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Competition Policy Review Panel Recommends Dramatic Changes to Canada's Foreign Investment and Competition Law Regimes

"Canada needs to get its act together"

June 27, 2008

On June 26, 2008, the Competition Policy Review Panel presented "Compete to Win", its report on Canada's competition and investment policies, to the federal Minister of Industry. The Panel proposed what it described as "a sweeping national Competitiveness Agenda based on the proposition that Canada's standard of living and economic performance will be raised through more competition in Canada and from abroad". In a press release, the Chair of the Panel said that "Canada needs to be more open to competition, as competition spurs the productivity enhancements that underpin our economic performance and ultimately our quality of life". He added that "Canada needs to get its act together as a nation" and adopt a more globally competitive mindset. The report's key recommendations are to:

- Substantially increase the *Investment Canada Act* review threshold for acquisitions of Canadian businesses by non-Canadians to a $1 billion enterprise

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value (except in the case of cultural businesses) and reverse the onus in the review standard to require that the Minister find that the proposed acquisition would be contrary to Canada's national interest.

- Increase the limit on foreign ownership of air carriers to 49% of voting equity on a reciprocal basis through bilateral negotiation.
- Remove the *de facto* prohibition on bank, insurance and cross-pillar mergers of large financial institutions.
- Initially allow foreign companies to establish new telecommunications businesses in Canada or acquire existing businesses with market shares of up to 10%, and subsequently further liberalize foreign ownership restrictions in this sector.
- Liberalize the non-resident ownership policy on uranium mining.
- Amend the merger notification process under the *Competition Act* to mirror the U.S. *Hart-Scott-Rodino Antitrust Improvements Act* process.
- Replace the existing conspiracy provisions in the *Competition Act* with a *per se* criminal offence to address "hard core" cartels and a civil provision to deal with other types of agreements between competitors that have anti-competitive effects.
- Grant the Competition Tribunal the power to order an administrative monetary penalty of up to $5 million for a "violation" of the abuse of dominant position provisions of the *Competition Act*.
- Repeal the *Competition Act*'s provisions relating to price discrimination, promotional allowances and predatory pricing and de-criminalize the price maintenance offence.

The proposals to amend the Canadian foreign investment review and regulation regime, as well as the proposals to repeal or de-criminalize certain pricing offences in the *Competition Act*, are welcome initiatives that would clearly enhance Canadian competitiveness and Canada's attraction to foreign investors. It is less clear that the proposed amendments to the conspiracy provisions, adoption of a U.S.-style merger notification system, or significant penalties for abuses of dominant positions will enhance the efficiency and competitiveness of Canadian businesses.

Some of the Panel's proposals relate to administrative discretion (e.g., greater transparency in the foreign investment review process) and could be implemented quickly. Others would require legislative amendment and it remains to be seen whether they will have sufficient political support in the context of the current minority government.

The Minister of Industry has said that he will respond to the Panel's report in the coming days.

A more detailed discussion of the Panel's report is set out below. While we do not discuss them in this note, the Panel's report also includes discussion and recommendations with respect to taxation, education, immigration, urban issues, growth of small and medium sized enterprises, securities law considerations in mergers and acquisitions (such as poison pills

and defensive tactics), environmental assessments and both interprovincial and Canada-U.S. trade barriers.

Background

On July 12, 2007, the Canadian government announced the creation of the Panel and tasked it with reviewing key elements of Canada's competition and investment policies. Broadly speaking, the Panel was asked to explore how best to encourage international investments by Canadians and position Canada to be a world-leading location for talent, capital and innovation.

The five-person Panel consisted of a mix of Canadian legal and business representatives. The Panel issued a consultation paper in October 2007 and received 155 written submissions expressing a wide range of viewpoints. The Panel also held a series of regional and thematic consultations across Canada and commissioned over 20 research projects.

Foreign Investment Review

If implemented, the Panel's recommendations with respect to the *Investment Canada Act* (the "ICA") would significantly reduce the scope of mergers and acquisitions subject to review under the ICA and greatly facilitate the review process where a review is required. Apart from certain specified sectors, the general review threshold for most direct acquisitions of Canadian businesses is currently $295 million based on the book value of the assets of the relevant company. While it is rare for a transaction to be blocked pursuant to the ICA, the review process can be frustrating, require the provision of undertakings that add costs and limit a company's ability to adapt quickly to changing market conditions, and cause foreign investors significant delay and prejudice in seeking to complete acquisitions of Canadian businesses, particularly in competitive auction contexts. A substantially higher $1 billion enterprise value review threshold, a reversal of the current onus on foreign investors to demonstrate that a proposed acquisition is likely to be of "net benefit to Canada", requiring instead that the Minister determine that a proposed transaction would be contrary to Canada's national interest before disallowing a transaction, and more transparent reviews, standards and processes would likely go a long way to addressing these issues.

The Panel's appointment came at a time of controversy over foreign investment in Canada. According to a recently published report from the Organization for Economic Co-operation and Development ("OECD"), Canada has more restrictions on foreign investment than most OECD countries. The OECD said this hampers productivity and slows the diffusion of new technology and management practices to Canadian businesses. However, recent foreign takeovers of Canadian business "icons" (such as Hudson's Bay and Inco) reinvigorated the debate about a possible "hollowing out" of corporate Canada. Specific concerns have been raised that the ICA review process does not adequately protect Canadian interests, notwithstanding that foreign acquirers are required to demonstrate that their transactions are of "net benefit" to Canada. The Panel rejected the view that the ICA has become an obstacle to foreign investment in Canada but concluded that the scope of the ICA should be narrowed to enhance Canada's attractiveness to foreign capital without undermining the government's

ability to safeguard Canada's national interests on a basis consistent with other industrialized countries.

Separately and apart from the Panel, the government recently issued guidelines on acquisitions by foreign state-owned enterprises with potentially non-commercial objectives, and announced that it is considering whether the ICA needs to be amended to address national security concerns.

Also, the Minister of Industry last month declined to approve under the ICA the proposed $1.325 billion acquisition by Alliant Techsystems Inc. of the space division of MacDonald, Dettwiler and Associates Ltd. ("MDA"). As a result, the proposed transaction could not be completed. While the Minister did not publicly provide much detail concerning his reasons for withholding approval, concerns had been raised about foreign ownership of MDA's remote sensing satellite given its importance for the scanning of Canada's Arctic region, particularly in light of international disputes relating to Canada's territorial claims in the Arctic. Apart from cultural businesses, this was the first reviewable acquisition for which the Minister denied approval under the ICA since it was enacted in 1985. (*See Perspective - History Is Made: Canadian Government Confirms Refusal of Foreign Acquisition Under Investment Canada Act for additional information about this decision.*) However, given the circumstances, it is not clear that a different result would have been reached with respect to the MDA proposal under the foreign investment review regime proposed by the Panel.

Sectoral Foreign Ownership Restrictions

The Panel examined several particular industry sectors in which it recommended greater scope for foreign investment and ownership. In some cases the proposals were conditional on reciprocity or the obtaining of other benefits from relevant foreign countries that currently restrict access to Canadian entities.

Air Transport

With respect to air transport, the Panel noted that Canada currently limits foreign ownership of Canadian air carriers to 25% of voting equity but that increasing the level of foreign investment permitted in the air transportation sector would increase sustainable competition in the Canadian industry without necessarily impairing service. The Panel recommended that the Minister of Transport increase the limit on foreign ownership of air carriers to 49% of voting equity on a reciprocal basis through bilateral negotiation, and complete "Open Skies" negotiations with the European Union as quickly as possible to be more competitive with the U.S. industry. The Panel also recommended that that Minister issue a policy statement by December 2009 on whether foreign investors should be permitted to establish separate Canadian-incorporated domestic air carriers using Canadian facilities and labour.

Financial Services

The Panel commented that since 1998, when the Minister of Finance declined to approve two separate proposed mergers of major Canadian banks, there has been a *de facto* prohibition on mergers between large financial institutions in Canada. The Panel noted the relative decline in the size of Canadian banks on a global scale since that time and

commented that bigger institutions could position Canada and Canadian-based firms and financial institutions to compete more effectively in international markets. At the same time, the Panel noted that allowing greater international competition as well as more competition between bank and non-bank lending institutions in Canada would benefit both the financial services sector and the public interest in competitive and efficient markets. Accordingly, the Panel recommended that the Minister of Finance should remove the *de facto* prohibition on bank, insurance and cross-pillar mergers of large financial institutions subject to regulatory safeguards, enforced and administered by the Office of the Superintendent of Financial Institutions and the Competition Bureau.

Telecommunications and Broadcasting

The Panel noted the significant and continuing product innovation in the telecommunications and broadcasting sector where the current rules limit the holding of voting shares by non-Canadians to 20% at the operating company level and 33.3% at the holding company level. The Panel concluded that liberalizing foreign investment restrictions would bring demonstrable economic benefit through increasing competitive pressure on all participants in the market. Consistent with a recent federal government telecommunications policy review panel, the Panel recommended a two-phased approach to foreign participation in the industry. In the first phase, foreign companies would be permitted to establish a new telecommunications business in Canada or to acquire an existing telecommunications company with a market share of up to 10% of the telecommunications market in Canada. The second phase should follow a review of broadcasting and cultural policies and liberalize the sector in a manner that is competitively neutral for telecommunications and broadcasting companies.

Uranium

The Panel discussed uranium mining and the fact that Canadian firms have a leading position in uranium production. While noting that most countries have ownership restrictions governing their uranium industries that are more restrictive than Canada's, the Panel recommended that the Minister of Natural Resources issue a policy directive to liberalize the non-resident ownership policy on uranium mining, subject to new national security legislation coming into force and Canada securing commensurate market access benefits allowing for Canadian participation in the development of uranium resources outside Canada or access to uranium processing technologies for the production of fuel for nuclear power plants.

Competition Act Amendments

The Panel has proposed some very significant changes to the *Competition Act*.

Mergers

The Panel recommends that the merger review process in Canada be aligned with the U.S. *Hart-Scott-Rodino Antitrust Improvements Act* ("HSR") procedure. The HSR process involves an initial 30-day waiting period in which a notified merger may not be completed and the government can assess the likely competitive effects of the proposed transaction.

Before that 30-day period expires, the government may choose to issue a "second request" for information and documents, in which case the proposed transaction may not be completed until 30 days after the parties substantially comply with the request. However, typical second requests in the U.S. have become very onerous, requiring vast amounts of documents and data. It can take months and cost hundreds of thousands of dollars to achieve compliance. If implemented, this proposal could therefore significantly raise the costs and lengthen the potential delays in *Competition Act* merger reviews for parties to notifiable transactions. Having said that, the Panel's stated goal in making this proposal was to reduce the time, complexity and cost of the Canadian merger review process. Accordingly, some limitations on the potential scope of second requests may have been intended.

Conspiracy

The Panel's proposal to repeal the existing conspiracy provisions and replace them with a *per se* criminal offence and a civil provision to deal with other types of agreements between competitors that have anti-competitive effects is appealing in principle, but may be impractical to implement, particularly having regard to the objective of encouraging innovation and collaboration in Canada. In the Panel's view, criminal law sanctions should be reserved for "conduct that is unambiguously harmful to competition and where clear standards can be applied that are understandable to the business community". However, reform of the conspiracy offence is an issue that has been hotly debated in Canada for several years without achieving any consensus on a specific amendment that would more effectively capture hard core cartel behaviour without also making illegal, or at least significantly deterring, efficiency enhancing or benign agreements, co-operative arrangements, or joint ventures between competitors and other third parties that limit or restrain competition to some extent. The Competition Bureau argues that the current offence, by requiring proof that the parties to an anti-competitive agreement possess some degree of market power, makes it too difficult to obtain convictions. However, this may be an area that requires flexibility and evolution through judicial interpretation in light of evolutions in economic thinking. While the Panel suggested that harmonizing Canadian conspiracy laws with those in the U.S. would be desirable, the U.S. *per se* cartel offence is not contained in an explicit statutory code, but has evolved through over 100 years of case law and judicial consideration of particular circumstances, and continues to evolve. Drastic amendments to the Canadian conspiracy offence that abandon Canada's own 100 years of judicial consideration of the current provisions risk creating the type of uncertainty that is antithetical to the encouragement of innovation, collaboration and investment in Canada.

Abuse of Dominance

Similarly, the proposal to establish administrative monetary penalties of up to $5 million for conduct constituting an abuse of dominant position pursuant to the *Competition Act* will, if implemented, raise significant issues for large Canadian companies and potentially alter their business practices. Companies that "dominate" markets in Canada may be subject to greater restrictions under the *Competition Act* than other companies with respect to marketing practices that may be viewed as excluding competitors (e.g., discounts for making the company the sole or a primary supplier). It is generally recognized that such practices

normally do not have significant anti-competitive effects, but overly aggressive enforcement of the abuse of dominance provisions against a major Canadian company, and the risk of substantial fines, would risk hampering the flexibility and aggressive competitiveness of leading Canadian businesses. Interestingly, elsewhere in its report, the Panel called for Canadian firms to become more innovative and entrepreneurial and increase their competitive intensity, stating at one point that "we must skate harder, shoot harder and keep our elbows up in the corners, to use a recognizably Canadian metaphor".

Bill C-454

Parliament is currently considering a Private Member's Bill (C-454) that would significantly amend key provisions of the *Competition Act*. Among other things, these proposed amendments would (a) revise the criminal conspiracy offence to dramatically widen the scope of illegality for agreements that lessen competition, (b) expand the concept of an abuse of dominant position that could be challenged under the Act, (c) allow private parties (not just the Commissioner) to initiate abuse of dominance proceedings before the Competition Tribunal, (d) add monetary penalties for abuses of dominant positions, and (e) enable the Commissioner to initiate market investigations even absent any reason to believe that an offence has occurred or that there are grounds to initiate proceedings in the relevant industry. It remains to be seen what impact the Panel's report will have on the Parliament's deliberations with respect to these proposed amendments. A number of the proposals in Bill C-454 deal with some of the same provisions of the *Competition Act* addressed by the Panel. However, in some cases, such as the proposed amendments to the conspiracy provisions, the specific proposed amendments in Bill C-454 would appear to make the legislation overly broad and prohibit or discourage pro-competitive conduct.

Competition Advocacy

Finally, the Panel recommended that responsibility for competition advocacy be moved from the Competition Bureau to a new Canadian Competitiveness Council. The Bureau has expended significant resources over the years in representations to government boards and agencies advocating consideration of procompetitive initiatives or criteria in assessing the impact of laws or regulations (or proposed laws and regulations) on competition or market efficiency, and promoting greater reliance on market forces. The Panel recommended a greater degree of competition advocacy, but that such responsibility be vested in a new specialized and independent Council, leaving the Bureau to focus on its core mandate of enforcing and promoting compliance with the *Competition Act*. The Panel recommended that the Council be led by a board of directors comprised of both government and non-government representatives, with a majority from outside government. In the Panel's view, such a Council would fill the most significant gap in Canadian competition policy and, over time, rival the impact of all the other recommendations discussed in its report.

Copies of the Panel's report, the Panel's backgrounder on the report, its consultation paper and the submissions made to the Panel can be found at the Panel's website at: http://www.ic.gc.ca/epic/site/cprp-gepmc.nsf/en/home. Summaries of the Panel's research reports are to be posted on this site on June 30, 2008.

If you have any questions regarding the foregoing, please contact George Addy, John Bodrug, Mark Katz, Christopher Margison, Hillel Rosen or any other member of the Competition and Foreign Investment Review Group at Davies Ward Phillips & Vineberg LLP at (416) 863-0900 (Toronto) or (514) 841-6400 (Montréal).

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