# CANADA

## Investment

## The *Investment Canada Act*: Is it Impeding Chinese Investment in Canada?

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When it comes to foreign direct investment, China and Canada have been described as a match "made in heaven." Canada has vast, undeveloped natural resources combined with the political will, but not necessarily the domestic financial capacity, to develop those resources; China has a major appetite for natural resource imports and massive levels of outward foreign direct investment.

The Canadian government, especially of late, has been making assiduous efforts to attract Chinese investment to Canada. However, a June 2012 report by the Conference Board of Canada (the Report), a non-profit economic and policy research institute, suggests that Canada is still seriously lagging behind other countries in attracting Chinese direct investment. Australia, for example, another resource-rich country, attracts approximately three times more Chinese direct investment than Canada does.

The Report acknowledges that Chinese investment in Canada tends to be politically sensitive because

(i) it focuses on natural resources and

(ii) it frequently involves investments by state-owned enterprises (SOEs).

There remains a lingering concern in Canada that China will use these investments to "lock-up" Canadian resources which will then be sold at below market prices for processing and use in China. There is also a general suspicion of the Chinese government's track record in human rights and foreign policy matters. Chinese investors are sensitive to these negative views and this may be one reason for comparatively lower levels of Chinese investment in Canada.

According to the Report, however, Canada's foreign investment review regime is the principal culprit responsible for Chinese reluctance to invest in Canada. In particular, the Report asserts that the opaqueness and politicized nature of this review regime discourages Chinese investment in Canada above current levels.

The *Investment Canada Act* (ICA) is the principal statute governing foreign investment in Canada. The ICA provides that foreign investments in Canada of a certain size and nature must first be approved by the Canadian government as being "of net benefit to Canada." The ICA also provides for a separate review process that can be invoked to determine if a foreign investment could be "injurious" to Canadian national security.

**The Report raises important questions about the potential negative impact of Canada's foreign investment review process on Chinese and other foreign direct investment.**

While almost all transactions involving foreign investors tend ultimately to be approved by the Canadian government, the Report points to the ICA approval process as a major impediment to greater Chinese investment in Canada. For example, although the ICA sets out general criteria for what constitutes a "net benefit to Canada," these criteria are vague and open to interpretation. As to the ICA's national security review process, the legislation does not even attempt to define when a transaction could be "injurious" to Canadian security. As a result, the ICA process inevitably—and deliberately—gives the Canadian government a great deal of political discretion when deciding whether to accept or reject a transaction. The Report argues that the difficulties in predicting how this political discretion will be exercised in any given case is at the root of Chinese reluctance to increase investment in Canada.

The Report is also critical of the lack of specificity in the ICA guidelines that were developed specifically to address the acquisition of Canadian businesses by foreign SOEs (the SOE Guidelines). The SOE Guidelines explain that the Canadian government will examine the corporate governance and reporting structures of foreign SOEs as part of the assessment process under the ICA. The government also will assess whether the acquired Canadian business will continue to operate on a commercial basis under the SOE's ownership (e.g., with respect to where the Canadian business will process and export its products). As noted by the Report, however, the Guidelines do not set out which governance structures will be found acceptable or the criteria that will be applied in determining whether the foreign SOE will continue to operate the Canadian business on a commercial basis. Moreover, the Report states that the utility of the Guidelines is limited further because they "operate within an opaque review process" overall.

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The Report offers several recommendations on how to improve Canada's foreign investment policies in order to increase Canadian competitiveness in attracting Chinese direct investment. These include:

- organizing the ICA around two clear tests – one related to Canada's "national economic interest" and the other related to national security;
- with respect to the "national economic interest" test, providing that the Canadian government will only be allowed to turn down a transaction if it can demonstrate that a foreign investment will be contrary to the "national economic interest"—this would reverse the onus of proof under the ICA, which currently requires that foreign investors persuade the government that the investment will be of "net benefit to Canada";
- with respect to the national security test, specifying the types of security risks that are meant to be addressed; and
- revising the SOE Guidelines so that they spell out specific undertakings that will be required to ensure that the acquired Canadian business will continue to operate on a commercial basis.

The Report raises important questions about the potential negative impact of Canada's foreign investment review process on Chinese and other foreign direct investment. The Report is particularly timely given the recent $15.1 billion offer by China National Offshore Oil Company Limited (CNOOC) to acquire Calgary-based Nexen Inc. (Nexen). CNOOC is China's largest producer of offshore crude oil and natural gas and one of the largest oil and gas exploration and production companies in the world. Nexen is an Alberta-based energy company that develops oil and gas resources in Canada, the North Sea, the Gulf of Mexico, Yemen and Nigeria.

As expected, CNOOC's proposed acquisition of Nexen has triggered concerns in some quarters about the prospect of Chinese companies gaining control of Canada's oil and gas sector. But CNOOC has clearly done its homework and has carefully tailored its offer to address many of the types of commitments commonly offered by foreign investors in order to secure ICA approval. For example, CNOOC has publicly offered to:

- make Calgary the site of its new North and Central American headquarters;
- maintain Nexen's current management and employees;
- list the company on the Toronto Stock Exchange;
- maintain and enhance capital expenditures on Nexen's assets; and
- enhance community and social investments.

In that respect, CNOOC is following the path of BHP Billiton, which had offered the Canadian government substantial commitments in an effort to gain approval of its proposed acquisition of Saskatchewan Potash Corporation in 2010. That bid failed, which reinforced concerns among foreign investors about the non-transparent and politicized nature of the ICA review process, as summarized by the Conference Board Report. The challenge now facing the Canadian government is whether it can afford to further undermine the credibility of the ICA review process—particularly in the eyes of Chinese investors—by turning down the proposed CNOOC/Nexen transaction as well.

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