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Proposed amendments to Canada's national security regime establish mandatory pre-closing review process for sensitive investments and expand enforcement powers

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On December 7, 2022, the Honourable François-Philippe Champagne, Canada's Minister of Innovation, Science and Industry (the Minister), introduced Bill C-34 [PDF], *The National Security Review of Investments Modernization Act*, in the House of Commons. Bill C-34 proposes a broad set of amendments to the *Investment Canada Act* (the ICA). The most significant of these amendments is to establish a mandatory pre-closing filing regime for investments by non-Canadians in business sectors viewed as especially sensitive from a national security perspective. Given the breadth and significance of the proposed amendments, the government intends to engage in a consultation process on the proposed regime before implementation, including on the content of draft regulations outlining the business sectors considered sensitive, as well as the timing implications. Further details regarding the consultation process are expected shortly, with an expected timeframe of spring or early summer 2023.

While this proposal constitutes a significant change to the regulation of foreign investment in Canada and the most extensive amendments proposed to the ICA in over a decade, the new regime would bring Canada in line with other countries such as the U.S. and the U.K., which have taken steps in recent years to require pre-closing notification of sensitive investments. In announcing the amendments, the Minister emphasized the importance of foreign investment to Canada's economy and the government's desire to strike an appropriate balance between continuing to welcome investment and protecting Canada's national security.

Objectives of the proposed amendments

The Minister has stated that the proposed modernization is intended to achieve three principal objectives:

- to make Canada's national security review regime (NSR) more efficient and robust
- to enhance the flexibility of the NSR to address potential national security injury
- to allow more sophisticated exchanges with Canada's foreign allies to better address common national security challenges

Bill C-34 follows the November 27 release of Canada's long-awaited Indo-Pacific Strategy [PDF], the announcement of which included a brief reference to plans to review and modernize the ICA to protect Canada's national interests.

New mandatory pre-closing filing requirement for investments in sensitive sectors

All foreign investment in Canada of any size or scope may be reviewed under the NSR of the ICA. However, foreign investment is subject to a mandatory pre-closing filing requirement in only a small percentage of cases. Currently, only direct acquisitions of control (a defined phrase in the ICA) by non-Canadian investors of businesses in Canada satisfying applicable financial thresholds are subject to mandatory pre-closing Ministerial approval. Direct acquisitions of control below these thresholds, indirect acquisitions of control and establishments of new Canadian businesses are only subject to a notification requirement, and the investor has the option to submit this notification post-closing (within thirty days after the implementation of the investment). Investments that would not constitute an acquisition of control are not subject to mandatory notification (although as of August 2022, there is now a voluntary filing option). As a result, many investments by non-Canadians do not come to the attention of the government prior to closing.

The new filing regime proposed in Bill C-34 would bring to the government's attention a greater proportion of foreign investment into Canada before it is implemented, thereby enhancing the robustness of Canada's NSR. Once the new filing regime takes effect, investments subject to the mandatory pre-closing filing requirement will not be permitted to close until a prescribed waiting period has elapsed or the Minister has indicated that consideration of the investment is complete.

Based on the current draft of the amendments, passive investment in the prescribed sensitive sectors will not be subject to the new regime. For this purpose, passive investments are those which do not confer to an investor the power to appoint individuals who can direct the business of the entity or confer special voting rights. However, the regime will apply broadly to a non-Canadian proposing to acquire (directly or indirectly), *in whole or in part*, an entity that has operations in Canada, employees/contractors in Canada or assets in Canada used in carrying on the entity's operations if the following three criteria are met:

1. the entity carries on a prescribed business activity
2. the non-Canadian could access or direct the use of material non-public technical information or material assets
3. the non-Canadian would gain the power to appoint or nominate persons such as directors or senior officers of the entity, or certain prescribed special rights

Where the above criteria are met, the non-Canadian investor will be required to file a pre-closing notification and observe a no-close period.

Key definitional elements of the new regime, including most notably the definition of a "prescribed business activity," remain to be established by regulation. In announcing the amendments, the Minister highlighted the following as sensitive sectors the amendments will seek to protect: business activities relating to critical minerals, vaccines, semiconductors, quantum computing, cyber-security, artificial intelligence, information technologies and personal data collection. In addition, the non-exhaustive list of sensitive technologies set out in the Minister's March 2021 Guidelines on national security reviews are likely to be illustrative. This list includes advanced materials and manufacturing; advanced sensing and surveillance; advanced weapons; aerospace; artificial intelligence; biotechnology; energy generation, storage and transmission; medical technology; neurotechnology and human-machine integration; next-generation computing and digital infrastructure; position, navigation and timing systems; quantum science; robotics and autonomous systems; and space technology.

Given the importance of certainty to investment timelines and the newly proposed significant penalties for failure to file (see below), we anticipate a detailed consultation process focused on ensuring an appropriate scope of what will be captured under the new regime, as well as appropriate process elements such as guidelines and other mechanisms for managing compliance. The Investment Review Division (IRD) is expected to issue guidance that will help investors determine if an entity is engaged in a "prescribed business activity" once that definition has been settled. Importantly, the IRD has indicated that the list of prescribed business activities will likely be subject to change over time. It is unclear at this time what the process will be for updating the list and how much advance notice of changes will be given.

Increased penalties

The amendments propose to increase the penalties for non-compliance under the ICA. Acts of non-compliance include (but are not limited to) failure to submit a required filing and failure to comply with an undertaking given to the Minister. Failure to comply with interim conditions imposed under the new Ministerial power will also be subject to penalties. As is currently the case, the imposition of penalties for non-compliance will require the Minister to make an application to a superior court.

In general, penalties would increase from a maximum of $10,000 for each day of non-compliance, per infraction, to $25,000 per day, per infraction. A new discretionary penalty of up to $500,000 would also be introduced for non-compliance with the new mandatory pre-closing notification requirement described above. The Minister would also be given the authority to update these penalties in the future without legislative amendment.

Improving the flexibility of the NSR by enhancing the Minister's jurisdiction

The proposed amendments seek to increase flexibility and efficiency within the NSR by giving the Minister the power to take certain steps that currently must be taken by Cabinet. The amendments would empower the Minister, following consultation with the Minister of Public Safety and Emergency Preparedness (the Public Safety Minister), to initiate a Cabinet-level NSR (i.e., without having to secure Cabinet approval for the review, as is currently required).

The proposed amendments would also authorize the Minister to bypass Cabinet and, after consulting with the Public Safety Minister, to accept binding undertakings from a non-Canadian investor as a condition of national security approval and to amend or release the non-Canadian investor from undertakings where circumstances change. By reducing the administrative bar for the Minister to impose undertakings, we may see conditional clearance subject to commitments as a basis for approval under the NSR more frequently than is currently the case.

The proposed amendments also provide for a new Ministerial power to order interim conditions under the NSR. The Minister, following consultation with the Public Safety Minister, would be empowered to impose interim conditions on any investment during the NSR process. These conditions could be imposed at any point from the moment the Minister becomes aware of the investment until the end of the review period, at which point they could be converted into permanent undertakings, or removed. The purpose of interim measures is to prevent irreparable harm to national security during the NSR process that might occur if, for example, the foreign investor has access to the intellectual property or trade secrets of the Canadian business as part of the commercial due diligence process.

Where an application for judicial review of an NSR order or decision is sought, the

amendments would also allow the Minister (not the applicant) to apply for a Federal Court order closing proceedings to the public and to the applicant and their counsel if disclosure of the evidence relating to the proceeding could be injurious to international relations, national defence or national security or could endanger the safety of any person.

Facilitating enhanced cooperation with Canada's allies

The proposed amendments would enable the Minister to disclose otherwise privileged information to a foreign state's government for the purpose of facilitating the Canadian government's national security review of an investment. This may allow the IRD to develop theories of harm to national security that draw on a specific investor's actions across multiple jurisdictions.

Next steps

Bill C-34 had its first reading in the House of Commons on December 7, 2022. After a second reading in the House of Commons, parliamentarians will vote on whether to send the bill to a parliamentary committee for further scrutiny. After the committee's examination, the bill must pass additional votes in the House of Commons and Senate before it can receive Royal Assent and become law. Even then, it may take substantial time before all the proposed amendments (which may be modified during this process) come into force and certain amendments may come into force before others. Consultations on the proposed amendments and the anticipated accompanying draft regulations are expected to take place sometime in the late spring or early summer of 2023.

For further information regarding the proposed amendments or any inquiries relating to Canada's foreign investment law regime, please contact the members of Osler's Competition and Foreign Investment Group.