THE CANADIAN BAR ASSOCIATION

L'ASSOCIATION DU BARREAU CANADIEN

Investment Canada Regulation Amendments

NATIONAL COMPETITION LAW SECTION
CANADIAN BAR ASSOCIATION

July 2012

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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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I. INTRODUCTION

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) published in *Canada Gazette Part 1* on 2 June 2012. We would be pleased to elaborate on our comments and to assist with their resolution.

In our view, the Draft IC Regulations are a significant improvement on the previous draft *Investment Canada Regulations* published for comment in 2009 (the 2009 Draft Regulations). The Draft IC Regulations appear to address many of the serious concerns we had expressed on the 2009 Draft Regulations, especially that an investor might not be able to determine the review status of a proposed transaction until very close to closing, or even after closing. Apart from the one issue noted below on the currency conversion date for asset acquisitions, we are of the view that the ability to file a notification or application for review and have the financial thresholds and review status determined as of that filing date has adequately addressed that issue. However, the Draft IC Regulations still present a number of technical issues, including the calculation of "enterprise value" and transition considerations. We believe these should be addressed with further revisions. In addition, we continue to have concerns about the proposed information requirements in general and particularly those relating to notifications.

In some instances, we restate our previously expressed concerns that have not been addressed.

II. DRAFT AMENDMENTS TO INVESTMENT CANADA REGULATIONS

A. High level comments

The Draft IC Regulations should ensure that “enterprise value” is fully determinable at the time of filing a notice or application for review in advance of closing. Further, “enterprise value” should:

(a) be fully determinable by an unsolicited bidder for a public company; and (b) not create an unnecessary burden on an entity to determine its own enterprise value. Insofar as possible, the definition of "enterprise value" should use concepts and information that an entity identifies and (for a public company) has disclosed in the ordinary course of its business. Also, insofar as possible, the elements of the definition of "enterprise value" should be internally consistent to avoid double-counting and relate to the same date or time period. Particular instances of revisions required to implement these principles are in our detailed comments.

Clear transitional rules for new *Investment Canada Regulations* are required to avoid unfair prejudice to parties to proposed transactions that become reviewable as a result of the change from a book value to an enterprise value standard for review thresholds.

Given the potential for new *Investment Canada Regulations* to create confusion and uncertainty for proposed transactions, we recommend that the government publish a further revised draft for consultation before the regulations are finalized, to permit stakeholders to provide further comments and explanations.

On balance, the proposed changes to Schedule I will result in notifications being substantially more burdensome than at present. While the increase in review thresholds may result in fewer reviews, applications for review will also be more burdensome. These developments are at odds with the recommendations of the June 2008 Final Report of the Competition Policy Review Panel. In particular, the Panel recommended that the obligation to notify regarding acquisitions that fall below the review threshold, and for the establishment of new businesses, be entirely eliminated for non-cultural businesses.

Filings will not only be more burdensome to prepare but, in our view, also more burdensome for Industry Canada to review. This may in turn require Industry Canada's resources to be increased to provide an acceptable level of service to investors.

B. Detailed comments

Section 1(2) (amending section 2 of the Regulations − definitions)

equity security

This definition would benefit from further revision to clarify that the term does not include debt securities. Any inclusion of debt securities in the meaning of equity security would result in

double-counting for purposes of determining enterprise value. (Debt separately forms part of the enterprise value definition.) The proposed definition tracks the definition of the same term in the *Securities Act* (Ontario). However, the *Securities Act* has a separate definition of "debt security", which clarifies that "debt security" and "equity security" are mutually exclusive categories.[1]

governing body

By requiring enterprise value to be determined by the board of directors (or equivalent) of an investor, the regulations would impose an unnecessary burden on the board and create a potential source of unnecessary delay in consummating transactions. We recommend that the definition of governing body be expanded so as to also include a properly authorized committee of the board, or any director, officer or other authorized person of the investor.

trading period

Apart from the currency conversion issue noted below, the timing issues we raised with the 2009 Draft Regulations appear to be addressed by enabling the investor to lock in an enterprise value by filing a notice before closing. This is an important improvement over the 2009 Draft Regulations. However, some technical issues remain.

For example, it may not be possible for a foreign investor to determine the number of shares of the target company outstanding on a daily basis throughout a trading period, particularly in the context of an unsolicited offer for a publicly-traded company. Publicly-traded companies are normally required to disclose the number of their outstanding securities in quarterly financial statements. So one practical alternative may be to base the trading period calculations on the last 20 trading days ending on the last day of the quarter that precedes the notification or application for review (or possibly the public announcement) of the proposed transaction, and using the number of shares outstanding as stated in the quarterly financial statements for each day of the trading period (unless more accurate available information about the number of shares outstanding on any particular day in the trading period is publicly available).

This approach would also alleviate a further issue in the Draft IC Regulations. In the current Draft, if the trading price of the shares of a target Canadian public company increases as a result

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1 "Debt security" is defined in the Securities Act as a bond, debenture, note or similar instrument representing indebtedness, whether secured or unsecured.

of an offer, it could increase the enterprise value so that a transaction initially below the review threshold proposed by foreign investor A may not be subject to review, while a subsequent competing offer by foreign investor B would be subject to review even though both offers are made by non-Canadians for the same Canadian business. We do not see any public policy rationale to justify such dramatically different outcomes.

Further, by subjecting any subsequent non-Canadian bidder to the review process, undertakings and significant delay relative to the first non-Canadian bidder, the Draft IC Regulations could impair the ability of Canadian companies to realize shareholder value (as it would discourage competing offers). This outcome would prejudice shareholders of Canadian publicly-listed companies and may discourage entities from listing in Canada.

Moving to a quarterly reference point may help reduce the potential for this outcome, but the risk could be eliminated by allowing any subsequent bidder (foreign investor B in our example) to calculate the trading period with reference to the public announcement of the prior offer provided that investor B files its notice within a reasonable time (six months, for example). The same timing principle might also apply for an initial bid by a Canadian investor which has the effect of increasing share value.

Sections 3 and 5 (amending headings in sections 3.1, 3.2 and 3.3)

The new headings before sections 3.1, 3.2 and 3.3 are misleading because section 14.1 applies not only to acquisitions by a WTO investor, but also acquisitions ***from*** a WTO investor (in each case, other than a WTO investor that is a Canadian). We suggest these headings instead refer to "Acquisitions Subject to Section 14 of the *Investment Canada Act*", "Acquisitions of Publicly Traded Entity Subject to Section 14.1 of the *Investment Canada Act*", and "Other Acquisitions Subject to Section 14.1 of the *Investment Canada Act*".

Section 4 (amending section 3.1)

Subsection 4(3) (amending section 3.1 by adding section 3.1(8)) should be amended to refer to the last date of the period covered by the relevant financial statements rather than the date on which the financial statements are released (which may be difficult to determine, and can be arbitrary).

We suggest that consideration be given to extending section 3.1 to capture all indirect transactions.

Section 5 (adding subsections 3.2 and 3.3)

Subsection 3.2(1) establishes a mechanism for determining "enterprise value" not in accord with the manner it is normally determined for business purposes. Enterprise value is normally considered to be the sum of market capitalization plus debt plus cash and cash equivalents, where debt includes only liabilities for borrowed money and excludes operating liabilities such as accounts payable and operating leases. The definition in the Draft IC Regulations would overstate the enterprise value relative to the manner it is understood for business purposes because it would include ordinary course debt (such as accounts payable) without balancing such values against ordinary course accounts receivable, for example.

Subsection 3.2(1) appears to apply only where the publicly-traded entity being acquired is an entity carrying on a Canadian business. Where a privately-held subsidiary carrying on a Canadian business is acquired in a manner described in subparagraph 28(1)(d)(i) and its Canadian publicly-traded parent is merely a holding company that does not carry on a Canadian business, subsection 3.2(1) appears not to apply, in which event subsection 3.3(1) would apply. If the intent of the enterprise value threshold is to determine the value of publicly-traded companies by reference to their market capitalization, subsection 3.2(1) should be clarified to expressly provide that acquisitions of publicly-traded Canadian holding companies with operating subsidiaries carrying on a Canadian business are also subject to that provision.

Subsection 3.2(2) (market capitalization)

Subsection 3.2(2) establishes a mechanism for determining "market capitalization". First, we refer to our comments above on the concept of “trading period”.

We believe clarification is required on how to deal with securities listed or traded on more than one exchange or market (as values can differ between exchanges). We suggest using the exchange or market with the highest trading volume for the shares at issue.

If the objective is to measure "enterprise value", the test for liabilities should reflect market value, not book value. The book value of liabilities may be significantly higher than their market value, especially for failing or flailing companies whose liabilities are valued at significant

discounts. Also, liabilities are referenced to the last quarter, but trading value is referenced to the last 20 days before the preceding month. Our proposal to calculate trading days with reference to the last quarter would more closely align the timing of the liabilities and the trading value (although it would not address our concern about the potential difference between market value and book value).

Where an investor concludes that enterprise value is below the review threshold, it should be able to certify that value without actually having to determine a specific value. Determining the enterprise value will be a burdensome exercise and in many instances it will be self-evident that the value is well below the applicable threshold for review.

In subsection 3.3(1), we recommend that "and control is acquired pursuant to paragraph 28(1)(a) or (b) or subparagraph 28(1)(d)(i)" be inserted after "publicly traded entity" in the third line.

In paragraph 3.3(2)(b) – acquisition of less than 100% of the voting interests in an entity – to avoid possible double-counting we suggest referring only to the consideration payable ***by the investor*** (or "by the non-Canadian") for the acquisition of the Canadian business. Otherwise, if there are two purchasers in one transaction document [say investor A (a non-Canadian) will acquire 70% and investor B (a Canadian) will acquire 30%], subparagraph 33(2)(b)(i) will capture the total acquisition price of the entity, while subparagraph 33(2)(b)(ii) will require a further addition of the fair market value of the 30% being acquired by investor B. Consideration should also be given to adding "if any" to the end of subparagraph 3.3(2)(b)(ii).

Under subsection 3.3(2), how is one to value the consideration payable when the consideration is not in cash (shares or a contractual right, for example)? Subsection 3.3(3) appears to partially address this scenario, but it is unclear what "quantified" means within that subsection – payment in a specific number of shares is "quantified", just not in currency. Perhaps "quantified" should be amended to state "quantified in currency", or something similar.

In section 3.3, we recommend that "set out in" the transaction documents in subsection 3.3(2) be replaced with "as reflected in" because the consideration to be paid may not be expressly stated in a transaction document, but may be determinable pursuant to the documents.

Subsection 3.3 appears internally inconsistent where only some of the assets of a business are being acquired. In that case, all liabilities must be included in "enterprise value", even though some or all of them are not being assumed. Only the assumed liabilities in an asset acquisition should be included in enterprise value.

We recommend that subparagraph 3.3(2)(b)(ii) be revised to read: "the amount that the governing body of the non-Canadian determines in good faith and certifies to be the fair market value of the voting interests that are not being acquired by the non-Canadian".

In referencing the date for applicable currency conversions, paragraph 3.3(7)(a) should refer to the last date of the preceding quarter (or whatever date is ultimately selected as the reference date for calculating liabilities and the end of the trading period) and not the date of implementation of the proposed transaction. Using the date of implementation can create considerable uncertainty as to whether a proposed transaction is reviewable as exchange rates can change after a notification has been submitted causing the enterprise value in Canadian dollars to then exceed the review threshold. The foreign investor must be able to definitively determine the relevant asset value in Canadian currency at the time it files its notification (or application for review).

Section 6 (amending sections 4 to 6)

The list of individuals who may sign a notice or application is unnecessarily narrow (and is narrower than the present ICA Regulations and the *Notifiable Transactions Regulations* under the *Competition Act*). We are of the view that the language of the current IC Regulations ("shall be signed by … a person authorized to bind the investor") should be retained.

Section 8 (coming into force) − need for transitional rules

Transition rules are required to clarify how to determine if and when the new regulations will apply to currently proposed transactions (for example, 75 days' notice before implementation or effective date). We also recommend that the final regulations state that they are not applicable to transactions notified before their effective date. This would give an investor the opportunity to lock in the status of a transaction under the existing IC Regulations. We expect some transactions ***not*** currently reviewable under the book value standard will become reviewable under the enterprise value or acquisition value standard.

Other

We agree that value information should not be required in a notice for an indirect transaction falling within the scope of paragraph 28(1)(d)(ii), as it is not relevant to the Minister's determination of whether the proposed transaction is reviewable.

Given that the global asset threshold catches corporations with only a minimal presence in Canada (such as resource companies that are incorporated in Canada and listed on the TSX so as to access Canadian capital markets) even a minimal management presence in Canada can trigger review. The prospect of an ICA review can be seen as an impediment to realizing full value and therefore creates a disincentive to establishing a Canadian presence in the first instance. We recommend that Industry Canada consider amending the guideline on what it will consider to be a "Canadian business" to require the presence of some operational revenue-generating assets in Canada, and not simply a head office. This approach would be consistent with the Competition Policy Review Panel recommendations to narrow the scope of reviews to capture only the most significant transactions for Canada.

The Draft IC Regulations contemplate continued use of book value as at the end of the immediately preceding fiscal year in certain instances. If the parties close after year end but before that year's financial statements become available, they may not know the relevant asset value. We recommend that investors be permitted to rely on the previous year's financial statements for up to three months following the end of the target's fiscal year in those instances. This is similar to use of the "reference period" in the *Notifiable Transactions Regulations* under the *Competition Act*.

III. NEW INFORMATION REQUIREMENTS FOR NOTIFICATIONS AND APPLICATIONS FOR REVIEW

A. General comments on the Schedules

Schedules I, II and II 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.

We assume these additional information requirements are intended to provide the Investment Review Division (IRD) with information considered necessary to assess whether a proposed (or implemented) investment raises potential national security concerns.[2] Disclosure of some of this additional information for notifiable investments, particularly investments to establish new Canadian businesses, would be unnecessarily burdensome for investors and unlikely to provide information relevant to assessing potential national security issues. This comment is equally applicable to reviewable transactions, but we are particularly concerned with the burden the additional information requirements would impose on investors for non-reviewable transactions.

The Competition Policy Review 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." The 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 appears inappropriate to move in the opposite direction of the Panel's recommendation and impose additional information requirements on investors for mandatory notifications.

B. Comments common to Schedules I and II

Personal information regarding directors, officers and owners of the investor will often be time-consuming to gather and of questionable utility in most cases. Disclosure of the five highest paid officers is unnecessarily intrusive for a private investor, particularly in a notification.
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. We suggest using "voting interest" instead as that term is already defined in the ICA.

The requirement to provide NAICS codes for the products produced by the Canadian business can be extremely onerous; if retained it should in any event be subject to a *de minimis* exception.

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

We have a number of concerns regarding the requirement to disclose "direct or indirect ownership" interests held by a foreign state:

1. The requirement refers to "ownership", but 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 term in this context creates uncertainty. Moreover, "ownership" suggests that non-voting ownership interests may be included, even if they do not allow a foreign state to materially influence an investor and thereby raise a national security concern. We suggest that it would be clearer and more consistent with the rest of the ICA to use the phrase "voting interest" here, too.

2. As a practical matter, many investors are unlikely to know for certain whether a foreign state may have a small ownership interest, voting or otherwise. An investor may know the identity of all of its registered shareholders, but may not know the beneficial owners or who owns those 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.

3. Consideration should be given to adopting a bright-line test. For example, requiring disclosure where a 10% voting interest threshold is met or exceeded would establish a clear, bright-line test and require disclosure of information investors are more likely to have available to them. To the extent there are concerns about "golden share" control issues (where a foreign state may have a small voting interest but is able to outvote other shareholders or exercise veto rights 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 over the investor, through the ownership of voting interests. This type of requirement would be clearer to investors and more consistent with concepts of ownership and control found elsewhere in the ICA.

4. We question 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, disclosure should be limited to principal, not all, sources. We also question whether this disclosure is relevant to a

national security assessment of an investment. If a lender were to acquire control, Industry Canada could presumably assess any national security issues at that time.

C. Comments specific to Schedule I

Section 21 – The market capitalization of a public company should either not be required or be satisfied by stating that it is not greater than the review threshold, for the reasons noted above.

Because indirect transactions involving WTO investors are reviewable only in the case of cultural investments and for national security purposes, the notification form for indirect transactions ought to be streamlined. Moreover, because the cultural review threshold remains based on book value, market value information should not be required for indirect transactions.

A copy of the purchase agreement should not be required for a notification. This may disclose confidential information not relevant to an ICA review, either for a net benefit analysis or a national security review.

Since notifications can be filed before implementation (and are more likely to be filed before notification if these draft regulations are implemented), the form item should say "Date of implementation or expected implementation".

IV. 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.