Blaney McMurtry LLP

PUBLICATION

Canada's Minister of Industry Announces Improvements to the Foreign Investment Review Process

Date: June 11, 2012

Original Newsletter(s) this article was published in: International Business Bulletin: June 2012

Introduction

On May 25, 2012, Christian Paradis, Canada's Minister of Industry, announced regulatory changes (the "Proposed Regulations") to its foreign investment review process under the *Investment Canada Act*[1] (the "Act"). The Proposed Regulations follow the Minister's previous announcement on April 27, 2012, which discussed proposed legislative changes that would result from *The Jobs, Growth and Long-term Prosperity Act*[2] (the "Proposed Act").

These changes are intended to address investor uncertainty caused by Industry Canada's objection to the $38.6 billion proposed takeover of Potash Corporation of Saskatchewan Inc. ("Potash Corporation") in November 2010. The proposed takeover by BHP Billiton, an Australian-based company, was blocked under the Act on the basis that it would not be of net benefit to Canada.

Potash Corporation produces about half of the world's supply of potash, a crucial ingredient used in fertilizers. Although it initially appeared as though the proposed takeover would be approved, both Potash Corporation and the Province of Saskatchewan aggressively lobbied Canada's Federal Government to block the deal. As a result of Industry Canada's negative decision, BHP Billiton withdrew its offer.

Proposed Regulatory Changes

The Minister's recent announcement indicated that the regulations would be amended to progressively raise the review threshold applicable to direct investment by members of the World Trade Organization ("WTO") to $1 billion in enterprise value over a four-year period. This is not actually a new proposal; it was first published in the *Canada Gazette* on July 11, 2009 (the "2009 Draft Regulations"). That said, the recent announcement confirms the Federal Government's intention to now follow through with the implementation of these changes.

The foreign investment review requirements are described in Part IV of the Act. Part IV makes a distinction between countries that are members of the WTO and those that are not. It also makes a distinction between direct and indirect acquisitions.

The 2012 review threshold for a WTO member, or a Canadian business that is ultimately controlled by a WTO member (other than a Canadian), is $330 million. Indirect acquisitions by WTO member investors are not reviewable but are subject to the notification requirements described in Part III of the Act.

Based on the 2009 Draft Regulations, the Federal Government intends to amend the *Investment Canada Regulations*[3] as follows:

a) It will change the basis for calculating the investment review threshold from “gross assets” to “enterprise value”; and

b) It will change the review threshold for WTO members to $600 million in enterprise value once the regulations come into force, rising progressively to $1 billion over a four-year period.

The current threshold applicable to WTO members is based on the book value of the gross assets of the Canadian business. Under the 2009 Proposed Regulations, this threshold will instead be based on the enterprise value of the Canadian business.

For acquisitions of control of a Canadian business that is a publicly-traded entity, the enterprise value of the assets of the Canadian business will be calculated as the market capitalization of the entity, plus its liabilities, minus the entity’s cash and cash equivalents. The entity’s market capitalization will be calculated by adding:

a) For each class of equity securities listed on a stock exchange, the average daily number of its securities of that class that are outstanding during the trading period multiplied by the average daily closing price of its equity securities of that class on the primary market during the trading period; and

b) For each class of its unlisted equity securities, the average daily closing price on the primary market of its equity securities belonging to the primary class during the trading period multiplied by the average daily number of the class of unlisted equity securities outstanding during the trading period.

“Trading period” is defined as the most recent 20 days of trading before the end of the entity’s quarterly fiscal period that immediately precedes the implementation of an investment to acquire control of the entity. “Primary market” is defined as the stock exchange on which the greatest volume of trading on those securities occurred during the trading period. “Primary class” means the class of securities that has the largest number of outstanding securities during the trading period.

The entity’s liabilities are equal to the total liabilities listed in its audited financial statements for the fiscal year immediately preceding the implementation of the investment. Similarly, the

entity's cash and cash equivalents are equal to the total cash and cash equivalents listed in its audited financial statements for the fiscal year immediately preceding the implementation of the investment. If audited financial statements are not available, unaudited statements may be used.

For an acquisition of control of a Canadian business that is not a publicly-traded entity, or where there is an acquisition of all or substantially all of the assets, the enterprise value of the assets of such a business will continue to be calculated according to the current method of valuation. In other words, the enterprise value will continue to be the book value of the Canadian business' gross assets.

The thresholds for transactions involving non-WTO members are currently $5 Million for direct investments and $50 Million for indirect investments and the value of gross assets is used. The Proposed Regulations will not affect these thresholds.

Proposed Legislative Changes

On April 27, 2012, the Minister of Industry also announced the Federal Government's introduction of the Proposed Act. Once enacted, it will permit the disclosure of certain information relating to the foreign investment review process and will facilitate the collection of fines by permitting the Minister to accept security.

The Proposed Act enables the responsible Minister to publicly communicate that an investor has been sent a provisional disapproval notice under the Act. Such a notice informs the investor that the Minister is not satisfied that the investment is likely to be of net benefit to Canada and advises the investor of its right to make representations and submit undertakings within 30 days from that notice or any further period agreed on by the investor and the Minister. The Proposed Act also authorizes the Minister to disclose reasons for sending such a notice, provided that he or she is satisfied that such disclosure would not prejudice the investor or Canadian business.

The ability of the Minister to publicly disclose information may help to improve transparency in the review process; lack of transparency was one of the main criticisms raised by Industry Canada's decision in the Potash Corporation case. However, the Proposed Act only permits the Minister to disclose this information; it does not actually compel the disclosure of this information.

The Proposed Act also allows the responsible Minister to accept security, when offered by an investor, for payment of any penalties ordered by a court in the event the investor is in contravention of the Act. In addition, it allows the Minister to disclose information relating to the acceptance of security, provided that he or she is satisfied such disclosure would not prejudice the investor or Canadian business.

Conclusion

Overall, the above changes represent a modest improvement in the foreign investment review process. However, they still fail to address the lack of clear guidelines regarding when a

proposed transaction will be considered of net benefit to Canada. The nebulous concept of net benefit was the basis for Industry Canada's decision to block the Potash Corporation takeover and it remains a source of uncertainty for foreign investors.

Although the proposed increase in review thresholds for WTO members will ensure certainty for a greater number of transactions, which will no longer be subject to review under the Act, the lack of clear guidelines relating to the concept of net benefit will continue to affect foreign investments that exceed those review thresholds.

---

[1] R.S., 1985 (1st Supp.).
[2] Bill C-38.
[3] SOR/85-611.