

INTRODUCTION

Target and J. Crew recently expanded to Canada and Nordstroms is on the way. Petronas, Korea Gas Corporation, PetroChina, Shell, Mitsubishi Corporation and other oil and gas behemoths have announced or are considering major investments in British Columbia's burgeoning LNG industry.¹ These are just a few examples of some of the larger foreign investments currently being undertaken in Canada.

For many years investors and businesses, large and small, from the U.S. and around the world have been attracted to Canada's strong economic fundamentals, abundance of natural resources, skilled labor force and business-friendly environment. While Canada is very much receptive to and has few restrictions on such foreign investment, certain investments are subject to governmental review and certain industries are subject to ownership and control limits under Canadian law.

CANADA'S LEGAL SYSTEM

The authority to make laws and regulations is divided between the federal and provincial governments by the Canadian Constitution. Provincial laws have a greater impact on most businesses because the provinces have power over "property and civil rights," a broad area which includes contract law, employment law, labor relations, real property law, municipal law and the regulation of professionals.

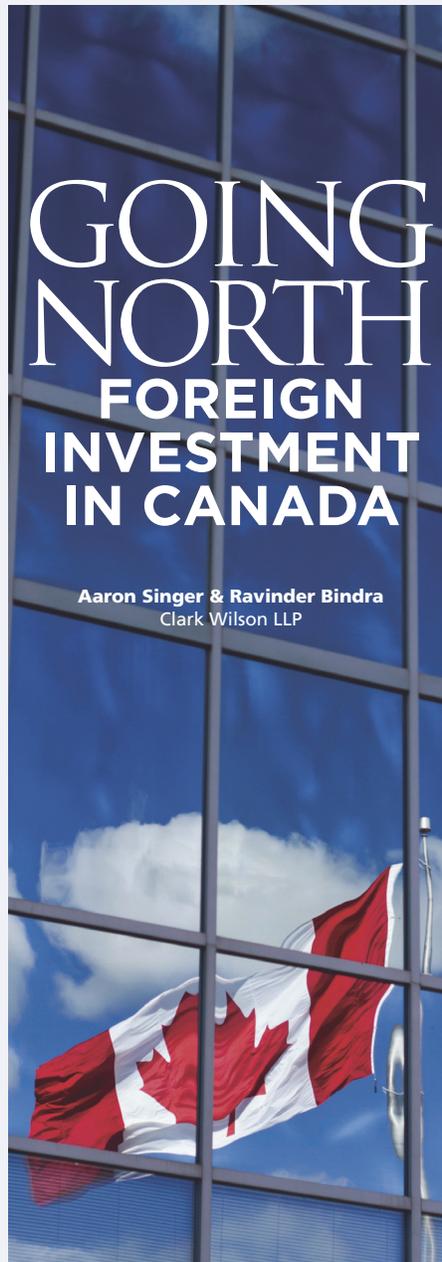
The federal government's jurisdiction is focused on businesses, property and matters which concern Canada's national interest, including matters relating to foreign investment.

In addition, for historical reasons, Canada has two legal systems – civil law in Quebec and common law in the rest of Canada. An important factor to keep in mind for foreign investors and their legal counsel when entering the Canadian market.

THE INVESTMENT CANADA ACT

The federal *Investment Canada Act* (the "ICA") is the primary statute governing investments in Canadian businesses by "non-Canadians." Ostensibly, the purpose of the ICA is to encourage investment in Canada and provide for the review and approval of significant investments in Canadian businesses. The ICA also protects national security by requiring the review of foreign investments that could be injurious to national security.

Under the ICA, an investment in a Canadian business by a non-Canadian is either "notifiable" or "reviewable." A notifiable investment requires a relatively simple



notice be filed with Industry Canada at any time prior to the completion of the investment or within 30 days thereafter. A reviewable investment involves a more complicated process requiring the submission of a detailed application and the approval of the Minister of Industry (the "Minister"), the individual responsible for the ICA, prior to the closing of the investment. While very few investments have been refused, the review process can increase costs and cause considerable delay in completing an investment transaction.

WHO IS A NON-CANADIAN AND WHAT IS A CANADIAN BUSINESS?

The ICA is applicable whenever a non-Canadian acquires the control of an exist-

ing Canadian business or establishes a new Canadian business.

The ICA defines a "non-Canadian" as any individual or entity that is not "Canadian." Under the ICA, an individual is a "Canadian" if he or she is a Canadian citizen, or a permanent resident of Canada. A privately owned company is a "Canadian" if its ultimate controlling shareholders are "Canadian." Using a Canadian corporate subsidiary to act as the investor does not establish "Canadian" status if the corporate subsidiary's ultimate controlling ownership is not Canadian. The ICA contains similar rules for publicly traded companies and other types of entities.

Under the ICA, a "Canadian business" means a business carried on in Canada that has (a) a place of business in Canada, (b) an individual or individuals in Canada who are employed or self-employed in connection with the business, and (c) assets in Canada used in carrying on the business.

ACQUISITION OF CONTROL

The ICA's rules for determining "control" are complex. In summary, any acquisition of 50% or more of the voting shares is an acquisition of control as is the acquisition of all or substantially all of the assets of a Canadian business. An acquisition of one-third or more, but less than a majority of voting shares is presumed to be acquisition of control, unless it can be shown that the acquired shares do not give control in fact to the investor. Acquisition of less than one-third of voting shares is deemed not to be an acquisition of control.

THRESHOLDS FOR REVIEW

An investment by non-Canadians in a Canadian business is subject to governmental review if the investment exceeds certain monetary thresholds, otherwise the transaction is only notifiable. Regardless of size, investments to establish a new Canadian business are not subject to review but are notifiable.

An investment by a non-Canadian is subject to a "net benefit" review if the asset value (as shown on the balance sheet at the end of the last completed fiscal year before the acquisition) of the Canadian business being acquired equals or exceeds the following thresholds:

- (a) C\$5 million for a direct acquisition by a non-WTO investor;
- (b) C\$50 million for an indirect acquisition (acquisition of control of the parent/owner of the Canadian business outside Canada) by a non-WTO investor (the \$5 million threshold will apply if the asset value of the Canadian business

- being acquired exceeds 50% of the asset value of the global transaction);
- (c) C\$354 million for a direct acquisition by a WTO investor in 2014²; and
- (d) the limits in (a) and (b) above apply to ALL investors for acquisitions of a Canadian cultural business.³

Indirect acquisitions (other than in respect of cultural businesses) by WTO investors are not reviewable but are notifiable under the ICA.

The higher WTO thresholds do not apply to the acquisition of control of a Canadian business that is a cultural business. Investors should keep in mind that a business will be considered a cultural business even if its cultural activities represent only a minor part of its operations.

APPLICATION PROCESS & TIMING

The obligation to file a Notification or Application for Review is on the non-Canadian making the investment. In practice, the target business or vendor usually cooperates with the process.

Notification may be made before the investment closes or within 30 days thereafter and consequently does not represent an obstacle to closing. On the other hand, if an investment is subject to review, the parties may not close until the transaction receives consent from the Minister, who has authority to order divestiture or unwinding if the investment completed but the Minister is not satisfied that it is likely to be a net benefit to Canada.

Under the ICA, the Minister has 45 days to determine whether or not to allow the investment. That 45-day period may be unilaterally extended by the Minister for another 30-day period by sending a notice to the investor prior to the expiration of the

initial 45-day period. Any further extensions require the investor's consent.

NET BENEFIT TEST

If an investment transaction is subject to review, the Minister must be satisfied that the investment is likely to be of "net benefit" to Canada. When determining if an investment is likely to be a net benefit to Canada, the Minister looks at the following factors:

- the effect of the investment on the level of economic activity in Canada, on employment, on resource processing, on the utilization of parts and services produced in Canada and on exports from Canada;
- the degree and significance of participation by Canadians in the Canadian business or new Canadian business and in any industry or industries in Canada;
- the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;
- the effect of the investment on competition within any industry in Canada;
- the compatibility of the investment with national industrial, economic and cultural policies; and
- the contribution of the investment to Canada's ability to compete in world markets.

Depending on the nature of and circumstances surrounding the investment and the business, some of the above factors are given more consideration than others. Each relevant factor should be addressed in the investor's business plan required to be submitted with the application for review. In some instances, during the review period, the investor will negotiate undertakings with the Minister which will be a

condition of the Minister's approval of the investment. The undertakings are legally binding commitments by the investor regarding the ongoing operation of the Canadian business after closing.

In connection with recent amendments to the ICA dealing with foreign state-owned enterprises ("SOE"), the Minister issued special guidelines⁴ concerning the application of the net benefit test to SOEs. The new SOE guidelines reflect the Government of Canada's more restrictive approach to foreign SOE investments in Canada. Like many countries, Canada has become concerned about the high level of investment by SOEs in certain strategic sectors.⁵

"NATIONAL SECURITY" REVIEW

Any direct or indirect investment in Canada by a non-Canadian, regardless of value, is subject to security review if the investment could be injurious to national security. This "national security" review introduced in 2009 was used for the first time in 2013 to block Egypt's Accelero from acquiring Allstream, a division of Manitoba Telecom. In announcing the decision, the Minister noted that Allstream provides critical telecommunication services to businesses and government, including the Government of Canada.

FINAL REMARKS

Although Canada is ripe for foreign investment, non-Canadians looking to invest need to be aware of the application of the ICA and other relevant legislation. While compliance requirements can cause delays and increase costs, the odds are excellent the investment will be approved. In the 40-year history of the ICA, only three major investments have been disallowed.

¹ In October 2013, Petronas announced it would invest C\$36 billion in developing LNG exports from British Columbia to Asia. In May 2013, Shell Canada Ltd., Korea Gas Corporation, Mitsubishi Corporation and PetroChina Company Limited announced the joint development of a proposed LNG export facility near Kitimat, British Columbia.

² Legislation has been passed that will increase the threshold to C\$600 million and change the method for calculating the threshold from book value to "enterprise value." The higher threshold will not apply to foreign SOEs or cultural businesses.

³ Cultural businesses are defined in the ICA as Canadian businesses that carry on any of the following activities: (a) publication, distribution or sale of books, magazines, periodicals or newspapers in print or machine-readable form; (b) production, distribution, sale or exhibition of film or video recordings; (c) production, distribution, sale or exhibition of audio or video music recordings; (d) publication, distribution or sale of music in print or machine-readable form; and (e) radio communications in which the transmissions are intended for direct reception by the general public, any radio, television and cable television broadcasting undertakings and any satellite programming and broadcast network services.

⁴ Industry Canada, Guidelines – Investments by state-owned enterprises – Net benefit assessment

⁵ In a statement released in 2012, the Canadian government indicated that given the inherent risks posed by foreign SOE acquisitions in the Canadian oil sands the Ministry of Industry will find the acquisition of control of a Canadian oil sands business by a foreign SOE to be a net benefit to Canada on an exceptional basis only.



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