

# Update

## Competition Law

July 23, 2009

### **Draft *Investment Canada Act* Regulations Published Providing More Details on Net Benefit Review Thresholds and National Security Review Process**

On July 11, 2009, the Government of Canada published draft regulations to give effect to certain amendments to the *Investment Canada Act* (“ICA”) which were enacted in March, 2009. The major focus of the draft regulations is to set out the rules to determine the new thresholds for the net benefit review of investments and to set the time periods for the national security review process under the ICA. The draft regulations also provide for new information requirements for filings under the ICA. The government has allowed for a 30 day period for comments to the draft regulations. It is expected that the regulations will come into effect by this fall.

#### **New Thresholds for Review**

The March amendments to the ICA changed the monetary threshold for investments requiring approval by the Industry Minister. The threshold for a direct acquisition of a Canadian business by WTO investors was changed from \$312 million of book value to \$600 million of “enterprise value”, increasing in stages to \$1 billion over a four year

period and indexed to account for inflation thereafter. The higher thresholds come into force once the regulations are enacted.

Under the draft regulations, for a direct acquisition of control of a Canadian business which is a publicly traded entity, the enterprise value of the Canadian business is the “market capitalization” of the entity plus its total liabilities minus its cash and cash equivalents. The draft regulations provide, generally, that the market capitalization for each class of listed equity securities is determined by multiplying the average daily closing price on the “primary market” (the stock exchange on which the greatest volume of trading occurred during the “trading period”) of each such class by the average daily number of outstanding securities of such class over the last 20 days of trading of the entity’s last fiscal quarter immediately preceding the implementation of the investment to acquire control of that entity (the “trading period”). For each class of the entity’s unlisted equity securities, the market capitalization is generally determined by multiplying the average daily closing price on the primary market of the “primary class” of its listed equity securities (the class with the largest number of equity securities) during the trading period multiplied by the average daily number of the class of unlisted equity securities outstanding during the trading period. The total value of all such classes constitutes the market capitalization of such entity. The entity’s liabilities and cash and cash equivalents are those amounts set forth on the audited financial statements of the entity for its fiscal year immediately preceding the implementation of the investment. For acquisitions of Canadian businesses which occur without acquiring a publicly traded entity, the enterprise value is the book value of the assets of the entity as shown on its annual financial statements as at the end of its most recently completed fiscal year

prior to the implementation of the investment. This is the current method for valuing assets for purposes of the net benefit review thresholds.

Determining the applicable enterprise value will, at least in the case of publicly traded entities, be more difficult than the present method of determining the book value threshold. In addition, if the enterprise value of a publicly traded entity is determined as at the end of the most recent quarter, for some transactions it may be difficult to provide for a sufficient time prior to closing to determine if a net benefit review is required and, if so, for that review process to be completed. For example, where an acquisition agreement is entered into in one quarter and the closing occurs in a subsequent quarter, the enterprise value will not be known at the time of the agreement, and there may not be sufficient time for the review to be completed if it is determined that a review is required and thereby delay the scheduled closing. It is likely that the enterprise value of a publicly traded entity will change as at the end of each fiscal quarter and, depending on market conditions, may change significantly. A more practical alternative would be to have the market capitalization calculation based on the last 20 trading days of the preceding completed fiscal year to reduce the timing problems associated with a quarterly analysis.

## **National Security Review Process**

The March amendments to the ICA authorized the Government of Canada to review investments that “could be injurious to national security”. This is in addition to the net benefit review process. The draft regulations set out the time periods for each step of the national security review process under the ICA.

Generally, the applicable time period for the national security review process for an investment will depend upon a number of factors including whether the transaction is notifiable, reviewable, or neither (the national security review process also applies to transactions in which a non-Canadian does not necessarily have a controlling interest); whether the Minister has given the

investor a prior notice of a possible national security review; and, of course, the actual length of the review process itself. At this point, there are a number of uncertainties created by the draft regulations. One of the principal ones is how the national security review process will impact on the timelines otherwise provided for a net benefit review. In certain circumstances, the timelines in the draft regulations could result in the national security review process taking 130 days and possibly longer if extensions are required by the Minister and agreed to by the investor. The March amendments to the ICA provide that the timelines for the net benefit review process will be extended to allow for the completion of any national security review. The draft regulations also permit a national security review after the implementation of the investment even when the investor has made the necessary filings well ahead of the closing, creating post-closing regulatory risk for foreign investors. Given the uncertainties raised by the national security review process, it would be very useful for the Government to create a clearance certificate mechanism that would provide an option for investors to eliminate or reduce the post-closing risk. Such a mechanism exists in the *Competition Act*.

## **Additional Information Requirements**

The draft regulations add additional information requirements to the forms for applications and notifications for net benefit reviews and for national security review purposes. Among the additional information now required is the name, mailing address, telephone number, fax number and e-mail address of each member of the investor’s board of directors and each of the investor’s five highest paid officers and of any person or entity that owns 10% or more of the investor’s equity or voting rights. In the case of individuals, their birth dates are also required. It is also necessary to disclose any ownership interest by a foreign state. The Government’s objective here clearly appears to be a desire to identify more than just the controllers of the investor and to focus on information which may be relevant to determine if a transaction might be injurious to

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Canada's national security. The additional information requirements will cause more difficulty and complexity in completing the required notification and review application forms.

If you would like to know more about this matter or have any questions with respect to the foregoing, please do not hesitate to contact Joel Schachter or any member of our Competition group:

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