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Canada Moves to Strengthen National Security Review of Foreign Investments

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The Canadian government has proposed legislation to update and reinforce its national security review process under the *Investment Canada Act* (ICA). The proposed changes – contained in Bill C-34, National Security Review of Investments Modernization Act (Bill) – are the most significant since the ICA's national security regime was introduced in 2009.

Proposed New Measures

- **New pre-closing filing regime for investments in prescribed sectors.** Investments in certain sectors (as yet undefined) will be subject to a new pre-closing filing and suspensory obligation under the ICA. Currently, only foreign investors who acquire control of a Canadian business or establish a new Canadian business must notify the government. The vast majority of these notifications have no suspensory effect on the implementation of the investment and may be filed after the fact. By contrast, the new pre-closing filing regime would require investors making sensitive sector investments, including certain investments to acquire less than control, to notify in advance. Under the new regime, such investments would be prevented from closing until review time frames lapse or are terminated. Investors who fail to comply with the pre-closing filing obligation would be subject to a penalty of up to C$500,000.Although the regulations have yet to define the sensitive sectors to which the new filing obligation would apply, they are likely to include critical minerals, businesses handling personally identifiable information of Canadians and certain sensitive technologies like artificial intelligence, quantum computing and other technologies currently identified in the federal government's Guidelines on the National Security Review of Investments. It is expected that consultations on the scope and definition of these sectors will take place before the new filing regime is implemented.
- **Enhanced ministerial powers.** The Bill also contemplates the devolution of administrative powers from the federal cabinet to the Minister of Innovation, Science and Industry (Minister) ostensibly to streamline the national security process and provide for greater flexibility to address potential national security concerns during and after a national security review. One new power would allow the Minister to unilaterally impose interim conditions on an investor while a review is underway. This would be a significant change that could involve, for example, the issuance of "hold separate" orders – even after the implementation of an investment – to limit an investor's access to sensitive intellectual property and data of a Canadian business pending the outcome of

a review. The Bill would also permit the Minister to accept undertakings from an investor during the review process, which could potentially lead to quicker reviews with fewer referrals to Cabinet; but this also may signal an expectation that undertakings be offered in a wider variety of circumstances to mitigate procedural delay and potentially negative outcomes.

- **Updated penalties for non-compliance with the ICA.** Under the ICA, the government may seek a wide variety of court orders in the case of unremedied non-compliance with the statute. These court orders include divestiture orders and monetary penalties of up to C$10,000 per day of non-compliance. Under the Bill, the maximum monetary penalties per day of non-compliance would be increased to C$25,000 while, as noted above, a new penalty of up to C$500,000 could be imposed for failure to comply with the new pre-closing filing obligation for sensitive sector investments. In each case, the Bill would provide for future increases to these maximums by way of regulation.
- **More permissive approach to sharing information about foreign investors with international counterparts.** The ICA currently contains very strong provisions designed to protect the confidentiality of information pertaining to investors that is obtained in the foreign investment review process. The Bill would authorize the sharing of such information with foreign investment review authorities in other jurisdictions to facilitate national security reviews where, for example, a common national security interest exists. At the same time, however, the government says that Canada will not share such information "*where there are confidentiality or other concerns*," which may signal an intent to share such information only with trusted jurisdictions that would, in turn, protect the confidentiality of such information.
- **New rules to shield detailed sensitive information in court proceedings.** The Bill also contains provisions that would permit the Minister to identify sensitive information, like classified intelligence information, that would be protected from disclosure in legal proceedings arising from enforcement action under the ICA, such as judicial reviews of orders to block or attach conditions on investments for national security reasons. Designated information could be used and considered by a judge but would be available to an investor and its counsel only in summary form.

New Pre-Closing Filing Regime at Centre of Amendments

The mandatory pre-implementation filing regime is the centrepiece of the Bill's proposed changes to the ICA. This new filing requirement may have a significant impact on transaction planning by Canadian businesses active in sensitive sectors (including high-tech startups seeking capital) and by foreign investors looking to invest in those businesses.

In 2021-22, the last fiscal year for which the government maintains statistics, only eight non-cultural investments were subject to a mandatory pre-closing notification and approval requirement, and these were all under the ICA's "*net benefit*" to Canada review process, which does not focus on national security issues. None of the other investments notified during the period (more than 1,200) were subject to pre-closing notification and waiting period requirements, although parties in at least some of these cases likely voluntarily elected to file and pre-clear in order to exclude or manage national security risk prior to closing. Although it remains to be seen how many investments will get caught in the Bill's pre-closing filing dragnet, the number is likely to be significant, especially since the new filing obligation would extend to certain non-control investments that are not currently subject to notification at all. Accordingly, important definitional questions will need to be resolved in order to determine the scope and application of the new pre-

closing filing obligation, and thus limit the burden, cost and potential uncertainty of complying with such a regime. Key terms of the implementing regulations will include the following:

- **Definitions of the sensitive sector activities subject to mandatory notice.** It may be a challenge to define these with specificity.
- **The scope of non-control investments caught by the obligation.** Currently, the Bill suggests these investments will include ones that provide the investor with some level of access to sensitive information about the business as well as the power to appoint or nominate any person (e.g., director, senior manager) with the capacity to direct the affairs of the business. It is unclear whether the regulations will provide any kind of safe harbour for *de minimis* percentage shareholdings, for example.
- **Administrative aspects of the filing and review process.** These aspects include the level of communication with investors about their filings and the potential for obtaining early termination of pre-closing waiting periods.

Particularly given the serious consequences of failing to comply with the pre-closing filing regime proposed in the Bill, it is hoped that these and other practical considerations will be the subject of consultations before the details are fleshed out and regulations are promulgated. Similarly, stakeholders would benefit from administrative guidelines to assist them in navigating the amended process. Quite apart from creating a category of investments that would become notifiable pre-closing, another potential effect of the Bill (including the prospect of interim orders) may be to also increase the frequency of *discretionary* pre-closing notifications. Voluntary pre-closing notifications have also been both encouraged by the recent introduction of a voluntary filing regime for non-control investments and incentivized by allowing the government to conduct a national security review of any non-notified investment for up to five years after closing.

What the Bill Does Not Include

In assessing the Bill, we should also note what is *not* included. For example, the Bill does not incorporate some recent suggestions made by the House of Commons Standing Committee on Industry and Technology (Committee) to strengthen the ICA. For example, the Committee had recommended that every acquisition of control by a foreign SOE should be subject to a pre-closing net benefit review and that all investments by foreign SOEs from "*authoritarian regimes*" be subject to a full national security review. The government has chosen not to go that far – at least for now. It also remains to be seen whether an increase in earlier notification filings will lead to a discernible increase in enforcement outcomes. In that connection, nothing in the Bill changes the government's substantive approach to assessing investments for potential national security concerns.

Context – Recent Tougher Stance on National Security

The Bill continues recent government moves to toughen enforcement of the ICA's national security review process. These initiatives were commenced with policies issued as a result of the COVID-19 pandemic and have recently been supplemented with tougher policies applying to Russian investments and to investments by state-owned enterprises (SOEs) in critical minerals while, overall, national security scrutiny of foreign investments has increased markedly.

The robust nature of national security review in Canada is reflected in the Canadian government's recently released 2021-2022 Annual Report covering foreign investment reviews under the ICA. In the most recent fiscal year covered by this report (April 1, 2021, through March 31, 2022), there were 12 investments subject to formal national security review, which is the highest number for such reviews in a single year. Seven of these investments were allowed to proceed unconditionally following the completion of the review; four of the investments were abandoned after the formal review was commenced, and one review is ongoing with the outcome still unknown.

An additional 12 investments were the subject of an extended initial screening process of 90 days (the screening process takes 45 days if not extended) but did not proceed to formal reviews. Of these 12 investments, nine were allowed to proceed unconditionally without undergoing a formal review, and three investments were abandoned after the investor was advised that a formal review might be commenced.

The report also confirms that the jurisdiction of the investor remains a key factor in determining whether a transaction may be subject to a formal national security review. Chinese (six) and Russian (four) investments accounted for 10 of the 12 investments subjected to a formal national security review in 2021-22. The one matter still undergoing review also involves an acquisition of control by a Chinese investor. The other transactions subject to formal reviews in 2021-22 involved investors from Finland and Jordan, indicating that investors from the "*usual suspect*" countries are not the only ones that get caught up in the national security review process.

The industry sectors that attracted scrutiny are also noteworthy. Some of these are obvious – for example, metal ore mining, data processing, computer systems design and scientific research and development services. But other sectors are not so obvious – for example, grocery stores, taxi and limousine services, and "*schools and instruction*". This diverse range of sectors underscores the discretionary and even unpredictable nature of the ICA national security review process.

The report also makes it evident that not only acquisitions of control may lead to the initiation of formal national security reviews. Minority investments and the establishment of new businesses also feature among the investments caught in 2021-22 (the latter category accounting for one-third of the reviews).

It is notable that the national security review process has been ratcheted up during the administration of the current Liberal government, which entered power in 2015 with a much more benign view of national security issues than was held by its Conservative predecessor. Indeed, as recently as the beginning of this year, questions were raised by the media and in Parliament concerning the government's seriousness about dealing with national security issues. However, geopolitical developments and pressure from allies have led to a noticeable change in the Canadian government's attitude, which is reflected in its evolving approach to the ICA. This evolution is also evident in other policy initiatives of the government, such as the new Indo-Pacific Strategy announced on November 27, 2022, and the new Critical Minerals Policy issued on December 9, 2022. Both policies contain relatively blunt statements about the potential national security threats posed by "*hostile*" non-like-minded nations and commit Canada to "*acting decisively*" when investments by SOEs and other foreign entities threaten Canada's national security.

Apart from anything else, therefore, the Bill is intended to signal to Canada's allies that it is re-orienting its position on the importance – and sources – of national security threats to align more closely with corresponding regimes in like-minded countries such as the United States and the

United Kingdom.

Finally, It is clear that the current conception of "*national security*" in Canada (as elsewhere) has evolved from a narrower focus on traditional concerns about espionage, national defence and critical infrastructure to a broader concept of economic security that includes strategic technologies and products that will drive the economy of the future. The government's backgrounder to the Bill leaves no doubts in this regard, referring as it does to the ICA's role in protecting Canada's "*economic security*" and mitigating "*economic security threats arising from foreign investment*".

If passed, it appears that the Bill and associated regulations may not come into force until the spring or latter half of 2023. However, the Bill's impact is already being felt. For example, investors in potentially sensitive sectors whose transactions are in the planning stages must consider the risk of being caught by the proposed mandatory notification regime when it comes into force and how that might impact deal timing and certainty. All the more reason that foreign investors in Canada must continue to be diligent in assessing the potential implications of the ICA as part of their transaction planning.

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