

## Competition, Antitrust and Foreign Investment

April 4, 2017

### Reversal of National Security Order Signals a Shift in Attitude Towards Investment from China

On Monday, March 27, 2017, Justin Trudeau's Liberal government reportedly reversed a decision of the previous Conservative government of Stephen Harper to block the purchase of a technology company on national security grounds.

#### The Transaction

In 2015, O-Net Communications Group Ltd., a developer of optical networking components based in Hong Kong, reported to be a subsidiary of Chinese state-owned China Electronics Corporation, acquired Montreal-based ITF Technologies Inc., which specializes in fibre components and modules, for \$5 million. Following the closing, the federal cabinet exercised its powers under the national security provisions of the *Investment Canada Act* (the "ICA") to require the divestiture of O-Net's investment.

#### National Security Review

The national security provisions of the ICA, introduced in 2009, do not specify a monetary threshold for a review where the federal cabinet determines an investment may be injurious to Canada's national security. (See our December 20, 2016 Update, "Government of Canada Provides Greater Clarity Around National Security Reviews and Reaffirms Higher Threshold for Net Benefit Reviews under *Investment Canada Act*.") As might be expected, proceedings under these provisions are conducted in private, and there is typically no publicly available information regarding such reviews. Indeed, even the non-Canadian investor involved may be kept in the dark

regarding the specifics of any national security concerns. O-Net brought its concerns over this process before the Federal Court by way of an application for judicial review filed in August 2015. In its application, O-Net claimed that the government breached its right to procedural fairness by, among other ways, failing to disclose its national security concerns with the transaction and provide an opportunity to respond.

In late 2016, it was announced that the new Liberal government had agreed to an order that it would undertake a new review of the acquisition. At the time, the government came under public criticism for opening the door to a fresh review of a transaction. As reported in the *Globe and Mail*, the Canadian national security agency had warned that transfer of the target's technology would undermine a technological edge enjoyed by Western militaries over that of China.

#### Reversal of Divestiture Order

The reversal of the O-Net divestiture order followed on the heels of remarks by the newly appointed Chinese ambassador to Canada, who was reported in the March 24 edition of the *Globe and Mail* as stating that China would view as "trade protectionism any attempt to invoke national security to block state-owned firms from buying Canadian companies or doing business with the federal government." This comment regarding national security reviews was made in an interview dealing more broadly with Beijing's desire for unfettered access for Chinese state-owned firms to all key sectors of the Canadian economy. The access sought would require the reversal of a policy put in place by the prior Harper government to block future acquisitions of control by state-owned enterprises over Canadian oilsands businesses.

# Goodmans<sup>LLP</sup> Update

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The decision to permit the investment is apparently subject to conditions. Although the details of such conditions are not publicly known, the imposition of conditions to address national security concerns has a clear analog in the “mitigation measures” to which investors are routinely required to agree in parallel national security reviews by CFIUS in the United States. However, there is an inherent risk that such measures can prove both difficult to fashion and impractical to enforce in respect of technology transfers. As noted in the *Globe and Mail*, an unnamed source within the government also explained that there were no other buyers for the Canadian business, and a divestiture might have resulted in the scattering of the expertise and knowledge residing within the business.

## **Conclusion**

The developments in the O-Net case are consistent with, and confirm, the widely held view that the Trudeau government would be more open to foreign investment, including, significantly, investment from China. The O-Net decision demonstrates how significant this shift in policy may be. In this respect, it will be important for the Trudeau government to balance the independent Canadian approach to attracting broader investment from China with the very close relationship between Canada and the United States in all matters of trade and security which is so fundamentally essential to Canada’s economic growth and prosperity.