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PUBLICATION

Canada Approves Proposed Oil and Gas Acquisitions Under the Investment Canada Act and Issues Revised Guidelines for State-Owned Enterprises

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On December 7, 2012, the Government of Canada (the "Government") approved two proposed acquisitions by state-owned enterprises ("SOEs") under the *Investment Canada Act* (the "Act"). On the same day, Industry Canada issued revised guidelines regarding how it would assess proposed acquisitions by SOEs in the future (the "Revised Guidelines").[1] The Prime Minister also gave a speech[2] on the issue of foreign investment and Industry Canada published a policy statement[3] on foreign investment by SOEs. Although none of these sources provide clear guidance on how "net benefit to Canada" will be assessed, they provide some additional insight regarding how the Government will assess foreign investments by SOEs in the future.

The decision to publish this Revised Guidance was prompted by the proposed acquisition of Progress Energy Resources Corp. by PETRONAS, and the proposed acquisition of Nexen Inc. by the China National Offshore Oil Company ("CNOOC"). Both deals involved the proposed acquisition of control, by an SOE, of a Canadian business operating in the oil and gas sector. PETRONAS is the national oil company of Malaysia and CNOOC is the third largest national oil company in the People's Republic of China.

While these proposed acquisitions were being reviewed under the Act, there was considerable public discussion regarding the inherent uncertainty of the "net benefit" criteria and its potential to discourage future foreign investment. The Government had indicated that additional guidance would be forthcoming regarding how it would review foreign investments made by SOEs in the future.

Once the Revised Guidelines were issued, it became clear that they did not offer any definitive guidance on the meaning of the phrase “net benefit to Canada,” as some had hoped; such a definition remains elusive. Foreign investors subject to the Act will continue to bear the burden of proving “net benefit to Canada,” without knowing exactly what this phrase means. However, the Revised Guidelines offer new guidance on who will be considered an SOE and what additional factors will be considered when an SOE seeks to acquire control of a Canadian business.

The revised guidelines have now expanded the definition of an SOE to include an enterprise that is *influenced* (directly or indirectly) by a foreign government. The previous guidelines only considered an enterprise to be an SOE if it was actually owned and controlled by a foreign government.

Under the previous guidelines, proposed acquisitions by SOEs (in contrast to privately-owned enterprises) were subject to a review of the following additional factors:

a) The Government would consider whether the SOE 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), and to Canadian laws and practices.

b) The Government would consider whether the Canadian business to be acquired by the SOE would continue to have the ability to operate on a commercial basis regarding:

1. Where to export;
2. Where to process;
3. The participation of Canadians in its operations in Canada and elsewhere;
4. Support of on-going innovation, research and development; and
5. The appropriate level of capital expenditures to maintain the Canadian business in a globally competitive position.

The Revised Guidelines now add the following to the existing list of *additional* factors considered when the proposed acquirer is an SOE:

a) The Government will consider 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.

b) The Government will also consider how and the extent to which the SOE is owned, controlled by a state or its conduct and operations are influenced by a state.

The Prime Minister’s speech further clarified the meaning of these additional actors by describing them as follows:

a) First, the degree of control or influence an SOE would likely exert on the *Canadian business* that is being acquired.

b) Second, the degree of control or influence that an SOE would likely exert *on the industry* in which the Canadian business operates.

c) Third, and most importantly, the extent to which the foreign government in question is likely to exercise control or influence over the SOE acquiring the Canadian business.

Although not specifically addressed in the Revised Guidelines, the Prime Minister's speech and Industry Canada's policy statement provided some additional commentary regarding future acquisitions by SOEs in the oil sands, as well as in the broader Canadian economy.

The Prime Minister's speech reiterated that purchases of Canadian assets by foreign governments through SOEs are not the same as other transactions; this is because the larger purposes of SOEs may go well beyond the commercial objectives of privately-owned companies. In discussing the issue of net benefit to Canada for SOEs, he stated that Canadians have not spent years reducing the ownership of sectors of the economy by our own governments, only to see them bought and controlled by foreign governments instead. The Prime Minister then concluded with the following statement:

In light of growing trends, and following the decisions made today, the Government of Canada has determined that foreign state control of oil sands development has reached the point at which further foreign state control would not be of net benefit to Canada. Therefore, going forward, the Minister [of Industry] will find the acquisition of control of a Canadian oil-sands business by a foreign state-owned enterprise to be of net benefit, only in an exceptional circumstance.

The Prime Minister has made it clear that future proposed acquisitions of control of Canadian oil sands businesses by SEOs are unlikely to be approved and that even SOE acquisitions relating to the broader Canadian economy will continue to be reviewed carefully. Of course, this does not affect direct acquisitions made by World Trade Organization ("WTO") members that have an asset value of less than $330 Million (the current threshold for direct investors by WTO member entities) or one that involves an SOE that is acquiring less than controlling interest; in these cases, the Act does not apply.

As previously reported, on May 25, 2012, the Minister of Industry announced proposed regulations that would gradually increase the review threshold for WTO members from the current $330 Million to $1 Billion over a four year period.[4] The Prime Minister again made reference to this proposed change in his speech but specifically stated that this increase would apply to privately-run enterprises only. Therefore, SOEs owned by WTO member countries will continue to be subject to the current $330 Million threshold.[5]

While the Government continues to encourage foreign investment, it has made clear that future acquisitions made by SOEs will be subject to stricter reviews under the Act. Those reviews will

also occur more frequently than privately-run enterprises due to the lower review threshold that will apply to SOEs in future years. Finally, as acquisitions of oil sands interests by SOEs are unlikely to be approved in the future, such entities should consider limiting their oil sands investments to non-controlling interests or acquisitions that are below the review threshold.

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1 http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#3.
2 http://www.pm.gc.ca/eng/media.asp?category=3&id=5195.
3 http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81147.html.
4 http://www.blaney.com/articles/canadas-minister-industry-announces-improvements-foreign-investment-review-process.
5 According to Subsections 14(3) and 14(4) of the Act, the thresholds for transactions involving non-WTO members are $5 Million for direct investments and $50 Million for indirect investments.