THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

April 28, 2010

The Honourable Michael Chong, P.C., M.P.
Chair
Standing Committee on Industry, Science and Technology
House of Commons
Ottawa, ON K1A 0A6

Dear Mr Chong:

Re: *Investment Canada Act* review

We understand that the Industry Committee plans to review the *Investment Canada Act*. Some submissions previously prepared by the National Competition Law Section of the Canadian Bar Association (the CBA Section) may be helpful in your deliberations:

- Excerpt (Part VII Foreign Investment Review) from submission to the Competition Policy Review Panel, January 2008;
- Submission to Industry Canada on Investment Canada Regulation Amendments and National Security Review of Investments Regulation (August 2009).

Since our submissions to the Competition Policy Review Panel, there have, of course, been important developments relating to the *Investment Canada Act* that are not addressed in those submissions. These include:

- The introduction of a National Security review process;
- The first ever rejection of a proposed investment by the Minister of Industry under the *Investment Canada Act* in the non-cultural sector (the proposed sale of MacDonald, Dettwiler and Associates Ltd to U.S.-based Alliant Techsystems Inc);
- The first substantial litigation in the courts brought by the Minister of Industry against an investor for failing to comply with undertakings (in relation to U.S. Steel's acquisition of Stelco);
- The repeal of lower review thresholds for financial, transport and uranium businesses; and
- Draft rules that would change the basis of the calculation of the *Investment Canada Act* threshold to one based on "entreprise value".

We would be most pleased to appear before the Committee in its hearings on this subject, and to assist the Committee with its review in any way that we can.

Yours truly,

(Original signed by Tamra L. Thomson for A. Michelle Lally)

A. Michelle Lally
Vice-Chair, National Competition Law Section

Encls.

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Investment Canada Regulation Amendments and National Security Review of Investments Regulations

NATIONAL COMPETITION LAW SECTION
CANADIAN BAR ASSOCIATION

August 2009

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PREFACE

The Canadian Bar Association is a national association representing 37,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the National Competition Law Section of the Canadian Bar Association with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved as a public statement of the National Competition Law Section of the Canadian Bar Association,

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Investment Canada Regulation Amendments and National Security Review of Investments Regulations

I. GENERAL COMMENTS

The Competition Law Section of the Canadian Bar Association (the CBA Section) appreciates the opportunity to comment on the draft amendments to the *Investment Canada Regulations* (the Draft IC Regulations) and the *National Security Review of Investments Regulations,* both published in *Canada Gazette Part 1* on 11 July 2009. However, because there was no public consultation on these regulations prior to publication in the *Canada Gazette*, the 30 day comment period has been insufficient for a thorough review of regulations that are complex and critical to an efficient and predictable foreign investment review process. Accordingly, the CBA Section is not able at this point to provide comprehensive comments with proposed solutions. Rather, this submission focuses on major concerns with light commentary on more detailed issues. We would be pleased to elaborate upon our concerns and to assist with their resolution.

II. INVESTMENT CANADA REGULATION AMENDMENTS

The CBA Section‟s overarching comments are as follows:

- The term “enterprise value” as defined in the Draft IC Regulations for asset acquisitions and private company acquisitions is not consistent with the intent of the report of the Competition Policy Review Panel.
- The “market capitalization” definition raises a host of issues, the most serious of which arises from the timing for determining the market capitalization value. We expect this will cause substantial unpredictability for foreign investors and urge that the Government address this issue.
- A possible solution to a number of the CBA Section‟s concerns would be to consider incorporating definitions relating to “market capitalization” and other definitions from securities laws which are known to investors and their counsel and are “tried and true”.

A. Enterprise Value

The Consultation section of the Regulatory Impact Analysis Statement notes that the amendments to the *Investment Canada Act* (the ICA) to which these Draft IC Regulations relate stem from the Competition Policy Review Panel report, *Compete to Win* (the Wilson Report). However, the definition of "enterprise value" in the Draft Regulations does not accord with that in the Wilson Report. The Wilson Report advocated that enterprise value be defined as the purchase price plus assumed liabilities minus current cash assets to ensure that the relative importance of target companies in technological sectors was recognized[1]. While the CBA Section recognizes that there may be difficulties in using the purchase price concept, it is not clear why an alternative measure of value other than the book value of assets could not have been found in those scenarios where purchase price was not suitable. As an example, the US pre-merger notification regime in the *Hart Scott-Rodino Act* offers alternatives to purchase price when this is not available as a measure[2].

The distinction in the Draft IC Regulations between enterprise value for public versus private companies emphasizes the form of a transaction over its substance (i.e., the relative importance of the Canadian business to the Canadian economy). A transaction structured as an asset acquisition would be subject to the book value determination as opposed to a market capitalization test, so one could be reviewable while the other is not.

B. Market Capitalization Determination

1. Trading Period

The CBA Section is concerned that the market capitalization definition as currently formulated will raise serious timing issues as a result of the proposed definition of the "trading period". A transaction might close very shortly after the end of a fiscal quarter such that the value of the equity securities cannot be determined until very close to closing, or

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1 See page 111 of the Wilson Report at www.competitionreview.ca.

2 For example, for non-publicly traded voting securities, the securities are valued at their "acquisition price" or, if the "acquisition price" has not been determined, at "fair market value." See http://www.ftc.gov/bc/hsr/introguides/guide2.pdf at 7.

may not even be known at closing. In situations where the market capitalization hovers around the review threshold, this would cause substantial unpredictability for the investor.

For example, for a proposed purchase of a publicly traded Canadian corporation with a calendar-based fiscal year, a foreign purchaser who signs an agreement in January but is not able to complete the transaction until July would not have definitive knowledge of the market capitalization value required to calculate the enterprise value until the end of June. In a volatile market, a deal that was not reviewable on the basis of its market capitalization in January might well be reviewable in June, if the target‟s stock was increasing in value on the market, with the converse being possible in a declining stock value situation[3]. Moreover, the proposed transaction itself could well have an impact on the market capitalization value as the share price may trend towards the offer price as the closing date approaches. This means that market capitalization may change significantly between announcement and closing.

The Regulatory Impact Analysis Statement notes that the Government rejected purchase price as an element of enterprise value because "the „price paid‟ may not be known until or, in some cases, after the closing of a transaction and because investors need to file an application for review in advance of closing". The same issue arises with the timing of the "trading period", as currently proposed: the purchaser‟s obligation to obtain pre-closing Ministerial approval may not be known until shortly before closing, or even after closing in some cases. To avoid this possibility, investors could feel compelled to make a "just in case" filing that might not ultimately be required. This scenario should be avoided, as neither the investor nor Industry Canada should expend resources on an unnecessary approval process[4].

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3 While this concern may be mitigated to a certain extent by the fact that share price will often trend towards the offer price as the closing date approaches, in a deal where the consideration for the target‟s shares includes not only cash but shares of the acquirer, volatility in the acquirer‟s share price could mean a wide divergence between the share price and the offer price.

4 Moreover, it is not clear how this scenario would be managed. If an investor has already signed undertakings and received Ministerial approval for a transaction that turns out to be below the review threshold, these undertakings should be considered null and void on the basis that the Minister did not have jurisdiction to review the transaction. One way to address this possibility would be to make the undertakings conditional on the transaction exceeding the applicable review threshold. However, it would be preferable to revise the regulations to avoid this scenario altogether.

Conversely, a last minute increase in share price should not result in an unanticipated ICA approval requirement and the delay of an imminent closing for two to three months to permit the investor to obtain the Minister‟s approval.

The CBA Section recommends defining "trading period" with reference to the most recent 20 days of trading before the end of the last fiscal period for which the necessary information is publicly available preceding signing of a definitive agreement or the first public communication of an offer which will result in an investment.

2. Other Issues Regarding Market Capitalization

- In certain circumstances, the shares of a publicly traded company that is normally listed may not be traded at all (for example, if there has been a cease trade order in effect or a bankruptcy). In this scenario, it would be inappropriate to measure the entity‟s market capitalization by using the share price in the most recent 20 days of trading as this would likely result in an artificially high or arbitrary value.

- Regarding paragraphs 3.2(2)(i) and (ii):

  - The number of shares outstanding can change on a daily basis and therefore may be difficult to determine. The Government should consider the total number of shares outstanding at the end of each quarter as a more practical alternative to address this issue, as this figure must be determined and publicly disclosed in any event.

  - For simplicity‟s sake, both paragraphs should refer to the "simple" average daily number of its securities of that class as opposed to a weighted average.

  - There may be different series of shares in each class of equity securities with different share prices. The regulations should indicate how this situation should be handled.

- In regard to the definition of "primary market", the NASDAQ may not be considered a "stock exchange" but should be included as it is considered to be equivalent to an exchange. The CBA Section also notes that it is not clear how to measure the "volume" of trading (by value of shares or by number).

- The valuation of unlisted shares of a public company that has other (listed) classes seems arbitrary. This valuation will be accurate only where the economic rights attached to the unlisted securities are substantially similar to those attached to listed shares. For example, an unlisted security may be used to give a particular shareholder additional voting rights but may not carry any economic value. In addition, splitting or consolidating either class of shares would have an arbitrary impact on the value of the unlisted shares. The CBA Section urges the Government to consider an alternative for unlisted shares that do not have substantially the same economic rights as the listed shares. In particular, in the context of securities law, Multi-national Instrument 61-101 may offer a helpful precedent.

- For the market capitalization value, it should be clarified as to what date the conversion should be calculated and by reference to what source. For example, the *Competition Act Notifiable Transactions Regulations* refers to the Bank of Canada rate. Similarly, the conversion rate in section 3.1 of the existing *Investment Canada Regulations* does not refer to a source for the currency conversion.

- The CBA Section observes that, if the objective is to measure "enterprise value", then the test for liabilities should reflect a market value, not book value. A book value of liabilities may well be significantly higher than its market value, especially for failing or "flailing" companies whose liabilities are valued at significant discounts. Secondly, "enterprise value" typically does not include liabilities other than those in respect of borrowed money.

- The Draft IC Regulations need to address the possibility that, in certain transactions, a target company may be acquired as a result of the purchase of the target company"s debt. For example, purchasers of bonds may have a voting right such that they would be considered under the current definition of equity securities to be equity holders. As "enterprise value" includes both market capitalization and liabilities, there would be double-counting of the bondholders" stake in this scenario. Further consideration needs to be given to how the *Investment Canada Regulations* should address this type of issue.

- It would be helpful to clarify the meaning of the term "cash equivalent".

C. Book Value of Assets

Paragraph 3.3 of the Draft Regulations contemplates the use of the book value as at the end of the last fiscal year for asset acquisitions or acquisitions of private entities. However, if the parties close after year end but before that year's financial statements become available, then they may not know the relevant asset value. But if the parties close after year end but before that year's financial statements become available, then they may not know the relevant asset value. This is equally an issue for section 3.1 of the existing *Investment Canada Regulations*. The CBA Section proposes permitting investors to rely on the previous year's financial statements for up to three months following the completion of the target"s fiscal year both for sections 3.1 of the *Investment Canada Regulations* and section 3.3 in the Draft IC Regulations. This is similar to the use of the "reference period" in the *Competition Act Notifiable Transaction Regulations*.

III. COMMENTS ON THE SCHEDULES

Schedules I, II and II of the Draft IC Regulations prescribe the information requirements for notification and application for review forms. The proposed information requirements would modify the current forms by adding new categories of information and by making consequential changes necessitated by the recent amendments to the ICA.

The CBA Section understands that the additional information requirements are intended to provide the Investment Review Division (IRD) with information to help assess whether or not a proposed (or implemented) investment may raise a potential national security concern.[5] The CBA Section respectfully submits that disclosure of some of this additional information in connection with notifiable investments, particularly investments to establish new Canadian businesses, may be unnecessarily burdensome for investors and unlikely to provide the IRD with information relevant to assess potential national security issues. The CBA Section believes that its comments are relevant to reviewable transactions as well, but is

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5 The Section is not aware of any other rationale for the disclosure of this additional information: it is not relevant to an assessment of whether an investment would be a reviewable transaction or of net benefit to Canada.

particularly concerned about the burden that the additional information requirements would impose on investors in connection with non-reviewable transactions.

The Wilson Panel recommended that the government "remove the obligation under the ICA to notify Industry Canada with regard to an acquisition that falls below the threshold for review or for the establishment of any new business."[6] The Wilson Panel was clearly of the view that notification forms were not sufficiently useful to justify the administrative burden of requiring investors to complete them. In this context, it would be inappropriate to move in the opposite direction of the Wilson Panel recommendation and impose additional information requirements on investors.

The CBA Section‟s specific concerns are as follows:

- Disclosure of personal information about the directors, officers and owners of the investor[7] will be time-consuming to gather in many cases and of questionable utility in most cases.
- The 10% ownership disclosure requirement in section 2 of Schedules I, II and III relates to ownership of the investor‟s "equity or voting rights", which are not defined in the ICA. These terms are unclear and capable of different interpretations. The CBA Section suggests that the phrase "voting interest" be used because it is defined in the ICA.
- The CBA Section has a number of concerns about the requirement to disclose "direct or indirect ownership" interests held by a foreign state[8]:
    - The requirement refers to "ownership" whereas the ICA uses and defines the phrase "voting interest", and the 10% ownership requirement noted above refers to the investor‟s "equity or voting rights". Introducing a new undefined word in this context creates uncertainty. Moreover, "ownership" suggests that non-voting ownership interests may be included, which some members of the CBA Section believe are unlikely to allow a foreign state to influence an investor and thereby raise a national security concern. The CBA Section suggests that it would be clearer and more consistent with the rest of the ICA to use the phrase "voting interest" here too.

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6 *Compete to Win* (Ottawa: Government of Canada, 2008) at p. 37.

7 The Schedules propose to require the disclosure of the names, addresses and dates of birth for all directors, the five highest paid officers and any persons owning more than 10% of the equity or voting rights in the investor.

8 Section 4 of Schedules I, II and III.

- The CBA Section believes that disclosure should be required only where a foreign state has an ownership (voting) interest or the ability to exercise significant influence over the investor. The proposed requirement in the Draft IC Regulations may extend to small, passive ownership interests that are unlikely to raise national security concerns. Moreover, as a practical matter, many investors are unlikely to know whether a foreign state may have a small ownership interest, voting or otherwise[9]. A number of alternative approaches could be adopted. A 10% voting interest threshold would establish a clear, bright-line test and require the disclosure of information investors are more likely to have. To the extent there is a concern about "golden share" control issues, where a foreign state may have a small voting interest but be able to outvote other shares in specific circumstances, the 10% voting interest threshold could be coupled with a *de facto* control test. Investors would be required to disclose whether a foreign state either owns 10% or more of the voting interests of the investor or has the ability to exercise control in fact of the investor, through the ownership of voting interests. This form of requirement, which adopts a bright line *de minimis* test plus *de facto* control concepts, would be clearer to investors and consistent with concepts of ownership and control found elsewhere in the ICA.
- Many investors are unlikely to be aware of an indirect ownership interest by a foreign state. For example, an investor may not know whether one of its shareholders is ultimately owned by a foreign state. As a practical matter, an investor will therefore simply have to complete the form requirements to the best of its knowledge and belief. As suggested below, the signing requirements for the forms therefore ought to expressly state that is the standard investors are required to meet.
- The CBA Section questions whether the concept of "foreign state" is sufficiently clear and whether a "foreign state" would include commercially-oriented government-owned entities such as postal services or pension funds. It may be helpful to define the term in the regulations.

• If investors are required to disclose "sources of funding" for the investment,[10] disclosure should be limited to principal, not all, sources of funding. Some members of the CBA Section also questioned whether this disclosure is relevant to a national security assessment of an investment. If a lender were to acquire control, the IRD could presumably assess any national security issues at that time.

• Sections 18 and 19 of Schedule I contain references to investments referred to in sections 14 and 14.1 of the ICA but Schedule I contains the information requirements for non-reviewable transactions and sections 14 and 14.1 relate to reviewable

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9 An investor may know the identity of its shareholders, but may not know who owns its shareholders. For example, an investor may know that Company A has a 10% ownership interest in the investor, but the investor may not know that a foreign state has a 0.5% interest in Company A.

10 Section 6 of Schedules I, II and III.

transactions. The CBA Section believes these references ought to refer to section 11 of the ICA.

- The signing requirement (in section 4 of the Draft IC Regulations) should make it clear that the investors are required to certify that the form is complete and correct in all material respects to the best of the investor"s knowledge and belief. This is likely the standard investors believe they have to meet in practice and it would be helpful if the regulations explicitly confirmed the compliance standard.

IV. NATIONAL SECURITY REVIEW OF INVESTMENTS REGULATIONS

The draft *National Security Review of Investment Regulations* (National Security Regulations) flesh out the procedures and timeframes for national security screening under the ICA. Although the National Security Regulations contemplate that reviewable transactions will be screened before closing, no comparable pre-closing process is available for notifiable transactions, or transactions that are neither reviewable nor notifiable. This is a significant deficiency that can and should be remedied to provide greater predictability and transparency to foreign investors and the Canadian businesses in which they invest. We also recommend that notifications filed under the ICA should be treated as confidential.

A. Pre-Clearance

Sections 2 and 4(b) of the National Security Regulations set out the time frames for the Minister to inform a non-Canadian that its investment is being screened on national security grounds. The Minister provides a notice to the non-Canadian by the end of the prescribed time frame either indicating no action will be taken, or initiating further screening activity. As the vast majority of foreign investments in Canada do not raise national security issues, these benign transactions will result in an eventual no-action response from the Minister.

In the case of a reviewable transaction under the ICA, the national security screening will be done simultaneously with the review. The screening timelines in sections 2(b) and 4(b)(ii) of the National Security Regulations dovetail with the review timelines in the ICA.

B. Notifiable Transactions

In the case of transactions that are notifiable under the ICA, the timelines in the National Security Regulations do not dovetail with the notification process. Under sections 2(a) and 4(b)(i), the screening can be initiated up to 45 days after the investment has been implemented. Thus, even where the Minster has received ample notice of the proposed transaction prior to its implementation, the investor cannot be certain that its investment will not be challenged on national security grounds post closing.

In our view, this is a serious deficiency in the National Security Regulations that can and should be remedied. Foreign investors, and Canadian businesses in which they invest, are entitled to a higher level of predictability and transparency from the federal government. By not providing for a procedure that allows pre-closing clearance, (i) an objective of the ICA, namely promoting foreign investment, is undermined, and (ii) Canada will deviate significantly from how our major trading partner handles national security screening. In the U.S., pre-closing clearance can be obtained under their *Exon-Florio Act* from the Committee on Foreign Investment in the United States – CFIUS.

Accordingly, the CBA Section recommends that sections 29(a) and 4(b)(i) be reworded as follows:

> "in respect of an investment referred to in section 11 of the ICA, the period ending 45 days after the certified date referred to in subsection 13(1) of the ICA"

This approach will give the Minister a full 45 days to decide whether to initiate a fuller screening process, which should be an ample amount of time.

C. Other Transactions

Transactions that are neither reviewable nor notifiable under the ICA may also be susceptible to national security screening. For example, a minority non-controlling investment by a non-Canadian could be caught by section 25.1(c) of the ICA. In such cases, the proposed regulations allow for national security screening up to 45 days after implementation of the investment. See sections 2(c) and 4(b)(iii)[11].

Consistent with our recommendation for notifiable investments under the ICA, we recommend that a mechanism be in place for foreign investors to obtain clearance before closing of non-notifiable investments, if they so choose. To achieve this result, foreign investors should have the option to submit information equivalent to what would be submitted in a notification and, if this is done, the investor should either receive clearance 45 days thereafter or, within that same timeframe, the Minister should take further national security screening steps as required in the ICA. Thus, sections 2(c) and 4(b)(iii) would be rewritten to specify an end point of the earlier of 45 days after the date that the optional filing is certified as complete and, as already contemplated by the draft regulations, 45 days after the implementation of the investment. The actual contents of the optional filing will need to be specified and set out in the proposed regulations. This optional filing can in large part be based on Schedule 1 of the *Investment Canada Regulations*, with suitable modifications.

D. Confidentiality of Notifications

The CBA Section recommends that the proposed regulations be amended to state that any notification filing discussed above, whether mandatory or optional, will be maintained in confidence by the Ministry. That way, investors contemplating notifications will be encouraged to make early filings, knowing there is no risk that the fact of the investment will be disclosed before implementation. In the case of a mandatory notification, once implementation has occurred, the usual disclosure would occur on the Ministry website: name of foreign investor, acquiree, and type of business of acquiree.

For optional filings, the regulations should state that no information from an optional filing shall be disclosed (except where enforcement proceedings are undertaken in accordance with

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11 We would also point out that sections 2(c) and 4(b)(iii) are technically flawed because the prescribed period begins "on the date the investment first comes to the Minister"s attention" and ends "45 days after the day on which it is implemented". Because this drafting could result in the illogical possibility that the period begins after it has ended, we would suggest deleting the reference as to when the period begins, as only the end date is relevant (which we suggest should be 45 days after the earlier of the implementation of the investment and the date that the optional filing is certified as complete).

the ICA). An optional filing is solely for the purpose of national security screening. It is not a foreign investment notification to which the ICA otherwise applies. The government should be satisfied that non-Canadians are willing to voluntarily disclose their investments for Canadian national security screening purposes when not otherwise required, and these investors should not have to worry that this voluntary disclosure will become public knowledge.

We recognize that section 36 of the ICA sets forth certain requirements of confidentiality. However, it is not clear that these confidentiality requirements will apply in all the circumstances noted above. Hence, clear statements in the regulations will be helpful both for foreign investors and the Canadian businesses in which they invest.

V. CONCLUSION

The CBA Section appreciates the opportunity to submit these comments and hopes they are of assistance. Given the short consultation period, the CBA Section would be pleased to discuss its comments further at Industry Canada‟s convenience.

Competition Policy Review Panel
(Excerpt on Foreign Investment Review)

NATIONAL COMPETITION LAW SECTION
CANADIAN BAR ASSOCIATION

January 2008

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PREFACE

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VII. FOREIGN INVESTMENT REVIEW

While the CBA Section believes that the *Competition Act* is, broadly speaking, functioning well and benefiting the Canadian economy, the same cannot be said for the *Investment Canada Act*. We wish to make the following points:

1. It is not apparent that the ICA is of net benefit to Canada. It potentially discourages or inhibits the influx of capital to Canada, and serves to make investments in Canada less efficient. It is not clear that distinguishing between investors on the basis of nationality is likely to benefit the economy. Business owners, whatever their nationality, should be presumed to operate in a profit-maximizing fashion. Other than in sectors of the economy where there may be specific concerns, consideration should be given to eliminating the general review of foreign investment, or to reversing the onus in the ICA so that investments are presumed to be beneficial to Canada unless there is evidence to the contrary. This would encourage investment in Canada, and bring Canada into closer alignment with the approach of its major trading partners.
2. Investment restrictions inherently reduce competition and economic efficiency. Establishing and maintaining restrictions, such as sectoral investment restrictions, should be pursued only where there is a clear, demonstrable need, and with awareness of the negative efficiency tradeoff in such restrictions. We urge an elimination of duplicate review of investments under the ICA and sector-specific statutes.
3. If the ICA regime is maintained, there are a number of process/administrative and substantive improvements which should be undertaken. Reviews of investments in the cultural sector, in particular, are very restrictive and could be significantly improved. These are outlined below. As well, review of investments in the "Sensitive Sectors" is largely duplicative of other statutory reviews which occur in these sectors, and should be eliminated.

We now turn to the specific questions posed by the consultation paper.

What impact has the ICA had on the Canadian economy and Canadian competitiveness and specifically on our ability to attract Foreign Direct Investment (FDI)?

(a) Non-Cultural Business Investment

All restrictions on investment, and any requirement that investment occur only on approved terms, potentially discourages investment and makes it less efficient. However, the application and impact of the ICA on foreign investment differs significantly depending on whether the investment involves businesses related to Canada's national identity and cultural heritage ("cultural businesses"). Under the ICA, FDI in cultural businesses is subject to considerably greater scrutiny by the Minister of Canadian Heritage than FDI of comparable size in other sectors of the economy. In certain cultural businesses, FDI is prohibited outright. As a consequence, the impact of the ICA on the Canadian economy is different depending on whether cultural businesses are involved.

The purpose of the ICA, set out in section 2 of the ICA is "to encourage investment in Canada by Canadians and non-Canadians that contributes to economic growth and employment opportunities and to provide for review of significant investments in Canada by non-Canadians to ensure such net benefit to Canada". However, nothing in the ICA or its operation encourages FDI. The ICA establishes a potentially onerous regulatory regime for notification of investments in Canada by non-Canadians and for pre-closing review and Ministerial approval of direct acquisitions of control of significant businesses in Canada by non-Canadians. This distinguishes Canada from most of its major trading partners.

It is not clear that the ICA actually achieves any objective at all – it is not reasonable to assume that Canadian owners are likely to manage a business in a way more beneficial to the Canadian economy than foreign owners. Both are equally likely to pursue profit maximization and act in their economic self- interests.

While the CBA Section is not aware of the Government disallowing any transaction pursuant to the ICA (outside the cultural sector), and believes that very few transactions have been abandoned as a result of potential ICA implications, the ICA discourages foreign bidders in auction settings.[1] In addition, it involves a time-consuming, burdensome and costly process. Foreign investors must demonstrate to the Minister that the acquisition will be of "net benefit to Canada" having regard to statutory criteria, so the Minister typically requires foreign investors to provide legally enforceable commitments or

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1 While transactions have not generally been abandoned transactions involving multiple bidders at least one of whom is Canadian and one of whom is non-Canadian, are significantly affected. In these circumstances, where time is of the essence, the ICA favours the Canadian bidder. In addition to being an extra cost for the non-Canadian bidder, generally the timeline to closing the transaction is an important factor for the seller in differentiating among bidders. If there are no other regulatory hurdles to closing a transaction with a timeline longer than the ICA approval process, the non-Canadian bidder is at a disadvantage to the Canadian bidder as it must obtain Ministerial approval prior to closing. While there is generally no practical concern about whether Ministerial approval will be obtained, there is invariably considerable concern about the timing of such approval. For this reason, the non-Canadian bidder may choose not to bid, thus shrinking the market available to the seller. Or, if the non-Canadian does bid, all other elements being equal among bidders, the seller may not select the non-Canadian's bid simply because of the timing uncertainty posed by the ICA.

"undertakings".[2] The binding nature of the undertakings may make it difficult to execute a change of direction or strategy while they are in place. The undertakings therefore may have the effect of making the Canadian business less nimble in changing circumstances. As well, since businesses should be presumed to act in their own best interests, the undertakings are likely, if they have any effect at all, to make the Canadian economy less efficient and productive than it would be absent the undertakings. When investors are compelled to make economic decisions to obtain a net benefit determination by the Minister, the ICA imposes costs on firms wanting to do business in Canada, rather than improving the business environment to encourage further investments in Canada.

The overall impact of the ICA on FDI in Canada must also be assessed in light of the effect of the ICA process on the investment. The ICA process includes both the negotiation of the undertakings as well as the implementation stage. The burden of the ICA process at the negotiation phase is significant, as the same executives who are intensely involved in the negotiation of the deal, diligence and other fundamental transaction steps divert considerable time to the ICA filing.

For all of these reasons, the CBA Section believes that the ICA does not likely provide a net benefit to Canada. The ICA process can be a frustrating, time-consuming and costly process. It may discourage FDI, and reduce the number of bidders for Canadian assets. It makes such investments less efficient.

(b) Cultural Business Investments

The ICA has not encouraged FDI in cultural businesses. Rather, it debilitates FDI in Canada's cultural businesses. The ICA prohibits significant FDI in businesses involved in the production, distribution, sale or exhibition of film and video products, and severely curtails FDI in the book publishing and distribution businesses.

In contrast to the situation in non-cultural sectors, the CBA Section is aware of investments by non-Canadians in the cultural area that have been abandoned or significantly modified, in order to secure approval from the Minister of Canadian Heritage. Cultural sector undertakings generally require the investor to do considerably more than it otherwise would but for the application of the ICA, thereby undermining the efficiency of the investments.

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2 These Undertakings typically have a term of three to five years and set forth annual benchmarks and expenditure targets with respect to such things as: employment levels in Canada; production or manufacturing activity in Canada (i.e., additional investment such as expansion of facilities, level of capital expenditures); research and development in Canada (in terms of expenditures and activities); technological, product or service innovation; export activity; the level of Canadian participation in senior management; and other subject areas.

In certain cultural businesses, Government policy prohibits foreign investors from acquiring control of a Canadian business. Therefore only Canadian investors can control these cultural segments of the economy. Accordingly, the ICA's discouragement of FDI in these segments of the cultural sector may appear to create greater investment opportunities for Canadians in these segments, but these are counterbalanced by negative consequences for Canadians selling the cultural businesses. Further, the limited market for the sale of such cultural businesses may discourage investment in such businesses even by Canadians who may view the scope for recovering their investment as too limited.

It is not clear to the CBA Section that discouraging FDI in the cultural sector of Canada's economy achieves the objectives underlying the Government's cultural policies administered under the ICA. The prohibitions and restrictions on FDI in the cultural area are denying these businesses access to foreign capital (and possibly domestic capital) and may be inhibiting the growth and expansion of these businesses and their competitiveness in the global marketplace.

If the principal policy objective is to promote the creation, dissemination and preservation of diverse Canadian content and the Canadian cultural community (authors, artists, actors, filmmakers, producers, journalists, etc.), the focus of the policy should be on modifying behaviour rather than on restricting FDI in the sector. For example, if the Government's objective is to ensure that book retailers sufficiently promote Canadian authors, this concern exists whether the retailer is owned by a Canadian or a non-Canadian. Moreover, the current book policy and film and video policy penalizes Canadian distributors of these products by precluding them from selling their businesses to the highest bidder. Reviews are triggered regardless of the actual content but rather by the form of the product. For example, a telephone directory and a book of poetry are both considered books and will trigger a cultural business review.

The policy creates an incentive for Canadian cultural businesses that are mobile (such as on-line books) to move to the US in advance of a sale in order to avoid the ICA. Thus, the ICA may also have negative repercussions for Canadian employment. For example, the book policy restricts foreigners from acquiring or establishing a book distribution business in Canada, to encourage Canadians in this business. There are no restrictions on investors establishing book distribution operations in Buffalo and shipping the books to Canada. Canadians may be denied employment in Canada because foreign distributors must work around the ICA policies. Another consequence is that the cultural division of a larger Canadian (non-cultural) business may be closed to avoid the delays, prohibitions or undertakings under the ICA and Canadian Heritage policies.

In the CBA Section's view, the Government should revisit its policies affecting FDI in the cultural sector to determine if they are the most effective means to achieve its desired objectives.

What, if any, changes to the investment review process would enhance Canada's competitiveness and improve Canadians' understanding of the benefits of FDI?

(a) Generally

To begin with, any process should review only investments in defined "sensitive" sectors, and not in other industries. Second, sectoral investment restrictions should be no broader than needed to achieve the desired outcomes. Third, even in sectors subject to review, the process ought not to presume that the nationality of the investor is relevant.

Fourth, a number of significant process improvements would assist in this area. The CBA Section believes that measures should be implemented to improve the transparency and predictability of the process. At a minimum, these measures should include the publication of guidelines which go well beyond the existing interpretation notes under the ICA, and articulate with examples as necessary:

- How the net benefit criteria are applied in practice, and the relative weight of the ICA section 20 factors. For example, current practice (in the CBA Section's experience) demonstrates that the impact of the investment on employment and capital expenditures is viewed as much more important than the impact on increasing the efficiencies of the Canadian business and, therefore, its international competitiveness. Guidelines, or other forms of guidance, should consider the legal and public policy basis for applying the relative weights to each of the factors.
- The Government's position on matters where legal interpretation or advice has been given to investors or their counsel in the past. As part of this process, consider recommencing the publication of generic opinion summaries similar to those published by the Investment Review Division in the 1980's.
- The consultation process undertaken by Industry Canada and the role that the provinces and territories and other departments play in the ICA review process.
- The Government's position on undertakings, and in particular:
  - The current practice typically requires undertakings. In the CBA Section's view, undertakings should be reserved for only the most significant cases or those cases raising national security concerns. Further, the CBA Section believes that only certain undertakings may be relevant to a particular transaction, and it should not be necessary for an investor to provide an undertaking on all or almost all of the factors when one or two undertakings can satisfy the net benefit test.
  - Baselines or benchmarks for undertakings should be clarified. For example, in defining the baseline for employment or capital expenditures for the term of the undertakings, barring unusual circumstances, the relevant baseline should be defined with reference to the employment levels or capital expenditures that would have prevailed over the next three years based on pre-existing plans of the target or reasonable projections.

- ➢ The undertakings that will be expected where the investor intends to engage in substantial rationalization or closures should be outlined. The Canadian government invests significant resources in understanding and reducing Canada's productivity gap with the U.S. and other countries. Rationalization efforts contribute to the improvement of industrial productivity, and should be assessed in light of their positive (not just negative) effects.
- ➢ Sample or model undertakings, with a detailed commentary similar to those published by the Department of Canadian Heritage for book publishing and distribution, should be published.
- ➢ The ICA should be amended so that the Minister cannot unilaterally divulge undertakings, given the commercially sensitive nature of such information.

Finally, CBA Section believes that the efficacy of the Government's policies and guidelines should be reviewed periodically to ensure that they are meeting the Government's current objectives.

(b) Sensitive Sectors

Most FDI reviews under the ICA are triggered either by the size of the transaction (asset value in excess of $295 million for 2008) or by the "sensitive" nature of the industry being acquired. Currently, the ICA broadly defines and subjects four sectors of Canada's economy to substantially lower review thresholds and greater regulatory scrutiny: uranium, transportation, financial services and cultural businesses (collectively the "sensitive sectors"). With the exception of uranium production and cultural business, it is unclear why the ICA has special rules for these sectors.

To the extent the Government has concerns about FDI as well as merger and acquisition activity in these sectors (excluding uranium production and certain segments of the cultural sector), it can and has largely chosen to address its concerns in specific legislation. The transportation sector is governed by the *Canada Transportation Act*. That legislation specifically limits foreign acquisitions of control of certain federal transportation undertakings and includes a public interest review for all transactions (regardless of whether the investor is Canadian or foreign controlled) involving transportation undertakings for which a notification is required under the *Competition Act*.

The financial services sector is governed at the federal level principally by the *Bank Act*, the *Insurance Companies Act* and *the Loan & Trust Companies Act*. The Minister of Finance and Superintendent of Financial Institutions review any material acquisition of control of a business governed by these Acts, regardless of whether the investor is Canadian or foreign controlled. There is a myriad of provincial legislation governing provincial financial institutions, including licensing requirements designed to protect any prudential or consumer protection concerns.

The broadcasting segment of the cultural sector is subject to comprehensive regulatory regime established by the *Broadcasting Act*. Currently the *Broadcasting Act* prohibits acquisitions of control of broadcasting undertakings and also subjects any acquisition of control of a broadcasting undertaking to review and approval by the CRTC.

We have cautioned generally against over-use of sectoral restrictions, but the application of the ICA in these sectors imposes a duplicative layer of regulatory oversight on the foreign investor. In the CBA Section's view, the ICA should not duplicate the review of acquisitions governed by specific legislation. To the extent that the federal government (or for that matter a provincial government) has chosen to regulate acquisitions of control of a sensitive sector business, that legislation should govern the acquisition process. A duplicative process for these sensitive sectors is unnecessary.[3]

Therefore, with the possible exception of certain segments of the cultural business (other than broadcasting) and uranium (where no duplicative federal acquisition review laws are in place), the sensitive sectors defined in the ICA should be eliminated.

Alternatively, if the application of the ICA to sensitive sectors is maintained, the Government should improve the process as follows:

- raise the review thresholds which have not changed since 1985 and should be increased to recognize at a minimum increases in Consumer Price Index;
- confirm that, in determining whether the sensitive sector review threshold is exceeded, only the assets related to sensitive sector activities should count; and
- confirm that the ICA does not apply to an investment simply because the target is engaged in sensitive sector activity that is incidental or ancillary to its principal business (i.e., establish a de minimis test)

[3] The CBA Section recognizes that, alternatively, duplication could be eliminated by the ICA being the only statute that gives rise to a review. However, this assumes that review of an acquisition by a domestic investor is not required. The CBA Section believes that, because of the very low threshold for review for sensitive sectors (businesses with a book value of $5 million in assets), the current broad scope of the definition of the sensitive sectors under the ICA results in filings and reviews of small acquisitions not consistent with the spirit or intent of the ICA (e.g., a small local transportation business). For example, the acquisition of a shuttle business or baggage handling operation at an airport has been considered a transportation undertaking and, therefore, subject to review. It is unclear why the acquisition of such a small business merits greater scrutiny than a myriad of other small businesses in Canada's economy. The ICA has no *de minimis* exceptions, with the result that a retailer that sells a few magazines will be considered to be a cultural business and will be subject to the lower ($5 million) threshold which takes into account all of the assets of the retailer.

Should the net benefit test be adapted to reflect the new competitive environment? If so, how?

The CBA Section generally questions the logic of subjecting foreign investments to review. If, however, foreign investments continue to be subject to scrutiny, we believe there should be a presumption that investment is positive or neutral, and should be blocked only if the Minister is satisfied that it is harmful to specific interests. The investor should not have to prove the investment is of net benefit.

Second, the net benefit test focuses in practice on "hard" criteria for evaluation of whether a proposed investment is of net benefit to Canada, such as the number of employees, the amount of capital expenditures and the amount spent on research and development, without regard for all of the criteria in section 20 of the ICA. However, the real drivers of the economy and the real fruits of foreign investment – such as technology transfer, managerial know-how, increased efficiency, increased competitiveness, or better access to global capital markets – are viewed as "soft" criteria that are difficult to quantify and appear to be accorded relatively less weight in making a net benefit determination. This approach should be changed.[4]

Third, the net benefit test is difficult to apply because the criteria in section 20 often conflict, and the decision to prioritize some criteria over others appears arbitrary. For example, efficiency and competition in Canada are two listed factors that could be part of a benefit to Canada. Making a business more efficient and competitive often requires that expenses be reduced through job cuts or reductions in expenditures. In the experience of the CBA Section, arguments that reductions in expenses will increase the competitiveness and efficiency of the Canadian business are given little, if any, weight in the current review process. Any issues relating to anti-competitive effects of an investment should be addressed exclusively by the Commissioner under the merger provisions of the *Competition Act* and not under the ICA review process.

Finally, some of the criteria used in assessing net benefit may be outdated. If unemployment is low in Canada, it may not be appropriate that employment be the key driver of a net benefit determination. The requirement to keep all head office functions in Canada can conflict with modern management structures for international businesses that manage product lines globally and not necessarily through a centralized head office structure.

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[4] A recently published Statistics Canada study found that foreign companies operating in Canada have generated two-thirds of the productivity growth over the past three decades, paid out higher wages and hired more white-collar workers in the key manufacturing sector, and contributed more to research and development than their domestic counterparts. See John R. Baldwin and Guy Gellatly: Global Links: Multinationals in Canada: An Overview of Research at Statistics Canada, Statistics Canada catalogue no. 11-622-MIE, no. 014, November 2007.

Some specific comments

1. National Security

Currently, national security does not appear to be a factor considered by the government in a review under the ICA. This makes Canada an outlier in the global marketplace. However, in the view of the CBA Section, any proposed amendment to the ICA in this regard should be clear, predictable and applied to avoid an unnecessarily expansive interpretation of the scope of national security.[5] Canada's national security, and economic interests, would be ill-served if amendments unnecessarily interfere with the promotion of investments that contribute to economic growth and employment and restrict the flow of foreign capital, technology and know-how to Canadian businesses.

2. The Anomoly of Businesses with Few Assets in Canada

The ICA requires the review and Ministerial approval of acquisitions of businesses in Canada with a book value of assets meeting or exceeding a prescribed threshold (for 2008, that threshold is $295 million). Where a business is headquartered in Canada but all or substantially all its operations are outside Canada, the ICA approval process may apply because the book value of the business assets are over the threshold, despite the company as a whole having little, if any, commercial operations in Canada (e.g., mining companies listed on a Canadian exchange with most or all mining assets outside Canada). The purpose of reviewing the acquisition of control of a company that does not have a significant presence in Canada is questionable. If Canada wishes to be an attractive head office location for companies with operations elsewhere, this objective will be undermined with acquisition of control rules that apply whether or not the revenue-generating activity of the business is in Canada or outside. Rather than subject themselves to additional regulatory review (and added delay and cost to potential apurchasers), these companies may choose to establish their headquarters outside Canada.

In the CBA Section's view, only if a business has a significant presence in Canada and impact on Canadians, should there be any basis for reviewing its acquisition by a non-Canadian.

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5 For instance, it is not obvious that there are national security concerns if foreign owners were to acquire resource properties in Canada.

3. Businesses Now Owned by Non-Canadians

Review under the ICA does not distinguish between Canadian-controlled business being sold to a non-Canadian, and a transaction where the Canadian business is already controlled by a non-Canadian.[6] Even if there may be good reasons to carefully consider the impact on Canada if a substantial Canadian-controlled business is acquired by a non-Canadian, it is less clear why review is appropriate if control of a business in Canada shifts from one non-Canadian to another non-Canadian (assuming that the replacement non-Canadian does not otherwise give rise to concerns)

4. Duplicate Review under the Competition Act and Investment Canada Act

The ICA should not be used as an instrument to enforce competition policy. Under the *Competition Act*. The Commissioner of Competition has the power and expertise to review any merger (even if the merger does not amount to an acquisition of control or meet the notification thresholds). Furthermore, the Commissioner must be notified of most substantial mergers. If the Commissioner believes that closing a merger needs to be delayed or prohibited, she may apply to the Competition Tribunal for an interim order if the criteria in the Competition Act are met. The ICA should not be used as another process to review mergers for competitive impact and should it be used as a tool to delay or enjoin a merger on competition grounds where the Commissioner is unable or unwilling to apply to the Competition Tribunal and meet the criteria for an injunction.

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[6] We note that some of the restrictive policies of the Department of Canadian Heritage (such as those for book and film distribution) only apply to the sale of a Canadian-controlled cultural business to a non-Canadian. If the business is already controlled by a non-Canadian, it can be sold to another non-Canadian without the restrictive policy applying, but such sales are subject to ICA review and undertakings.