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Canada Clamps Down on Foreign SOE Investments in Critical Minerals

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The Canadian government announced a new policy on October 28, 2022 (the Policy) under the *Investment Canada Act* (ICA) governing investments by state-owned enterprises (SOEs) in Canada's critical minerals sector. The government followed the issuance of the Policy with an [announcement](#) on November 2, 2022 that it had ordered three Chinese investors to divest their interests in Canadian incorporated junior mining companies involved in critical minerals.

The Policy, which is described in more detail below, provides that foreign SOEs and related parties investing in Canadian critical minerals businesses will be able to obtain "net benefit" approval only "on an exceptional basis" where such approval may be required, and can expect to face a full national security review for any such investments. This marks an important and tougher shift in the Canadian government's attitude toward foreign SOE investment in Canada's critical minerals sector. The government's subsequent announcement of the three divestiture orders also sends a strong signal to investors – and Canada's allies – that Canada is serious in its new approach.

What You Need to Know About the Policy

1. **The Policy covers 31 minerals that the Canadian government deems to be "critical."** The government views [these minerals](#) – which include aluminum, copper, potash, uranium, magnesium and zinc – as strategic assets vital to Canada's future prosperity and national security. Consequently, it is also developing a "[Critical Minerals Strategy](#)" to support the development of Canada's industrial capacity and access to critical minerals, as well as to attract major investments to develop Canada's strategic assets from mines to manufacturing. The Policy should be considered in this context, specifically clarifying which types of investments the Canadian government does **not** wish to attract.
2. **The Policy applies to investments across all stages of the critical minerals value chain**, including exploration, development and production, resource processing and refining. This is quite broad, in the sense that "exploration properties" have not historically been treated as subject to the ICA's net benefit review process, although there is no such limitation for national security review. It also leaves questions unanswered, including, for example, whether the Policy would apply to an exploration property or operating mine that only has trace or non-commercial amounts of a critical mineral, but not enough for production.
3. **The Policy is not strictly limited to foreign SOE investors.** It also applies to "private investors assessed as being closely tied to, subject to influence from, or who could be compelled to comply with extrajudicial direction from" foreign governments, particularly "non-like minded" or "hostile" governments.
4. **The Policy affects both review processes under the ICA – net benefit review and national security review.** The former applies to certain acquisitions of control of Canadian businesses by foreign investors that exceed specified financial thresholds, while the latter applies to all foreign investments in Canada, without regard to value or whether control is acquired. In practice, the number of net benefit reviews has declined significantly in the last few years because of threshold increases. Accordingly, the Policy may have greater impact on the enforcement of the ICA's national security review process, which is broader in scope and application.

5. **With respect to net benefit review, the Policy states that investments by foreign SOEs (or private investors as described above) will receive approval only “on an exceptional basis.”** The Policy lists several factors that will be relevant to this determination (many of which are borrowed from an already existing policy of general application to SOE investments), including the following:
- i. the extent to which a foreign state is likely to exercise direct operational and strategic control over the Canadian business as a result of the transaction;
 - ii. the degree of competition that exists in the sector, and the potential for significant concentration of foreign ownership in the sector as a result of the transaction;
 - iii. the corporate governance and reporting structure of the foreign SOE, including whether it adheres to Canadian standards of corporate governance and to Canadian laws and practices, including free market principles in its Canadian operations; and
 - iv. whether the Canadian business to be acquired is likely to continue to operate on a commercial basis, e.g., where products will be exported or processed; the participation of Canadians in its operations in Canada and elsewhere; the impact of the investment on productivity and industrial efficiency in Canada; support of ongoing innovation, research and development in Canada; and appropriate levels of capital expenditures to maintain the Canadian business in a globally competitive position.
6. **With respect to national security review, the Policy states that the participation of foreign SOEs or foreign-influenced private investors in an investment will “support a finding that there are reasonable grounds to believe that the investment could be injurious to Canada’s national security.”** Foreign SOE investors can therefore expect to face a full review into whether their investment should be prohibited. Factors the government may consider in conducting this review include the following:
- i. the size, scope and location of the Canadian business;
 - ii. the nature and strategic value to Canada of the mineral assets or supply chain involved;
 - iii. the degree of control or influence an SOE would likely exert on the Canadian business, the supply chain and the industry;
 - iv. the effect the transaction may have on the ability of Canadian supply chains to exploit the asset or access alternative sources (including domestic supply); and
 - v. the current geopolitical circumstances and potential impact on allied relations.
7. **The Policy has already been applied.** The Canadian government underscored the serious nature of its new Policy by swiftly announcing that it had ordered Chinese investors to divest their interests in three Canadian businesses active in the critical minerals sector:
- i. **Sinomine (Hong Kong) Rare Metals Resources Co., Ltd. was required to divest its investment in Power Metals Corp., a Vancouver-based mining company.** This transaction, originally announced in December 2021, resulted in Sinomine acquiring a 5.7% interest in Power Metals, which has cesium, lithium and tantalum exploration assets in Canada (all defined by the Canadian government as “critical minerals”). The parties also entered into an offtake agreement in March 2022, covering all of Power Metals’ future output. Sinomine is the world’s largest supplier of cesium products and a leading supplier of lithium products.
 - ii. **Chengze Lithium International Ltd., China’s second largest lithium processor, was required to divest its investment in Lithium Chile Inc., which is headquartered in Calgary.** This transaction, originally announced in April 2022 and closed in May, resulted in Chengze acquiring an approximate 19% interest in Lithium Chile and the right to

appoint two directors. Lithium Chile's exploration properties are all in Chile and Argentina; it has no exploration properties in Canada.

- iii. **Zangge Mining Investment (Chengdu) Co., Ltd., a Chinese lithium and potassium producer, was required to divest its investment in Ultra Lithium Inc., a Vancouver-based resource development company with lithium exploration assets in Canada, the United States and Argentina.** This transaction, originally announced in May 2022, gave Zangge an approximate 14% interest in Ultra Lithium. In addition, Zangge and Ultra Lithium entered into a subsequent agreement in June 2022 that gave Zangge a 65% interest in an Argentinian subsidiary of Ultra Lithium, which owns an exploration property in Argentina.

It is unclear how the government learned of these transactions because they do not appear to have been subject to mandatory notification under the ICA. However, as seen in prior cases, the government will utilize different information sources to proactively “call in” investments that may be of concern.

Implications

1. **The Policy represents an important shift in the Canadian government’s approach.** Although foreign investment in “critical minerals” had previously been identified as a potential national security concern, and investments by foreign SOEs were already subject to “enhanced scrutiny” (in theory at least), the Policy articulates a new, systematic and much stricter approach to foreign SOE investments in Canadian companies engaged in activities related to critical minerals. The principles enunciated in the Policy stand in sharp contrast to the government’s attitude toward the investment earlier this year by a Chinese SOE, Zijin Mining Group, in Neo Lithium Corp., which was cleared without a formal national security review. The Canadian government was criticized for this decision, which also led to calls by a parliamentary committee for a full national security review of all investments in the critical minerals sector by SOEs from “authoritarian” regimes. The introduction of the Policy also seems to have been influenced by broader geopolitical considerations, with Canada now adopting a more critical attitude toward China (the Foreign Minister recently referred to China as “an increasingly disruptive global power”) and promoting enhanced economic relations with “friendly” democracies rather than authoritarian “non-like minded” countries.
2. **The Policy covers a potentially broad array of transactions.** The Policy extends not only to foreign SOEs but also to private investors who may have ties to foreign governments or are otherwise subject to their influence. Indeed, on the face of it at least, two of the Chinese companies whose critical minerals investments were ordered unwound are publicly-listed companies with no obvious government or SOE controlling shareholder. This places even greater importance on knowing who your investor is when assessing potential issues. Moreover, as can be seen from the investments that were recently disallowed, the Canadian government can prohibit minority investments and transactions in which no mining assets in Canada are at issue. The government can also unwind investments that have already been made and will likely show little regard for the impact this may have on the share price of the Canadian businesses involved.
3. **The Policy’s focus is on investors from countries with “non-like minded” or “hostile” governments.** Although not stated expressly, the Policy seems principally directed at investors from the “usual suspect” countries such as China, Russia (which is also covered by a separate policy as a result of the conflict in Ukraine) and the like. The Policy is, however, not necessarily an absolute bar on all foreign SOE investments in the critical minerals sectors. Foreign SOE investors from “friendly” jurisdictions may be in a position to persuade the government that their investments are of net benefit to Canada and do not pose national security risks, having particular regard to the factors set out in the Policy. Indeed, the Policy may actually open up new investment opportunities. The Canadian government has recognized that its restrictive stance will cut off a traditional and significant source of capital to domestic companies, and it has expressed its intention to help domestic critical minerals players obtain the investments they need. In the right circumstances, this could include SOE investments from countries with similarly “like-minded” governments to Canada.

4. **Early planning and engagement are key.** ICA approval must be at the forefront of transaction planning for foreign SOEs (or related private investors) who are considering investing in Canada's critical minerals sector. This includes risk-assessment by the parties and their advisers, and the drafting of appropriate agreement provisions that reflect those risks. Importantly, parties should also consider the possibility of initiating pre-investment consultations with the government. At the very least, investors who are not subject to mandatory pre-investment approval under the ICA (e.g., because their investments are below the relevant net benefit thresholds or because they are acquiring only minority positions) should consider using the opportunity to notify the government sufficiently in advance of closing to ensure that any issues are disclosed and addressed before the investment is made. Otherwise, they face the potential of post-closing review and sanctions. Indeed, minority investments can now be reviewed up to five years post-closing, unless a voluntary notification is made under the ICA.
5. **More publicity is now to be expected for national security reviews.** The Canadian government has traditionally been very circumspect about publicizing the commencement and results of its national security reviews. However, in its announcement of the three decisions to block the Chinese critical minerals investments, the government said that it now intends to publicly release details of national security reviews that result in an investment being ordered blocked or divested, or allowed to proceed only on the basis of mitigation measures. Accordingly, foreign investors (not just SOEs) and Canadian businesses considering investments that may be reviewed under the ICA's national security review process should plan carefully for the possibility that the transaction, and its potential failure to pass national security muster, may become public at some point. The same is true for any foreign investor establishing a new business in Canada that could raise national security concerns.

The Policy is not the last word on likely changes to the ICA. The Canadian government is committed, in its words, to "continue to work toward an ICA framework that is well calibrated to ensure Canada's continued prosperity and to face evolving national security challenges." Given the tenor and tone of the Policy, any such changes are likely to make the ICA process even more challenging – at least for certain investors.

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