FOREIGN INVESTMENT IN CANADA: RECENT DEVELOPMENTS

By Cyrus Reporter

The economic benefits derived from the free flow of capital across the United States–Canada border cannot be understated, and indeed, are almost universally acknowledged by business leaders and politicians from both sides of the border. More to the point, our success through the years at generating cross-border investment speaks for itself.

Just last year, Canadians invested more than $210 billion in the United States, representing 61 percent of all Canadian outward foreign direct investment (FDI). American investors sent $258 billion north of the border during the same period. With this almost half-trillion-dollar annual flow of capital has come improved resource allocation, enhanced technological and organizational knowledge, and increased productivity. However, although these benefits continue to accrue, a recent spate of high-profile foreign acquisitions in Canada has reopened a debate about whether Canada's existing regime for encouraging and vetting new foreign investment can adequately address the modern challenges and opportunities of the global marketplace.

On July 12, 2007, the governing conservative party announced that it would bring Canadian competition and investment policy under the microscope by establishing a Competition Policy Review Panel. The panel, comprised of several industry leaders, would be assigned the difficult task of reviewing Canada's competition and investment regime, and reporting back to the federal government in less than one year.

One look at the current framework suggests that this will be no small task.

The Investment Canada Act

It might come as some surprise to many Americans that even in the post-Free Trade Agreement era, Canada continues to have a broad review clause in an act entitled the Investment Canada Act (ICA), which is applicable to *all* industry sectors. In fact, the framework that is set out in this act has been in place for several decades.

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The act requires that *direct* investments exceeding $265 million (C$281 million) and resulting in the acquisition of control of a Canadian company must be reviewed in order to ensure that there is a net benefit to Canada. This standard is applicable for firms in World Trade Organization (WTO) member countries only, with firms in non-member countries being subject to review in situations of direct investment resulting in control where more than $4.7 million (C$5 million) is invested. In the case of *indirect* investments resulting in control by non-WTO firms (i.e., investment in a parent or holding company that owns some or all of a Canadian company), a review will occur where the investment exceeds $47 million (C$50 million). Where the "asset value of the Canadian business being acquired exceeds 50 percent of the asset value of the global transaction," the lower $4.7 million threshold otherwise only applicable to direct investments will apply.

While U.S. investors clearly fall within the WTO-member category, *all* investors are subject to the non-WTO thresholds where certain sensitive sectors are at issue, including uranium production, financial services, transportation services, and cultural businesses. The far-reaching definitions of these latter two categories have further ramifications than might ordinarily be inferred. For example, "transportation services" include oil and gas pipelines, thereby subjecting many firms in the energy sector to the low threshold for review.

Further, reference to "cultural businesses" covers not only the production of books and audio/video content, but also the *distribution* of these cultural items. Moreover, the broadcasting and telecommunications sectors are subject to substantially lower investment thresholds regardless of the nationality of the investor.

The net benefit test of the ICA considers, among other things, the effect of the acquisition on Canadian productivity, employment, and innovation, as well as Canada's ability to compete in world markets, and compatibility of the acquisition with national policies.

Sector-specific Restrictions

Under the Telecommunications Act, facilities-based telecommunications carriers are subject to strict foreign ownership restraints, which limit direct foreign ownership

of a carrier's voting shares to 20 percent, and indirect foreign ownership of a carrier holding company to 33.3 percent. Control in fact by non-Canadians, which could still occur even if non-Canadians hold a minority voting share interest, is also prohibited. With some creative structuring, a combined 46.6 percent of the voting shares of a telecommunications carrier could be foreign-owned.

In its 2007 flagship publication *Going for Growth 2007*, the Organization for Economic Cooperation and Development (OECD) recommends that ownership restrictions in the Canadian telecommunications sector be eliminated, and many experts both hope and expect that the panel will come to the same conclusion upon completing its review. As then Industry Canada Deputy Minister Peter Harder (now senior policy advisor to Fraser Milner Casgrain LLP) pointed out in 2003, "almost all other OECD countries have telecommunications investment regimes more liberal than Canada." Harder also commented that "only Turkey is more closed." This is something that Turkey has now remedied, while Canada continues to navigate its current course.

The broadcasting sector is subject to similar rules with respect to direct and indirect foreign control restrictions. However, these limits come with additional caveats. For example, where the ownership structure of a broadcast licensee involves a holding company and an operating company, the voting shares of the holding company (including the votes attached to such shares) may not be more than 20 percent foreign-controlled (as compared to the usual 33.3 percent limit) if the holding company seeks to exercise "control or influence over any programming decisions" of the operating company. Furthermore, the CEO of the operating company must be Canadian, and where the holding company wishes to exert control over programming decisions, it too must be run by a Canadian.

The Canadian airline industry, like that of the United States, continues to be governed by a 25 percent foreign control restriction.

Competition Policy Review Panel

The panel membership named by the government of Canada has a well-varied and extensive background in industry, and will be chaired by former BCE CEO Lynton "Red" Wilson. In addition to his post at the top of Canada's largest telecommunications firm, Wilson also has served as a provincial deputy minister, and currently sits on the board of directors of CAE, AllerGen NCE, and DaimlerChrysler. He is joined on the panel by Isabelle Hudon (president and CEO of the board of trade of Metropolitan Montreal), P. Thomas Jenkins (executive chairman and chief strategy officer of Open Text Corporation), Brian Levitt (cochair of Osler, Hoskin & Harcourt LLP) and N. Murray Edwards (owner and president of Edco Financial Holdings Ltd.).

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To facilitate the work of the panel, a consultation paper was released on October 30 entitled *Sharpening Canada's Competitive Edge,* which provides insight into the issues to be examined by the panel and solicits input from interested parties. In light of the compact period in which the panel will be making its recommendations, all comments to the panel are to be submitted by January 11, 2008, and may not exceed 20 pages in length. Although the panel will also "participate in a series of meetings with interested parties across the country" and commission research and evidence from leading experts, it is clear that written submissions will be the primary mechanism for participating in the consultation process. Details of the process aside, one thing is certain: The panel's terms of reference are very broad. The government has requested that the panel examine all competition legislation affecting Canadian global competitiveness and productivity. Further, the panel may also address other competition matters that have been postponed during the past few years, such as the treatment of efficiencies under the merger and unilateral market power provisions of the Competition Act. It should be noted that although Canadian competition policy is naturally non-nationalistic—with prospective mergers being examined in an identical manner, whether they involve foreign companies or not—it would be presumptuous to assume that any recommended amendments to the Competition Act will not affect FDI rules. For example, the Competition Act could be used as a subtle and more nuanced mechanism to complement the straightforward bright-line tests usually applied in the immediate investment context, perhaps by

placing greater weight on international markets and trade in assessing mergers and dominant firm conduct.

A Focus on Investment

In an effort to guide the work of the panel, the government initially had provided several key areas for examination. First, and in accordance with recommendations made by several Canadian business leaders, the panel was to consider a mechanism whereby the level of reciprocity between Canada's direct investment laws and those of foreign jurisdictions will be considered when examining a prospective foreign takeover. Second, the panel was to analyze the possibility of a national security review clause, and more to the point, when such a clause might be employed. Finally and closely connected to the

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issue of national security was the politically popular issue of state-owned and nontraditional (e.g., non-share capital) enterprises investing in Canada. These investments are especially sensitive not only because they raise issues of fairness regarding the ability of unsubsidized private companies to compete with the resources of state-owned entity, but also because of the national security implications associated with such acquisitions. Simply put, there is concern as to whether a state-owned entity, often governed by strategic political concerns, can be expected to act in a manner that assures the investment provides a net benefit to Canada.

Perhaps illustrating the sensitivity of these latter two concerns—both economically and politically—the Minister of Industry, Jim Prentice, announced at an October 9 Vancouver Board of Trade speech that the government would be fast-tracking action on state-owned enterprises and national security, with an examination that began in the fall. Interestingly, and despite earlier suggestions, the possibility of introducing a form of reciprocity test was dismissed by the minister, who suggested that this matter would be best addressed through trade negotiations and not the review of individual acquisitions.

Assuming that the government concludes after its examination that a mechanism for special screening of state-owned investors is warranted, an interesting question is what legislative changes would actually be required to implement such a screening system. Although it is convenient to envision a stand-alone clause directed specifically toward this issue, Canada continues to have a broad review clause in the ICA, applicable to *all* industry sectors, and already requiring the vetting of large foreign acquisitions. Furthermore, section 38 of the ICA allows the government to complement the legislated review mechanism with guidelines and interpretative notes in order to provide further clarity. As such, and as already alluded to by Minister Prentice, a national security review clause will likely come in the form of guidelines, and not legislative amendments. A question certain to dominate the panel's deliberations is whether sectoral foreign ownership restrictions should be lifted, and if so, whether there should be somewhat more robust scrutiny of "strategic" sectors under the ICA. There is certainly a strong argument in favor of easing certain existing restrictions, especially where they relate to the airline and telecommunications sectors. With respect to the broadcasting sector and other cultural industry sectors such as newspaper and book publishing, the prospect of lifting foreign-ownership restrictions raises issues of cultural sovereignty and, therefore, would likely be met with greater opposition. Ironically, as a technical matter, the broadcasting limits can be adjusted via Order-in-Council, while amendments to the rules governing airlines and telecommunications must be made through a full legislative process.

Another pressing issue that will need to be addressed is whether and how the existing net benefit test will be adapted. Will it be adjusted to better deal with modern challenges and opportunities such as the emergence of new economic powers (e.g., Brazil, Russia, India, and China—collectively known as the BRICs) and aggressive state-owned suitors? As always, the economics of foreign investment cannot be analyzed in a vacuum without considering the associated political risks and opportunities. The timing of the commission suggests that no matter what the panel recommends, we shouldn't expect any action prior to the next federal election. Furthermore, analysis and recommendations are only the first steps in what could be a lengthy process, as after the panel

reports its findings, the difficult task of implementing (or ignoring) the recommendations will begin. In large part, how this is done may depend upon the results of the next election, especially if foreign investment becomes an election issue.

Of course, we also cannot forget the reciprocal nature of trade negotiations. Even if the Canadian government does decide to remove investment restrictions, we shouldn't expect it to occur overnight. Canada would likely seek to obtain concessions from its trading partners in exchange for liberalizing its own markets. This will be all the more true if, as should be expected, the panel recommends that Canada must find a way to facilitate its own companies in growing and expanding internationally.

Although still left with more questions than answers at this point, if all goes well, the next few years could prove to be a transformative period in the history of Canadian competition and investment policy. ✦

COLOMBIA: FOREIGN INVESTMENT RETURNS

By Camilo Gomez

Despite ongoing social and political problems, Colombia is currently enjoying a renaissance of foreign direct investment (FDI). In fact, flows of FDI to Colombia went from US$2.139 million in 2002 to US$6.463 million in 2006. Between 2005 and 2006, investment flows entering the country grew by 17 percent. In the first quarter of 2007, FDI jumped 100 percent compared with that of first quarter of 2006. This clearly demonstrates the confidence that foreign investors have in the present and future Colombian market.

Colombia is the fourth largest economy in Latin America, after Mexico, Brazil, and Argentina. Colombia produces 4.4 percent of the total Gross Domestic Income of the region. It is geographically privileged, with coasts on two oceans. Although it does not have different seasons, Colombia has all climates. Three large mountain chains traverse the nation. Much of Colombia's economic success is due to high-demand exports such as coffee, emeralds, and flowers.

Nonetheless, Colombia's political problems are undeniable. Multiple illegal groups and armed bands have been waging war inside the country for decades. They all seek control over the drug-trafficking business, and the Colombian government seeks control over them. Colombia also suffers from the typical problems of any developing nation, such as corruption, poverty, infrastructure deficiencies, and legal uncertainty.

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The Economic Opening and the 1991 Colombian Constitution

How has a country facing so many hurdles managed to inspire so much confidence in foreign investors? The first reason may go back to the 1990s, when the foundation of the "economic opening" was laid. Traditionally, Colombia had operated under a purely protectionist policy. By 1990, however, it became clear that we had to open Colombia's borders and expose Colombia's products and producers to international competition.

Colombia's protectionist policies were a flawed response to the country's historical shortcomings. Political inequities and an utterly skewed distribution of income and wealth had created a hodgepodge of laws that reflected the contradictions that drove them. This put the country at an obvious disadvantage in the eyes of consumers and investors, compared to other countries at equivalent levels of development.

César Gaviría was the president of Colombia at the time. Gaviría developed and championed the economic opening process, and also paid the political price for doing so. He did not believe that mere legislation or amendments to Colombia's 100-year-old constitution were sufficient. Instead, in order to effect the necessary changes wrought by the economic opening, he believed that Colombia had to enact an entirely new constitution. Each and every relevant political group drafted, discussed, and eventually signed the 1991 constitution that governs Colombia today.

Initially, Colombia paid a high price to open its economy. When foreign competitors entered the Colombian