Columbia FDI Perspectives
Perspectives on topical foreign direct investment issues by
the Vale Columbia Center on Sustainable International Investment
No. 10, July 30, 2009

National Security with a Canadian Twist: The Investment Canada Act and the New National Security Review Test

by

Subrata Bhattacharjee[*]

On March 12, 2009, the Canadian federal government passed significant amendments to the *Investment Canada Act* (ICA), Canada's foreign investment law of general application.[1] Though the amendments generally liberalize important aspects of the Canadian foreign investment review regime, they also include a broadly worded national security test that now allows the responsible Minister[2] to review proposed investments in Canada on national security grounds. On July 11, 2009, the government published draft regulations that provide the details of the new national security review process. A detailed summary of the amendments and regulations is included in an extended note available at www.vcc.columbia.edu.[3]

At a time when many jurisdictions, including the U.S. and certain E.U. member states, have or are contemplating national security reviews, it is unsurprising that the Canadian government has put a similar process in place. Indeed, the Canadian national security review raises issues akin to those raised in other jurisdictions with similar tests, including uncertainty about the meaning of "national security", concern that the new test may be used to target sovereign investment (particularly in the natural resources and energy sectors), and the likelihood of politicization of national security reviews.[4]

---

[*] Subrata Bhattacharjee is a Partner at Heenan Blaikie LLP. He can be contacted at sbhattach@heenan.ca. **The views expressed by the individual author in this article do not necessarily reflect the opinions of Columbia University or its partners and supporters.** The author wishes to thank Anthony Baldanza and Ed Safarian for their helpful comments on this *Perspective*. *Columbia FDI Perspectives* is a peer-reviewed series.

[1] It is important to note that foreign investment in Canada may be subject to sector specific legislation depending on the industry in question. See, e.g. D. McFetridge, "The role of sectoral ownership restrictions" (15 March 2008) (on file with the Competition Policy Review Panel).

[2] The ICA provides that the federal Minister of Industry is responsible for administering the legislation in all contexts save those relating to investment in a Canadian "cultural business" (as the term is defined at section 14.1(5) of the ICA). The administration of the ICA as it relates to such businesses is the responsibility of the Minister of Canadian Heritage. Investments that are both cultural and non-cultural may be subject to the jurisdiction of both Ministers: http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00053.html (accessed March 30, 2009).

[3] The link for the Extended Note is: http://vcc.columbia.edu/pubs/documents/ICAextendednote-Final.pdf.

[4] See, e.g. Edward M. Graham and David M. Marchick, *U.S. National Security and Foreign Direct Investment* (Washington, D.C.: Institute for International Economics, 2006).

As is the case in new processes which lack precise statutory or regulatory definition, it is unclear how the new test will be applied, and there are reasons to believe that it could be applied in a wide range of situations. There are at least three possible dimensions of national security: 1) economic welfare; 2) national security; and 3) super-national security.[5] The application of any of these dimensions to a merger review raises the possibility that a potential transaction that will increase economic efficiencies is rejected for political reasons. First, an interest in economic welfare may raise concerns that domestic industries should be protected from being bought out by foreign investors. In the past, producers of "clothespin[s], peanut[s], pottery, shoe[s], pen[s], paper and pencil[s]" in jurisdictions around the world have invoked the economic welfare dimension of national security to protect their industry.[6] Second, an interest in national security may refer to a concern that sectors of a country's economy that are strategically sensitive for defence reasons should not be owned by foreign companies. Finally, an interest in super-national security may refer to the overarching imperative to "protect the homeland" from investment by countries that are viewed as a security risk.

Recently, it could be argued that the federal government and Canadian public view *all* three of these dimensions as relevant to national security reviews in Canada. Successive federal governments have expressed concern over investments by state-owned enterprises (SOEs) in Canadian businesses, exemplified by public debate over inbound investments by UAE SOEs and the issuance of review guidelines under the ICA specific to SOEs.[7] The current government's decision (seemingly supported by all parties) to block the Alliant/MDA Transaction on the basis of arguably unusual concerns relating to U.S. access to surveillance technology further suggests that there is political will to consider similar restrictions on defence related acquisitions, even emanating from countries like the U.S.

Finally, public concern over the alleged "hollowing out" of corporate Canada, whether through elimination of Canadian head offices, stock exchange listings or reduced R&D has been apparent in the context of high profile acquisitions of Canadian businesses. Indeed, the consultation undertaken by the federal government, which preceded passage of the amendments to the ICA,

---

[5] Deborah M. Mostaghel, "Dubai Ports World under Exon-Florio: a threat to national security or a tempest in a seaport?" (2007) 70 *Alb. L. Rev.* 583 at 607-14.

[6] *Ibid.* at 608.

[7] Industry Canada, Guidelines, "Investment by state-owned enterprises: net benefit assessment" (7 December 2007). The guidelines are a statement of policy and, as such, do not have any legal effect or introduce any legislative amendments to the ICA. Instead, they specify particular factors that the Minister should consider when applying the six economic factors under the ICA's net benefit test to a proposed investment by an SOE, being:

- The SOE's adherence to Canadian laws, practices, and standards of corporate governance, including commitments to transparency and disclosure, independent members of the board of directors, independent audit committees and equitable treatment of shareholders;
- The nature of and extent to which the SOE is controlled by a foreign government; and
- Whether the acquired Canadian business will continue to operate on a commercial basis.

The guidelines also suggest that SOEs should submit specific undertakings to the Minister in support of a proposed transaction. Examples of possible undertakings include:

- Appointing Canadians as independent directors on the board of directors;
- Employing Canadians in senior management positions; Incorporating the new business in Canada; or
- Listing the shares of the acquiring company or the Canadian business on a Canadian stock exchange.

explicitly considered the issue in its deliberations, and did not rule out the possibility, for example, that the loss of Canadian head offices due to foreign acquisitions of Canadian businesses could have negative consequences for the Canadian economy, though it did not recommend further direct restrictions on foreign investment.[8]

When these tendencies are considered in light of the breadth of the national security test, the federal government should be cautious in adopting an over-expansive approach to the application of the new test. The above tendencies demonstrate the country's preoccupations with national champions, Canadian control over natural resources and domestic head offices. Allowing these preoccupations to dominate a national security review would counter the intended purpose of the test, and instead of functioning as a transparent tool to be used by the federal government in the limited circumstances in which foreign investment may threaten Canada's national security, the national security test would become a meaningless catchphrase to be touted against unpopular, but legitimate foreign investments. Having said this, and as of the writing of this *Perspective*, the seemingly smooth progress (to date) of the recently announced acquisition by China Investment Corporation (CIC) of a minority voting interest in Teck Resources Ltd. (a major Canadian mining concern) under the new national security test is a welcome sign.[9] This transaction, involving a leading Chinese sovereign wealth fund acquiring a stake in a Canadian natural resource company, was precisely the type of acquisition that was to be scrutinized under the new test.

Foreign investors considering investments that could be subject to the new process will also have to adjust to a review process that is no longer primarily administrative, but essentially political. The national security review process is highly consultative in nature, and invites input from the cabinet of the federal government, departments of the federal government, as well as provinces affected by the transaction. All of these constituencies are heavily influenced by public concern about high profile transactions, especially those that are the subject of extensive media comment. Prudent foreign investors are well advised to recognize this at an early stage of their planning and to consider government relations and public relations strategies that are consistent with the approach taken to review under the ICA. Investors who appreciate the multifaceted nature of the Canadian foreign investment review process will have the most success in securing Ministerial approval in a timely and acceptable manner.

For further information please contact: Vale Columbia Center on Sustainable International Investment, Karl P. Sauvant, Executive Director, (212) 854-0689, Karl.Sauvant@law.columbia.edu or Lisa Sachs, Program Coordinator, (212) 854-0691, Lsachs1@law.columbia.edu.

Vale Columbia Center on Sustainable International Investment (VCC), led by Dr. Karl P. Sauvant, is a joint center of Columbia Law School and The Earth Institute at Columbia University. It seeks to be a leader on issues related to

[8] Competition Policy Review Panel, *Compete to Win: Final Report* (Government of Canada, June 2008).
[9] "Teck Resources announces C$1.74 billion private placement," News Release (3 July 2009): <www.teck.com>.

foreign direct investment (FDI) in the global economy. VCC focuses on the analysis and teaching of the implications of FDI for public policy and international investment law.

Previous Columbia FDI Perspectives

- No. 1. Karl P. Sauvant, "The FDI Recession has Begun," November 22, 2008.
- No. 2. Mark E. Plotkin and David N. Fagan, "The Revised National Security Review Process for FDI in the US," January 7, 2009.
- No. 3. Anne van Aaken and Jürgen Kurtz, "The Global Financial Crisis: Will State Emergency Measures Trigger International Investment Disputes?" March 23, 2009.
- No. 4. Gert Bruche, "A New Geography of Innovation—China and India Rising," April 29, 2009.
- No. 5. Ken Davies, "While Global FDI Falls, China's Outward FDI Doubles," May 26, 2009.
- No. 6. Christian Bellak and Markus Leibrecht, "Improving infrastructure or lowering taxes to attract foreign direct investment?" June 3, 2009.
- No. 7. Susan D. Franck, "International Investment Arbitration: Winning, Losing and Why," June 15, 2009.
- No. 8. Lorenzo Cotula, "Land grab or development opportunity? International farmland deals in Africa," June 22, 2009.
- No. 9. Veljko Fotak and William Megginson, "Are SWFs Welcome Now?" July 22, 2009.