Office, mitigation measures may be increasingly perceived as effective only where the national security risk can be remedied by a measure that is straightforward and relatively easy to implement and does not require post-implementation monitoring. For example, where the national security concern stems from the target's proximity to an important government facility, an agreement to relocate the business could resolve the concern. However, in most cases, where the government determines that a proposed investment is injurious to national security, the only viable remedy is likely to be a full block, or in the case of completed transaction, a divestiture.

Changes to the U.S. national security regime

Another important recent development that will have implications for the Canadian business community is the enactment of the Foreign Investment Risk Review Modernization Act (FIRRMA) in the United States. FIRRMA significantly transforms the jurisdiction and operation of the Committee on Foreign Investment in the United States (CFIUS), which is responsible for reviewing certain foreign investments to determine the effect on the national security of the United States. FIRRMA expands the scope of investments CFIUS may review to include, for example, non-controlling investments, investments in real estate in close proximity to sensitive U.S. government facilities and any acquisition of a business anywhere in the world provided that the business sells goods or services into the United States. In addition, FIRRMA imposes a mandatory pre-closing filing requirement on foreign investments in certain sensitive sectors and directs CFIUS to establish a formal process to facilitate the exchange of information important to national security analysis with foreign allies, including Canada.

The implications of FIRRMA remain to be seen, but there is a consensus that FIRRMA will result in national security review becoming an increasingly important consideration in the planning and negotiation of transactions where the target business has any nexus with the United States. In addition, while we understand that there already exists substantial collaboration on security issues and threats between and among the intelligence agencies of the "Five Eyes" (comprising Australia, Canada, New Zealand, the United Kingdom and the United States FIRRMA may be expected to enhance the collaboration between CFIUS and Canadian security and intelligence agencies on security issues related to foreign investment matters.

Also, one would expect that the Canadian government will be assessing the implications of FIRRMA for national security review in Canada and, in particular, considering the efficacy of imposing its own mandatory notification regime for investments that would not otherwise be subject to pre-closing review under the *Investment Canada Act*. Although the Canadian government has not to date proposed any changes to the national security review regime to make national security review mandatory for certain categories of investors or investment, this may become a subject of greater discussion in the coming year. In this regard, on December 11th, a Conservative (opposition party) Senator introduced a bill to amend the Investment Canada Act to provide for the mandatory national security review of investments made by foreign state-owned enterprises.

The net benefit regime – A less frequent pre-closing condition and a streamlined process

While the prospect of national security review has increased in importance, fewer transactions are now subject to the requirement to obtain ministerial approval under the *Investment Canada Act*'s net benefit regime as a result of the substantially increased review thresholds.

As we outlined in our Foreign investment in Canada: Osler Fall 2017 update on osler.com, the substantial increase in the review thresholds of the net benefit regime of the *Investment Canada Act* has resulted in a decline in the number of investments subject to pre-closing ministerial approval. Of the 742 filings received in the 2017-2018 fiscal year, only nine investments exceeded the review threshold and therefore were subject to a net benefit review. These nine investments represent a 60% decrease in transactions subject to net benefit review as compared to the previous annual period. In addition, process improvements have been implemented. The government has increasingly focused

undertakings on key areas relevant to Canadian business and sought clear and precise benchmarks against which future performance can be easily measured. In certain circumstances, the government has not required the investor to provide any undertakings, instead relying solely on the investor's business plans as set out in the investor's application for review. The result of these process improvements is a more streamlined, predictable and efficient net benefit review process.

Conclusion

With the increase in the net benefit review threshold and corresponding streamlined review process, many foreign investors have benefited from a reduced regulatory burden relative to prior years. However, the increased emphasis on the national security implications of foreign investments in Canada means that the assessment of national security-related considerations of a transaction and the management and allocation of perceived risk are becoming increasingly important features of transaction planning and negotiation.