

# Kluwer Competition Law Blog

## Foreign Investment Review in Canada

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The past year generated substantial interest in the operation of Canada’s principal legislation governing the review of foreign investments, the *Investment Canada Act* (“ICA”). In particular, attention was focused on the ICA’s national security review process, which authorizes the Canadian government to block investments by non-Canadians that would be “injurious” to Canada’s national security.

We expect foreign investment review to remain an issue of public and political concern in 2022, as the Canadian government continues to search for the proper balance between encouraging foreign investment and guarding against national security risks, especially insofar as China is concerned.

We first review several key developments from the past year, and then look ahead to how the coming year may unfold. One potential trend to watch for is whether the ICA will be amended to create a tougher review environment for investments by non-Canadians in Canada.

### A. The Year in Review: Importance of National Security Reviews

The best place to start for a recap of the past year’s developments is the most recent annual report on the ICA, which was released by the Canadian Ministry of Innovation, Science and Economic Development (“ISED”) on February 2, 2022. ISED is the Canadian government ministry responsible for the administration and application of the ICA. The most recent annual report (the “Annual Report”) covers the period from April 1, 2020, through March 31, 2021.

Given that the Canadian government rarely provides details of specific ICA reviews, including declining to confirm whether a review even took place, ISED’s annual reports are an indispensable tool for gaining insight into the workings of the ICA review processes.

The most recent Annual Report is no exception. Notably, it confirms the growing importance of national security reviews in relation to the ICA’s other – and older – “net benefit to Canada” review process.

Under the ICA’s national security review regime, the Canadian government can review all foreign investments – regardless of value – to determine if they could be “injurious” to Canadian national security. If the government identifies national security issues, it may prohibit the investment from

proceeding, order the Canadian business to be divested (if closing has already occurred) or permit the investment to proceed with conditions that the investor must agree to (or abandon the transaction). The ICA's "net benefit" review process, on the other hand, obliges a foreign investor to apply for government approval for any acquisition of control of a Canadian business that exceeds certain thresholds. If those thresholds are not exceeded, the investor's only obligation is to advise the government of the transaction by filing a "notification" at any time up to 30 days following closing. Similar notification obligations apply when a foreign investor establishes a new business in Canada.

According to the Annual Report, despite 2020-21 seeing fewer foreign investments in Canada due to COVID-19-related factors, there were almost as many investments subject either to formal national security review or heightened screening as there were in the four prior reporting years *combined*. As in recent years, investments from China continued to attract a high level of scrutiny relative to investments from other countries.

At the same time, and in contrast to the growth in national security reviews under the ICA, data in the Annual Report reveal a sustained decrease in the number of foreign investments reviewed under the ICA's "net benefit" process. Indeed, there were fewer "net benefit" reviews undertaken last year than at any time since ISED's first annual report was published in 2010-11.

These developments are discussed in more detail below.

#### *Decline in Net Benefit Reviews*

In 2020-21, foreign investors submitted 826 filings under the ICA for acquisitions of control of Canadian businesses that were not Canadian "cultural" businesses; this number was 20% lower than the 1,032 filings submitted in 2019-20. The Annual Report identifies COVID-19 as the primary reason for the decline in the number of "net benefit" filings under the ICA. This is consistent with statistics maintained by the Organisation for Economic Co-operation and Development ("OECD"), which indicate an approximately 50% reduction in foreign direct investment for Canada and the OECD countries in 2020 compared with 2019.

Of the 826 filings, 823 were notifications, down 19.6% from the 1,023 notifications filed in 2019-20, and only three were applications for net benefit review and approval. The three applications for review were down from nine in each of the previous three fiscal years, and much lower than the 22 applications in 2016-17. Indeed, 2020-21 saw the fewest applications for net benefit review since the first Annual Report was published in 2010-11. This continues a material downward trend in applications for review since the financial thresholds for such reviews were significantly increased starting in 2009.

Despite the dramatic decrease in net benefit filings, the median review period for net benefit reviews in 2020-21 was 77 days, up slightly from 76 days in 2019-20 and 64 days in 2018-19. This is consistent with our own experience, which has seen reviews take longer to conclude even as the number of reviews overall has declined. This may be the result of the corresponding increase in attention paid to transactions under the national security review process, with those transactions siphoning off resources from net benefit reviews. Anecdotally, we also understand that the current ISED Minister is taking a more active interest in specific files which may occasion some additional delay.

### *Increase in National Security Reviews*

In contrast to the decline in net benefit reviews, national security reviews under the ICA increased to new highs in 2020-21, with 23 notices sent to non-Canadians informing them of a potential national security review. This number set a new record by a substantial margin and was almost the same number as had been issued in the four previous years combined. In addition, one other investment proceeded straight to a formal national security review.

Eleven of these 24 investments were subject to a formal national security review (12 did not proceed to formal review and one was withdrawn by the investor). This number represents a notable increase compared with the seven reviews initiated in the previous year, and constitutes more than one-third of the 32 national security reviews commenced over the past five years. The reviews also took a substantial period of time to complete, averaging 225 days across the 11 investments.

Of the 11 investments that were subject to formal review, four were allowed to proceed at the completion of the review with no remedies required, and sanctions were imposed in three cases. In the remaining four cases, investors abandoned their transactions after the formal reviews were initiated. In the three cases involving sanctions, one investor was prohibited from proceeding with the investment, and the other two were required to wind up or divest their investments.

### *Broader National Security Mandate*

The increase in the number of transactions subject to a formal national security review process is at least partly attributable to the government's decision to expand the scope of potential national security concerns after the onset of the COVID-19 pandemic. This policy was first articulated in the government's Policy Statement on Foreign Investment Review and Covid-19 released in April 2020, which stated that "foreign direct investments of any value, controlling or non-controlling, in Canadian businesses that are related to public health or involved in the critical supply of goods and services to Canadians or the Government" would be subject to "enhanced scrutiny" under the ICA. The policy also announced that all investments by foreign states or foreign state owned enterprises ("SOEs") would be subject to "enhanced scrutiny" as well. The April 2020 policy attributed this new approach to the need "to ensure that inbound investment does not introduce new risks to Canada's economy or national security, including the health and safety of Canadians", and the federal government's concern that foreign investors might engage in "opportunistic behavior" in acquiring vulnerable companies.

In March 2021, ISED released revised Guidelines on the National Security Review of Investments, which affirmed many of the changes in the April 2020 policy. For example, the revised guidelines re-emphasize that the government will consider "the security of Canada's critical infrastructure", including infrastructure "essential to the health of Canadians", in considering the national security risks of an investment, and highlighted that foreign acquisitions involving medical technology could be a concern. Consistent with the April 2020 policy, the revised guidelines also state that the government "will subject all foreign investments by state-owned investors, or private investors assessed as being closely tied to or subject to direction from foreign governments, to enhanced scrutiny" under the national security review provisions of the ICA, regardless of the value of the

investment. Although not COVID 19-related, the guidelines also identified two other areas of growing concern, i.e., foreign investments impacting (i) certain critical minerals, including critical mineral supply chains; and (ii) sensitive personal data.

The government's broader focus is reflected in the investments that were subject to a formal national security review in 2020-21: one involved the metal ore mining industry (which was blocked) and three involved pharmaceutical manufacturing, scientific research or medical and diagnostic laboratories (one was permitted to proceed and two were withdrawn). Five of the investments related to software, computer systems or other telecommunications, a more "traditional" area of national security concern (three were permitted to proceed and two were required to wind up or divest); while the other two investments involved road construction and financial transaction processing (both were withdrawn).

### *China still a Focal Point of National Security Review*

The Annual Report also implicitly confirms that the jurisdiction of the investor remains a key factor in determining whether a transaction may be subject to national security review. Chinese investments accounted for seven of the 11 investments subjected to a formal national security review in 2020-21; one of the investments was blocked, one required divestiture, three were withdrawn, and two were permitted to proceed. This is no surprise given that Chinese investments have constituted a majority of the investments subjected to formal national security reviews in four of the past five years. The other countries of origin subject to formal reviews in 2020-21 were Taiwan, Russia, the United Kingdom and the United Arab Emirates (which involved the other transaction requiring a divestiture).

While the Annual Report does not identify the parties to transactions subjected to national security review, at least two of the China-related transactions may be discerned from the public record. The blocked Chinese transaction is likely the proposed acquisition by Shandong Gold Mining Co., Ltd. ("Shandong") of TMAC Resources Inc., which the Canadian government prohibited in December 2020. Observers have speculated that political and diplomatic tensions between Canada and China, as well as concerns about the impact on Canada's ability to defend its sovereignty in the Canadian Arctic, were at the root of the government's decision to block the transaction.

Similarly, it is likely that the Chinese investment that was required to be wound up or divested refers to the case of China Mobile International (Canada) Inc. ("China Mobile Canada"), a subsidiary of a Chinese-state-owned company, China Mobile Communications Group Co., Ltd. ("China Mobile"). China Mobile Canada was established as a new business in Canada in 2015 and commenced operations in 2016. However, China Mobile failed at the time to notify the government of this fact, which it was required to do under the ICA (as described above). When the government inquired about this omission in 2020, China Mobile Canada filed the required notification in October of that year. The government then initiated a formal national security review process, which culminated in an order in August 2021 requiring China Mobile to wind-up or divest its Canadian operations. China Mobile and China Mobile Canada filed an application for judicial review of the government's decision in September 2021, with an accompanying motion to stay the government's divestiture order pending the resolution of the application for judicial review. In arguing against the motion for a stay, the federal government characterized the Chinese government as "a foreign entity posing a strategic threat to Canada and carrying out activities

detrimental to the national security and economic prosperity of Canada and other likeminded countries.” The Court agreed and held that there was sufficient evidence to support the government’s claim that the Chinese government could use its indirect control over China Mobile to “facilitate espionage and foreign interference activities in Canada.” China Mobile’s motion to stay was dismissed and it was ordered to comply with the divestiture order, even though its challenge to the order will not be heard until later this year.

## **B. The Year Ahead: Potential Amendments to the ICA Regime?**

### *Continued focus on national security*

We expect foreign investment review issues to continue to attract public and government attention in 2022, especially as the Canadian government continues to grapple with how aggressively to apply the ICA’s national security review process. While the Canadian government seemingly took a fairly strong line last year, 2022 opened with the disclosure that the government had decided not to initiate a formal national security review in connection with the acquisition of Neo Lithium Corp. by Zijin Mining Group Co., a Chinese SOE. The opposition parties in Canada’s Parliament and certain national security experts criticized the government’s decision, and a parliamentary committee is currently investigating the matter further.

Admittedly, the government’s decision appears to run contrary to the unequivocal language it used in its China Mobile filings, where it described the Chinese government as “a strategic threat to Canada”. It also casts doubt on what exactly the government means when it says that it will apply “enhanced scrutiny” to all SOE investments. According to the government, however, a proper and complete review of the Neo Lithium transaction was conducted, which ultimately concluded that the transaction would not be injurious to Canadian national security and that a formal national security review was not required. The government appears to have reached this conclusion because, among other things, Neo Lithium’s assets are located in South America and its belief that the type of lithium produced by Neo Lithium is of relatively lesser strategic importance than other types of lithium.

### *Standing Committee’s Recommended Amendments*

Given the scrutiny and attention the Neo Lithium case has received, it may also bolster calls to amend the ICA to enhance enforcement, particularly as it relates to national security matters.

In March 2021, for example, the House of Commons Standing Committee on Industry and Technology (“INDU Committee”) made several recommendations for amending the ICA, including the following:

- The review thresholds for all investments by SOEs should be reduced to \$0, so that all such transactions are subject to the ICA’s net benefit review and national security review regimes.
- The ICA should be used to protect strategic sectors, including health, pharmaceuticals, agri-food, manufacturing, natural resources, and intangibles related to innovation, intellectual property, data and “expertise.”
- Any Canadian business or entity holding a “sensitive asset” should be required to notify the

federal government 30 days before implementing the transfer of that asset to a non-Canadian entity.

- The government should be required to explain the factors for decisions made under the ICA, and to make public any undertakings or conditions imposed on foreign investors as the basis for the approval of transactions.

These proposals do not have the force of law, nor have they been incorporated into the revised National Security Review Guidelines. They do, however, demonstrate a willingness among Members of Parliament to consider more aggressive reforms to the ICA in the future.

#### *Task Force on Economic-Based threats to National Security*

In addition to the INDU Committee's efforts, a federal government task force is currently leading an interdepartmental policy review examining whether additional measures are needed to ensure Canada's continued ability to respond to economic-based threats to national security. Specific concerns include the loss of sensitive goods, technology and intellectual property; the malicious use of sensitive personal information of Canadians; and compromised critical infrastructure.

Among the issues the task force is exploring is whether the ICA should be amended, with a focus on three principal questions:

- Should the ICA's procedures be amended to expand the scope of transactions that are subject to mandatory pre-closing review?
- Are mitigation measures (e.g., undertakings) that permit a transaction to proceed subject to conditions effective in dealing with potential national security concerns?
- Should the penalties for non-compliance with the ICA be increased?

A public report that summarizes the input received by the task force is expected to be released by May 2022.

#### *Mandate Letter to Responsible Minister*

The impetus for reforming the ICA was given a further boost recently when Prime Minister Justin Trudeau's latest mandate letter to the Minister responsible for ISED, François-Philippe Champagne, directed him to "contribute to broader efforts to promote economic security and combat foreign interference by reviewing and modernizing the *Investment Canada Act* to strengthen the national security review process and better identify and mitigate economic security threats from foreign investment." It is certainly possible that the Minister will take steps in 2022 to turn these high-level directions into concrete changes to the ICA.

#### *Proposed Regulations To permit certain ICA Filings and extend time to review non-notified investments*

In the interim, the government has proposed more modest amendments to the ICA regulations that would allow investors to obtain pre-closing comfort for certain foreign investments, such as

minority acquisitions, that do not require an application or a notification to be filed under the ICA's net benefit regime.

The national security review process does not currently contemplate notifications where a net benefit filing does not have to be made – for example, in certain minority acquisitions. The government can initiate a formal national security review of such a transaction within 45 days of its implementation. Investors can informally contact the government to discuss such transactions pre-closing, but cannot obtain formal pre-closing comfort that they will not face a national security review until the expiry of the 45-day period following closing. The proposed amendments would address this situation by permitting investors to submit prescribed information before closing and, if no issues are raised within 45 days of such filing, proceed with the assurance that the investment will not be challenged post-closing.

The wrinkle is that the government's proposal also provides that if the investor does not file a notification, the investment will be subject to a potential national security review for up to *five years* following closing. That is a dramatic increase from the current 45-day limit. In other words, if the amendments are adopted, foreign investors that may otherwise have elected not to advise the government of a transaction would now be faced with the choice of either providing notice "voluntarily" or accepting the risk of a possible national security review for five years. The government's objective seems to be to increase the reporting of transactions that might be of national security concern and that otherwise would have escaped its attention.

### **C. Implications**

In 2020-21, a record number of investments received initial notices under the national security review process, and a record number of investments were then subjected to full formal reviews. That said, it is necessary to place this in perspective. Only a tiny percentage of transactions that are within the scope of the ICA ever undergo formal national security review. In the last year, for example, only 11 out of the 826 transactions (1.3%) for which ICA filings were made went to a full formal national security review. Moreover, of these 11 transactions, four were permitted to proceed with no remedies required, meaning that even the commencement of a full national security review does not necessarily spell the inevitable demise of the transaction.

Even in the case of Chinese investments, a national security review does not necessarily lead to their prohibition. Of the 42 Chinese investments for which ICA filings were made in 2020-21, only two (less than 5%) were ultimately prohibited or ordered to be unwound.

In sum, the question of how vigorously the ICA national security review process will be applied remains unsettled and each case will depend upon its particular facts. Therefore, potential foreign investors in Canada must continue to be diligent in assessing the potential implications of the ICA as part of their transaction planning. Future developments, including potential amendments to the ICA regime, will also need to be factored carefully into the analysis.

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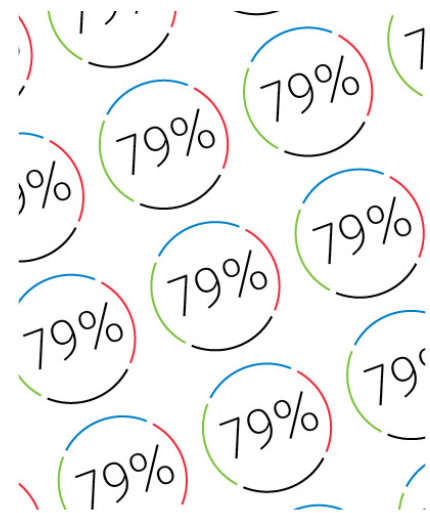
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