July 17, 2009 marks a day on which several unprecedented events occurred, each of which represents a significant development on the foreign investment landscape in Canada and each of which follows by less than a week the publication by Industry Canada on July 11, 2009 of proposed new National Security Review of Investments Regulations and amendments to the Investment Canada Regulations addressing review thresholds and more stringent information requirements.

On July 17th, the Government of Canada, through the Minister of Industry, commenced legal proceedings against United States Steel Corporation ("US Steel"), alleging that it failed to honour certain commitments given in connection with preserving jobs and production levels in Canada. The commitments – referred to as undertakings under Canada’s Investment Canada Act ("ICA") – were given by US Steel to secure the approval of the government for its 2007 takeover of Stelco Inc., which operated steel-making facilities in Ontario.

The Minister has asked the Federal Court to order US Steel to comply with its production undertaking, in which the investor promised to increase production over a three-year post-closing period, and its employment undertaking, in which US Steel promised to maintain an average level of employment of 3,105 employees on a full time equivalent. The government’s court pleading alleges that between “temporary” lay offs (1,570 employees) and retirements (810 employees), 77% of the workers that US Steel committed to be employed in the Canadian business were no longer actively employed in steel-making. The court filing also alleges that raw materials were being transferred from the Canadian business to US Steel facilities in the U.S. In addition to the enforcement order, the government has also asked the court to impose a penalty of $10,000 per day, per breach of the undertakings calculated from November 1, 2008, when layoffs occurred, until US Steel complies with the undertakings.

US Steel has stated that it intends to vigorously defend its decisions made post-closing, in light of declines in the global demand for steel.

The action taken by the Canadian government is unprecedented and may signal a new approach in the monitoring and enforcement of undertakings given by foreign investors that acquire Canadian businesses.

July 17th is also significant because it marks the day that China’s sovereign wealth fund, China Investment Corporation ("CIC") completed a US$1.5 billion investment in one of Canada’s iconic resource companies, Teck Resources Limited ("Teck"). That this private placement giving CIC a minority equity position in Teck was completed, without triggering Canadian government oversight under Canada’s foreign investment laws, is seen as a significant milestone in Canada – China economic relations. Neither the new national security review provisions, which potentially could have been invoked, nor the state-owned enterprises guidelines, which apply only under the net benefit review provisions, came into play.

July 17th is also the day on which the Chinese Government, in an unrelated transaction, gave its approval to a state-owned enterprise, Wuhan Iron and Steel Corporation Limited ("Wuhan"), to proceed with its US$240 million strategic investment in Canada’s Consolidated Thompson Iron Mines Limited ("CLM"). Although Wuhan has taken only a minority equity position in the Canadian mining company and in a related newly formed limited partnership, as part of its investment, Wuhan has successfully negotiated off-take agreements, entitling it to purchase at fair market value 50% + of the ore produced by the target resource property and a right of first offer to purchase ore produced from two other resource properties owned and operated by CLM. The Wuhan investment was completed on July 20th, without triggering Canadian oversight under foreign investment laws.

Against this backdrop of foreign investment developments, this update provides a high-level overview of proposed Regulations under the ICA, which are intended to give effect to the significant amendments made to the ICA as part of the Budget Implementation Act 2009 (Bill C-10) in March 2009. The proposed Regulations were published on July 11th and the public comment period is open until August 10th.
proposed Regulations could take effect as early as August 11, 2009.

ICA Proposed Regulations

Net Benefit Review Threshold – Enterprise Value Defined

Proposed amendments to the ICA Regulations provide that the financial threshold for review of a direct acquisition of a Canadian business (except for a cultural business) by or from a WTO investor is to be increased substantially from the current $312 million to $600 million. The review threshold will be increased over a five-year period to $1 billion.

Proposed amendments to the ICA Regulations also establish that the “enterprise value” of the assets of the acquired business is the measurement standard for threshold review purposes.

The “net benefit to Canada” review process will be triggered where the enterprise value of the assets of the target Canadian business exceeds the prescribed threshold. The proposed Regulations set out how the calculation of the enterprise value is to be made:

- In the case of an acquisition of control of a Canadian business which is not a publicly-traded entity or where the transaction is structured as an asset purchase (where all or substantially all of the assets of the Canadian target entity’s assets are acquired), the enterprise value of the assets of the Canadian business is the book value of the assets of the Canadian business as shown in the audited financial statements for the fiscal year immediately preceding the implementation of the investment. This calculation is the same method that is prescribed under the existing ICA Regulations.

- In the case of an acquisition of control of a Canadian business which is publicly-traded, the enterprise value of the assets of the Canadian business is calculated as the market capitalization of the target entity plus its liabilities minus the entity’s cash and cash equivalents.

- The proposed Regulations set out a complex formula for calculating market capitalization of the entity, based on market trades in the last fiscal quarter immediately preceding the implementation of the investment. In contrast, the target entity’s liabilities, cash and cash equivalents are to be determined by reference to the entity’s audited financial statements for the fiscal year immediately preceding the implementation of the investment.

National Security Review Process

Under the ICA, a national security review process will be triggered where the government determines that an investment may be “injurious to national security”. Notably, the national security review test applies not only to the establishment of a new business and the acquisition of control of a Canadian business, but also, to a minority investment in a Canadian business.

The proposed ICA Regulations do not define what sectors or business activities are considered injurious to national security nor do they identify factors to be considered by the government in assessing whether an investment may be injurious to national security.

This approach may be understandable at the political level but injects significant ministerial discretion and considerable uncertainty into the investment review process for foreign investors.

The proposed Regulations fail to provide prospective foreign investors with guidance as to what business activities are either “off limits” or are likely to trigger a national security review. Questions remain, for example, whether a foreign investment in Canada’s energy sector, in strategic infrastructure assets, in marine shipping and port terminal operations or in the aerospace sector, would trigger a national security review.

Nor do the proposed Regulations establish a pre-closing mechanism that would allow a foreign investor to voluntarily seek clearance of a proposed investment in advance of closing.
The proposed Regulations set out timelines for completion of the steps involved in the national security review process, which could take up to 130 days. The timelines are as follows:

- notification to the non-Canadian investor that a review of the investment has been ordered by the federal Cabinet – within 45 days from the time that the Minister of Industry becomes aware of the investment (or within 70 days, where notice of a possible review was given to the investor within 45 days, giving Cabinet a further 25 days to determine whether to order a review of the investment).

- conduct of the review by the Minister of Industry in consultation with potentially 19 other government departments and agencies and providing a report and recommendations to Cabinet, or if satisfied that the proposed investment will not be injurious to national security, sending a notice to the investor – within 45 days from the date Cabinet ordered a review of the investment.

- Cabinet, on recommendations from the Minister, may order any measure it considers advisable to protect national security, include allowing the investment, subject to undertakings or commitments given by the foreign investor, or prohibiting the investment by a non-Canadian or if already implemented, ordering a divestiture of the acquired business – within 15 days from the date the Minister reported on the investment.

New Information Requirements

Many investments by non-Canadians in Canada are subject to a notification requirement, even where the monetary threshold for a net benefit review is not triggered under the ICA. Investments to establish a new business, or to acquire control of a Canadian business that are not reviewable, nonetheless require the non-Canadian investor to notify the government before or within 30 days after implementation of the investment.

The proposed regulations establish new information requirements and require disclosure of:

- the names of the members of the investor’s board of directors
- the investor’s five highest paid officers
- any person or entity that owns 10% or more of the investor’s equity or voting rights
- contact details for each of the above, including date of birth for the individuals identified
- name(s) of any foreign state that has a direct or indirect foreign ownership in the investor
- the sources of funding for the investment.

The new information requirements will give the Canadian government more information with which to assess whether a national security review is required under the ICA. All foreign investors will be required to make more detailed disclosure about their ultimate ownership and control to the Canadian government.

The foregoing information provides a brief overview of Canadian foreign investment law developments and should not be regarded or relied upon as legal advice or opinions.

Contacts

Catherine A. Pawluch is a partner in the Toronto office of Gowlings practising antitrust/competition, foreign investment and aviation law. She is the Toronto office leader for the Firm’s China Group and leads the Transportation National Practice Group. She can be reached at 416.862.4371 or catherine.pawluch@gowlings.com

Henry S. Brown, Q.C. is a partner in the Ottawa office of Gowlings practising foreign investment and government relations. He is the leader of the Firm’s Government Industry Group. He can be reached at (613) 786-0139 or henry.brown@gowlings.com.
Nicholas E.J. Dietrich is a partner in the Toronto office of Gowlings practising in corporate and commercial law with extensive exposure to mergers and acquisitions, finance and private equity/venture capital investment. He can be reached at 416.369.7288 (toll free: 1-866-862-5787 ext. 87288) or nicholas.dietrich@gowlings.com.

Robert E. Milnes is a partner in the Toronto office of Gowlings practising corporate and commercial law. He advises a variety of corporations on a full range of legal problems, including mergers and acquisitions and Investment Canada Act issues. He can be reached at (416) 369-7236 or robert.milnes@gowlings.com.