Foreign investment in Canada — A love-hate relationship?

Does Canada lose another little piece of its soul when one of its corporate icons falls into the hands of foreign owners? This question continues to bedevil us as companies such as The Hudson's Bay Company, Labatt, Seagram, Inco, Falconbridge, and Dofasco are taken over by offshore interests.

By Alan Young

From the protectionist Trudeau-era Foreign Investment Review Act to the more welcoming approach of former prime minister Brian Mulroney's Investment Canada Act (ICA), Canadian governments have long sought to strike the appropriate balance between encouraging foreign investment — which most agree is in Canada's economic interest — and developing a vibrant, indigenous business community including head offices spinning off direct, indirect and induced economic benefits across the country.

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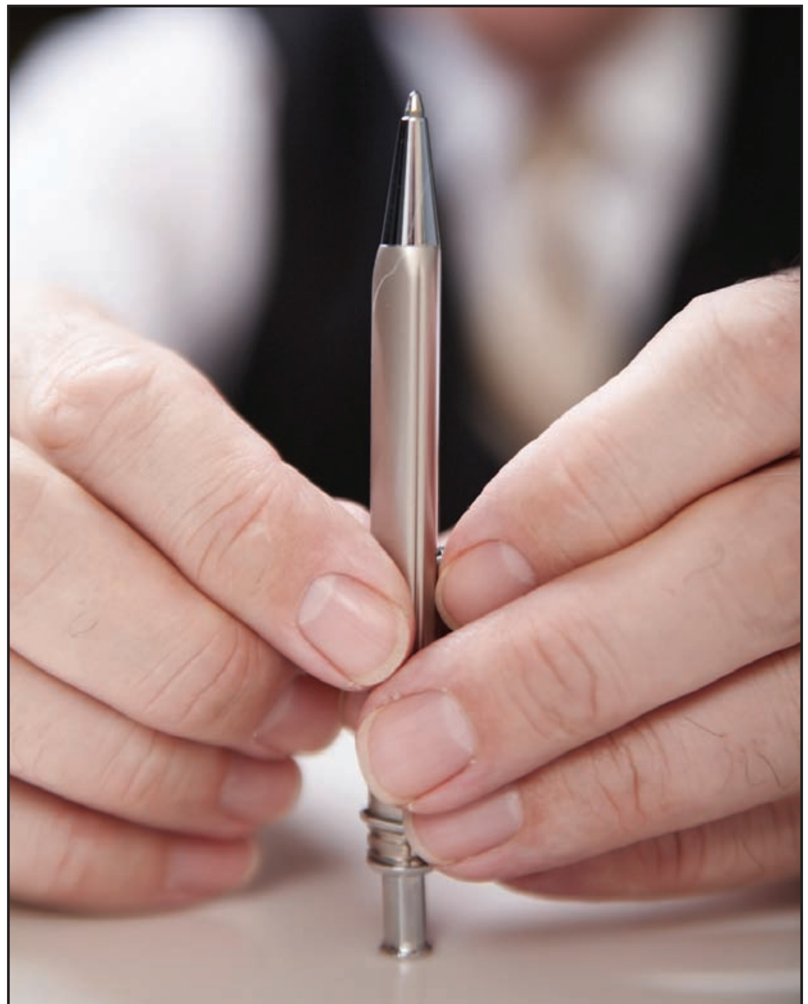

The most recent attempt to find the right balance arose in unusual circumstances. When Finance Minister Jim Flaherty stood up in the House of Commons in late January to table his 2009 Budget, Canadians expected, and received, a blueprint to deal with the worst economic crisis facing Canada in a generation. They did not, however, expect measures that would fundamentally alter one of Canada's most important economic framework laws — the Investment Canada Act. In a highly unorthodox move, included in the 550-page Budget Implementation Act, which included many of Minister Flaherty's budgetary objectives, were provisions that will affect merger and acquisition activity in Canada's corporate sector in the years ahead.

Introducing a national security test

The most significant amendment to the ICA was the introduction of a process to review investments if the Minister of Industry has reasonable grounds to believe that a foreign investment "could be injurious to national security." Adding a national security test to foreign investments is not unusual. Other countries, including the United States, have similar provisions. Furthermore, former prime minister Paul Martin's Liberal government introduced an identical amendment in the fall of 2005 which died on the Order Paper when the Martin government was defeated. There is little doubt, however, that a national security review increases the potential for a greater degree of politicizatio, and uncertainty to future foreign investments.

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A definition of what could be harmful to national security was not offered in the legislation. Moreover, although regulations to accompany the ICA amendments are expected in the months ahead, it is anticipated that no attempt will be made to add clarity to what may or may not constitute an injury to national security. This will give the government of the day maximum flexibility to deal with each investment on its own facts and merits. Interestingly, it is not only the usual triggering mechanisms of the establishment of a new business or the acquisition of control of a Canadian business by a non-Canadian that lead to a national security review. All that is required is an investment "in whole or in part" of an entity with any of its operations in Canada. Thus, the scope of the national security provision is deliberately quite broad. The Minister of Industry continues to be responsible for the ICA (with the exception of investments in cultural businesses). However, the full cabinet must be included in the decision-making process if the Minister, following consultations with the Minister of Public Safety and Emergency Preparedness, believes an investment would be injurious to national security or is unable to determine if it would be injurious. And it is the cabinet that will make orders to the potential foreign investor to take any measures that the cabinet considers to be advisable to protect national security. Accordingly, foreign investors caught by the national security test will be advised to take necessary and prudent steps to factor in the interests of all cabinet ministers.

Reducing barriers to foreign investment

While the national security test may be seen as erecting a barrier to certain foreign investments, other notable changes to the foreign investment regime sent a positive signal that Canada is open to foreign investment. The threshold for review of an investment by a WTO investor was raised from $312 million in assets to $1 billion on a five-year phase-in basis (the initial threshold will be $600 million). In addition, the much lower threshold previously set for four particularly "sensitive" sectors of the Canadian economy, namely cultural businesses, transportation, financial services, and uranium production were eliminated for the latter three. The good news for foreign investors considering Canada as a destination for their capital is that these important changes will reduce the number of transactions that are subject to the ICA. A related change to the increased thresholds triggering the application of a review that may be of particular interest to CMAs is that investments will now be measured in terms of "enterprise value" rather than the gross assets of the target company. As noted in the June 2008 Competition Policy Review Panel report entitled Compete to Win, using gross assets as the standard for measuring the size of Canadian businesses was out of date, given that the value of many service and knowledge-based companies is found in its employees, intellectual property and other intangible assets that are not recognized in a balance sheet. The Harper government accepted the Panel's recommendation to replace gross assets with enterprise value as the new measure. Unfortunately, the legislative amendments did not define "enterprise value." Guidance was provided, however, by the Panel as it noted enterprise value "is equal to the sum of the price to be paid for the equity of an acquired business and the assumption of liabilities on its balance sheet minus its current cash assets."[1] Hopefully, regulations or an Investment Canada guideline will provide greater clarity to this new measure.

The method used to amend the Investment Canada Act — a massive omnibus budget bill — was unusual and was criticized as circumventing a thoughtful and thorough review by Parliamentary Committees focusing specifically on the new measures. Nevertheless, these important changes are now the law of the land. They represent the latest attempt by the Government of Canada to balance the desire for foreign investment against competing national economic and social policy objectives. ■

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[1] Compete to Win, Final Report — June 2008, Competition Policy Review Panel; pages 31 and 111.