Regulation of Foreign Investment and Merger Regulation

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Doing Business in Canada

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REGULATION OF FOREIGN INVESTMENT

The *Investment Canada Act* (the "**ICA**") applies when a "non-Canadian" (a non-Canadian-controlled entity): establishes a new business in Canada or acquires, either directly or indirectly, control of a Canadian business. Direct acquisitions of control that exceed specified statutory monetary thresholds are subject to a "net benefit" review which precludes the investor from completing the acquisition until the investment has been reviewed and the Minister is satisfied that the investment "is likely to be of net benefit to Canada."

Notification Procedure

In view of the high monetary thresholds which trigger a net benefit review, most investments by non-Canadians require only that the Director of Investments (an officer appointed under the ICA) be notified of the investment (unless the investment relates to a "culturally sensitive" business, which is reviewed by the Canadian Heritage Minister). The notification, which may be filed up to 30 days after closing, requires information concerning the non-Canadian investor; the nature of the investment; a description of the Canadian business being established or acquired; details relating to the investor's officers, directors and shareholders; its sources of financing for the proposed investment; the transaction documents (or the principal terms and conditions, including the estimated total purchase price of the investment); whether the investor is owned, controlled or influenced, directly or indirectly, by a foreign government; and information to permit enterprise value information to be collected.

The notice is filed with the Director of Investments who issues a receipt certifying the date on which the notice is deemed complete. The receipt indicates that the establishment, or acquisition, of the business is not reviewable under Part IV of the ICA. The certified date of a complete notice is also relevant to commence the 45-day period in which any investment can be reviewed under the national security provisions of the ICA (see below).

Review Thresholds: WTO Transactions

By reason of the Agreement Establishing the World Trade Organization ("**WTO**") between Canada and certain other countries (there are currently 164 WTO members), direct acquisitions by non-Canadians who are WTO investors and direct acquisitions of Canadian businesses controlled by WTO investors have been subject to historically higher thresholds for review under the ICA. The review threshold for WTO investments (by investors other than state-owned enterprises ("**SOE**"), which is addressed below) for 2022 is C$1.141 billion in "enterprise value".

For certain trade agreement investors, the review threshold for 2022 is C$1.711 billion in enterprise value. This higher review threshold applies to European Union investors falling under the Comprehensive Economic and Trade Agreement ("**CETA**") between Canada and the European Union as well as and to other Free Trade Agreement ("FTA") investment partners benefiting from Canada's Most-Favoured-Nation ("**MFN**") trade commitments. MFN treatment will be accorded to many FTA jurisdictions including the United States, Mexico, Chile, Colombia, Panama, Peru, Honduras, South Korea, Japan, Singapore, New Zealand, Australia and Vietnam.

Enterprise Value: Methodology

Regulations made under the ICA provide for a detailed methodology for calculating the enterprise value when an acquisition of control of a Canadian business has occurred. The calculation of enterprise value depends on the type of transaction contemplated (i.e., where the acquired entity is a publicly traded entity, a non-publicly traded entity, or if the transaction involves the acquisition of assets). There are also specific rules to calculate enterprise value in contingent payment scenarios, such as transactions with potential earn-outs.

Indirect acquisitions of control of non-cultural Canadian businesses by non-Canadians (i.e., by acquiring control of a non-Canadian parent of a Canadian subsidiary) are not subject to review for WTO investors (or for non-Canadian WTO sellers).

These established review thresholds (as well as the statutory exempt review for indirect acquisitions of control) are not applicable in certain enumerated circumstances set out in the ICA (see below).

Review Thresholds: Non-WTO Transactions

Acquisitions of control by non-Canadian investors who are neither WTO investors nor trade agreement investors remain subject to review where the book value of acquired assets exceeds C$5 million or C$50 million for indirect acquisitions of control.

Cultural Heritage or National Identity

Investment proposals, including indirect acquisitions of control, that might ordinarily be only notifiable can be ordered for review where the business is related to Canadian cultural heritage or national identity. Currently, these "culturally sensitive" businesses include the publication, distribution

and sale or exhibition of books, magazines, periodicals, newspapers, films, videos and music. These acquisitions are subject to review where the book value of acquired assets exceeds C$5 million, while indirect acquisitions of control are subject to review where the book value of the acquired assets exceeds C$50 million (the federal Cabinet retains discretionary authority to review an investment in a cultural business falling below these thresholds).

State-owned Enterprises

The review threshold for direct acquisitions by a SOE investor in 2022 is based on the book value of the assets of the acquired Canadian business exceeding C$454 million. The threshold is subject to an annual index. Indirect acquisitions of control by WTO SOE investors remain exempt from review.

The Canadian government has issued guidelines on the additional considerations that the Minister of the Department of Innovation, Science and Economic Development ("**ISED**") will take into account with respect to SOE investors. These guidelines expressly consider:

- whether the non-Canadian adheres to Canadian standards of corporate governance (including, for example, commitments to transparency and disclosure, independent members of the board of directors, independent audit committees and equitable treatment of shareholders);
- adherence to Canadian laws and practices, including adherence to free market principles;
- the effect of the investment on the level and nature of economic activity in Canada, including the effect on employment, production and capital levels in Canada;
- the extent to which the non-Canadian is owned, controlled by a state or its conduct and operations are influenced by a state; and
- whether a Canadian business to be acquired by a non-Canadian that is an SOE will likely operate on a commercial basis.

In addition to the above guidelines, amendments to the ICA in 2013 incorporated a definition of an SOE to include "an entity that is controlled or influenced, directly or indirectly, by a government or agency" of a foreign state. As well, the Minister has been given the power to determine that an otherwise Canadian-controlled entity is not a Canadian-controlled entity if the Minister is "satisfied that the entity is controlled in fact by one or more" SOEs.

Acquisitions by SOEs which do not result in the acquisition of control are not reviewed under the SOE guidelines, but may be subject to review under the national security provisions of the ICA (see below).

Factors

Where a proposed investment is reviewable, the Minister of ISED (or the Canadian Heritage Minister in the case of "culturally sensitive" businesses) will approve the investment where the proposal is considered to be of "net benefit" to Canada. In assessing net benefit, the Minister will consider, with no particular weighting, such factors as the effect of the proposed investment on economic activity in Canada, participation by Canadians in the business, productivity, competition, the compatibility of the investment with national, industrial, economic or cultural policies and the contribution by the business to Canada's ability to compete in world markets. Often, applicants negotiate undertakings with the Director of Investments, which undertakings are designed to satisfy the net benefit to Canada criteria.

National Security

In 2009, amendments were enacted to the ICA concerning investments that may be considered injurious to national security. The amendments introduce a process similar to that found in the United States under the Committee on Foreign Investment in the United States ("**CFIUS**") review process, pursuant to which CFIUS is authorized to review, investigate and block any transaction or investment that could result in the control of any U.S. businesses or assets by a foreign person that may raise national security concerns, or involve critical infrastructure.

Under the national security provisions of the ICA, if the relevant Minister has reasonable grounds to believe that an investment by a non-Canadian "could be injurious to national security," the Minister may send the non-Canadian a notice under Part IV.1 of the ICA (within 45 days of a notification or application for review) indicating that an order for review of the investment may be made. The review of an investment on the grounds of national security may occur whether or not an investment is otherwise subject to a net benefit review or otherwise only subject to notification under the ICA. Moreover, a national security review can occur even if there is no "acquisition of control" of a Canadian business (i.e., minority investments that do not transfer de facto control). There is no process for investors to request pre-closing approval in order to obtain comfort.

There are significant time periods in the event of a national security review under Part IV.1 of the ICA. Once an investor has received a notice indicating that an order for review of the investment may be made, the national security review timeframe under the ICA can be as long as 200 days (or longer with the consent of the investor).

In March 2021, the Minister of ISED issued *Guidelines on the National Security Review of Investments* . The Guidelines provide information of the procedures that will be followed in the administration of the national security review process in Part IV.1 of the ICA. The Guidelines set out eleven factors that the government may consider as they relate to national security. The focus of the factors are on core areas including defence, technology, critical minerals, critical infrastructure, intelligence gathering and enforcement and access to sensitive personal data.

The Canadian Government must report annually on the administration of the national security provisions of the ICA. Such annual reporting is now included in each Annual Report made under the ICA. The Report also provides information on the numbers of transactions reviewed under the national security provisions, the numbers of notices and orders issued, and the actions taken to protect national security.

The above-noted 45-day waiting period under Part IV.1 of the ICA in which the Minister may notify the non-Canadian investor of a possible national security review presents significant transaction uncertainty, particularly in the context of notifiable investments (i.e., those not ordinarily subject to review). To foreclose any risk of such a review arising after closing for investments that would not otherwise be subject to review, parties will often send the requisite notification to the Director of Investments at least 45 days before closing, thereby achieving certainty that no national security issues will arise.

This practice has been effectively confirmed in the above-noted *Guidelines on the National Security Review of Investments under the ICA*. The Guidelines strongly encourage, particularly where an investor is a SOE (or subject to state-influence), or in cases where the eleven factors may be present, to contact the Investment Review Division "at the earliest stages of the development of their investment projects to discuss the investment and, where applicable, to file a notification (or an application for net benefit review) at least 45 days prior to its planned implementation."

Thus, investors should now be aware that the government has indicated its preference that in situations in which national security concerns are present, it prefers to manage these concerns on a "pre-closing basis" before ownership has transferred in lieu of the current requirement in the ICA which permits an investor to wait for as long as 30 days following closing for transactions that are only subject to notification. Thus, in order to achieve absolute investment certainty, the parties to a transaction should endeavour to file as soon as possible, ideally 45 days prior to closing if the transaction circumstances permits such a step to be taken.

MERGER REGULATION

Mergers

Under the *Competition Act* (Canada), the Commissioner of Competition (the "**Commissioner**") has authority for the administration and enforcement of the *Competition Act*, including the authority to review any merger, regardless of its size. A "merger" is defined to mean the acquisition or establishment, direct or indirect, by one or more persons (whether Canadian or non-Canadian), whether by purchase of shares or purchase or lease of assets, by amalgamation or combination or otherwise, of control over or significant interest in the whole or a part of a business of a competitor, supplier, customer or other person.

Merger Transaction Notification

As is the case in the United States under the Hart-Scott-Rodino ("**HSR**") notification process, the *Competition Act* provides that the parties to certain large transactions must notify the Commissioner prior to completing a transaction. While the Commissioner may review all mergers irrespective of size, the *Competition Act* requires notification of a proposed transaction if both a parties' threshold and a transaction threshold are exceeded.

The parties' threshold is exceeded if the parties to the proposed transaction, together with their affiliates, have combined assets in Canada or gross annual revenues from sales "in, from or into" Canada exceeding C$400 million. The target or transaction threshold is exceeded where, in respect of the following five forms of transactions:

(a) the acquisition of assets in Canada of an operating business;

(b) certain acquisitions of shares (see below) of the target corporation carrying on an operating business or of corporations carrying on an operating business controlled by that corporation;

(c) amalgamations of two or more corporations if one or more of those corporations carries on an operating business, or controls a corporation that carries on an operating business;

(d) other forms of non-corporate combinations; or

(e) an acquisition of an interest in a combination that carries on an operating business otherwise than through a corporation,

the target (or the entity formed by amalgamation/combination) has assets in Canada or revenues from sales in or from Canada exceeding C$93 million, which is the threshold for transactions closing in 2022.

In the case of a person acquiring shares, the threshold is also subject to the minimum requirement that such person, together with their affiliates, acquire more than 20% of the voting shares of a corporation that is publicly traded or more than 35% of the voting shares of non-publicly traded corporations.[1]

Where both the parties' threshold and the transaction threshold are exceeded, notification under the *Competition Act* is required where persons, together with their affiliates, acquire more than 20% of the voting shares of a corporation that is publicly traded, or will acquire more than 50% if, prior to the proposed transaction, such persons owned more than 20%. In the case of voting shares of a corporation (none of the voting shares of which are publicly traded), the *Competition Act* requires notification (when the thresholds are exceeded) where persons acquiring such shares together with their affiliates would, as a result of the proposed transaction, own in the aggregate more than 35% of the voting shares or will acquire more than 50% if, prior to the proposed transaction, such persons owned more than 35%.

Where the above-noted thresholds are exceeded, the parties to the proposed transaction must notify the Commissioner by supplying information in accordance with the *Competition Act* and Section 16 of the Notifiable Transaction Regulations before completing the merger. Typically, counsel for the acquiring party will also file a submission concerning the competitive impact of the proposed transaction. While all of the information provided to the Commissioner is treated as confidential under the *Competition Act*, the Commissioner has taken the position that the confidentiality provisions in the *Competition Act* permit the Competition Bureau to share the information filed with them and their review with others on the grounds that such exchanges are made for purposes relating to the administration or enforcement of the *Competition Act*. Also, the Competition Bureau has the power to speak with affected parties and others for the purposes of gathering information as part of their review. In the ordinary course, filing parties are aware of certain of and consent to these activities by the regulatory authorities.

Among the information that must be provided as part of a notification are any studies, surveys, analyses and reports "prepared or received by an officer or director … for the purposes of evaluating or analyzing the proposed transaction." This broad information requirement is similar to that found in Item 4(c) of the HSR notification reporting form which must be submitted under the U.S. pre-merger notification rules.

Once the notification form is filed with the Commissioner, the parties must wait 30 days before completing the transaction, unless the Competition Bureau issues a supplementary information request, or SIR, within 30 days of the original filing, in which case the 30-day waiting period will commence once the parties have complied with the SIR. The Bureau has indicated that it "will only issue a SIR when the proposed transaction raises significant competition issues and additional information is required." In cases where the Commissioner has no concerns about the proposed merger, an advance ruling certificate (see below) or a "no-action letter" may be issued that will allow the parties to proceed with the proposed transaction even if the 30-day waiting period has not expired.

The *Competition Act* imposes criminal sanctions for failure to comply with the waiting period requirements. These criminal sanctions may also apply if a party fails to notify when required. In addition, administrative monetary penalties of up to C$10,000 per day may be assessed for non-compliance. Typically, a transaction will proceed following the expiry of the waiting period, unless the Commissioner applies or threatens to apply to the Tribunal to prevent the proposed transaction from proceeding in cases where the Commissioner believes that substantive competition issues will arise from the proposed transaction.

The *Competition Act* provides limited exemptions to the notification requirements when a transaction otherwise exceeds the two financial thresholds referred to above. For example, transactions between affiliated parties are exempt from the notification requirements.

1 In either scenario, if prior to the proposed transaction, such persons owned more than 20% (public) or more than 35% (non-public), the threshold is triggered where such persons will acquire more than a 50% voting interest.

Advance Ruling Certificates

Parties to a proposed merger, whether or not subject to transaction notification, may apply to the Commissioner for an advance ruling certificate (an "**ARC**") with respect to such merger. The issuance of an ARC certifies that the Commissioner is satisfied that the proposed merger will not prevent or lessen competition substantially. Parties will often apply for an ARC when it is clear that no substantive competition issues will arise in connection with the proposed transaction and will often couple such application with the transaction notice filing.

The issuance of an ARC exempts the parties from the above-noted transaction notification requirements which otherwise may apply. Upon issuing an ARC, the Commissioner cannot apply to the Tribunal in respect of the proposed merger solely on the basis of information that is the same or substantially the same as the information on the basis of which the ARC was issued, provided the merger has been substantially completed within one year following the issuance of the ARC.

Challenges before the Competition Tribunal

Under the *Competition Act*, the Commissioner may, by application made to the Competition Tribunal (the "**Tribunal**"), challenge a proposed merger (or any substantially completed merger within one year following closing) based on the grounds that the merger will prevent or lessen, or is likely to prevent or lessen, competition substantially. The Tribunal is comprised of judges of the Federal Court and non-judicial members knowledgeable in industry or economics. The *Competition Act* provides a list of factors for the Tribunal to consider in assessing whether a merger lessens competition substantially, including: competition from imports and by foreign competitors; the solvency of the target business; the availability of product or service substitutes; trade and other barriers to entry; and the competitive effect of other firms in the relevant market.

If the Tribunal finds that a merger or a proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially, the Tribunal is permitted to make certain orders, including the prohibition of a merger before it occurs, the dissolution of a merger after it has occurred and the disposition of assets or shares.

Recent Amendments to the *Competition Act*

On June 23, 2022, amendments to the *Competition Act* received Royal Assent as part of the *Budget Implementation Act, 2022* (**Bill C-19**). The amendments came into force immediately upon Royal Assent.[2] Certain of the amendments have significance to the Competition Bureau's merger review analysis. In particular, a new anti-avoidance provision expressly states that the pre-merger notification requirements under the *Competition Act* will apply to any non-notifiable transaction that was "designed to avoid" the pre-merger notification regime. Moreover, the amendments have expanded the relevant factors for assessing whether a merger prevents or lessens, or is likely to prevent or lessen, competition substantially. In addition to the long-standing factors set out in Section 93 of the *Competition Act*, the amendments expressly include additional factors, namely "network effects within the market", "whether the merger would contribute to the entrenchment of the market position of leading incumbents" and "any effect of the merger or proposed merger on price or non-price competition, including quality, choice or consumer privacy".

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2 With the exception that the amendments to the criminal conspiracy provisions will come into effect one year later, on June 23, 2023.

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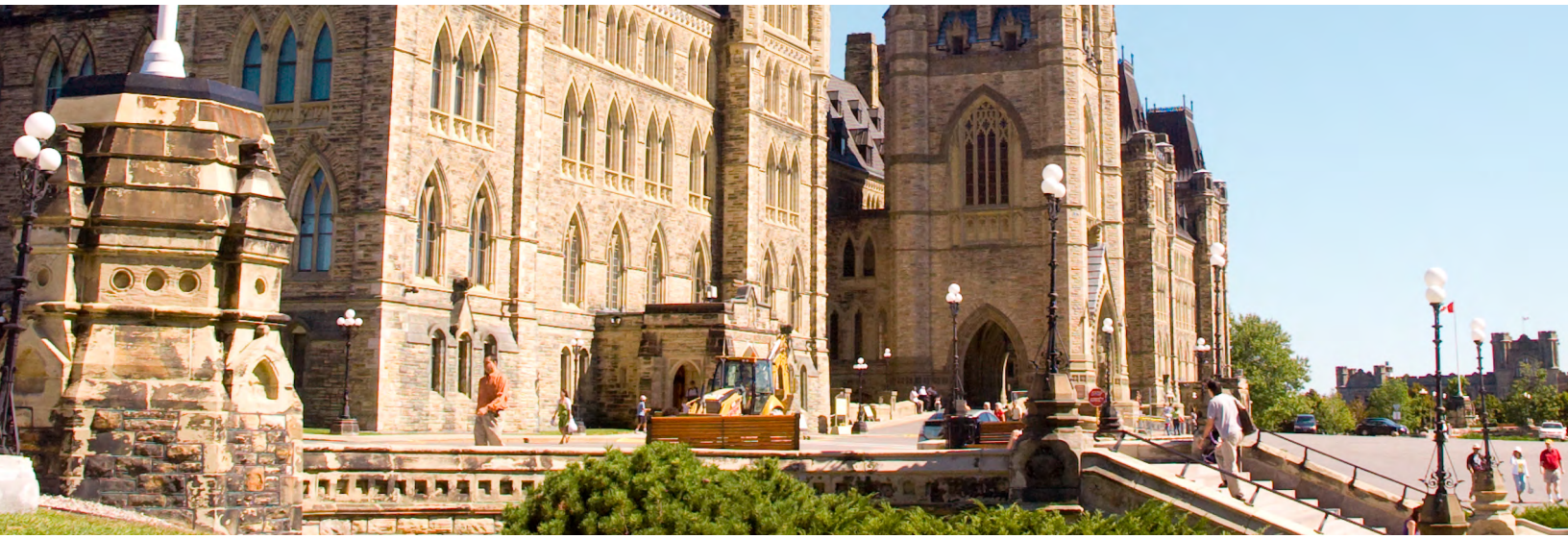

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