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Canada Toughens its Scrutiny of Foreign Investments

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After an initial period of indifferent interest, the current Canadian government continues to toughen its approach to the review of foreign investments in Canada.

Two important developments in March 2024 underscore this trend.

First, the government enacted substantial amendments to the Investment Canada Act (ICA) on March 22, 2024.These amendments, the most significant since 2009, will come into effect on a date to be fixed by the federal government. Based on statements from government officials, it is likely that certain amendments will come into effect in relatively short order, while other amendments requiring implementing regulations will not come into effect until late 2024 or early 2025.

Second, the government issued on March 1, 2024 policy statements regarding its approach to foreign investment in the Canadian interactive digital media (IDM) sector. Given the importance of this sector to the Canadian economy, the government has made it clear that foreign investments in the sector will be subject to rigorous review.

Both the amendments to the ICA and the IDM policy statements are in keeping with the government's increased scrutiny of foreign investments in recent years. The amendments also signal to Canada's allies that it is aligning its attitudes and review processes more closely with corresponding regimes in like-minded countries such as the United States and the United Kingdom.

The ICA Amendments

The amendments to the ICA impact both of its review processes, net benefit review and national security review:

- Net benefit review: foreign investors proposing an acquisition or other investment that meets relevant statutory criteria must satisfy the Canadian government that the proposed investment is likely to benefit Canada based on certain prescribed criteria. This often requires the investor to provide commitments to the government regarding the operation of the target Canadian business after the implementation of the investment.
- National security review: the Canadian government may review essentially any foreign

investment – including those not subject to the net benefit review process – to determine if it could be "injurious" to Canada's national security interests. The government has broad authority to intervene in such cases, including blocking or unwinding the investment or allowing it to proceed subject to "mitigating" conditions.

Mandatory national security filings

Arguably the most important change will see the establishment of a new mandatory filing regime that will require foreign investors to notify the government of their investments in advance of closing if they involve certain prescribed sectors. The purpose of this amendment is to increase the number of investments that come to the government's attention, with a view to catching additional transactions that may create national security concerns.

Currently, acquisitions of control of Canadian businesses by non-Canadians that fall below the Investment Canada Act's net benefit review thresholds need only be notified up to 30 days post closing, and acquisitions of less than control are not subject to mandatory notification at all. Similarly, investments in new businesses need only be notified within 30 days of closing. The new pre-closing filing regime will change all of that for investments in the prescribed sectors, as it will require pre-closing filings to be made regardless of the value of the investment, even if the investment only involves the acquisition of a minority interest, and even if there is no acquisition of an existing business at all and the investment involves the establishment of a new business. Investments caught by the new regime will be prohibited from closing until the review time frame (also to be prescribed) expires or is terminated. Investors that fail to comply with the pre-closing filing obligation will be subject to a penalty of up to C$500,000.

Important details still remain to be prescribed by the regulations that the government will be drafting for the next several months. Most importantly, the sectors to which the new regime will apply still have to be worked out. That said, during hearings held by the Canadian Senate on the draft legislation, a government official provided a lengthy but non-exhaustive list of sectors that may be caught, including aerospace; artificial intelligence; biotechnology; energy generation, storage and transmission; next-generation computing and digital infrastructure; and various types of advanced technologies. The final list of sectors may very well also include critical minerals, IDM and/or the pharmaceutical sector.

Whatever the final list of sectors, there is no question that the new filing regime will expand the number of transactions subject to national security review once it comes into force, and may even cause cautious investors to voluntarily file before the amendments come into force if they are concerned about being caught afterwards.

"Call in" power for SOE investments

Another important change has been made to the ICA's net benefit review process. Pursuant to the amendments, the Canadian government will be authorized to order the review of investments that fall below the relevant net benefit thresholds in cases where (a) the investor is a SOE from a country without a trade agreement with Canada, and (b) the government is "of the opinion that a review of the investment is in the public interest". This discretionary "call in" power would not

apply to major investors in Canada such as the United States, members of the European Union, Japan and South Korea, all of which have trade agreements with Canada. However, it could be applied to investments from China or Russia (not surprisingly) and other countries without trade agreements with Canada. At one point, it had been suggested that all SOE investments be subjected to net benefit review, regardless of jurisdiction. The amendments do not go that far. However, the threat of this new power being exercised will add yet another element of uncertainty for investors from non-trade agreement jurisdictions and will have to be considered in developing a filing strategy.

Other key amendments

Other key amendments to the ICA that have been enacted now include:

- expanding the ICA's net benefit review criteria to take into account the effect of the investment on (a) any intellectual property whose development has been funded, in whole or in part, by the Canadian government, and (b) on the use and protection of personal information relating to Canadians;
- expressly providing that the ICA's national security review provisions apply to acquisitions by foreign state-owned enterprises (SOEs) when the assets of the target Canadian business are located outside of Canada;
- allowing the government to commence a national security review if a non-Canadian investor has been convicted, within or outside Canada, of an offence involving an act of corruption;
- increasing the penalties for non-compliance with the ICA; and
- promoting greater information sharing with foreign agencies.

New Policies on Foreign Investment in IDM

The other major development in March was the Canadian government's release of policy statements on IDM regarding its approach to reviewing foreign investments in the Canadian IDM sector (IDM Statements). IDM is broadly defined for these purposes as "digital content and/or an environment in which users can actively participate or that facilitates collaborative participation among multiple users for the purposes of entertainment, information or education, and [which is] commonly delivered via the Internet, mobile networks, gaming consoles or media storage devices."

As set out in the IDM Statements, the government's principal objectives in reviewing foreign investment in Canadian IDM are to (a) ensure "the continued expression of Canadian voices and stories reflective of Canadian values", (b) protect the creation and retention of distinct Canadian-owned and -created intellectual (a major government concern outside of the specific IDM context as well), (c) prevent the sensitive private data of Canadians from foreign access (another matter of general government concern) and (d) preclude the use of IDM by foreign states to manipulate information and disseminate propaganda.

Given these concerns, the IDM Statements provide that foreign investments in Canadian IDM businesses will be subject to :

(a) "stringent undertakings" in order to secure net benefit approval, especially if these businesses

create or own IP or create content reflecting Canadian "values," "voices" and "stories." These undertakings will be directed in particular at ensuring the "creative independence" of the Canadian business, robust corporate governance and transparency in decision-making, and ongoing reporting, auditing and rights of inspection. Investors may also be required to commit to undertakings for a longer period of time than the norm, particularly with respect to creative independence, corporate governance and transparency. This could mean undertakings of five years of duration rather than the more typical three years.

(b) "enhanced scrutiny" under the ICA's national security provisions. Although the application of "enhanced scrutiny" does not mean that every transaction subject to such scrutiny will be blocked, it certainly entails the increased likelihood of a more probing initial examination and greater risk that the government will conduct a full scale national security review of the investment.

To a large degree, the IDM Statements are intended to reflect and make transparent the Canadian government's existing approach to foreign investment in the Canadian IDM sector. For example, following the release of the IDM Statements on March 1, 2024, the government announced that it had commenced in September 2023 a national security review into Tik-Tok's plans to expand its business presence in Canada.

Implications

Both the amendments to the ICA and the IDM Statements reflect a shift by the Canadian government to greater rigour in net benefit and national security reviews of foreign investments in Canada, especially if those investments are in specific sectors (such as IDM or critical minerals) and/or involve state actors from hostile jurisdictions—which in practice to date has largely meant China or Russia. Both of these developments also highlight the need for non-Canadian investors to consider the national security and net benefit review implications of their investments in Canada at an early stage.

Finally, even though the process of bringing the ICA amendments forward has been slow (almost 15 months since they were first introduced), we may not have heard the last of proposed changes to the foreign investment review regime in Canada. In its report on the ICA amendments, the committee of the Canadian Senate reviewing the amendments said that it was only supporting them "with reservations". The Senate Committee expressed concern that the scope of the amendments "is too limited and does not adequately balance our economic and national security needs." It therefore recommended that the government report back in three years on whether the amended Investment Canada Act is meeting its objectives. As such, even more stringent changes may be in the offing at some point in the near future.

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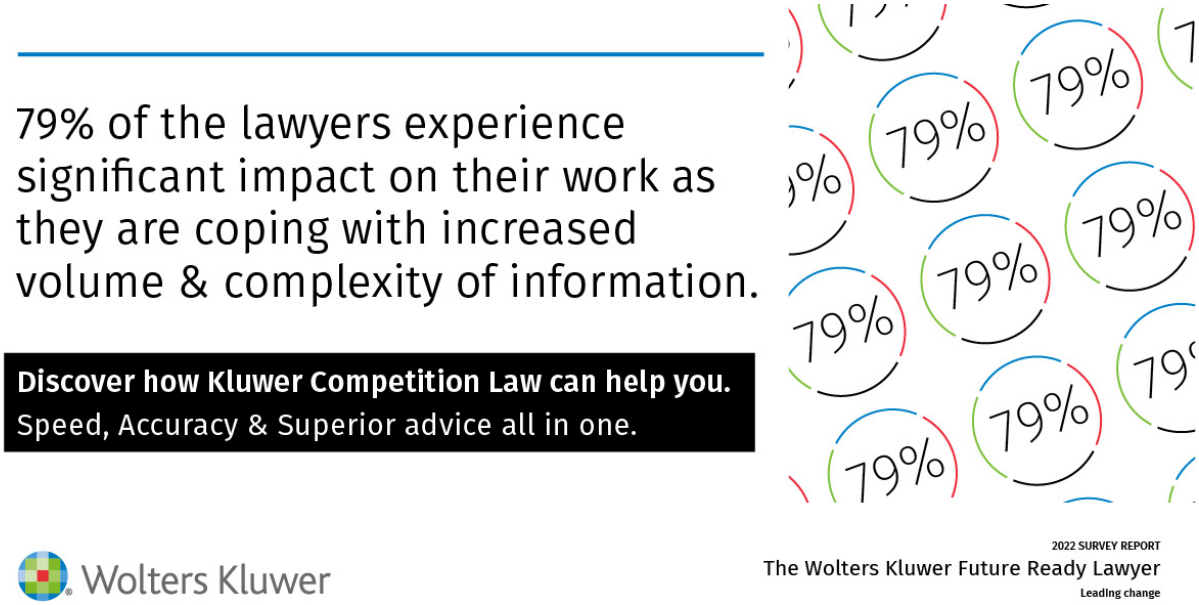

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