

# Kluwer Competition Law Blog

## Main Development in Foreign Investment Law 2022 – Canada

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In this annual review of Canadian foreign investment law, we discuss developments over the past year, including proposed amendments to the *Investment Canada Act* (ICA) and new government policies on the treatment of specific categories of investments. We also consider how these trends will influence enforcement in the year to come. Our central observation is that national security issues will continue to be the key focus of ICA enforcement, with the Canadian government's attitude hardening toward state-owned (and state-influenced) investors, particularly in certain sectors of the economy.

### Current State of Foreign Investment Review in Canada

There are two streams of ICA review. The “*net benefit*” review process requires a non-Canadian investor to apply for government approval for any acquisition of control of a Canadian business that exceeds prescribed thresholds. If the thresholds are not reached, the investor is only obliged to file a notification either before or within 30 days of closing. A similar notification obligation applies when a foreign investor establishes a new business in Canada.

The “*national security*” review process applies more broadly, including to foreign investments that are not subject to the net benefit process, such as acquisitions of minority interests in Canadian businesses. The ICA authorizes the Canadian government to intervene in any investment that it finds “injurious” to Canadian national security.

The Canadian government's *2021-2022 Annual Report* on non-cultural foreign investment reviews under the ICA (which covers the period from April 1, 2021, to March 31, 2022) illustrates three main trends in Canadian foreign investment reviews: (i) the number of filings (including notifications and applications for net benefit review) has returned to (and exceeded) pre-pandemic levels; (ii) the number of applications for net benefit review (as opposed to notifications) remains comparatively low; and (iii) the national security review process continues to grow in importance and prominence.

### Number of Filings Has Recovered

The 2021-22 period saw the highest number ever of filings for investments to establish or acquire control of (non-cultural) Canadian businesses. All told, foreign investors submitted 1,255 filings under the ICA – up 52% from the 826 filings made in the 2020-21 period (when global investment flows were still suffering from the impact of the COVID-19 pandemic), and also higher (by about 22%) than the year before the pandemic (1,023 filings were made in the 2019-20 period).

### **Applications for Review Remain Infrequent**

Although the 2021-22 period saw a record number of filings related to acquisitions of control of (non-cultural) Canadian businesses, only eight of these filings were applications for review requiring government approval; the remainder (1,247) were notifications for investments for which no approval was required. The comparatively low number of applications for review reflects the cumulative impact of increases in the relevant financial thresholds since 2009, to the point where applications for review represented only 0.72% of all filings in the 2021-22 period.

### **Focus on National Security Reviews**

As applications for review under the net benefit provisions remain infrequent, national security considerations have continued to dominate the Canadian government's substantive review of investments by non-Canadian investors.

During the 2021-22 period, 12 investments in Canada by non-Canadian investors were subject to a formal national security review – a record level. 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 subject to an extended initial screening process (90 days) but did not proceed to a formal review. Of these 12 investments, nine were allowed to proceed unconditionally without undergoing a formal review and three were abandoned after the investor was advised that a formal review might be commenced.

The jurisdiction of origin of the non-Canadian investor remains a key factor in the national security review process. In the 2021-22 period, Chinese (six) and Russian (four) investors accounted for 10 of the 12 investments subjected to formal national security reviews.

The industry sectors that were subject to review are also noteworthy. While some sectors had obvious connections to potential national security concerns – for example, metal ore mining, data processing, computer systems design, and scientific research and development services – others were less obvious (e.g., grocery stores, taxi and limousine services, and “schools and instruction”). This diverse range of sectors underscores the discretionary and at times even unpredictable nature of the ICA national security review process.

Finally, it is clear that the government is willing to initiate a formal national security review even when there is no acquisition of control. Minority investments and the establishment of new businesses also featured among the investments caught by the national security review process in

the 2021-22 period (with the latter category accounting for one-third of the reviews).

### **Tougher National Security Enforcement Likely**

The ongoing prominence of national security reviews under the ICA reflects the current Canadian government's growing sensitivity to the impact of broader geopolitical developments on Canada, principally the increased friction between the West, on the one hand, and the Chinese and Russian governments, on the other.

When the current Liberal government first took office in 2015, it had a much more benign view of national security issues than was held by its Conservative predecessor. As recently as the beginning of 2022, questions were raised about the government's seriousness in dealing with national security issues after it permitted a Chinese mining company to acquire a Canadian company with lithium assets.

However, geopolitical developments and pressure from allies have led to a noticeable change in the Canadian government's attitude to national security issues. This evolution is evident in a variety of policy initiatives not limited to the ICA, such as the new [Indo-Pacific Strategy](#) announced on November 27, 2022, and the new [Critical Minerals Strategy](#) 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 to "acting decisively" when investments by state-owned enterprises and other foreign entities are seen to threaten Canada's national security.

With respect to the ICA specifically, in the past year, the Canadian government issued tougher policies governing certain categories of investments and investors, as well as introducing important proposed amendments to the ICA. These initiatives are briefly summarized below.

#### **New Policy for Russian Investors**

On March 8, 2022, the government issued a [policy statement](#) regarding the review of Russian investors' investments in Canada, in the wake of Russia's invasion of Ukraine. The policy provides that all direct or indirect investments by Russian investors (whether or not connected to the Russian government) that are subject to a net benefit review under the ICA will be approved only on "an exceptional basis." Furthermore, all investments that have "ties, direct or indirect, to an individual or entity associated with, controlled by or subject to influence by the Russian state" will provide grounds for a full and formal national security review under the ICA.

#### **New Policy for Investments in Critical Minerals**

In October 2022, the government announced a [new policy](#) governing investments by state-owned enterprises in Canada's critical minerals sector. Given the strategic importance of critical minerals, the policy states that applications for net benefit review involving investments in the Canadian critical minerals sector by foreign state-owned enterprises or "foreign-influenced private investors" will be approved only on an "exceptional basis." Foreign-influenced private investors are private

investors who are “closely tied to, subject to influence from, or who could be compelled to comply with extrajudicial direction from” foreign governments. The policy also states that the participation of foreign state-owned enterprises and foreign-influenced private investors in an investment involving critical minerals will support a finding that reasonable grounds exist to believe that the investment could be injurious to Canada’s national security. Shortly following the release of the policy, the government **announced** that it had ordered three Chinese mining companies to divest minority investments in Canadian critical mineral companies.

## **Proposed Amendments to the ICA**

On December 7, 2022, the federal government introduced *Bill C-34, National Security Review of Investments Modernization Act* (Bill C-34), which contains significant proposed amendments to the ICA’s national security review process.

The headline amendment in Bill C-34 would introduce a new pre-closing filing regime for investments in (yet-to-be) prescribed sectors. Specifically, non-Canadian investors in new or existing Canadian businesses engaged in the prescribed sectors would be required to provide notice of their investments in advance of closing and prevented from implementing the investment until the statutory review time period has lapsed or been terminated. Importantly, this proposed mandatory notice requirement would apply to direct and indirect investments in the prescribed sectors and, in certain circumstances, to investments to acquire less than control of the Canadian business. Non-Canadian investors who fail to comply with the pre-closing filing obligation would be subject to a penalty of up to \$500,000.

Additional proposed amendments in Bill C-34 include:

- An expansion of the administrative powers of the Minister of Innovation, Science and Industry (Minister), including a new power to unilaterally impose interim conditions on a non-Canadian investor during a national security review process and the ability to accept undertakings from a non-Canadian investor;
- An increase in the maximum available monetary penalty to \$25,000 per day, from \$10,000 per day, for non-compliance with the ICA;
- An expansion of the government’s ability to share information obtained in the course of the foreign investment review process with authorities in other jurisdictions, subject to “*confidentiality or other concerns*”; and
- Protection of sensitive information (e.g., classified intelligence information) that the government may rely on in legal proceedings arising from enforcement under the ICA. Importantly, information deemed sensitive could be used and considered by a judge but would be provided to the non-Canadian investor only in summary form.

It appears that Bill C-34 and associated regulations may not come into force until the latter half of 2023. A number of important questions will have to be answered as Bill C-34 makes its way through the legislative process. Most importantly, there is a need to:

- Define the specific sectors that will be subject to the new mandatory notice regime;
- Specify which minority investments will be caught by the new mandatory notice regime (e.g., identify any safe harbour or *de minimis* thresholds below which notification will not be mandatory); and

- Establish the administrative aspects of the filing and review process (e.g., the information to be provided and the potential for early termination of any waiting periods).

Bill C-34's impact is already being felt. For example, as it is unclear when a new notification regime may become effective, investors in potentially sensitive sectors whose transactions are in the planning stages must already consider the risk of being caught by the proposed mandatory notification regime when it comes into force and how that might affect deal timing and certainty.

## **Other Developments**

### *Voluntary Filings for Minority Investments*

On August 2, 2022, amendments to the *National Security Review of Investments Regulations* (Regulations) under the ICA came into force. The amendments to the Regulations introduced a new voluntary pre-clearance filing mechanism for investments that are not captured by the current mandatory filing requirements (e.g., minority acquisitions). As a result, non-Canadian investors that are not otherwise required to submit a filing under the ICA may voluntarily provide the prescribed information if they want greater certainty (especially pre-closing) as to whether their transactions will be subject to national security review. Following receipt of a complete filing, the Minister has an initial 45 days to determine whether to pursue a national security review (subject to a right to extend this period by 45 days).

However, the amendments also substantially extend the post-closing review period for any investment for which the non-Canadian investor does not choose to utilize the voluntary filing option. Under the revised Regulations, the Minister may commence a national security review up to five years after the implementation of the investment. The prospect of being exposed for such a significant period of time is designed to incentivize investors to report transactions that they may otherwise have decided not to disclose to the government at all.

Non-Canadian investors will now need to consider the new voluntary filing regime with respect to the ICA implications of minority investments in Canadian businesses. In cases where national security could be an issue, the amendments provide a helpful mechanism to obtain pre-closing comfort that was not available before. But even in cases with no obvious national security concerns, some investors may prefer the regulatory certainty of submitting a voluntary filing to the risk of exposure to possible review for five years.

### *Increased Transparency*

As a rule, the federal government does not provide information on its national security reviews under the ICA, with the exception of the anonymized and aggregated information found in the *Annual Report*. The government recently departed from this established practice in announcing the above-mentioned decisions to order three Chinese mining companies to divest minority investments in Canadian critical mineral companies. The government added that it will now issue similar announcements for all final decisions that involve an investment being ordered blocked or divested or allowed to proceed only on the basis of mitigation measures.

The government's new approach responds to consistent complaints about the lack of transparency in the ICA's national security review process. In that sense, it marks a positive development. However, it also means that foreign investors and Canadian businesses considering investments that may be reviewed under the ICA's national security review process should plan carefully for the possibility that the transaction, and its potential failure to clear the national security hurdle, may become public at some point. The same is true for any foreign investor establishing a new business in Canada that could raise national security concerns.

### Looking Ahead to 2023

The Canadian government has reoriented its thinking about national security issues, bringing its policies into closer alignment with key allies, both at a geopolitical level and in terms of enforcement policies. For example, the government's proposal to introduce a mandatory pre-closing notification regime for investments in certain sensitive sectors moves Canada closer to the approach in both the United States and the United Kingdom.

We expect to see a continued focus on national security issues in 2023, especially as the government's new policies are applied in practice and the details of the proposed changes to the ICA are fleshed out, and with no clear end in sight for ongoing geopolitical turmoil.

We further expect that the concept of national security will continue to expand beyond traditional concerns about espionage, national defence and critical infrastructure to a broader concept of national security that includes sensitive personal data, and strategic technologies and products that will drive the economy of the future. The government's backgrounder to Bill C-34 leaves no doubts in this regard in its description of the ICA's role in protecting Canada's "*economic security*" and mitigating "*economic security threats arising from foreign investment*."

In short, 2023 promises to be another eventful year under the ICA's national security regime. While most foreign investments in Canada ultimately will not raise any national security concerns, the scope for the potential application of this regime is only going to expand – all the more reason for foreign investors in Canada and their prospective Canadian partners to continue to be diligent in assessing the potential implications of the ICA as part of their transaction planning.

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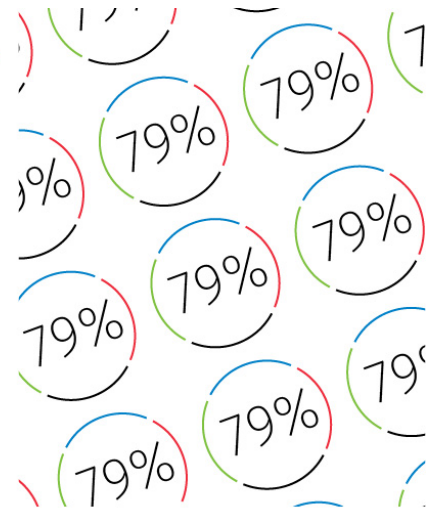
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