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Foreign Direct Investment and the National Interest

A Way Forward

Dany H. Assaf and Rory A. McGillis

The *Investment Canada Act* has worked well for Canada, but if we are to remain competitive in global capital markets, we need to more proactively and clearly communicate to foreign investors what we expect of them.

La *Loi sur Investissement Canada* a bien servi les intérêts du pays. Mais pour rester compétitif sur le marché mondial des capitaux, le Canada doit communiquer ses attentes aux investisseurs étrangers de façon plus active et plus claire.

Compétitivité, productivité et croissance économique

Competitiveness, Productivity and Economic Growth

Contents

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Summary

The federal government's effective rejection of BHP Billiton's bid for Saskatchewan's Potash Corporation in 2010 was seen as a flashpoint in the recent evolution of the *Investment Canada Act* (*ICA*), which many hoped would lead to greater clarity in the rules of the game for foreign direct investment (FDI). But uncertainty persists and, with the introduction of provisions such as "exceptional" circumstances, new questions have been raised. While the federal government has undertaken measures to address specific gaps in the *ICA*, it has done so without conducting a more general reassessment of the overall policy regime.

What is Canada's national interest with respect to FDI? Is there a need for further policy reform in light of the patterns and flows of changes in international capital, trade and investment? Where do we stand in relation to other global competitors for investment? In this study, Dany Assaf and Rory McGillis examine these questions as they pertain to the *ICA* and assess how transparent, clear and coherent the Act is compared with the regimes of 11 other countries.

They argue that international rankings like the OECD's FDI Restrictiveness Index misrepresent Canada as being guarded toward foreign investment, while other countries employ more informal means to reject investments. In practice, since 1985 the *ICA* has produced only two refusal decisions that have ultimately blocked takeovers (in noncultural industries).

However, the fact that these rejections have all occurred in recent years and are part of a global trend toward greater scrutiny suggests the need for a more transparent review process. This would provide greater certainty for investors and all Canadians alike, and it would avoid the need for drastic policy amendments in reaction to the specific issues raised by high-profile cases, as happened with Nexen and Progress Energy Resources.

Assaf and McGillis argue in favour of keeping the net benefit test, the centrepiece of the current review process. They argue that it has worked comparatively well over its long history, and investors are familiar with its overall direction. They recommend the government focus instead on better communicating to investors what is expected of them. Among other things, they recommend the government

- modernize the net benefit test to include additional criteria such as an investment's compatibility with environmental, fiscal and trade policy objectives;
- publish a model list of undertakings to inform investors of the requirements that may be attached to a transaction's approval;
- adopt formal guidelines for national security reviews; and
- amend the guidelines for state-owned enterprises to clarify issues of reciprocity, "exceptional" circumstances and other specific requirements (e.g., bonds).

As a more general comment, the authors note with concern the increasing reference in public discourse to the concept of "strategic assets." As the term is open to broad political interpretation, they say it is of little practical utility for policy and should be strongly resisted.

Résumé

Le rejet, par Ottawa, de l'offre publique d'achat de BHP Billiton en vue d'acquérir Potash Corporation en 2010 a été considéré comme un point tournant dans l'évolution de la *Loi sur Investissement Canada* (LIC). Ils étaient nombreux à espérer que ce refus susciterait des changements et clarifierait les règles du jeu en matière d'investissement direct étranger (IDE). Mais une certaine confusion persiste, alors que, parmi d'autres modifications, la référence à des « circonstances exceptionnelles » soulève de nouvelles questions. Ottawa a effectivement pris des mesures pour remédier à des lacunes de la LIC, mais il l'a fait sans procéder à une réévaluation générale du régime des politiques d'investissement.

Quel est l'intérêt du Canada en matière d'IDE ? Faut-il adopter d'autres réformes face aux changements structurels en cours en matière de commerce, de capitaux et d'investissements internationaux ? Où en sommes-nous par rapport à nos concurrents mondiaux sur le plan des investissements ? Dany Assaf et Rory McGillis examinent ces questions en ce qui concerne la LIC, et évaluent la clarté, la cohérence et la transparence de la Loi comparativement aux régimes de 11 autres pays.

Ils soutiennent tout d'abord que les classements internationaux, notamment l'indice des restrictions à l'IDE de l'OCDE, donnent du Canada l'image erronée d'un pays qui se méfie des investissements étrangers. Or d'autres recourent à des moyens plus informels pour rejeter des investissements. Depuis 1985, la LIC n'a donné lieu qu'à deux refus (secteurs autres que culturels) bloquant les offres publiques d'achat.

Mais ces blocages — parce qu'ils sont survenus récemment et participent d'une tendance mondiale en faveur de contrôles accrus — ont fait ressortir la nécessité d'un processus d'examen plus transparent. Une meilleure transparence rassurerait les investisseurs, tout comme les Canadiens, et éviterait le recours à des changements soudains de politiques en réaction aux problèmes particuliers soulevés par des cas très médiatisés, tels ceux de Nexen et de Progress Energy.

Les auteurs préconisent donc le maintien du critère de l'avantage net, qui est au cœur de l'actuel processus d'examen, puisqu'il a été relativement efficace au cours de sa longue histoire et que les investisseurs en connaissent bien l'orientation générale. Ils estiment plutôt qu'Ottawa doit mieux communiquer ses attentes aux investisseurs. À cet égard, ils formulent plusieurs recommandations au gouvernement, notamment :

- Actualiser le critère de l'avantage net en y ajoutant des éléments comme la compatibilité des investissements avec des objectifs environnementaux, fiscaux et commerciaux ;
- Publier une liste modèle d'engagements qui informe les investisseurs des exigences susceptibles d'être rattachées à l'approbation d'une transaction ;
- Adopter des lignes directrices officielles en matière d'examen de sécurité nationale ;
- Modifier les lignes directrices applicables aux sociétés d'État étrangères pour clarifier les questions de réciprocité, de « circonstances exceptionnelles » et autres (cautionnements par exemple).

Dans un commentaire d'ordre plus général, les auteurs se montrent préoccupés par l'utilisation fréquente du terme d'« actifs stratégiques » dans le discours public. Selon eux, comme le concept se prête à toutes sortes d'interprétations politiques, il est peu utile et on devrait cesser de l'employer.

Foreign Direct Investment and the National Interest: A Way Forward

Dany H. Assaf and Rory A. McGillis

Introduction

> *Until the policy is clarified, it will be understandable if investors believe their money is no longer welcome in Canada.*
>
> — Financial Times, *October 22, 2012*

The quote above is the punchline to an editorial in response to the interim rejection[1] of the takeover of Progress Energy Resources, a Canadian gas producer, by Malaysia's national oil company, Petronas — a transaction that ultimately was revised and approved. This case and the high-profile acquisition of Nexen by state-owned China National Offshore Oil Corporation (CNOOC) highlighted important questions about the role of foreign direct investment (FDI) in Canada and the effectiveness of Canada's investment review process. Since the rejection of the proposed takeover of MacDonald Dettwiler in 2008 and the effective rejection of the proposed takeover of Potash Corporation of Saskatchewan (Potash Corp.) in 2010,[2] Canadians have been subjected to many views on the potential benefits and detriments of foreign investment. Although Canada remains a significant destination for foreign capital, a great deal of discussion has ensued regarding the federal government's approach to FDI.

The Canadian investment review process has also seen significant developments in the past several years, including the introduction of rules for national security review, policy guidelines for acquisitions involving foreign state-owned or -controlled entities (SOEs) and the recent introduction of a new "exceptional" standard of review for SOEs targeting the Canadian oil sands sector. In isolation, each of these changes might be worthwhile, but the incremental process by which they have been implemented has added uncertainty to the overall direction of Canada's investment policy. Also, the federal government has not yet provided the clarity many had expected on the interpretation of the "net benefit" test — the lynchpin of the *Investment Canada Act*[3] (*ICA*) — a commitment it made in 2010 following the Potash case.

If Canada is to continue to position itself effectively in the global investment climate and if the Canadian public and investors are to have greater certainty and clarity about investment rules, the *ICA* policy needs to be examined in a forward-looking and comprehensive manner. How, then, does Canada get the most from its investment policy? This study seeks to answer this question by examining both the *ICA* and how it compares with foreign investment review regimes in 11 leading jurisdictions.[4] We begin with a review of the *ICA*'s linkages to broader trade policy, its evolution over time and the basic statutory functions it plays today. We then assess the *ICA*'s relevance to contemporary investment policy issues, and how it compares in effectiveness and coherence with those of global competitors.

Canada is not alone in facing challenges to its foreign investment review policy or changes in the international investment environment. Leading economies around the world are introducing new guidelines to respond to international developments, scrutiny of proposed acquisitions is increasing and rejections are becoming more frequent. Our findings reveal that, in fact, Canada does comparatively well in providing a rules-based framework for reviewing foreign investments. It is our view that Canada remains committed to FDI and to open and interconnected markets. Building on this foundation, we provide a series of recommendations on how to further clarify the rules and ensure that they remain responsive to Canadians' concern that foreign investment be of "net benefit" to Canada.

Key assumptions

Before going further, it is important to clarify several principles that inform the study throughout. In the face of the uncertain and shifting foreign investment landscape, it can be difficult to discern the best way forward for Canada's foreign investment regime. In such circumstances, it is best to turn back to the core interests of any policy and work ahead from there.

The core principles surrounding foreign investment in Canada should be viewed through the lens of the Canadian national interest and the benefits and costs to our economy. In this regard, the starting point of analysis is the reality that Canadians benefit from having others invest their capital in our country and help us fund projects and expand our businesses more quickly and cost efficiently than we could on our own. Whether blue- or white-collar workers, all Canadians benefit; we all depend on strong businesses operating in Canada.

The reasons for this are simple and compelling: the pool of capital available within the Canadian population of 35 million people is much less than that available within a global population of 7 billion people. If Canadian business were to rely on seeking capital only within Canada, the laws of supply and demand would dictate that our cost of capital would be much higher than the cost for our global competitors, which have access to greater capital resources. This approach would hinder the growth and competitiveness of Canadian businesses and the economy and their potential to create jobs, only making things worse for all of us. These facts are hard to overcome.

Accordingly, there is no logic in turning down or fearing investment capital from any particular country as a matter of principle. This is especially so in a world where significant wealth and capital have accumulated in new places — such as Asia and South America — and will continue to do so for the coming century. Although challenges to the continued growth of global trade and investment remain, it is clear that past and future benefits of global commerce and development are too compelling to developed, emerging and developing countries alike to be seriously reversed at this stage.

At the same time, it is perfectly acceptable for Canada, a strong and prosperous country with attractive assets, to insist on ensuring that significant foreign investments offer specific and tangible benefits to the Canadian economy.

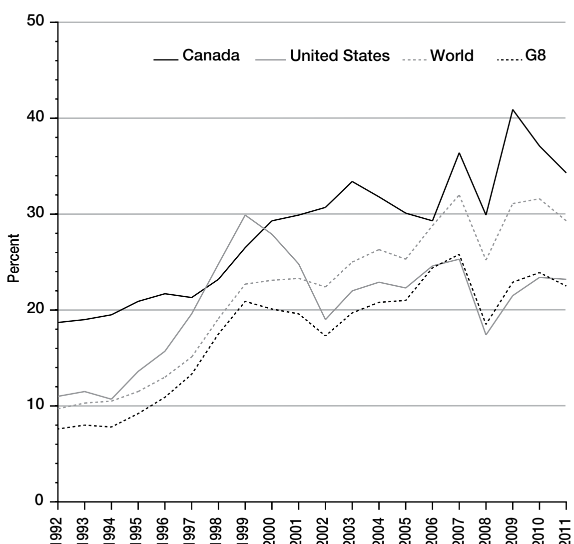
In the face of shifting developments and the increasing public scrutiny of foreign investments, we also approach this analysis with the perspective that policy must seek an appropriate balance between flexibility and clarity in the rules. These goals are not incompatible. It is reasonable that governments need to retain a certain degree of flexibility in foreign investment review to ensure that the national interest is well served and can effectively evolve to deal with new issues and challenges. Recognizing this dynamic at the outset is crucial for both government and investors to understand clearly how the investment review process will unfold.

The art of remaining open to vital foreign investment and maximizing the benefits is in having clear rules that provide certainty to the process and encourage the right kinds of investment. In the true Canadian tradition, the operating principle should be: we generally do not care where you come from or what your background is, but if you are prepared to invest here and act as a genuine partner in the Canadian economy and follow the rules, your investment is welcome.

International Trade and Investment and Canada

Over the past 40 years, technological advancements in information sharing, communications and transportation, coupled with the movement to liberalize and standardize domestic and international commercial regulation, have supported a dramatic advance in the internationalization of the world's economies. The flow of global FDI increased from US$13 billion to US$1.5 trillion between 1970 and 2011, an increase of over 12,000 percent (UNCTAD 2012).[5] Canada has been an active participant in this internationalization trend, its stock of *inbound* FDI having grown appreciably over the past two decades and remaining considerably higher than that of our main competitors (figure 1). At the end of 2011, this stock totalled $607.5 billion, equivalent to 34 percent of Canada's gross domestic product (GDP) (DFAIT 2012b),[6] while Canadian *outbound* direct investment in foreign markets totalled an even greater $684.5 billion (DFAIT 2012a). Canada's further integration into the global economy is a policy initiative actively fostered by all levels of government and supported by Canada's demographics.[7]

Figure 1. Stock of inbound FDI as a share of GDP, Canada, the United States, the world and the G8, 1992-2011



Source: UNCTAD (2012).

International trade and investment has long played a key role in Canada's economy. We see this in each generation — trade with Great Britain during our founding ; manufacturing exports to the United States after the Second World War; and new markets in Asia and South America at present. From shortly after the birth of the Canadian nation-state, the Canadian Pacific Railway was moving goods from within Canada to international markets and immigrants from all over the world into the Canadian interior to help build the country. This history set the stage for the key role of international trade in Canada's modern economy where, in 2011, exports accounted for more than one-quarter of Canada's GDP ($456.5 billion of $1,720.7 billion) (Statistics Canada 2013; Statistics Canada 2012). Access to international markets and foreign capital has given western Canada the financing — $116 billion between 2000 and 2010 (Alberta 2012) — to develop its capital-intensive oil sands resources. The Alberta government has stated that foreign investment is critical to further development and as a competitive source of capital (Wingrove 2012). As of 2011, Alberta's oil and gas development and mining sectors employed 151,000 people, and oil sands royalties contributed more than $3.7 billion to the provincial government's coffers in fiscal year 2010-11 (Alberta 2012). Another $364 billion is expected to be invested in Canada's oil sands industry between 2012 and 2035, supporting 880,000 direct and 1.45 million indirect person-years of employment; more than 40 percent of the domestic income effects are predicted to occur outside Alberta (Arcand, Burt, and Crawford 2012).

In addition, it is important to remember Canada's "original" free trade agreement, the iconic Canada-United States Automotive Products Agreement (the Auto Pact),[8] signed by the two countries in January 1965 to remove tariffs on automotive products and parts and to guarantee a minimum volume of US automotive manufacturers' production in Canada. The agreement facilitated investment in, and development of, a world-class automotive industry in Canada, a key part of Ontario's manufacturing sector for the past five decades. Moreover, the Auto Pact led to generations of quality jobs and livelihoods for Canadians. Between 1990 and 2011, automotive manufacturers made nearly $40 billion in direct investment in Canada. Prior to the financial crises, automotive exports totalled roughly $70 billion in 2007, more than $67 billion of which went to the United States. Trade in finished vehicles with the United States resulted in a $25-billion trade surplus in 2007, accounting for 18.5 percent of Canada's total trade surplus with that country and 57 percent of Canada's total industrial trade surplus (Canadian Vehicle Manufacturers' Association, n.d.).

As we look ahead, we are encouraged by the part that foreign investment could play as Canadians develop other priorities, such as renewable energy and other emerging industries and related employment opportunities. For example, in January 2010, the Ontario government announced an agreement for a consortium led by South Korea-based Samsung C&T Corp. and the Korea Electric Corporation to invest $7 billion in wind and solar power construction and operation in Ontario. This investment is expected to create more than 16,000 green energy jobs in the manufacturing, construction, installation and operation of renewable energy projects, and provide approximately 10 percent of Ontario's energy needs — although the full extent of these expected benefits might be imperilled by a trade dispute regarding domestic-content requirements in Ontario's renewable energy program (Ontario 2010).[9]

FDI continues to be beneficial to the Canadian economy in other ways. It increases the pool, and competitively decreases the cost, of capital available to Canadian business to develop Canadian resources and create employment and training opportunities. It attracts top management talent to Canada and disseminates management training and expertise into the Canadian labour force. It facilitates technology transfer into the Canadian economy from foreign jurisdictions. And it further integrates Canada into international markets with concomitant reciprocal trade and investment accessibility for Canadian businesses (Hejazi 2010).

International trade has not been wholly without challenges, however. There are long-held concerns in Canada that foreign capital, left unchecked, would purchase and control many of the country's most valuable assets. This, it is argued, would result in a "hollowing out" of Canadian industry and leave a branch plant economy, with management jobs and profits repatriated to foreign corporate headquarters and with Canada's most talented and ambitious labour in hot pursuit (Dawson 2012). In the postwar decades, this concern grew more acute as US interests increasingly dominated Canadian industry. By 1970, Canadian ownership in certain industries, such as petroleum and rubber, was below 10 percent, and three-quarters of all FDI in Canada came from the United States (O'Sullivan 1980, 177). Public support in Canada for foreign investment and opening its markets was vulnerable to opinion that foreign investors were profiting from their acquisition of Canadian businesses at the expense of Canadians.

An assessment of more recent transactions and rejections reveals that they come on the heels of a string of high-profile foreign acquisitions of Canadian companies over the past decade, rekindling the debate about Canada becoming a branch plant economy. Iconic Canadian companies — among them Alcan, Inco, Falconbridge, Dofasco, Stelco, Ipsco, Molson, Fairmont, Four Seasons and Newbridge (Reguly 2012) — have become foreign owned or subsidiaries of foreign multinationals. Meanwhile, Canada's unwavering commitment to the rules and principles of open investment in the face of the formal and informal practices of certain countries to protect their industries from foreign acquirors generated media scrutiny and some public criticism. For instance, Scott Hand, then Chief Executive Officer of Canada's former mining giant Inco (until it was acquired in 2006 by Brazilian-based Vale), said, "Other countries have judiciously exercised their right to stop takeovers; there is no reason why Canada can't. Canada is a Boy Scout playing among other countries that play hardball" (McNish, Clark and Laghi 2008).

As noted, however, Canada's stock of outward FDI now significantly exceeds its stock of inward FDI — by almost $80 billion at the end of 2011. Canadians have been increasingly active on the global stage, with investors such as the Ontario Municipal Employees Retirement System (OMERS), the Ontario Teachers' Pension Plan (OTPP) and the Canada Pension Plan Investment Board (CPPIB), to name a few, that are making significant acquisitions overseas. For instance, in late 2010, OMERS and OTPP teamed up to acquire the rights to operate the high-speed rail link connecting London and the Channel Tunnel (HS1) for $3.4 billion (OMERS 2010), and in April 2012 the CPPIB agreed to pay $1.14 billion for stakes in several major Chilean toll roads (CPPIB 2012). Clearly, foreign investment is not simply a one-way issue for the Canadian public interest. Furthermore, as Walid Hejazi points out, fears of "hollowing out" are not reflected in the facts, which show an upward trend in the number of world-leading Canadian companies (Hejazi 2010, 9).

It is against this historical trade and investment backdrop that it is helpful to view Canada's foreign investment review legislation.

The Statutory Review Process

The precursor to the *Investment Canada Act* was the *Foreign Investment Review Act* (*FIRA*),[10] which existed between 1973 and 1985, and required foreign acquirors to prove that their proposed transaction was "a significant benefit to Canada" (section 2(1)). Although no acquisitions were rejected under *FIRA*, the reviews were often onerous and the acquisitions approved with strict conditions (Spence and Takach 1986, 13). In 1985, the federal government replaced *FIRA* with the *ICA*, and the "significant benefit to Canada" test with a less onerous review standard of "net benefit to Canada." The new legislation was also intended to signal to foreign investors that Canada was indeed open and welcoming to them (Spence and Takach 1986). More than 1,600 applications have been reviewed and approved, and more than 13,000 notifications processed, under the *ICA* (Industry Canada 2012f). Only two investment applications have not been approved; a third, the Petronas-Progress transaction, was approved only after an initial rejection (Feteke 2012).

The *ICA* and the net benefit test

Foreign investment reviews under the *ICA* are handled by Industry Canada or, in the case of investments in the cultural sector, by the Department of Canadian Heritage. To be approved, the investments must be determined to be of "net benefit" to Canada by the relevant minister.

Generally, any non-Canadian investor who proposes to acquire direct control of a Canadian corporation of a certain size and that carries on a Canadian business must file an Application for Review (the "Application") with the minister of industry. For 2013, the relevant review threshold for World Trade Organization (WTO) investors is $344 million of worldwide value of the assets of the target Canadian business (Industry Canada 2013). Once implemented, recent amendments to the *ICA* will increase the review threshold to $600 million in "enterprise value"; over the next four years, it will rise to $1 billion, followed by annual GDP-indexed increases thereafter (*Budget Implementation Act*, section 448).[11] The acquisition of *indirect* control of a Canadian business by an investor from a WTO member country is generally not subject to review and approval — for example, when a Canadian subsidiary is acquired as a result of the acquisition of the shares of a non-Canadian corporation in the context of a global takeover. Investments in certain culturally sensitive areas, such as the publication and distribution of books, magazines, films and music, are subject to a greater level of scrutiny than other transactions, and may be prohibited as a matter of government policy (*Investment Canada Regulations*, schedule IV).[12] The review threshold for cultural investments is $5 million (Industry Canada 2013).

When a proposed acquisition of control of a Canadian business exceeds the review threshold, an investor must file the Application and the industry minister will assess whether the proposed investment is "likely to be of net benefit" to Canada (*ICA*, section 16(1)). Among other things, the Application describes the investor's plans for the Canadian business it proposes to acquire, and explains why the investment will likely be of net benefit to Canada. Initially, the industry minister has 45 days to review the Application but this can be extended (*ICA*, section 22(1)).

When a proposed acquisition of control does not exceed the review threshold, the *ICA* requires an investor to file a two-page notification form within 30 days of the implementation of the investment (section 11(b)).

The substantive net benefit assessment is made on the basis of policy statements by the industry minister and the following broad economic and policy criteria under section 20 of the *ICA*:

(1) the effect of the investment on economic activity in Canada; (2) the degree and significance of participation by Canadians in the Canadian business and in any industry in Canada of which the Canadian business forms a part; (3) the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety; (4) the effect of the investment on competition within Canada; (5) the compatibility of the investment with national industrial, economic and cultural policies; and (6) the contribution of the investment to Canada's ability to compete in world markets.

Although the "net benefit" test is not perfect, we would not recommend changing it to a new standard for two key reasons. First, by the nature of the exercise, any new foreign investment review test would still incorporate concepts incapable of exact definition. Second, from an enforcement and interpretation perspective, we would have to start all over again to flesh out the practical definition of any new standard. The existing net benefit test is not unreasonable — and our history and experience with it help provide meaningful contours to the concept that are worth preserving.

To satisfy the net benefit test, investors typically enter into binding undertakings with the Canadian government regarding certain benefits to Canada that will result from the investment. These undertakings typically include commitments such as maintaining the Canadian head office, making planned capital expenditures and providing ongoing opportunities for Canadians to participate in the management of the business. In addition, undertakings relating to maintaining Canadian production, employment, research and capital expenditures are usually made for a period of at least three to five years. Normally, there are no continuing restrictions on foreign investors after the undertakings expire. In the case of an investment by an SOE, however, undertakings relating to corporate governance and commercial orientation can survive for as long as the SOE controls the Canadian business.

The Investment Review Division of Industry Canada monitors compliance with undertakings by reference to its *Guidelines: Administrative Procedures* (Industry Canada 2012a). These guidelines provide that a performance evaluation ordinarily will be made 18 months after the implementation of the investment. If the evaluation finds that implementation — subject to subsequent circumstances beyond the investor's control — is substantially consistent with the original expectations and that no major commitments remain unfulfilled, there is no further monitoring. Failure to comply with an undertaking can result in, among other things, the forced divestiture of the investment or monetary penalties (*ICA*, section 40(2). The guidelines also provide that, "where inability to fulfill a commitment is clearly the result of factors beyond the control of the investor, the investor will not be held accountable" (Industry Canada 2012b). In practice, and in accordance with section 39.1 of the *ICA*, the government and the investor may agree to variances or replacement undertakings if an original undertaking is clearly unachievable.

For instance, it has been reported that Industry Canada declined to pursue foreign mining companies Vale, Xstrata and Rio Tinto for apparent breaches of employment undertakings related to their acquisitions of Canadian mining companies — respectively, Inco, Falconbridge and Alcan — although the undertakings have not been made public, and so we are unable to confirm their actual commitments. All these foreign mining companies made significant job cuts to their acquired Canadian businesses in 2009 (Hoffman 2010).

However, Industry Canada's later efforts to enforce the undertakings of US Steel might signal a heightened sensitivity to this guideline and a limit to Industry Canada's willingness to accommodate a foreign acquiror in breach of its undertakings (McCarthy 2012; Hoffman 2010). *US Steel*[13] was the first case in which proceedings were brought against an investor for failing to comply with its undertakings. US Steel allegedly failed to comply with undertakings it had made in connection with its 2007 acquisition of Stelco, the large Canadian steel manufacturer, including maintaining a minimum level of steel production and employment at Stelco's Canadian facilities; US Steel also had made no apparent attempt to renegotiate new or revised undertakings (Wakil 2009). Instead, the company transferred considerable steel production to its US facilities and laid off a significant portion of its Canadian workforce. It is likely that this both invoked the federal government's displeasure and raised questions about whether the Canadian plant closures were truly "the result of factors beyond the control of the investor," as US Steel claimed, or a business decision to concentrate production in the United States (Wakil 2009). In any event, the Industry Minister rejected US Steel's claim that fallout from the 2008 financial crisis rendered it unable to fulfill its undertakings. The parties eventually settled the case on the basis of strengthened undertakings after US Steel failed in its constitutional challenge, which claimed that the *ICA* process and penalties for enforcing the undertakings violated its constitutional rights to a "presumption of innocence" and a fair hearing.

Recent Developments and Concerns

The past several years have been a tumultuous period for Canadian FDI policy. The context in which Canadians and investors view foreign investment rules and how they are enforced by government has been influenced by the global financial crisis generally and more specifically by issues relating to (1) the first rejections issued under the *ICA* (outside the cultural sector);[14] (2) concerns regarding the sale of so-called strategic assets; (3) the development of national security reviews over the 12 years since the terrorist attacks of September 11, 2001; and (4) the rise of SOEs as active foreign investors.

In the 23 years in which no proposed acquisition was rejected under the net benefit test, criticism of the test was relatively muted. Then, in 2008 and 2010, respectively, came the rejection of the MacDonald Dettwiler and Potash Corp. transactions, which drew attention to Canada's foreign investment review system and encouraged calls for greater clarity on what exactly constitutes "net benefit" under the *ICA* and how the test is applied.

The 2008 MacDonald Dettwiler rejection put the net benefit test and decision-making transparency into the spotlight and broke any taboos surrounding the issue of rejection (Assaf 2008). In response, in 2009 the federal government amended the *ICA* to promote greater transparency. The amendments required that the industry minister provide reasons for any decision to reject an investment (section 23.1), authorized the minister to disclose information on the review process if doing so would not prejudice investors (section 36(4.1)) and required the publication of annual reports regarding the administration of the *ICA* (section 38.1). Attention to the issue had largely subsided by 2010, when the rejection of BHP Billiton's bid for Potash Corp. triggered renewed criticism about the uncertainty and the opaqueness of the review process and prompted concern that Canada was becoming a more restrictive economy. The recent interim rejection of the Petronas acquisition has only exacerbated matters.

A by-product of the debate on high-profile transactions such as MacDonald Dettwiler-Alliant Techsystems, BHP Billiton-Potash Corp. and CNOOC-Nexen is the increasingly casual use of the term “strategic asset” by politicians and media commentators in connection with foreign acquisitions. This has led to some politicization of the concept. In fact, although the designation “strategic asset” or “strategic industry” is a notion found in the foreign investment review systems of several major countries, it is not part of Canada’s system. During the debate over the BHP Billiton-Potash Corp. transaction, Industry Minister Tony Clement specifically emphasized that “strategic” does not appear in the *ICA* and is not taken into consideration in the review of a proposed foreign acquisition (Chase 2010). Continued use of the term, however, perhaps has led to a misperception by the public of certain aspects of the *ICA* review process.

Another recent development is the federal government’s introduction in 2009 of a national security review provision in the *ICA*. The review establishes a legal process to assess acquisitions that potentially involve national security issues and to solicit relevant information from the foreign investor. The review does not define or provide guidance on what constitutes a “national security” concern — an omission that could cause uncertainty for investors. When it announced its most recent guidelines on SOEs, Industry Canada also said that amendments to the *ICA* would provide greater flexibility to extend the duration of national security reviews of proposed foreign investments in exceptional circumstances (Canada 2012). As of this writing, however, the government had provided no further information regarding the amendments.

In 2007 the federal government introduced special review guidelines for SOEs under the net benefit test. It recently announced revisions to those guidelines in response to concerns raised in the context of the CNOOC’s $15.1-billion bid for Nexen and Petronas’ $5.2-billion bid for Progress Energy Resources (Canada 2012). Australia and the United States have also introduced special rules for foreign SOE investors. Interestingly, Australia’s Foreign Investment Review Board (FIRB) chairman, Brian Wilson, announced in August 2012 that the FIRB would also be updating its policy guidelines to clarify when foreign SOE investments need FIRB approval (Australia 2012; Tempone and Campbell 2012).

We explore these developments and their effects in more detail below.

ICA rejections

MacDonald Dettwiler-Alliant Techsystems

The first investment rejection under the *ICA* occurred in May 2008 when US-based Alliant Techsystems’ $1.33-billion proposed acquisition of MacDonald Dettwiler was denied. MacDonald Dettwiler is a Canadian-based aerospace, information and products company that, among other things, owns and operates RADARSAT satellites that monitor remote areas in northern Canada (MacDonald, Dettwiler and Associates, n.d.). The Industry Minister stated that Alliant had not satisfied the net benefit test but did not provide further explanation (Industry Canada 2008). There was speculation that the federal government’s chief concern was the effect of US national security laws on Canada’s priority access to RADARSAT information (Todd 2011). In addition, there were some concerns that MacDonald Dettwiler’s business development had been supported by federal development funds, and that those benefits would be realized or captured by foreign investors (Harb 2008). Primarily, this case appeared to raise national security concerns, although there was no formal national security review at the time.

BHP Billiton-Potash Corp.

In August 2010, Australia-based BHP Billiton's $40-billion hostile takeover bid for Potash Corp. was denied approval. BHP Billiton's bid generated considerable controversy over the prospect of one of Saskatchewan's largest companies and a global industry leader becoming a subsidiary of a multinational company, and the potential consequences to the significant tax and royalty revenue stream that Potash Corp. generates for the Saskatchewan government (Wall 2010). The Industry Minister's assessment that the proposed transaction was not likely to be of net benefit to Canada was not final — BHP Billiton had 30 days to make additional representations and submit undertakings, which the company did not elect to do (Industry Canada 2010) — so the Minister was not required to provide in-depth reasons for rejecting the acquisition. (Had the decision been final, he would have been required to submit reasons under a 2009 amendment to the *ICA*.) The Minister did state in a press conference, however, that the acquisition would not have helped Canada to compete in world markets, would not have boosted productivity, efficiency and innovation, and would not have elevated economic activity; moreover, BHP Billiton lacked Potash Corp.'s experience in the potash industry (Todd 2011).

Petronas-Progress Energy Resources

Petronas' attempt to acquire Progress Energy Resources was initially rejected, in October 2012. Petronas had apparently denied Industry Canada's request for a delay until December 7 to make a determination of the proposed transaction, even though there had been no indication that approval would have been withheld. In response, Industry Canada abruptly rejected the transaction (Cattaneo 2012b). In the aftermath, Prime Minister Stephen Harper gave Petronas a period of 30 days in which to respond and said that the Canadian government would soon "put out a clear, new policy framework regarding these sorts of transactions" (Cattaneo 2012b). Industry Canada subsequently approved the Petronas acquisition, on December 7 as it had originally requested, and also announced revisions to the policy guidelines relating to SOE investments (Industry Canada 2012c; Canada 2012).

A comment on the rejections

Perceptions that Industry Canada did not provide sufficiently detailed explanations of why these three transactions were not of net benefit to Canada caused concern over the potential uncertainty being communicated to foreign investors interested in the Canadian market ("Closing Canada" 2012). One commentator went as far as to suggest that Saskatchewan was a "banana republic" as a result of the provincial government's opposition to the Potash Corp. acquisition (Corcoran 2010). Further amplifying this uncertainty was the introduction of the terms "strategic resource" and "strategic asset" in the discussion regarding the *ICA* review. The rejections, regardless of their merit, broke taboos about using the *ICA* to reject a foreign takeover, and it is not known what chilling effect they might have had on future investment plans. In our view, therefore, these developments make it necessary for the federal government not only to further clarify the net benefit test, but also to make its current enforcement policy more transparent.

"Strategic assets"

Although neither "strategic asset" nor "strategic resource" is found in the *ICA*, the terms gained currency in public debate following the MacDonald Dettwiler and Potash Corp. rejections. The general connotation is fairly straightforward: a strategic asset or resource is a company that employs many people, has significant symbolic value and/or controls critical resources or technology and is an important player in the economy. This concept is somewhat analogous to the "strategic industry" protections common in European jurisdictions. It also once formed part of Canada's foreign investment review regime, attracting special restrictions or review for foreign investment above a certain threshold in certain industries deemed of special importance.[15] The current question is whether it is prudent or necessary for Canada to adopt this concept formally, as part of the *ICA*.

Saskatchewan Premier Brad Wall maintained that BHP Billiton's bid should be rejected because Potash Corp. was a "strategic resource" (Wall 2010). Premier Wall based his assessment on the expected loss of Saskatchewan's institutional leverage in the potash sector — Saskatchewan has almost half of proven global reserves (Potash Corporation of Saskatchewan 2011) — and the potential jeopardy to the significant potash royalty revenue stream flowing to the provincial government (Jasinski 2011; Rocha 2010). He also noted that BHP Billiton, as a large multinational for which potash would simply be one of many different business lines, had indicated a weak commitment to ensuring a high potash price (Wall 2010). Furthermore, following the rejection of BHP Billiton's bid, Gerry Ritz — the federal Agriculture Minister and regional minister for Saskatchewan on behalf of the federal government — stated that "the government rejected BHP's bid in part because it decided that the mineral is a 'strategic resource' in the global food supply" and that Saskatchewan's potash reserves give "Canada an influential position in the marketing of a key agricultural commodity" (Reguly, Hoffman and Bouw 2010).

John Manley, a former industry minister and now President and Chief Executive Officer of the Canadian Council of Chief Executives, alleged that Premier Wall's remarks were politically motivated: "The Premier's 'strategic resource' rationale is a political calculation — one that he is entitled to make if he feels he can justify it to his citizens. But the *ICA* exists to ensure that Canadians benefit from foreign investment, not to protect resource companies designated as 'strategic' at the 11th hour by provincial governments" (Manley 2010). Industry Minister Tony Clement then clarified the federal government's position regarding "strategic asset" and "strategic resource," noting that as neither term appears in the *ICA*, neither was taken into consideration in the review of the proposed acquisition (Chase 2010).

This case brought to the fore issues of strategic assets and foreign control and implied that Canadians need to control or have access to the supply of these resources. Control would be especially important, if, for example, the owners later exposed themselves as acting to harm Canadian national security or hoarding a resource for their own citizens in times of national crises. The case also highlighted the interests of governments as stakeholders at risk of losing tax revenue that could harm their fiscal health in an era of austerity and deficits.

Despite the federal government's position, the use of "strategic asset" nevertheless persists. For example, Ontario Finance Minister Dwight Duncan described the TMX Group Inc., the entity that owns and operates the Toronto Stock Exchange and TSX Venture Exchange, as a "strategic asset" and "one of the country's crown jewels" after the 2011 announcement of a proposed merger between the TMX Group and the London Stock Exchange Group, owner of the Borsa Italiana and the London Stock Exchange (Howlett 2011). In March 2012, Saskatchewan politicians debated in the provincial legislature whether Canada's grain industry should be considered a "strategic economic sector" following the announcement of potential takeover bids for Viterra Inc., a global Canadian-based agribusiness and successor company to the Saskatchewan Wheat Pool (Saskatchewan 2012). Finally, in July 2012, on the eve of an announcement of a provincial election, Quebec Finance Minister Raymond Bachand called home-improvement retailer Rona Inc. a "strategic asset" and said that, if necessary, the federal government should reject the hostile takeover bid made by US-based Lowe's Companies, Inc. (Van Praet 2012). Bachand supported this assertion by noting that Rona employs 28,000 Canadians directly, and an additional 90,000 jobs are tied to Rona's suppliers ("Lowe's Offer" 2012).

The continued use of the term thus generates uncertainty; it also has the potential to create an informal category of reviewable, easily politicized transactions and to confuse the *ICA* net benefit analysis. In fact, the concept of "strategic asset" is already subsumed within the "net benefit" framework, as Minister Bachand implied in citing the number of Canadian jobs tied to Rona, as a foreign acquisition's impact on Canadian jobs is a key part of the net benefit test and associated undertakings. The purpose of the net benefit test is to ensure that foreign investors create value for Canada, whether or not the investment has a high "strategic value." The test requires that the foreign acquisition be beneficial to Canada on a holistic assessment of factors. A potential acquiror essentially is required to show and confirm that its acquisition of the Canadian business would benefit Canada relative to the existing benchmarks of the business under existing Canadian control. By this standard, there is already consideration of the strategic value of the Canadian-based target of a foreign acquiror, albeit not specifically under that terminology. It is not in Canada's interest to allow the use of "strategic asset" to become a politicized code to prevent a deal from being approved for political reasons. The consideration of a company's strategic value should be clearly identified as already subsumed within the net benefit test.

National security review

The *ICA* was amended in March 2009 to add an explicit national security review, which applies to proposed investments to establish a new Canadian business or acquisitions of any size, with no financial threshold (part IV.1). An investment may be reviewed before or after closing (section 25.1). This followed the recommendation of Industry Canada's 2008 Competition Policy Review Panel that it is "in Canada's interests in a post-9/11 world to have in place an explicit national security test to support its trade and investment policies" (Competition Policy Review Panel 2008, 30). The introduction of an explicit test brought Canadian policy in line with that of other advanced national economies such as the United States, the United Kingdom, China, Japan and Germany (31). It was speculated at the time that this recommendation was in part prompted by the 2008 rejection of Alliant Techsystems' attempted takeover of MacDonald Dettwiler. Because an explicit national security test did not exist in the ICA at the time, the federal government was forced to view this question in the light of the net benefit test, which was not explicitly designed for such a purpose (VanDuzer 2010, 22).

National security review under the *ICA* engages government players other than the industry minister. An investment is reviewable under part IV.1 if (1) the minister considers that the investment could be injurious to national security, after consultation with the minister of public safety and emergency preparedness (to whom the Canadian Security Intelligence Service reports); and (2) the governor in council makes an order for review on the recommendation of the minister (section 25.3(1)). More generally, the *ICA* provides that the minister shall (where appropriate) use the services and facilities of other departments, branches or agencies of the federal government in exercising powers or performing duties under the statute (section 5(2)(a)).

The national security review authorizes the industry minister to initiate a review of an investment of any size by a foreign investor if the minister has reasonable grounds to believe that the investment could be injurious to national security (section 25.2). The minister may also require the foreign investor to provide any information necessary to determine whether those grounds exist (section 25.2). The minister must notify the foreign investor that its investment is under review and that the investor has the right to make representations to the minister (section 25.2). A foreign investor who receives this notice may not implement the investment unless it receives either a notice indicating that no further action will be taken in respect of the investment or a copy of an order authorizing the investment to be implemented (section 25.3). In addition, the minister may review an investment that has already been implemented (section 25.1). If the review finds it advisable in order to protect national security, the foreign investor may be (1) prohibited from implementing the investment, (2) authorized to implement the investment on certain conditions or undertakings, or (3), if it has already implemented the investment, required to divest itself of control of the Canadian business or of its investment in the entity (section 25.3).

The national security review has been criticized for its opaqueness and ambiguity because the *ICA* does not define "national security" or identify sectors of particular concern (McCarthy 2011). The review, however, is consistent with those of major trading nations, which also do not define "national security." Some jurisdictions, such as the United States, provide guidance on what might be relevant to a national security review, which generally suggests that a very broad category of transactions is potentially reviewable. Industry Canada, however, has issued no such guidance. The most official publicly available discussion of the meaning of the term comes from the testimony of Industry Canada officials before the Senate committee hearing that considered the proposed national security review amendments to the statute. In describing to the committee why "national security" would not be defined in the *ICA*, Richard Saillant, then Director of Investment Policy at the Market Framework Policy Branch of Industry Canada, stated:

> *There is an agreement amongst countries that national security issues have evolved since September 11 and they are constantly evolving. Therefore, there has been a tendency to accept that concerns are self-judging. Countries have been reluctant to challenge each other on their definitions of national security because they accept, first of all, that national security is a prime concern but is also something that is evolving. Therefore, there is no explicit definition of the term "national security" in the [*ICA*], but there is clearly intent to comply and to be consistent with our trade obligations…We need the flexibility to be able to identify threats as they arise. Very few countries have employed an explicit definition of national security. For instance, in the United States they provide examples but, in the end, the illustrative lists being provided covers a very broad swath of the American economy. (Standing Senate Committee on National Finance 2009)*

Colette Downie, then Director General of the Marketplace Framework Policy Branch, told the committee, "WTO agreements apply to how national security reviews will be done or potentially done. [The definition of 'national security'] must be consistent with those obligations. They define a preset series of national security-related issues" (Standing Senate Committee on National Finance 2009).

The WTO agreements and the North American Free Trade Agreement (NAFTA) are Canada's most important treaties regarding international trade and protection, but neither provides much additional guidance regarding the definition of national security as it pertains to the *ICA* review. The WTO incorporates by reference the General Agreement on Tariffs and Trade (GATT), which contains a "security exceptions" clause that allows a contracting party to take any action it "considers necessary for the protection of its essential security interests" relating to fissionable materials, traffic in arms, ammunition and other war materials, or "taken in time of war or other emergency in international relations" (article XXI). GATT does not define "essential security interests," "time of war" or "emergency in international relations." NAFTA has a similar "national security" clause, which also allows a party to take any action it "considers necessary for the protection of its essential security interests" relating to traffic in arms, ammunition and other war materials, "taken in time of war or other emergency in international relations" or relating to nuclear weaponry (article 2102).

Maintaining flexibility is key to ensuring for any government that national security can be protected in unforeseen circumstances. At the same time, a national security review should be sufficiently transparent and provide sufficient guidance to promote a predictable and certain investment environment, in which the review is used to assess actual concerns and to mitigate potential egregious politicization of national security issues.

Given the degree of Canada-US integration in national security policy, it is instructive in this context to consider the practice of US authorities in reviewing the national security implications of foreign investments. A more detailed and comprehensive international comparison can be found in appendix A.

US national security review

The United States introduced its national security review and presidential veto authority of foreign transactions in 1988 through the Exon-Florio Amendment of the *Defense Production Act of 1950* (*DPA*).[16] The national security review is undertaken by the Committee on Foreign Investment in the United States (CFIUS), created in 1975 to monitor the impact of foreign investment and coordinate the implementation of US foreign investment policy. The Exon-Florio Amendment authorized the president to review the effect on national security of foreign acquisitions of US entities and to suspend or prohibit acquisitions threatening to impair national security (section 2170(b)). "National security" was not defined in the amendment; the amendment's cosponsor, Senator J. James Exon, stated before Congress that the meaning of the term was intended to "be read in a broad and flexible manner" (quoted in Fagan 2009, 11). The amendment does, however, provide a list of factors to be considered in reviewing a foreign acquisition for national security concerns. These include the domestic production required for national defence, the control of domestic industries and commercial activity by foreign citizens as it affects US national security, the potential national security-related effects of the transaction on US critical infrastructure or critical technologies and such other factors as the president or CFIUS may determine to be appropriate (section 721(f)) (see appendix A). These factors were supplemented by the *USA Patriot Act of 2001*, the *Homeland Security Act of 2002* and the *Foreign Investment and National Security Act of 2007* (*FINSA*),[17] which collectively added "critical infrastructure" and "homeland security" as areas of concern comparable to national security. These statutes also provide substantially further guidance on what constitutes "critical infrastructure" and additional factors by which the president and CFIUS can assess foreign investments.

A foreign investor may voluntarily file a notice with CFIUS for a proposed transaction that might create a national security risk. If CFIUS finds that "the covered transaction does not present any national security risks or that other legal provisions provide adequate and appropriate authority to address the risks," then CFIUS will advise the parties in writing that they have received a "safe harbour" with respect to that transaction. If CFIUS finds that this standard is not met, it may "enter into an agreement with, or impose conditions on, parties to mitigate such risks or refer the case to the president" (United States 2010). Under the *DPA*, the president has wide discretion to suspend or prohibit any foreign transaction (section 721(d)).

Although the US government has provided substantially more guidance to its national security review than comparable jurisdictions, it has also attracted criticism alleging it has politicized the national security review. For instance, in August 2005, CNOOC withdrew its US$18.5-billion offer to buy US-based Unocal Corporation after strong and vocal political opposition in the United States, including a 398-15 vote in the House of Representatives for a measure calling on President George W. Bush to review the proposed transaction (CNOOC Limited 2005; Mostaghel 2007, 605). In another infamous example, Dubai Ports World was forced to divest itself of its acquired US port operations the next year, following political pressure (Borger 2006).

The allegations of politicization, if true, also might reflect the disadvantages of an overall foreign investment review regime based on national security grounds. Other than the CFIUS review, the United States has no review regime of general application or of specific application to SOEs. As a result, when a proposed foreign acquisition is thought to be contrary to US national interests, its opponents must fit it into a national security rubric. It is worth noting here that *FINSA* broadly defines transactions subject to review (a "covered transaction") as "any acquisition, merger or takeover after the effective date by or with any foreign person, which could result in control of a US business by a foreign person" (section 2(a)(3)). We discuss this as it applies to SOEs in the next section.

Canada should provide at least as much guidance as the United States offers, given that country's importance to Canada and its renowned pursuit of effective national security protections. As examples of such guidance, Canada could look to the factors to be considered that are listed in the Exon-Florio Amendment, the *USA Patriot Act of 2001*, the *Homeland Security Act of 2002* and *FINSA* (see appendix A).

State-owned enterprises

The rise of state-owned enterprises has introduced new players and potential issues as wealth moves from West to East. Are SOEs motivated by commercial objectives or by noncommercial objectives that current trade and investment rules did not contemplate and are not really designed to address? A corporation is presumed to be motivated almost solely by the desire to increase its value for its shareholders. An SOE, however, cannot be always presumed to share the same motivation. Thus, there is some degree of uncertainty whether foreign investment review regimes need to be altered to review SOEs and, if so, how.

It is hard to ignore the significant capital resources and prominence of SOEs today; they will continue to play a large role in the global economy. In September 2008, the *Economist* described the recent rise of the emerging economies as "the rise of state capitalism" ("The Rise of State Capitalism" 2008). Then, in January 2012, the magazine reported that, of the 100 largest companies from emerging markets, 28 were SOEs. China's 121 biggest SOEs saw their total assets increase from US$360 billion in 2002 to US$2.9 trillion in 2010, and sovereign wealth funds currently account for some of the largest reservoirs of investment capital, controlling approximately US$4.8 trillion in assets, and expected to surpass US$10 trillion by 2020 ("New Masters of the Universe" 2012). Their importance has become apparent in countries such as Canada, which has sizable natural-resource-based industries and requires capital-intensive development. Industry Canada reports that, between 2008 and 2011, SOE investment in Canada grew from a share that was marginal to more than 20 percent of the total asset value of foreign investment subject to *ICA* review (Industry Canada 2012e).

Current ICA *guidelines on SOEs*

In December 2007, Industry Canada released guidelines to inform investors how a proposed SOE investment might attract additional scrutiny regarding governance and commercial motivations in determining "net benefit" (Industry Canada 2012d). Then, on December 7, 2012, concurrent with the approvals of the CNOOC and Petronas acquisitions, Industry Canada announced revised SOE guidelines (Canada 2012), which it described as necessary for the federal government to be clear and transparent in its oversight and application of the *ICA* following a significant increase of SOE investment activity since 2008 and the increasing interest of SOEs in the resource sector (Industry Canada 2012e). The trend, the federal government had decided, raised a range of issues about the open market orientation, productivity and industrial efficiency of the Canadian economy. As Prime Minister Stephen Harper said in an accompanying statement, "To be blunt, Canadians have not spent years reducing the ownership of sectors of the economy by our own governments, only to see them bought and controlled by foreign governments instead" (Harper 2012). Accordingly, the revisions expanded the definition of SOEs to include enterprises that are "influenced" (directly or indirectly) by a foreign government (in addition to "owned" or "controlled"); they also indicated that the current review threshold for SOE investments will be maintained — the threshold for private sector investors, in contrast, is set to rise to $1 billion (as described above) (Canada 2012).

According to the guidelines, SOE investors, in their business plans and undertakings, are expected to address whether "they are susceptible to state influence," and they "will also need to demonstrate their strong commitment to transparent and commercial operations" (Industry Canada 2012a). In applying the net benefit test, the industry minister will examine the extent to which the SOE is owned, controlled or influenced by a foreign government. The minister will also examine the corporate governance and reporting structure of the SOE, including whether the foreign investor adheres to Canadian laws and practices (including adherence to free market principles), as well as to Canadian standards of corporate governance. These standards may include commitments to transparency and disclosure, independence of members of the board of directors, independence of audit committees and equitable treatment of shareholders. Furthermore, the "minister will assess the effect of the investment on the level and nature of economic activity in Canada, including the effect on employment, production and capital levels in Canada" (Industry Canada 2012a).

Regarding the commercial orientation of an SOE, the minister will assess whether the Canadian business to be acquired can continue to operate on a commercial basis with respect to the destination of its exports; place of processing; the participation of Canadians in its operations in Canada and elsewhere; support of ongoing innovation, research and development in Canada; the appropriate level of capital expenditures to maintain the Canadian business in a globally competitive position; and, particularly, the impact of the investment on productivity and industrial efficiency in Canada (Industry Canada 2012a). The guidelines also encourage specific undertakings to supplement the SOE's plans for the Canadian business to help ensure that the acquisition would be of net benefit to Canada. These undertakings include appointing Canadians as independent members of the board of directors, employing Canadians in senior management positions, incorporating the business in Canada and listing shares of the acquiring company or the Canadian business being acquired on a Canadian stock exchange (Industry Canada 2012a).

An accompanying statement also announced that the industry minister would carefully monitor SOE transactions throughout the Canadian economy, particularly in regard to the

> *degree of control or influence a SOE would likely exert on the Canadian business that is being acquired; the degree of control or influence a SOE would likely exert on the industry in which the Canadian business operates; and the extent to which a foreign state is likely to exercise control or influence over the SOE acquiring the Canadian business. Where due to a high concentration of ownership a small number of acquisitions of control by SOEs could undermine the private sector orientation of an industry, and consequently subject an industrial sector to an inordinate amount of foreign state influence, the Canadian government will act to safeguard Canadian interests. (Industry Canada 2012d)*

Most significant, however, was the federal government's announcement regarding future SOE involvement in the oil sands. Statements by both the Prime Minister and Industry Canada indicated that, due to the high level of "foreign state control" of oil sands development, going forward, the government would operate on the principle that an application for control of a Canadian oil sands business by an SOE will pass the net benefit test only on an "exceptional basis" (Industry Canada 2012d; Harper 2012). Industry Canada's statement emphasized the global importance and "immense value" of the oil sands "to the future economic prosperity of all Canadians," and highlighted Canada's interest in maintaining a high concentration of private sector ownership in the oil sands, in contrast to the vast majority of global energy deposits, which are state controlled (Industry Canada 2012d). The department, however, gave no further details on the circumstances that would constitute an "exceptional basis"; an SOE's unacceptable degree of "control or influence" over a Canadian business or relevant industry; or a foreign state's unacceptable degree of control or influence over the SOE that intended to acquire the Canadian business.

Soon after, Natural Resources Minister Joe Oliver told reporters that the CNOOC-Nexen deal would not have been approved under the new policy (Tait and McCarthy 2012). Indeed, that acquisition — the largest foreign acquisition by a Chinese company — and the acquisition of Progress Energy Resources by Petronas merely followed a number of very large acquisitions of control of Canadian oil sands businesses by SOEs. These include Korea National Oil Corporation's $4.1-billion acquisition of Harvest Energy Trust in 2009, PetroChina's $1.9-billion acquisition of a 60 percent interest in two oil sands projects from Athabasca Oil Sands Corp. in 2009 and a $680-million acquisition of the remaining 40 percent interest in 2012, Sinopec's US$4.65-billion acquisition of ConocoPhillips' interest in Syncrude in 2010 and $2.2-billion acquisition of Daylight Energy in 2011, and CNOOC's US$2.1-billion acquisition of OPTI Canada Inc. in 2011 (Feteke 2012; Lally et al. 2012; Cattaneo 2012a).

In making these changes, Prime Minister Harper reiterated that the Canadian government would continue to strongly encourage inward investment in Canada and that it would maintain an open, market-based approach to foreign investment (Harper 2012). The new policy does not affect non-SOE private sector investment in the oil sands, or minority investments, joint ventures or greenfield investments in any sector of the Canadian economy by or involving SOEs; nor does the "exceptional basis" policy currently apply to SOE investment in any sector of the Canadian economy other than the oil sands. Indeed, on December 13, 2012, less than a week after the policy announcement, Canadian energy company Encana Corporation announced a $2.18-billion deal with PetroChina to develop an Alberta natural gas project; since PetroChina's share will be 49.9 percent, the investment is not subject to *ICA* review (Encana Corporation 2012).

Again, before commenting on the additional measures and guidelines Canada could offer in this area, it is helpful to review what other major players and trading partners are doing.

Guidelines on SOEs in other countries

The United States provides for a review of investments by SOEs within the framework of its national security review under CFIUS. In 1992, Congress amended the Exon-Florio Amendment to require CFIUS to investigate proposed mergers, acquisitions or takeovers in cases where two criteria are met: first, where "the acquiror is controlled by or acting on behalf of a foreign government," and, second, where "the acquisition results in control of a person engaged in interstate commerce in the United States that could affect the national security of the United States" (Byrd Amendment, section 837(a)).[18] The 1992 amendments followed two transactions involving SOE parties in which the foreign state ownership of the acquirors raised more concern than a national security review would have otherwise (Mostaghel 2007, 597-600). The first was the November 1989 acquisition by the Chinese National Aero-Technology Import and Export Corporation

(CATIC) of MAMCO, a US producer of metal parts for civil aircraft. President George H.W. Bush ordered CATIC to divest itself of its holdings in MAMCO, which caused investor uncertainty regarding the definition of "national security" and what would constitute a threat to national security (597). The second transaction was an attempted acquisition in 1992 of LTV Corporation's Missile Division by French SOE Thomson-CSF. The further uncertainty regarding CFIUS review of that investment demonstrated a pressing need to clarify US legislation regarding the investment review of SOEs (599-601).

In 2007, *FINSA* was passed following the failed 2005 CNOOC bid for Unocal and the 2006 Dubai Ports World divestiture. A 2007 Senate Committee on Foreign Relations report supporting legislative reform (such as *FINSA*) stated that "over the last several decades, and in particular after September 11, 2001, it has become more challenging to balance a strong national security while remaining open to foreign direct investment from all regions of the world. It is vital to achieve the correct balance for many reasons" (United States 2007). *FINSA* requires an extended 45-day investigation if a CFIUS review reveals that an investment may result in the transfer of control of a US business to a foreign government or to an entity controlled by a foreign government (section 2(b)(1)(a)). Control is broadly defined as the direct or indirect power to determine, direct or decide important matters affecting an entity (Fagan 2009, 11). *FINSA* applies to government-controlled entities even when these operate as commercial entities (LaRussa and Raisner 2012, 117-18). CFIUS assesses the potential threat posed by the investor and the vulnerability of the US assets and business, and determines the balance between the two (Fagan 2009, 12). Additional nontransaction-specific factors must be considered, including the particular foreign country's compliance with US policy on counterterrorism, non-proliferation and export control (West et al. 2007, 8).

In Australia, foreign investment is reviewed pursuant to the *Foreign Acquisitions and Takeovers Act* (*FATA*).[19] In February 2008, the Australian government introduced into its Foreign Investment Policy special guidelines governing investments by foreign governments and their agencies (Swan 2008). All SOEs are required to notify the government and get prior approval before making a direct investment in Australia, regardless of the value of the investment (Australia 2012). The guidelines also state that proposed investments by SOEs will be assessed on the same basis as private sector proposals — namely, that of Australia's national interest. Investments by SOEs, however, raise additional factors that also must be examined out of a concern that "investors with links to foreign governments may not operate solely in accordance with normal commercial considerations and may instead pursue broader political or strategic objectives that could be contrary to Australia's national interest" (Australia 2008).

The Australian guidelines require notification for prior approval of a foreign SOE direct investment of any size (Australia 2008). A foreign SOE is statutorily defined as an entity in which a foreign government owns a 15 percent interest or more (*FATA*, section 5). The guidelines suggest that the review of such investments will cover whether (1) the investor's operations are independent of the relevant foreign government; (2) the investor is subject to and adheres to the law and observes common standards of business behaviour; (3) the investment may hinder competition or lead to undue concentration or control in the industry or sectors concerned;

(4) the investment may have an impact on Australian government revenue or other policies (such as the environment); (5) the investment may have an impact on Australia's national security; and (6) the investment may have an impact on the operations and directions of an Australian business, as well as its contribution to the Australian economy and broader community (Australia 2012). Mitigating factors in determining that a proposal is not contrary to the national interest include (1) the existence of external partners or shareholders in the investment; (2) the level of nonassociated ownership interests; (3) the governance arrangements for the investment; (4) ongoing arrangements to protect Australian interests from noncommercial dealings; and (5) whether the target will be, or will remain, listed on the Australian Securities Exchange or another recognized exchange (Australia 2012).

In Russia, the *Strategic Investments Law* and the *Foreign Investments Law*[20] contain specific rules applicable to foreign state-controlled investors. Under the *Strategic Investments Law*, foreign state-controlled investors are subject to lower review thresholds than ordinary foreign investors; any acquisition of more than 25 percent of the shares of a strategic company, or the right to block the decisions of a strategic company, must be cleared in advance (Polonsky and Pozdnyakova 2012, 86). Foreign state-controlled investors are also not permitted to obtain "control" over strategic companies — that is, those carrying on business in any of 42 strategically significant areas, including defence and natural resources (Syrbe, Pavlovich and Nogovitsyna 2012, 3). "Control" is defined to include having more than 50 percent of the voting shares; having the right to appoint a sole executive officer or more than 50 percent of the management body; having the right to appoint more than 50 percent of the board; or being entitled to make decisions on behalf of the company. Under the *Foreign Investments Law*, acquisition by a foreign state-controlled investor of more than 25 percent of any company's shares or the right to block any company's decisions is also subject to a clearance requirement (Syrbe, Pavlovich and Nogovitsyna 2012, 3).

Although foreign investment filings are not disclosed to the public, the *Strategic Investments Law* restrictions were engaged in the Megafon case. Under a joint venture agreement, TeliaSonera and Altimo agreed to combine their shares in Turkcell and Megafon in a new corporation (Polonsky and Pozdnyakova 2012, 88; Syrbe, Pavlovich and Nogovitsyna 2012, 7). The arbitration court in Moscow held that the agreement violated the *Strategic Investments Law*. On appeal, the ruling was upheld, the court finding that TeliaSonera was controlled by foreign states (Sweden and Finland) and that the agreement was therefore void because it would have permitted a foreign state-controlled investor to establish control over a strategic entity (Syrbe, Pavlovich and Nogovitsyna 2012, 7).

Canada and Australia are close comparative examples of countries that have moved to formalize their policies on SOEs. As both countries explicitly state, these policies reflect each economy's strong natural resource base and attractiveness to SOE investment, and the two countries' efforts to ensure transparency and guidance and to remain welcoming and open to foreign investment (Australia 2012; Industry Canada 2012a).

In comparison with other players, it would appear that Canada has transparent, clear and measured guidance. However, there are improvements that can be made and, in the following section, we propose a series of changes to the *ICA*, including several recommendations that could be used to further refine the SOE guidelines. Recognizing that SOEs are an increasingly significant presence in global capital markets, we believe these changes are necessary to help assuage Canadians' concerns regarding SOE investments and to prevent a backlash against SOE investments.

Global Investment Review Uncertainty

While the *Financial Times* editorial cited in the epigraph focuses on Canada, there are similar general trends toward stronger enforcement in other countries.

Criticism of the *ICA* regarding a lack of certainty and transparency in the review process as well as charges of the review's vulnerability to politicization is mirrored in other jurisdictions. A variety of foreign investment review systems are used throughout the world, authorizing national governments to block foreign acquisitions. Our survey results reveal that this authority attracts strong criticism from various quarters whenever exercised (see appendix B for a comparison of foreign investment review systems).

In 2011, for example, the Australian government rejected the proposed A$8.4-billion acquisition of the Australian Securities Exchange by Singapore-based Singapore Exchange Ltd. on the grounds that the transaction was not in Australia's national interest because it ran counter to the objectives of maintaining a strong and stable financial system and building Australia as a global financial services leader in Asia (Swan 2011).

In 2006 a bipartisan majority in the United States Congress effectively pressured United Arab Emirates-based Dubai Ports World to divest the US port operations it had recently acquired from P&O Steam Navigation Co., despite previous CFIUS approval (Mostaghel 2007, 613-14). President George W. Bush publicly stated that the transaction posed no national security concerns and that "it would send a terrible signal to friends and allies not to let this transaction go through," and he threatened a potential veto ("Bush Threatens Veto in Ports Row" 2006).

In recent years, CFIUS national security reviews have become more frequent. Only 25 such investigations were triggered between the enactment of the Exon-Florio Amendment in 1988 and the 2007 amendments, but there were 40 CFIUS investigations in 2011 alone (United States 2011) — a decade into the post-9/11 era. Some proposed investments did not pass the review. In 2009, CFIUS blocked the acquisition of a 51 percent stake in a Nevada gold mining corporation by Northwest Nonferrous, a Chinese SOE, because some of the properties owned by the target were close to an Air Force base (Corr, Erb and Burke 2010). In 2011, CFIUS blocked Huawei Technologies Co., a Chinese company, from purchasing US$2 million in assets from a US company because of Huawei's ties to the Chinese military (Ikenson 2011). In 2012, President Barack Obama ordered the China-based Ralls Corporation to divest four small wind farm projects that were located too close to a US Navy weapons systems training facility in Oregon (Forden 2012).

In France, Prime Minister Dominique de Villepin told a news conference in 2005 that he had assured French yogurt company Danone that the French government would support

Danone in fending off unwanted suitors: "A group like Danone is obviously one of our industrial treasures and we will of course defend the interests of France" (Fuller 2005). The statement came amid market rumours that Pepsico Inc. was planning to bid for Danone (Matlack 2005). The French government had identified 11 strategic sectors in which a foreign investment would be subject to review to determine its potential harm to French public order, public security or national defence interests.[21] These sectors include casinos, companies involved in developing pathogens or toxic substances and companies involved in developing military technology. Additionally, the French government has taken active steps to protect strategic industries, forming a US$25-billion state investment fund to protect strategic industrial assets (Bennhold 2008). The fund is managed and controlled by the Caisse des Dépôts et Consignations, of which the French government owns a 49 percent interest (Bennhold 2008).

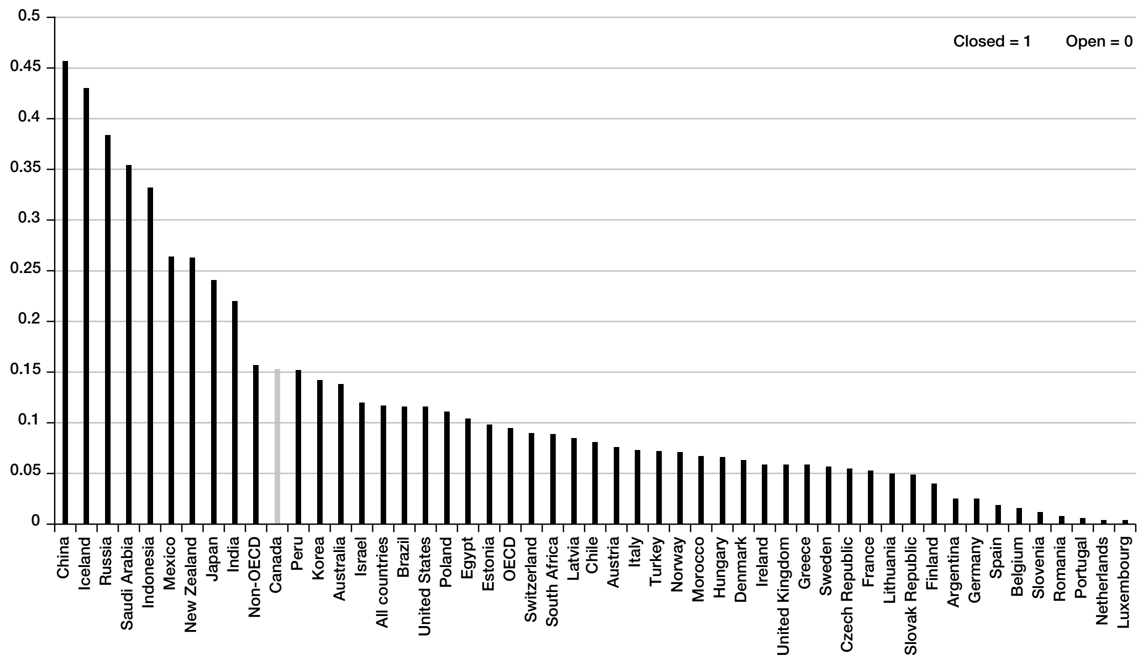
In the United Kingdom, the €35-billion merger of British defence company BAE Systems and European Aeronautic Defence & Space Co. (EADS) was withdrawn in October 2012, reportedly because of the German government's opposition to the transaction and the potential resulting loss of German jobs (Pickard, Jones and Wiesmann 2012). Days before the withdrawal announcement, UK Defence Secretary Philip Hammond also publicly announced that his government would not support the proposed transaction unless the French and German governments were limited in the potential interest they could acquire in the combined entity (Pickard 2012). The French government maintains a 15 percent interest in EADS and the German government retains indirect control through its shareholdings in Daimler AG (Michaels 2012). The UK government, meanwhile, holds a golden share in BAE Systems, which provides it effective rights over the corporation, including the right to block the merger (USGAO 2008, 102).

Another example comes from Israel, where, in November 2012, the government asked Canada's Potash Corp. to explain how its proposed US$13.5-billion acquisition of Israel Chemicals (ICL) — in which the Israeli government holds a golden share — would secure Israel's interests (Jordan 2012; the issue was unresolved at time of writing).

Rejection: The power to say no

The increasing number of government rejections of foreign investment proposals around the world is troubling, and perhaps reflects the growing complexity of international investment flows. It also might reflect notions of protectionism as governments put the brakes on what they regard as threatening foreign investment in times of economic uncertainty. Canada, in contrast, has played a leading role in attempting to meet new foreign investment challenges in a straightforward, transparent and rules-bound manner. Yet, despite having rejected only two proposals since foreign investment review legislation was introduced in 1973, Canada, as figure 2 shows, is rated as one of the most restrictive countries in the Organisation for Economic Co-operation and Development (OECD). This is because the OECD ignores each country's restrictiveness in practice and measures only the formal legal framework for FDI across a series of comparable industries (Kalinova, Palerm and Thomsen 2010). By this standard, the US government's rejection of Dubai Ports World and

Figure 2. The OECD's FDI restrictiveness index, 2010



Source: Kalinova, Palerm and Thomsen (2010).

France's protection of Danone had no effect on either country's restrictiveness rating because they introduced no new laws.

Both of Canada's rejections — whether or not one agrees with them — were rooted in a logic consistent, or at least not inconsistent, with the overall objectives of the *ICA*.

The MacDonald Dettwiler rejection prompted concerns in the investment community because it was the first rejection, but the national security concerns of the proposed transaction were certainly credible in a post-9/11environment.

In the Potash Corp. transaction, the Saskatchewan government was criticized for pressuring the federal government to reject the proposed deal, but from its perspective, potash royalties — which were expected to contribute $221 million to the province's revenues for the 2010-11 budget (2 percent of total provincial government revenues) — were in jeopardy because BHP Billiton refused to offer a long-term commitment to remain in Canpotex, the Saskatchewan-based marketing agency that promotes high potash prices (Blackwell 2012; Wall 2010).[22] Furthermore, BHP Billiton offered only a small premium on the then Potash Corp. share price at the time, which had fallen by almost 50 percent the previous year in the midst of the 2008 economic collapse and resulting commodities down-cycle (Bouw 2011). This was a very different approach from that taken by UK-based Anglo-Dutch Billiton PLC (Billiton) when it acquired Australian-based Broken Hill Proprietary (BHP). Billiton provided *perpetual* undertakings to the Australian government that (1) BHP Billiton Limited would remain an Australian resident company listed on the Australian Stock Exchange; (2) the headquarters of BHP Limited and the global headquarters of the combined BHP Billiton Group would be in Australia and that each would be publicly acknowledged as being in Australia in public announcements and documents; (3) BHP Limited would remain the ultimate holding company of, and continue to ultimately manage and control, the subsidiary businesses; (4) both the CEO of the BHP Billiton Group and the CFO of BHP Limited would have their principal residences in Australia; (5) the majority of all regularly scheduled board meetings and executive committee meetings of BHP Limited would be held in Australia each year; (6) the BHP Limited board of directors would be elected in accordance with Treasurer-approved procedures; and (7) BHP Limited would obtain prior Treasurer approval if it wished to act differently from these undertakings (Australia 2001).

Under the current version of the net benefit test, the industry minister is required to consider the compatibility of the transaction with the stated "industrial, economic and cultural policy objectives" of the provincial government that would be significantly affected by an investment (*ICA*, section 20). In the case of Saskatchewan, although the *ICA* does not expressly identify fiscal objectives, it was not certain that the BHP Billiton-Potash Corp. transaction would have offered significant economic gains to offset the potential loss of royalty revenues were the acquired company to withdraw from Canpotex.

Petronas' failure to grant Industry Canada a 30-day extension to review its proposed acquisition of Progress Energy Resources left the federal government with the option of either approving the transaction despite an unfinished review or rejecting it and allowing Petronas to appeal (*ICA*, section 22). The business media subsequently reported that the federal government might have wished to delay the completion of its review until the release of additional SOE guidelines, which were being finalized at the time amid the high-profile CNOOC-Nexen transaction (Hoffman and Tait 2012). Indeed, the Petronas and CNOOC acquisitions were ultimately approved, and new SOE guidelines released, all on the same day (Industry Canada 2012d).

Despite the deeper issues at play in these rejections and the international context in which they occurred, as well as the Canadian government's continued efforts toward a more straightforward and rules-based regime, any perceived hesitation to embrace a foreign acquisition swiftly attracts attack upon the *ICA* and, in particular, the net benefit test. Critics complain that the test, as well as the accompanying section 20 criteria, is ambiguous and dependent upon the subjective discretion of the industry minister. Some argue that the net benefit test should be replaced by a reverse onus test, made subject to judicial review or amended to provide a more objective and measurable basis of determining net benefit (see Competition Policy Review Panel 2008, 32).

Yet replacing the net benefit test might only create more uncertainty by essentially pushing the reset button on Canadian foreign investment review policy and practice. In addition, no amount of legislative change and amendment is likely to remove the approval of significant foreign investments from the ambit of government decision-making.

For similar reasons, a reverse onus test would fail to provide a realistic and viable alternative; it would require the Canadian government essentially to prove that a foreign acquisition of a Canadian business would *not* be of net benefit to Canada. Proponents suggest that the reverse onus test would reflect the basic policy premise that foreign investment generates positive benefits for the country and that it would counter any negative and misleading perceptions that the *ICA* is a barrier to foreign investment (Competition Policy Review Panel 2008, 32). Laudable though this premise is, it is hard to imagine that any national government would allow its discretion concerning foreign investment decisions to be so fettered or its flexibility to respond to market changes and unforeseen policy concerns to be so impaired (Assaf and Meredith 2012).

Furthermore, a reverse onus test might nurture a more adversarial relationship between the federal government and foreign investors generally, as the government would have to describe and highlight an investor's shortcomings and faults more rigorously. This would be a significant departure from the current presumption of a collaborative relationship, particularly in the monitoring and enforcement of undertakings. The public controversy that already arises with respect to foreign investment issues and high-profile acquisitions also could become more inflamed by an adversarial process, not to mention the potential incentive this would offer for political opportunism.

Recommendations

Clarification of the net benefit test and of the *Investment Canada Act* more generally is needed to provide a more objective and straightforward review process for potential foreign investors in Canada. The recommendations we present below are directed toward this objective; we note, however, that care should be taken to avoid creating an overly prescriptive and bureaucratic process.

The foreign investment review regime under the *ICA* measures up well against those of other jurisdictions as a fair and rules-based system. In general, the commitment to open investment is tempered only by considerations of net benefit, as well as by national security and implications arising from foreign government investment through SOEs. However, in view of recent developments and concerns relating to both the perceived and the actual lack of clarity in the rules and any potential chilling effect, and to ensure that the rules remain responsive to Canadians' desire that foreign investment be of net benefit to Canada, we make the following recommendations: (1) modernize and clarify the net benefit test; (2) clarify the SOE guidelines; (3) publish national security guidelines; (4) clarify Canada's position on "strategic assets"; and (5) publish model draft undertakings

Modernize and clarify the net benefit test

The net benefit test currently described in section 20 of the *ICA* should be modernized and revised to describe more clearly what practice and policy are relevant today (see box 1). Specifically, section 20 should explicitly include references to the effect of the foreign investment on opportunities for Canadian management; benefits and compatibility to trade, fiscal and environmental policies; its potential contribution to advancing Canadian international trade and investment objectives (such as reciprocity); and, for completeness, its possible effect on national security. In addition, the description of some of the existing benefits should be clarified.

We largely see the addition of our proposed factors as only confirming current practice and reflecting important priorities for Canadians. For example, in almost all cases, investors ultimately would be required to agree to undertakings to promote and maintain Canadian partici-

Box 1 — Proposed revisions to the net benefit test

20. For the purposes of section 21, the factors to be taken into account, where relevant, are

(a) the impact ~~effect~~ of the investment on the level and nature of economic activity and development in Canada, including, without limiting the generality of the foregoing, the effect on and any potential benefits to, regional economic development, employment, ~~on~~ resource processing, productivity, industrial efficiency, technological development, product innovation, capital investment, and exports from Canada ~~on the utilization of parts, components and services produced in Canada and on exports from Canada;~~

(b) the degree and importance ~~significance~~ of participation and management by Canadians in the Canadian business or new Canadian business and in any industry or industries in Canada relating to the investment ~~of which the Canadian business or new Canadian business forms or would form a part;~~

~~(c) the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;~~

(~~d~~c) the effect of the investment on competition within any industry or industries in Canada;

(~~e~~d) the benefit and compatibility of the investment with ~~to~~ national industrial, economic, trade, fiscal, environmental and cultural policies, taking into consideration industrial, economic, trade, fiscal, environmental and cultural policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the investment; ~~and~~

(~~f~~e) the contribution of the investment to Canada's ability to compete in and attain access to world markets and to generally advance Canadian international trade and investment objectives; and

(f) any impact on Canadian national security.

pation in management. Furthermore, as the BHP Billiton case showed, it makes sense to assess a proposed investment's compatibility with the fiscal objectives of the host province, which has constitutional authority over natural resources and for which changes to royalty revenue might have a material effect on its tax revenues and fiscal condition. Such a change would be consistent with policy already in place in Australia (Australia 2012).

Also, it is hard to imagine that most Canadians would not wish to be assured that the federal government was examining an investor's record as a responsible environmental steward and, consistent with existing environmental protection legislation, that the operations of the Canadian business would continue to be in compliance with these rules. The move to introduce a corporate social responsibility regime for Canada's extractive sector operating abroad is an example of the attention these issues are attracting in the trade and investment discussion. Again, more generally, Australia already requires investments to be consistent with the government's objectives in relation to environmental impact (Australia 2012).

Another key sentiment that has become apparent among Canadians and policy-makers alike is reciprocity. If Canada permits foreign investors (especially SOEs) to acquire control of Canadian businesses, Canadians in turn should be granted reciprocal access to those industries in the investors' countries. Accordingly, the concept of the benefit, compatibility and contribution of an investment to overall Canadian investment and trade policy should be added.

Finally, since the *ICA* now includes an explicit and formal national security test, that factor should also be reflected in the net benefit provision.

Clarify the SOE guidelines

Additional guidelines are needed to address long-standing concerns related to investment by SOEs (see box 2). Although not everyone might agree with the federal government's decisions in the Nexen and Progress deals, it would be difficult to characterize them as unreasonable responses to the questions posed by SOE investment in the Canadian economy, and in the oil sands specifically. But larger questions remain. As much as the Nexen deal posed, as Prime Minister Harper said in October 2012, "a range of…difficult and forward-looking issues," this was never the venue for rethinking the *ICA*'s basic principles related to SOE acquisitions (Assaf and Meredith 2012). Difficult cases should not, in isolation, make law.

For many reasons — including, fundamentally, Canada's national interest —no good is served by shutting SOE investors out of Canada as a blanket policy. Therefore, can we identify and isolate specific concerns, and obtain assurances that help mitigate these concerns, while maintaining Canada's general openness to investments from SOEs? If Canadians are concerned that certain countries are not inclined to open their markets and industries to reciprocal investment and/or entry by Canadian companies, why should this lack of reciprocity not be a relevant factor under the SOE guidelines in the net benefit test?

While it is not prudent or necessarily fair to put the entire burden of advancing Canadian trade policy on the shoulders of a single transaction and those parties, it is not unreasonable for the Canadian government to consider this issue by examining the history of a country's SOE investment in Canada. Then we could assess whether our trust has been reciprocated by having led to facilitating similar access for Canadian companies to these other important foreign markets to help the growth and expansion of our Canadian-owned businesses as well.

In certain cases, it would also be reasonable for Canada to request that a bond be posted to guarantee certain commitments, since it is sometimes difficult (for a variety of political, legal and/or other considerations) to "prosecute" a foreign government entity after the fact. In addition, to minimize or prevent any excessive diplomatic fallout if an investment were to go poorly from an *ICA* perspective, realizing on a preexisting bond or commitment should be less politically contentious than advancing legal proceedings against another country.[23] In any case, we have already seen bonds requested in cases involving private companies, such as in the BHP Billiton-Potash Corp. transaction, which has reduced any stigma that would attach to requesting bonds from SOEs in certain transactions.

Another concern is that SOEs might not behave like traditional commercial actors but are buying Canadian businesses only for strategic reasons or to assure resource supply for their own industries. This concern could be accommodated by requiring SOEs to commit to providing a reasonable supply of that resource, product or critical technology to Canadians in times of economic or security crises or emergencies.

Guidelines also could explicitly state that SOEs and their patron states could be prohibited from making certain subsequent investments in Canada if they had a poor record of complying with undertakings and commitments in previous instances and did not take reasonable and responsible steps to address any lack of compliance.

Box 2 — Additional guidelines for SOE investments

- To ensure that investments by SOEs are of net benefit to Canada, the minister may, in appropriate circumstances, also take into consideration the extent to which reciprocal investments are permitted by Canadians in that state. In addition, the minister will also take into consideration the investment rationale of the SOE and its compatibility with Canadian economic and trade policy.
- The minister may require the posting of a bond against the performance of any required undertaking(s).
- In certain limited circumstances, especially in connection with investments relating to strategic resources and technology and any potential impact on national security, the minister may consider undertakings to commit supply to Canadian markets in times of a security or economic crisis.
- In addition, the minister may prohibit certain subsequent investments by an SOE where the SOE or a related SOE and patron state have failed to implement undertakings relating to previous investments in Canada if reasonable and responsible steps were not taken to address such failures.
- "Exceptional" circumstances does not mean a complete prohibition on SOE investments in the oil sands industry, but in determining net benefit such proposed investments will be strictly and rigorously assessed on the basis of their impact on the Canadian business, the oil sands industry and the Canadian economy pursuant to section 21 and the SOE guidelines.

Finally, additional guidance should be offered on the meaning of "exceptional" circumstances regarding the future ability of SOEs to acquire control of an oil sands business. As a start, the federal government should clarify that "exceptional circumstances" does not mean a blanket prohibition of such investments. It is in Canada's national interest to ensure that economic development, including in the oil sands, continues to have long-term access to capital on competitive and lowest-cost terms. Shutting out a major source of capital such as SOEs would be detrimental both to this sector and to Canada's long-term needs. Competition drives lower prices and costs, not passports and residency. Also, market conditions can change quickly and no person or government can predict when the energy business will boom, bust or just muddle along. For example, no one can be sure of the implications of the US becoming energy self-sufficient if that comes to pass. As a result, it is difficult *ex ante* to predict who or what a market may need in the future to ensure that our resources get developed for our national interest. We are already seeing energy markets slow as concerns about environmental issues, pipeline access and US energy self-sufficiency create market uncertainty. (See box 2 for a summary of additional guidelines for SOE investments.)

Publish national security guidelines

Canada should publish basic national security guidelines similar to those in the United States. At a minimum, these guidelines should include the same list of factors to be considered for national security review that are provided in the Exon-Florio Amendment, the *USA Patriot Act of 2001*, the *Homeland Security Act of 2002* and *FINSA*. Although the concept of national security must remain fluid and responsive to new threats, it is important to have a transparent framework that illustrates the broad outline of issues under review. National security issues are rightly sensitive, but basic guidelines can mitigate the risks of excessive politicization. US guidance is an important starting point for Canadian guidelines since national security is often conceived as part of a continental context.

Clarify Canada's position on "strategic assets"

The identification of particular "strategic assets" does not contribute much to the consideration of *ICA* enforcement, nor does it ensure that an investment will be of any greater net benefit to Canada than that which the *ICA* already effectively requires. It is a loaded term, and easily politicized and misused by any stakeholder, as we have seen. Given the salience of the term "strategic asset" and its increasing prevalence in political debate and media commentary, the federal government should reiterate that no review category of transactions exists for such purposes, and that the nature of a Canadian business and its importance to the Canadian economy are already an important factor in the *ICA* review.

Publish model draft undertakings

Finally, to provide greater clarity and guidance, the federal government should consider issuing model draft undertakings (see box 3) reflecting the types of commitments it most regularly seeks as common practice, as it already does in the cultural review context (Canadian Heritage 2008). Going forward, the federal government could also note alternative commitments it might request in special cases to provide additional clarity on what is expected. Potential investors would then be able to better manage expectations in advance and further minimize potential misunderstandings later in the heat of the review process. The process would become more transparent not only for investors but also for Canadians generally, who then would be able to see the connection between the implementation of undertakings and the net benefit test and be assured that the national interest was being served.

Box 3 — Typical categories of undertakings

- ➤ Maintain head office in Canada
- ➤ Maintain management jobs and board positions in Canada
- ➤ Capital investment in Canada
- ➤ Investment in research and development in Canada
- ➤ Investment in local communities in Canada
- ➤ Appropriate employment level commitments reflecting industry conditions
- ➤ Safety and environmental performance
- ➤ Operational efficiency of existing businesses

Conclusion

The *Investment Canada Act* currently provides the key tools to assure Canadians that foreign investments will be of net benefit to Canada. The *ICA* also measures up well against the foreign investment regimes of Canada's key trading partners as a transparent, rules-based system. Although the vast majority of proposed foreign investments are approved, recent examples of rejections and global trade and investment developments have created some uncertainty about the *ICA* process.

Our recommendations are intended to offer an integrated approach to augmenting the existing rules. We hope they further contribute to measures to promote transparency and to address recent challenges, especially those relating to the net benefit test, national security, SOE investment and current enforcement practices. The objective is to maintain Canada's national interest while attracting as much global capital as possible on beneficial terms, so as to realize the potential of the Canadian economy in the twenty-first century for the mutual benefit of all Canadians.

Appendix A: National Security Considerations in Foreign Investment Review in Selected Countries

The European Union

The Treaty Establishing the European Community (the EC Treaty)[24] provides for the free movement of capital throughout the European Union, "between Member States and between Member States and third countries" (article 56). Article 58(1)(b) allows member states "to take measures which are justified on grounds of public policy or public security." This power is restricted, however, by article 58(3), which states that these measures cannot be used to arbitrarily discriminate or disguise restrictions on the free movement of capital. The 2004 EU *Merger Regulation* reiterates this exception, providing that "public security, plurality of the media and prudential rules" are legitimate grounds on which investment can be restricted.[25] The European Court of Justice (ECJ), the supreme adjudicative body of EU law, narrowed the broad scope of this power in the 2002 leading cases of *Commission v. Belgium* and *Commission v. France,*[26] which highlighted that reference may be made to public policy and public security only if a genuine and sufficiently serious threat exists that affects a fundamental interest of society. These provisions establish a baseline liberalism for inward foreign investment that EU members cannot derogate from.

The United Kingdom

Foreign investment in the United Kingdom is regulated primarily by the *Enterprise Act 2002.*[27] There are several circumstances in which the government can intervene in transactions due to public interest concerns. Where a merger is otherwise subject to the UK's merger control regime, the secretary of state may intervene if there are reasonable grounds to suspect that at least one public interest consideration under the statute is engaged. The public interest considerations (enumerated in section 58) include "the interests of national security." Where a merger is not caught by the merger control regime but nevertheless raises public interest considerations, intervention may nevertheless be possible. Ultimately, the secretary of state retains broad authority to consider additional factors not identified in the legislation that, in the opinion of the secretary, should be considered. However, there is no obligation to give notice of transactions that raise potential public interest issues, and it is the responsibility of the government to identify transactions subject to review (Harrison, Hockley and Ward 2012, 111-13).

The UK government retains golden shares in certain corporations that are significant to national security. These shares are created through the corporations' articles of association and confer rights such as those relating to citizenship, control over the percentage of foreign-owned shares and approval conditions for dissolution or disposition of assets (USGAO 2008, 101). Among the UK firms in which the government retains golden shares are BAE, Rolls-Royce, Rosyth Royal Dockyard Limited, Davenport Royal Dockyard Limited, BAES (Marine) Limited, the Atomic Weapons Establishment and QinetiQ (USGAO 2008, 102).

Japan

Foreign investment in Japan is subject to the *Foreign Exchange and Foreign Trade Act*,[28] enacted in 1949. The legislation's definition of foreign investment is broad and includes, *inter alia*, acquisition of at least 10 percent of shares in a company listed on a Japanese exchange, acquisition of shares in an unlisted company and establishment of a branch, factory or office in Japan (USGAO 2008, 77).

Under the Ordinance on Inward Direct Investment, prior notification of the Japanese authorities is required only in the following categories of investment: investment that may threaten the nation's security, hamper the conservation of public order or interfere with public safety; investment that may adversely affect the smooth operation of the economy; investment from countries with which Japan has not established a foreign investment treaty; and certain investments involving Iranian entities (Takahashi and Kato 2012, 65). The ordinance, however, is not specific about the factors to be used to evaluate an investment according to these criteria; rather, the onus is on the investor to demonstrate that the elements of the test have been satisfied (Takahashi and Kato 2012, 65-9).

The overwhelming majority of recent foreign investments in Japan have proceeded without incident, including Renault's investment in Nissan and Citigroup's purchase of Nikko Cordial (a brokerage firm) (Hibbard et al. 2009). One failed effort, however, was the acquisition of shares in J-Power by The Children's Investment Fund (TCI), a London-based hedge fund. In 2008, TCI pushed to increase its stake in Japan's largest electric utility company but met resistance from the Japanese government, which, for the first time, exercised its discretion to block a transaction on national security grounds (Takahashi and Kato 2012, 69). A senior government minister said that the transaction "would [have] a negative impact on stable supply of electricity and our national policies on nuclear power" ("Japan Shuns UK Power Investment" 2008). TCI decried the government's move as lacking transparency but did not appeal the decision (McCurry 2008; Nakamoto 2008).

Germany

As a member state of the European Union, Germany is subject to the EC Treaty and its provisions regarding free movement of capital among member states. Foreign investment in Germany is reviewed mainly under the *Foreign Trade and Payments Act*[29] (Horstkotte and Pfeil 2012, 37). Notification is required for investments above a specific threshold in the following industries: defence, encryption for government purposes, satellite remote sensing systems, telecommunications and postal services. For all other industries, the Ministry of Economics and Technology is entitled to review transactions by which a foreign investor acquires an interest of 25 percent or greater, but there is no notification requirement. The substantive test is whether the investment would threaten public security or public order (Horstkotte and Pfeil 2012, 38-9). Commentators have noted that the ostensibly broad language of "public order or safety" actually has been interpreted narrowly under ECJ jurisprudence and is therefore unlikely to apply outside of "extreme and rather remote" cases (Braun and Zeppezauer 2009). This is particularly true given that the onus is on the German government to demonstrate that the investment threatens public order or safety (Horstkotte and Pfeil 2012, 39).

Details on the foreign investment review process in Germany are confidential. As a result, there is no publicly available information with respect to decisions taken on a public order basis (Horstkotte and Pfeil 2012, 41).

Australia

Foreign investment in Australia is reviewed pursuant to the *Foreign Acquisitions and Takeovers Act*. The legislation incorporates a "national interest" test whereby the federal treasurer may demonstrate that a particular transaction would be contrary to the national interest (Hutton and MacDonald 2012, 128). The legislation itself does not identify specific factors to be considered when evaluating the national interest. However, the Foreign Investment Policy provides information on how the Foreign Investment Review Board applies *FATA* and includes five factors relevant to the national interest, one of which is the impact of the investment on strategic and security interests (Poddar, Benson and Sylow 2012, 7-12). Advice from the national security agencies also inform the government's decision-making, but the Foreign Investment Policy acknowledges that the definition of what is contrary to the national interest "cannot be answered with hard and fast rules" (Australia 2012).

Because Australia's regime allows for negotiation and undertakings, outright rejections are rare: in the past decade, only two rejections have been issued (Hutton and MacDonald 2012). The more recent of the two — the rejection of Singapore Exchange Ltd.'s takeover of ASX Ltd. — was based on economic grounds and does not appear to have engaged security interests. The other rejection occurred in 2001 to prevent Shell Australia Investment Ltd.'s acquisition of Woodside Petroleum Ltd., the operator of Australia's then-largest developed energy resource. As was true of the ASX transaction, security issues do not appear to have been a primary factor in the decision, which was largely concerned with maximizing development and sales of the resource (Costello 2001). Of course, to the extent that economic stability is associated with national security, it is not obvious that national security can be excluded as an underlying consideration.

China

Several kinds of foreign investment in China are subject to an independent national security review. These include the acquisition of enterprises in the defence industry or enterprises that impact defence, as well as the acquisition of significant agricultural products, natural resources, infrastructure or key technologies/equipment where the enterprise will come under foreign control (Chan 2012, 24-8; Mayer Brown 2011). Laws and regulations governing foreign investment include the "Circular of the General Office of the State Council on the Establishment of Security Review System Regarding Merger and Acquisition of Domestic Enterprises by Foreign Investors" (2011)[30] and "Provisions of the Ministry of Commerce for the Implementation of the Security Review System for Merger and Acquisition of Domestic Enterprises by Foreign Investors" (2011).[31] National security reviews are completed by the Joint Ministerial Conference, which is led by the National Development and Reform Commission and the Ministry of Commerce (Chan 2012, 24-8).

Chinese authorities enjoy broad discretionary power to reject transactions, particularly on national security grounds. The regulatory framework for national security review is both new and sparse. The substantive test is whether the transaction would have an impact on national defence, economic stability, basic social order or research and development capability, and whether this impact would affect national security (Chan 2012, 24-8).

Although no rejections have been reported under the new national security regime, in 2005 the media noted the rejection of a proposed acquisition by Carlyle Group (a US private equity firm) of Xuzhou Construction Machinery Science & Technology Company. Under the original agreement, Carlyle intended to acquire 85 percent of Xuzhou. After national security concerns were expressed, the proposed acquisition was reduced to 50 percent in 2006 and to 45 percent in 2007. Still, approval could not be obtained prior to the expiration of the agreements, and the bid was abandoned (Chan 2012, 28). The proposal's failure to obtain approval is believed to be based on the importance of Xuzhou, China's largest manufacturer of heavy equipment, to the economy and national security (Chan 2012, 28; Zhang and Zhang 2007).

The United States

The United States introduced its national security review and presidential veto authority of foreign transactions in 1988 through the Exon-Florio Amendment of the *Defense Production Act of 1950*. The amendment provides a list of factors to be considered in reviewing a foreign acquisition for national security concerns:

- domestic production needed for projected national defence requirements;
- the capability and capacity of domestic industries to meet national defence requirements, including the availability of human resources, products, technology, materials and other supplies and services;
- the control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security;
- the potential effects of the proposed or pending transaction on sales of military goods, equipment or technology to a country that supports terrorism, is a country of concern regarding missile proliferation or the proliferation of chemical and biological weapons, poses a potential regional military threat to the interests of the US or is listed on the nuclear nonproliferation special-country list;
- the potential effects of the transaction on US international technological leadership in areas affecting US national security;
- the potential national-security-related effects on US critical infrastructure, including major energy assets;
- the potential national-security-related effects on US critical technologies;
- whether the covered transaction is a foreign-government-controlled transaction;
- the adherence of the subject country to nonproliferation control regimes, the cooperation of the subject country with the United States, specifically in counterterrorism efforts, and the potential for transshipment or diversion of technologies with military applications;
- the long-term projection of US requirements for sources of energy and other critical resources and material; and
- such other factors as the president or the CFIUS may determine to be appropriate, generally or in connection with a specific review or investigation (*Defense Production Act of 1950*, section 721 (f)).

The *USA Patriot Act of 2001* defines critical infrastructure as "systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems and assets would have a debilitating impact on security, national economic security, national public health or safety, or any combination of those matters" (section 5195c(e)).

The *Homeland Security Act of 2002* added "key resources" to the list of critical infrastructure, defined as "publicly or privately controlled resources essential to the minimal operations of the economy and government" (section 2(9)). The Department of Homeland Security identified the following 17 sectors of the economy as falling within the definition of critical infrastructure and/or key resources: agriculture and food; defence industrial base; energy; public health and health care; national monuments and icons; banking and finance; drinking water and water treatment systems; chemical; commercial facilities; dams; emergency services; commercial nuclear reactors, materials and waste; information technology; telecommunications; postal and shipping; transportation systems; and government facilities. Critical manufacturing was added in March 2008.

The United States also prohibits FDI in such industries as maritime, aircraft, banking, resources and power. These restrictions predate the Exon-Florio Amendment and are intended to prevent public services and public interest activities from falling under foreign control, primarily for national defence purposes (United States 2010).

Appendix B: Foreign Investment Review Regimes in Selected Countries

Monetary threshold and the national interest

Both Australia and New Zealand apply a screening system for foreign investment above a specified monetary threshold, similar to Canada's.

Australia

The Australian foreign investment review legislation, the *Foreign Acquisitions and Takeovers Act*, requires a determination whether a proposed foreign acquisition is consistent with Australia's "national interest" (*FATA*, section 5). A review is required when a proposed transaction exceeds the prescribed financial thresholds. Non-US foreign investors must notify the Foreign Investment Review Board of any transactions involving the acquisition of a 15 percent share in an Australian entity worth more than A$244 million; for investors from the United States and New Zealand, a value threshold of A$1,062 million applies (Australia 2012). The legislation does not define "national interest" or offer any specific guidance as to what it constitutes. In the Foreign Investment Policy, however, the "national interest" criteria are national security and the effect of an investment on Australia's ability to protect its strategic and security interests; competition concerns in Australia and the global market; the effect on other Australian government policies, including tax; the effect on the economy and the community; and the character of the investor, including the transparency of its operations and adequacy of its corporate governance practices — and, in regards to an SOE, its independence from the relevant foreign government (Australia 2012; Poddar, Benson and Sylow 2012, 8).

The 2011 takeover offer of the Australian Securities Exchange's parent company ASX Ltd. by Singapore Exchange Ltd. for A$8.4 billion was rejected on the grounds that the transaction was not in Australia's national interest, as it was against the objectives of maintaining a strong and stable financial system and building Australia as a global financial services leader in Asia (Swan 2011).

New Zealand

New Zealand's foreign investment legislation, the *Overseas Investment Act 2005* (*OIA*),[32] requires government consent for overseas investment in sensitive New Zealand assets, which include investments in "significant" business assets (those having a value greater than NZ$100 million). The final decision is made by the minister for land information and the finance minister, with the assistance of the Overseas Investment Office (Smith 2008). A 2008 amendment to the *OIA* allowed the New Zealand government to consider whether a transaction was likely to assist in maintaining New Zealand control over "important infrastructure on sensitive land," including airports and ports (Smith 2008). The 2008 acquisition of a 40 percent stake in Auckland International Airport by the Canada Pension Plan Investment Board was declined by the relevant ministers for *OIA* decisions on the grounds that the "net benefit to New Zealand" test had not been met (New Zealand 2008).

National security and strategic industry

A screening system of foreign investment based on national security or strategic industry concerns is common in other jurisdictions, including France, Germany, Japan, China, Russia and India.

France

As a member of the European Union, France must comply with the EC Treaty, under which foreign investors must be allowed to conduct business freely within EU member states, but member states may restrict foreign investment on the basis of bona fide public security considerations (USGAO 2008, 53).

The French government, in Decree No. 2005-1739, has identified 11 strategic sectors — deemed to be potentially able to harm French public order, public security or national defence — that are subject to foreign investment review, including casino gambling, companies involved in developing pathogens or toxic substances, companies involved in developing military technology and those engaged in cryptology services. The decree applies to both EU and non-EU investors, but the regime is more restrictive of the latter. France has also established a €20-billion state investment fund to protect strategic industrial assets. The fund is managed and controlled by the Caisse des Dépôts et Consignations, with the French government owning a 49 percent stake (Bennhold 2008). France also has several sector-specific restrictions in addition to the requirements of the decree. For example, public monopolies such as coal mines, atomic energy and railway passenger transport are not open to foreign investment (USGAO 2008, 58-9).

Germany

In Germany, the *Foreign Trade and Payments Act* allows the federal government to review a potential acquisition by a non-EU firm where 25 percent or more of a German company's voting rights are being purchased. Given the 25 percent threshold, a "safe harbour" exists if the buyer purchases less than that percentage of the voting rights, whether the investment is intended to be active or passive (Stork 2010, 264).

The review is to determine whether the transaction would jeopardize "public security" or "public order" (Koch 2010), although neither is defined in the legislation. The terms are well-known in EU law, however, applying where restraints on fundamental freedoms are concerned. As a result, a transaction likely would be blocked only in the rare instance that it posed a genuine and significant threat that would affect one or more of the fundamental interests of society (Stork 2010, 269). Indeed, the ECJ has interpreted "public security" quite narrowly as concerned with the provision of certain critical services such as telecommunications or electricity (Martinius 2009). Economic or financial interests, therefore, cannot serve as the basis of restricting foreign investments in Germany generally (Stork 2010, 269-70).

Japan

Japan's *Foreign Exchange and Foreign Trade Act* allows government ministries to prohibit or place conditions on foreign investments in certain sectors that potentially impair national security (undefined), disturb public order or public safety or have a significant adverse effect on the "smooth management of the Japanese economy" (USGAO 2008, 75; Sauvant 2009, 9-11). Investments are reviewed on a case-by-case basis, but the exact criteria used to determine whether an investment poses a serious threat are not published (USGAO 2008, 78). Sectors where foreign investments are subject to review include petroleum, forestry, aerospace, utilities, telecommunications and defence (USGAO 2008, 76). Unrestricted sectors do not attract similar review measures; generally, FDI in these sectors can be reported following the actual investment (Deloitte 2010).

China

In China, the primary framework for FDI review is constructed on two regulations: the 2006 "Provisions for Merger and Acquisition of Domestic Enterprises by Foreign Investors"[33] and the 2011 "Catalogue for the Guidance of Foreign Investment Industries."[34] According to the Provisions, the Chinese government must approve transactions involving national economic security, major industries or famous trademarks or traditional Chinese brands (all undefined) (USGAO 2008, 44). Foreign acquisitions having implications for Chinese national security are subject to both competition and national security review (Sauvant 2009, 12). In all cases, reviewing authorities are given broad discretionary powers in deciding whether a foreign acquisition should be approved or rejected (Chan 2012, 25).

The Catalogue is a more specific regulation, restricting foreign investment in particular sectors. It categorizes all industry sectors as either prohibited, restricted or encouraged (Chan 2012, 24). Prohibited sectors are those the Chinese government believes are key to its national security, although neither the reason for placing a particular sector in that category nor the definition of "national security" is provided (USGAO 2008, 44). The focus of a national security review has less to do with the exact percentage of a business that is being acquired than with "actual control" of that business. As a result, no monetary or percentage threshold is required to trigger a national security review, although the larger the foreign investment the more significance it is likely to have from the perspective of a national security review (Chan 2012, 26).

Russia

In Russia, foreign investment review falls under the *Strategic Investment Law*. The legislation requires that foreign investment in Russian companies be subject to government approval if the Russian company is engaged in an "activity of strategic importance to the country's defence and national security" and the transaction will result in foreign control of a Russian "strategic entity" or in ownership of all or part of a "strategic company with rights to natural resource deposits having federal importance" (Gati 2008, 4). "Strategic entities" can be grouped into several broad industries, including aerospace, fishing, defence, broadcasting and printing (Syrbe, Pavlovich and Nogovistyna 2012, 3).

Upon review, if the Russian government determines a Russian company is "strategic," it also determines whether the company meets any of the criteria spelled out in the *Strategic Investment Law*. These include whether the company is licensed to trade in controlled goods and technologies, has exclusive rights to critical technologies or is licensed to have access to state secrets (Syrbe, Pavlovich and Nogovistyna 2012, 3-4). If it meets any of these criteria, the foreign investor is required to assume certain obligations imposed by a government committee charged with the task of determining exactly what these obligations should be (Gati 2008, 8).

India

In India, the primary law regulating foreign investment is the *Foreign Exchange Management Act* (*FEMA*).[35] *FEMA*, in turn, is implemented through regulations known as "Press Notes," which establish the sectors in which foreign investment must obtain prior government approval and the foreign ownership thresholds of businesses in each sector that will trigger governmental review (USGAO 2008, 66). Although the Foreign Investment Review Board — the agency authorized to review foreign investment transactions — routinely considers certain factors, it is given a fair amount of latitude in making its decisions. One such factor is whether an investment has any strategic or defence-related considerations, although there is no indication of what these considerations might be. In all cases, however, the primary focus is a consideration of whether the investment is in line with Indian investment policies concerning factors such as joint venture approval requirements, equity caps and industrial licensing requirements (USGAO 2008, 69).

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Notes

1 The "interim rejection" refers to a notice sent to Petronas by the Industry Minister pursuant to section 23(1) of the *ICA* that he was not satisfied that Petronas' investment in Progress Energy Resources was likely to be of net benefit to Canada and that Petronas had 30 days to make additional representations and submit undertakings.

2 BHP Billiton received the section 23(1) notice from the Industry Minister and withdrew its applicaton for review. Therefore, as with Petronas' "interim rejection," BHP Billiton's rejection was not a final rejection by the Minister. MacDonald Dettwiler was issued a final notice of rejection pursuant to section 23(3)(b) of the *ICA*.

3 *Investment Canada Act*, R.S.C. 1985 (1st Supp.), c. 28.

4 These are Australia, China, the European Union, France, Germany, India, Japan, New Zealand, Russia, the United Kingdom and the United States.

5 All dollar amounts in this study are expressed in Canadian currency unless otherwise noted.

6 Of the $607.5 billion in FDI in Canada, $192 billion was invested in manufacturing, $116 billion in mining and oil and gas extraction and $109 billion in professional, scientific and technical services (DFAIT 2012b).

7 For example, the federal, provincial and municipal governments regularly sponsor trade missions for political and business leaders to countries around the world. Furthermore, the Canadian Trade Commissioner Service operates offices in 163 countries to assist Canadian investors in assessing local market potential, finding qualified contacts and establishing business operations (Canadian Trade Commissioner Service 2013; Canadian Trade Commissioner Service, n.d.). Canada's interconnectedness with foreign markets is underlined by its history and bolstered by demographics: foreign-born residents account for approximately one-fifth of Canada's population and one-half of the population of Toronto, Canada's business capital (Statistics Canada 2011, 180; Toronto, n.d.).

8 *Agreement concerning automotive products between the Government of Canada and the Government of the United States of America*, 16 January 1965, Can. T.S. 1966/14. The Auto Pact was a precursor to both the Canada-US Free Trade Agreement and the North American Free Trade Agreement.

9 The World Trade Organization released a decision on December 19, 2012, in favour of a challenge by Japan and the United States that domestic-content requirements in Ontario's renewable energy program discriminated against foreign manufacturers (WTO 2013). The Canadian government has appealed the decision on behalf of the Ontario government (WTO 2013).

10 *Foreign Investment Review Act*, S.C. 1973-74, c. 46.

11 *Budget Implementation Act*, S.C. 2009, c. 2. The $330 million review threshold for 2012 will remain for SOE acquisitions (Industry Canada 2012b). Also, lower thresholds do and will continue to apply in connection with investments in the cultural sector and where the investor and seller are not ultimately controlled by nationals of WTO member states (Industry Canada 2013).

12 *Investment Canada Regulations*, S.C. 1984-85, c. 20. However, enforcement in the cultural sector might be relaxing with the approved entry of Amazon.com and the sale of e-book company Kobo Inc. to Rakuten (Canadian Heritage 2010; "Kobo Positioned for International Growth" 2012).

13 *Canada (Attorney General) v. United States Steel Corporation*, 2010 FC 642; affirmed in *United States Steel Corporation and U.S. Steel Canada Inc. v. The Attorney General of Canada*, 2011 FCA 277.

14 There have been several rejections under the *ICA* of investments in Canadian cultural businesses, including three rejections since 1999 (and 98 approvals over the same period) (Industry Canada 2013; Competition Policy Review Panel 2008, 29). Investments in Canadian cultural industries are treated as categorically different from investments in other Canadian industries and are subject to thresholds of $5 million for direct acquisitions and $50 million for indirect investments (Industry Canada 2013). In our consideration of *ICA* investment review and rejections in this study, we therefore exclude from consideration investments that relate to cultural industries.

15 See appendix B for examples of European jurisdictions with foreign investment restrictions with respect to strategic industries. Canada had special foreign investment restrictions for the uranium production, transport services, financial services and cultural (including publishing, film, video, music and broadcasting) industries. These sectoral controls were liberalized in 2011, except for those that apply to cultural industries, which remain in place (Competition Policy Review Panel 2007; Industry Canada 2013).

16 Exon-Florio Amendment 50 U.S.C. § 2070 (1988) to Title VII of the *Defense Production Act of 1950*, 50 U.S.C. § 2061-2071 (1950). The Committee on Foreign Investment in the United States (CFIUS) predates Exon-Florio, having been established by President Ford's Executive Order 11858 (7 May 1975) tasking CFIUS with monitoring the impact of foreign investment in the United States and coordinating the implementation of US foreign investment policy. There was no formal enforcement or veto authority prior to the Exon-Florio Amendment.

17 *USA Patriot Act of 2001*, Pub. L. No. 107-56, 115 Stat. 272 (2001); *Homeland Security Act of 2002*, Pub. L. No. 107-296, 116 Stat. 2135 (2002); *Foreign Investment and National Security Act of 2007*, Pub. L. No. 110-49, 121 Stat. 246 (amending 50 U.S.C. app. § 2170).

18 *National Defense Authorization Act for Fiscal Year 1993*, Pub. L. No. 102-484, 106 Stat. 2315, 2464 (1992), [Byrd Amendment].

19 *Foreign Acquisitions and Takeovers Act 1975*, Act No. 92 of 1975.

20 *Strategic Investments Law*, Federal Law No. 57-FZ "On Procedures for Foreign Investments in Companies of Strategic Importance for National Defence and Security" of 29 April 2008, (RUS), and *Foreign Investments Law*, Federal Law No. 160-FZ on "Foreign Investments in the Russian Federation" of 9 July 1999.

21 Decree no. 2005-1739 of December 30, 2005, Official Journal, December 31, 2005.

22 Although the commitment was not originally offered in its proposal for acquisition, as public opposition to its bid grew, BHP Billiton eventually promised to remain in Canpotex for a limited period if *ICA* approval was granted (Simon 2011).

23 Section 19(2) of the *ICA* allows the government to accept any security for payment in respect of any penalty that may be imposed under section 40(2)(d).

24 EC, *Consolidated Version of the Treaty Establishing the European Community*, [2006] O.J. C 321 E/37.

25 EC, *Council Regulation (EC) No. 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation*), [2004] O.J. L 24.

26 *Commission v. Belgium*, C-503/99, [2002]; *Commission v. France*, C-483/99, [2002].

27 *Enterprise Act 2002*, (U.K.) 2002, c. 40.

28 *Boeki kawuse kanri ho* [Foreign Exchange and Foreign Trade Act], Law no. 228 of December 1, 1949, as last amended by Law No. 102 of October 21, 2005.

29 *Foreign Trade and Payments Act of 28 April, 1961 (Außenwirtschaftsgesetz — AWG)*, Federal Law Gazette I 481.

30 "Circular of the General Office of the State Council on the Establishment of Security Review System Regarding Merger and Acquisition of Domestic Enterprises by Foreign Investors" (Guo Ban Fa [2011] No. 6).

31 "Provisions of the Ministry of Commerce for the Implementation of the Security Review System for Merger and Acquisition of Domestic Enterprises by Foreign Investors" (Guo Ban Fa [2011] No. 8).

32 *Overseas Investment Act 2005*, (N.Z.), 2005/82.

33 "Provisions for Merger and Acquisition of Domestic Enterprises by Foreign Investors" (Guo Ban Fa [2006] No. 10).

34 "Catalogue for the Guidance of Foreign Investment Industries" (Revised 2011).

35 *Foreign Exchange Management Act*, Act No. 42 of 1999 (India).

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