WOODS, LAFORTUNE LLP
INTERNATIONAL TRADE LAW

Amendments to the *Investment Canada Act*: A More Restrictive Approach to Foreign State-Owned Enterprise Investment in Canada

By Paul Moen, Madelaine Mackenzie and Catherine Walsh

INTRODUCTION

Foreign investment in Canada's energy sector is a vital element to its development and future growth. Over the last several years, the Government of Canada has taken active steps to encourage this advancement and has worked to improve Canada's investment regime to make it a more attractive investment destination for foreign investors. In previous articles, we have reviewed the Canada-China Foreign Investment Protection and Promotion Agreement ("**CC-FIPA**") and its impact on both Canadian and Chinese investors. Once implemented, the CC-FIPA will give Chinese investors improved rights as well as the ability to better protect those rights in the post-establishment context. The same will be true for Canadian investors in China.

The recent spectre of large Chinese investments into the Canadian oil and gas industry has brought about new regulations pertaining to foreign investment. Of particular importance are the ones that aim to address policy concerns about the nature of investments made by State-Owned Enterprises ("**SOE**"). Below, we review recent amendments to the *Investment Canada Act* 1985 (Canada), which create new barriers to SOEs' investments into Canada and which may raise important concerns about Canada's ability to attract foreign investment in the future.

BACKGROUND

On December 7, 2012, the Government of Canada (the "**Government**") approved two major foreign SOE acquisitions of Canadian oil sands businesses: the China National Offshore Oil Corporation's ("**CNOOC**") acquisition of Nexen Inc. ("**Nexen**") and Petronas' acquisition of Progress Energy ("**Progress**"). On the same day, the Government released a policy statement (the "**December 2012 Statement**") and announced important changes to the "Guidelines – Investment by State-Owned Enterprises" (the "**SOE Guidelines**") under the *Investment Canada Act* (the "***ICA***").

The $15.1 billion CNOOC/Nexen transaction in particular, received much public attention. The acquisition proposal underwent a rigorous review before ultimately being approved by the Government. In making its assessment, the Government aimed to strike a balance between its desire to promote foreign investment in the Canadian oil industry and concerns about allowing a foreign SOE to acquire control of a large Canadian oil sands player. In the December 2012 Statement, the Government acknowledged that foreign investment in the oil sands is essential to Canada's economic prosperity, but also recognized the risks associated with extensive SOE control over Canada's oil resources. The main concern has been that SOEs may be influenced by a foreign government's political agenda and that this political agenda may conflict with Canadian industrial and economic objectives. In fact, in its December 2012 Statement, the Government took the view that SOE acquisitions of

Canadian businesses may adversely affect the "efficiency, productivity and competiveness" of the acquired companies, resulting in a negative impact on Canada's long-term economy. Further, the Government placed a particular emphasis on Canada's oil sands, stating that foreign SOE acquisitions of control over Canadian oil sands businesses will be approved under the *ICA*'s "net benefit to Canada" test on an "exceptional basis" only.[1]

On April 29, 2013, then Finance Minister Jim Flaherty tabled the Economic Action Plan 2013 Act (Bill C-60), which, *inter alia*, proposed to amend the *ICA* (the "**Amendments**").[2] The proposed Amendments took several steps further than the December 2012 Statement in restricting foreign SOE investments in Canada. These Amendments were enacted into law and became effective on June 26, 2013, with retroactive effect to April 29, 2013. The Amendments codify the changes made to the SOE Guidelines, expanding the Government's power to declare that a foreign investing entity is an SOE and consequently, to declare that an otherwise non-reviewable acquisition by an SOE is subject to governmental review.

While it had been hoped that the Government would clarify the treatment of foreign SOEs investing in Canada,[3] the language of the Amendments and of the 2012 December Statement have created some uncertainty as to how and when SOE investments will be reviewable. Specifically, it is unclear what constitutes "indirect government influence" for the purposes of defining an SOE under the *ICA* and what qualifies as an "exceptional basis" for approving SOE investments. Overall, the changes brought forth by the Amendments were met with mixed reaction and concerns that the Government had "erased that nice, clear dividing line and replaced it with a much looser standard that focuses on de facto control."[4]

G-7 countries are all faced with the tension between the need to attract foreign investment and the need to ensure that economic, commercial, and national security interests are protected. In fact, the balancing task in addressing the issues related to foreign SOE investments are arising in other international contexts as well. For instance, one element of the ongoing Trans-Pacific Partnership Agreement (the "**TPP**") negotiations has been the development of a legal regime for SOE investments, with the objective that SOEs and private companies compete on a level playing field. Many of the concerns raised in the context of the TPP negotiations echo those expressed by the Government of Canada, such as SOEs' compliance with laws and regulations and the need to ensure that SOEs act in accordance with commercial considerations. In the context of multi-national trade and investment negotiations such as the TPP, however, there is the additional emphasis that SOE's do not receive preferential financing from their parent governments if such financing would cause harm to private competitors.

POLICY CHANGES - REVISIONS TO THE SOE GUIDLINES AND THE GOVERNMENT'S POLICY STATEMENT

The SOE Guidelines are neither law nor resolutions and are therefore not binding on the Government. They do however inform the Government's approach to foreign SOE investment review under the *ICA*. As indicated, the recent changes to the SOE Guidelines reflect the Government's more restrictive approach to foreign SOE investment in Canada.[5]

As a precursor to the Amendments, the SOE Guidelines expanded the definition of "SOE" to include not just an entity directly or indirectly *owned* and *controlled* by a foreign government, but one that is directly or indirectly under foreign government *influence*.[6]

Assessing whether an SOE investment will be of "net benefit" to Canada under the SOE Guidelines, the Minister must be satisfied that the investor will:

- Operate on a commercial basis;
- Be free from political influence;
- Operate in conformity with Canadian corporate standards, including commitments to transparency and disclosure, independent members of the board of directors, independent audit committees, and equitable treatment of shareholders;
- Be committed to Canadian laws and practices, including adherence to free market principles; and
- Contribute to the employment and capital level, as well as the productivity and industrial efficiency of the Canadian business.[7]

Pursuant to the SOE Guidelines, the Minister is responsible for examining the degree of control or influence that an SOE will likely exert on the Canadian business it seeks to acquire and the industry in which the Canadian business operates. The Minister will also consider the degree of control or influence the foreign government will exercise over the SOE.[8]

It appears that a successful bid by a foreign SOE would likely require a convincing submission addressing the issue of susceptibility to home government influence and include a strong commitment to transparency and commercial operations in its business plans and undertakings.[9] The SOE Guidelines suggest that SOEs may consider, for example, appointment of Canadians as independent members of the board of directors, employing Canadians in senior management positions, incorporating the business in Canada, and listing shares of the company on a Canadian stock exchange.[10]

One of the challenges for potential foreign investors is that the SOE Guidelines are applied on a case-by-case basis. When the CNOOC/Nexen acquisition was approved, CNOOC publicized a list of commitments that it would undertake in order to increase its chances of obtaining the Minister's approval, some of which mirror the examples in the SOE Guidelines.[11] However, a foreign investor's final undertakings are not publicized and the Minister is not required to release the reasons for his final decision. Even if this information was publicly available, the fact that decisions are made on a case-by-case basis means that a similar application will not necessarily be approved. Thus, potential investors cannot predict the course of a review assessment when proposing an investment with any degree of certainty.

LEGAL CHANGES – THE AMENDMENTS TO SOE INVESTMENTS

As indicated, the Amendments to the *ICA* codify the broad definition of SOE in the SOE Guidelines. Again, the definition includes an entity that is directly or indirectly controlled or *influenced* by a foreign government or government agency. The definition also includes an individual acting under the direction or influence, directly or indirectly, of a government or government agency.[12] Given that the term "indirect

influence" is not specifically defined in the Amendments, the expanded definition appears intended to give the Government greater discretion to label a foreign investor an SOE.

Under the previous version of the *ICA*, an investment by a *non- Canadian* in a Canadian business was a reviewable transaction if there was an *acquisition of control* of the Canadian business (*i.e.* an acquisition exceeding 33.3%) and the acquired business exceeded a threshold of $344 million in asset value. The Amendments however, extend the reach of the Government under the *ICA* where foreign SOE investors are concerned, subjecting proposed investments to greater scrutiny.[13]

First, under the Amendments, an otherwise "Canadian" business may be deemed non-Canadian if the Minister is satisfied that it is controlled in fact by one or more SOEs. The Minister may consider "any information and evidence" made available to him. If an entity refuses or fails to provide, within a reasonable time, any information that the Minister requests in order to make a decision, the Minister may declare that entity to be a non-Canadian-controlled entity. These powers may be exercised retroactively.[14]

Also, the Amendments blur the dividing line between an acquisition of control and an acquisition of control *in fact*. Under the new regime, the Government may declare that a proposed foreign investment is an acquisition of control in fact, even where the 33.3% threshold is not met, if the Government is satisfied that the entity is under the control of one or more SOEs. Consequently, an otherwise non-reviewable acquisition may be subject to review if proposed by an SOE. In making this determination, the Minister may consider "any information and evidence" made available to him. Again, these powers may be exercised retroactively.[15]

Further, investments proposed by investors classified as SOEs are, and will remain, subject to a review threshold of $344 million in asset value. Under the Amendments, however, the review threshold for private sector investors will increase to $600 million enterprise value , and will continue to increase by $200 million every two years until it reaches $1 billion.[16] Effectively, this will create a much lower review threshold for SOEs as compared to private investors, reflecting the Government's openness to private foreign investment, on the one hand, and skepticism of SOE investment in Canada on the other.

IS THE CNOOC/NEXEN TRANSACTION INDICATIVE OF AN "EXCEPTIONAL CIRCUMSTANCE"?

CNOOC's acquisition of Nexen was reviewed and approved under the old SOE Guidelines, before the December 2012 Statement was announced. However, the Government was deliberating the changes to SOE investments while considering the $15.1 billion SOE transaction and thus, it will be presumed that the new restricted approach influenced the Government's review of that transaction to some degree.

As noted above, the final undertakings CNOOC made to win the Minister's approval are not publicly available, although CNOOC did publicly release a number of significant commitments that it made. These commitments include: establishing Calgary as CNOOC's North and Central American headquarters; seeking to retain Nexen's current management team and employees; investing significant capital in the development of oil and gas resources in Canada; listing CNOOC shares on the Toronto Stock Exchange; and maintaining Nexen's corporate social responsibility, particularly with respect to First Nations and local communities.[17]

Many of these commitments address concerns of transparency and disclosure, commercial orientation,

adherence to Canadian laws and practices including free market principles, and long-term commitment to the Canadian economy, as outlined in the SOE Guidelines. Without knowledge of CNOOC's specific undertakings though, it is difficult to know whether the commitments outlined above are enough to convince the Government that a similar transaction would be of net benefit to Canada.

As indicated, CNOOC/Nexen transaction was approved on the same day the Government approved the acquisition of Progress by the Malaysian SOE, Petronas. Similar to CNOOC, Petronas had made several commitments such as capital investment, retaining Canadian employment and keeping the operation bases in Canada.[18] Announcing the two approvals, however, Prime Minister Harper cautioned that they were "not the beginning of a trend, but rather the end of a trend".[19] In addition, due to the Amendments to the *ICA*, the Government now has a greater reach to review proposed investments involving foreign entities, subjecting them to stricter scrutiny. Nevertheless, at least one SOE investment has been approved in Canada since the CNOOC/Petronas decisions. In May 2014, the Government approved the acquisition of Statoil Canada's several oil sand projects by PTTEP, a Thai SOE.[20] It has been reported[21] that this approval has been "in large part" due to the fact that Statoil Canada was itself a subsidiary of Norwegian SOE Statoil ASA.[22] The Government's reasons for this decision, however, remain unknown, which further highlights the problem of limited transparency in the Government's decision-making process. The lack of transparency in turn makes it difficult to predict whether SOE investors emulating CNOOC/Petronas' approach of making voluntary undertakings will or will not survive the Government's scrutiny and satisfy the "exceptional basis" net benefit test. Finally, the current ambiguity of what would constitute an "indirect influence" or "control in fact" expands the uncertainty to foreign investors who may not be traditionally classified as SOEs.

AUTHORS

Paul Moen is a trade law and policy expert with over 20 years of experience advising business and government clients on a wide range of international legal, regulatory and public policy matters. He is counsel to Woods, LaFortune LLP and CEO of MoenGlobal Advisors Inc., and previously held senior leadership positions in the global biotechnology industry and at the Government of Canada.

Madelaine Mackenzie is an articling student at Power Law. She has an Honours BA in Criminology from Carleton University and completed the JD program at the University of Ottawa. Throughout law school, she worked as a Research Assistant, Teaching Assistant and Legal Writing Peer Mentor.

Catherine Walsh serves as legal counsel at Woods, LaFortune LLP where she practices trade law and advises clients on international business strategies. She graduated from the University of Ottawa in social sciences with a concentration in criminology and then went on to complete her LL.B. before pursuing a Master in Business Administration. She combines her growing trade law experience with her corporate work and MBA training to help companies build strong strategies and effective business plans.

[1] Investment Canada Act, Statement Regarding Investment by Foreign State-Owned Enterprises (7 December 2012), online: Industry Canada h<http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81147.html>.
[2] See Canada Bill C-60, An Act to implement certain provisions of the budget tabled in Parliament on March 21, 2013 and other measures, 1st Sess, 41st Parl, 2013, Status of the Bill online: Parliament of Canada <http://www.parl.gc.ca/LegisInfo/BillDetails.aspx?Language=E&Mode=1&billId=6108103>
[3] See Department of Finance, Press Release, "Harper Government Focused on Jobs, Growth and Long-Term Prosperity With Economic Action Plan 2013 Act No 1" (29 April 2013) online: Department of Finance <http://www.fin.gc.ca/n13/13-064- eng.asp> and Canada Bill C-60, An Act to implement certain provisions of the budget tabled in Parliament on March 21, 2013 and other measures, 1st Sess, 41st Parl, 2013, Executive Summary online: Parliament of Canada <http://www.parl.gc.ca/LegisInfo/BillDetails.aspx?Language=E&Mode=1&billId=6108103&View=8>
[4] Drew Hasselback, "What C-60 means to industry", National Post (22 May 2013) LP6. See also Lawson Hunter and Michael Kilby, "Chilling SOEs: Government amendments potentially discourage foreign investment", Financial Post (9 May 2013), online: <http://opinion.financialpost.com/2013/05/09/chilling-soes/>; Alicia K. Quesnel, "The chilling effect of uncertainty – foreign direct investment by state owned enterprises in Canada's resources sector", Financier Worldview (November 2013), online: <http://www.financierworldwide.com/the-chilling-effect-of-uncertainty-foreign-direct-investment-by-state-owned-enterprises/#.U_H54fldUhY>; and Rebecca Penty and Andrew Mayeda, "India Says Canada Investment Rules May Cut LNG Spending", Bloomberg (9 May 2013), online: <http://www.bloomberg.com/news/print/2013-05-09/india-says-canada-investment-rules-may-cut-lng-spending.html>.
[5] Industry Canada, Guidelines – Investment by state-owned enterprises – net benefit assessment, online: <http://www.ic.gc. ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2>.
[6] Industry Canada, Guidelines – Investment by state-owned enterprises – net benefit assessment, online: <http://www.ic.gc. ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2>.
[7] Industry Canada, Guidelines – Investment by state-owned enterprises – net benefit assessment, online: <http://www.ic.gc. ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2>.
[8] Investment Canada Act, Statement Regarding Investment by Foreign State-Owned Enterprises (7 December 2012), online: Industry Canada h<http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81147.html>.
[9] Industry Canada, Guidelines – Investment by state-owned enterprises – net benefit assessment, online: <http://www.ic.gc. ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2>.
[10] Industry Canada, Guidelines – Investment by state-owned enterprises – net benefit assessment, online: <http://www.ic.gc. ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2>.
[11] CNOOC Ltd, Press Release, "CNOOC Limited Receives Industry Canada Approval on Its Proposed Acquisitions of Nexen Inc." (8 December 2012) online: CNOOC Ltd. <http://www.cnoocltd.com/encnoocltd/newszx/news/2012/2181.shtml>.
[12] *Investment Canada Act*, RSC, 1985, c 28, s 3.
[13] Investment Canada Act, Statement Regarding Investment by Foreign State-Owned Enterprises (7 December 2012), online: Industry Canada h<http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81147.html>.
[14] *Investment Canada Act*, RSC, 1985, c 28, ss 26(2.31)-26(2.33).
[15] *Investment Canada Act*, RSC, 1985, c 28, ss 28(6.1)-28(6.3).
[16] *Investment Canada Act*, RSC, 1985, c 28, s 14.1(1) (Amendments Not in Force).
[17] Industry Canada, Guidelines – Investment by state-owned enterprises – net benefit assessment, online: <http://www.ic.gc. ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2>.
[18] See "PETRONAS to Acquire Progress Energy", Newswire (28 June 2012), online: <http://www.newswire.ca/en/story/1000685/petronas-to-acquire-progress-energy>.

[19] See Aaron Wherry, "Harper government approves CNOOC and Petronas deals", Macleans (7 December 2012), online: <http://www.macleans.ca/economy/business/harper-government-approves-cnooc-and-petronas-deals/>.

[20] See Lawson Hunter and Michael Kilby, "Investment Canada Act approval for oil sands investment by State-Owned Enterprise", The Competitor (15 July 2014), online: <http://www.thecompetitor.ca/2014/07/articles/investment-canada/investment-canada-act-approval-for-oil-sands-investment-by-stateowned-enterprise/>.

[21] See Peter Mazereeuw, "Plenty of foreign interest in Canadian natural gas—for now", Embassy (23 July 2014), online: <http://www.cwilson.com/download/canadian-lng.pdf>.

[22] See also Jeffrey Jones, "Statoil, PTTEP deal to test tighter oil sands rules", GlobeAdvisor.com (31 January 2014), online: <http://www.globeadvisor.com/servlet/ArticleNews/story/gam/20140131/RBSTATOILCANADAJONESATL>.