FOREIGN INVESTMENT REVIEW ACT

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The Foreign Investment Review Act is a complex piece of legislation which will have an important impact on the Canadian business community. The Act provides the federal government with authority to review and approve or reject investments by "non-eligible persons" to acquire control of existing Canadian businesses, to create new businesses, and to expand existing businesses in Canada. The author briefly discusses the purpose of the Act and the reviewing mechanism. He then provides an analysis of some of the possible effects of the Act on the Canadian oil and gas industry.

It is not my intention to enter into a detailed analysis of the Foreign Investment Review Act. It is a very complex piece of legislation, containing very detailed procedures and many presumptions. I intend instead to review only briefly the purpose of the Act and how it operates. I will then consider the Act generally as to its effect on the oil and gas industry and will raise certain problems and anomalies therein from that point of view.

I. INTRODUCTION

The Foreign Investment Review Act[1] of Canada was passed by the House of Commons of Canada in November, 1973, and by the Senate of Canada in December, 1973. It technically became law on December 12, 1973, and partially came into force on April 9, 1974. The purpose of the Act is to provide the Canadian Government with legal authority to review:

(1) acquisition of control of existing Canadian businesses by foreigners or deemed foreigners who are defined as non-eligible persons;

(2) creation of new businesses in Canada by such non-eligible persons; and

(3) expansion of existing businesses in Canada of such non-eligible persons into unrelated businesses.

The sections of the Act relating to acquisitions of existing businesses came into force when proclaimed on April 9, 1974, but those sections relating to new businesses and expansion into unrelated businesses will not be proclaimed until a later date, possibly in March of 1975.

The Act contains a large number of definitions, as well as rules and exceptions governing the meaning of these basic terms. It sets out the procedures whereby applicable investments are made subject to governmental review and assessment, to determine what investments are "of significant benefit to Canada" and should therefore be approved.

The Act establishes the Foreign Investment Review Agency which will bring to the attention of Cabinet, for purposes of its review, proposed or actual investments to which the Act applies. The Agency is headed by a Commissioner, who is responsible to the Minister of Industry, Trade and Commerce (the Honourable Mr. Allister Gillespie), for the administration of the Act. The first Commissioner

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[1] S.C. 1973-74, c. 46.

is Mr. J. Richard Murray, former managing director of the Hudson's Bay Company.

The decision-making process under the Act commences with the notice which any prospective investor, if he is a non-eligible person, must give to the Agency of his intention to make an investment to which the Act applies. The Regulations provide, at the moment, only for the notice provisions relating to takeovers.

II. SPECIFIC MATTERS

1. The Government has stressed that it is not the intention of the Act to *block* foreign investment, but rather to subject it to a reasonable review in order to determine whether or not it is of *significant benefit to Canada.* The factors to be looked at in making this determination are set out in Section 2. However, it will be obvious that the Government can bring a very subjective approach to the assessment. Thus it will depend very much upon those in charge as to how the Act is in fact administered and the effect it will have on foreign investment. In an energy context it is not unthinkable that the Act could be used by the Federal Government as a weapon in its continuing battle with the Alberta Government. While the Cabinet has been given certain statutory criteria as to what investments might be of significant benefit to Canada, the fact remains that the Cabinet decision depends upon the exercise of discretion and, except for an obvious case of dereliction of duty, the decision of the Cabinet is final and unappealable. One of the statutory criteria in establishing "significant benefit to Canada" is the "compatibility of the proposed investment with national industrial and economic policies, taking into consideration industrial and economic policy objectives that have been enunciated by the government or legislature of any province likely to be significantly affected". An interesting question is how the Federal Government will reconcile the differing policy objectives of Liberal, Conservative and NDP provincial governments. If a foreign investor wishes to establish a new business in Alberta, clearly Alberta would be significantly affected. But if the foreign investor proposed the takeover of the business of an oil producer in Alberta is not the Province of Ontario also affected? Accordingly, investments may be judged by the differing views of several governments.

2. The oil and gas industry has traditionally been one in which takeovers are commonplace. The Federal Government will now have the final say as to whether these takeovers, either by share purchase,[2] or asset purchase[3] will be permitted, in cases where non-eligible persons are making the acquisition. The exemption provisions contained in section 5(1)(c) exclude the application of the Act to business enterprises the gross assets of which do not exceed $250,000 *and* the gross revenue of which for the latest completed fiscal period is less than $3,000,000. Accordingly, small takeover transactions can still take place without review. However, pursuant to section 31(3) once the new business provisions are proclaimed, this mini-business exemption will cease to apply to acquisitions of control by non-eligible persons not already carrying on business in Canada.

3. Another interesting question is the extent to which the Act will apply to share acquisitions subsequent to control having been acquired, or in addition to the shares necessary to establish control. Since the Act is designed specifically to review acquisitions of control, a non-eligible person who can demonstrate that he already controls a Canadian business enterprise can presumably increase his

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[2] *Id.* at s. 3(3)(a)(i)(A).
[3] *Id.* at s. 3(3)(a)(i)(B).

ownership in such enterprise without going through the review procedures, subject to the provisions of section 3(8) of the Act relating to step transactions. Section 3(8) provides as follows:

> 3(8) For greater certainty, a reference in this Act to the acquisition of anything includes any acquisition thereof that occurs as a result of more than one transaction or event, whether or not those transactions or events occur or have occurred as or as part of a series of related transactions or events and, subject to any other provision of this Act, whether or not one or more of those transactions or events occurred before the coming into force of this Act.

It is not clear from this section how far back in time the Minister is prepared to go, but there is no time limit set out restricting him.

4. Property acquisitions will similarly be subject to review upon the new business provisions in the Act being proclaimed.[4] It should be noted, however, that the Minister of Industry, Trade and Commerce, the Honourable Mr. Allister Gillespie, stated in a news release dated December 30, 1973, that in the interim before the new business provisions are proclaimed, foreign investors would be *requested* to discuss with the Government any plans they may have involving large new investments in Canada. You may recall the Government used this same device prior to the proclamation of the control aspects of the Act. As before, the Minister did not elaborate as to what the Government would do if its *request* was ignored. Presumably the Government would not consider the investor to be a good citizen, whatever that may mean. The Minister's office has indicated on an informal basis that its concept of a "large new investment" to which their request relates during this interim period, does not involve investments of less than $10,000,000.

After proclamation of the new business provisions there will not be any lower limit on the size of the new business as there is under the control provisions. Accordingly, with the exception of acquisitions of all or substantially all of the assets of a company, covered under the control provisions of the Act, all property acquisitions of whatsoever size will be subject to review pursuant to the charging provisions of section 8(2). This section requires every non-eligible person proposing "to establish a new business in Canada" to notify the Foreign Investment Review Agency. There are several important qualifications to this requirement, however. First, non-eligible persons already carrying on an oil and gas business in Canada are entitled to expand that business by such a purchase without the purchase being subject to review.[5] Secondly, what is meant by the words "establish a new business in Canada"? Section 3(4) of the Act answers the question as follows:

> (4) For the purposes of this Act, a business is established in Canada *only if there is an establishment in Canada to which one or more employees of the person or group of persons establishing the business report for work in connection with the business,* and the time at which a business is established in Canada is the time at which the first of such employees reports for work in connection with the business at such an establishment. (Italics added.)

As we all know, there are many occasions in the oil and gas industry when participants, frequently in the U.S., share the cost of a well to acquire an interest in certain lands. The interest earned by such foreign participant is held in trust for it by the operator in Canada. At no time does the U.S. participant, perhaps a limited partnership, create in Canada an establishment to which its employees

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[4] *Id.* at s. 6 and s. 31(2).

[5] *Id.* at s. 8(2)(b).

report for work. Even if the U.S. participant set up an Alberta company to hold the property, it may very likely have no employees, and the office of the company would be the office of the law firm which incorporated the company. The astonishing attitude of the Agency to this question has very recently been disclosed in a letter from general counsel for an oil company in Calgary to the Independent Petroleum Association of Canada. Due to the extreme importance of this matter to the oil and gas industry I shall set forth in considerable detail the contents of this letter. This counsel had met in Ottawa with officers of the Compliance Section of the Agency to discuss a proposed acquisition of oil and gas properties and interests by a non-eligible person, as defined by section 3(1) of the Act.

It had been his opinion, and that of other counsel, that a "Canadian business enterprise" as defined in section 3(1) of the Foreign Investment Review Act was not being acquired in the given situation, as this was not an undertaking or enterprise carried on in Canada in anticipation of profit by a corporation that maintained an establishment in Canada to which employees ordinarily reported for work. Since the oil and gas properties in question did not fall within the ambit of the definition of "Canadian business enterprise", it had been concluded that advance written notice was not required to be given to the Foreign Investment Review Agency. The whole transaction had been viewed as one which was entered into in the ordinary course of business.

Because the view expressed above was based on a somewhat technical interpretation of the relevant sections of the Act, and in the light of the substantial monetary value involved, informal discussions, in general terms, of the proposed transaction were held with officers of the Agency, to ensure that it could not be regarded as being contrary to the intention or spirit of the Act.

It was discovered that the officials to whom the administration of the Act had been entrusted did not put the same interpretation on the provisions of the Act. They asserted that:

(1) Each oil and gas property (may it be land, a well, an undivided interest, a right to oil under a contract, *etc.*) can be considered as a separate "business" under the Act, and, if it has a gross asset value of $250,000 or more, or annual gross revenues which exceed $3,000,000, the acquisition thereof is subject to review;

(2) It is necessary to consider if there are any links between two or more of these properties (such as having the same operators or the same joint owners) to determine if such a group constitutes a "business" which has a gross asset value of $250,000 or more, or annual gross revenues which exceed $3,000,000;

(3) The mere existence of an oil and gas property as such, constitutes an establishment in Canada, and if operated by the owner or a joint owner, it is considered to be an establishment to which employees report for work. Moreover, employees of a third party, such as those of an operator who is not the owner, or a joint owner of the property, are deemed to be employees of the owner or of each joint owner of the property.

It therefore appears that the Compliance Section officers of the Agency intend to treat what are really daily occurrences in the oil and gas industry as "acquisitions", as defined under the Act, despite certain past statements of public officials to the effect that it was not the intent nor the purpose of the Act to cause transactions of this nature to be subject to review.

5. There is another important provision, section 3(9) of the Act, which raises a question as to the applicability of the Act to land acquisition, both under the "acquisition of control" provisions and under the "establishment of new businesses" provisions. Under section 5(1), the Act applies in respect of the acquisition of control of a "Canadian business enterprise" as that term is defined. As stated previously, section 3(3)(a)(i)(B) provides that control may be acquired by the acquisition of all, or substantially all, of the property used in carrying on the *business* in Canada. Under section 8(2), the Act applies to every non-eligible person who proposes to establish a new *business* in Canada. It will be seen, therefore, that in order for the Act to apply, the property acquired in either case must constitute a *business*. "*Business*" is defined in section 3 as including "any undertaking or enterprise carried on in anticipation of profit". Section 3(9) of the Act provides as follows:

> (9) For greater certainty, a person, group of persons or corporation that acquires and holds land, whether with the intention of disposing thereof within a fixed or determinable period of time or otherwise, does not, by reason only of the holding of the land and the expenditure of funds to maintain the land in the condition in which it was acquired or to improve the land for the personal use and enjoyment of the person or persons holding it or of the shareholders of the corporation holding it, carry on a business.

The section was obviously designed to remove the acquisition of land from the operation of the Act. However, it is poorly worded and capable of different interpretations. While it appears to apply to persons acquiring and holding land, it does not clearly state that the acquisition of land as such does not constitute the acquisition of a business. The intention seems to be that if a non-eligible person merely acquires land, this is not the acquisition of a business, but if that land has upon it an apartment block or other asset of an income-producing nature, then it does constitute a business, and the Act will apply thereto. The obvious analogy to the oil and gas industry is the distinction between an acquisition of non-producing, unproven acreage, and the acquisition of producing properties upon which oil or gas wells are situate. I would suggest that producing properties would undoubtedly constitute a *business*, but that an argument may be made that under section 3(9) an acquisition of non-producing acreage would not. If such an argument prevails then the Act would not apply to acquisition by non-eligible persons of non-producing properties.

The problem has been raised with the Minister. Heward Stikeman alludes to this in, *The Foreign Investment Review Act — The Shape of Things to Come*, as follows:

> The Minister has recently made available proposed guidelines concerning real estate in an attempt to clarify whether or not the acquisition of or investment in 'real estate or property' constitutes a 'business' and therefore falls within the ambit of the review procedures of the Act. The guidelines are not binding and do not have the force of law but are designed to give investors an idea of the Minister's attitude towards real estate transactions. The criteria set forth in the guidelines are difficult to apply to specific fact siuations, but basically the guidelines distinguish between 'business property' (which may include most large rental properties) and smaller holdings of land or buildings held as 'circulating assets' which under most normal circumstances will not be considered a business. The guidelines, besides the objecive tests related to the property and its size, also take into account the subjective circumstances of the transferor and the transferee in order to determine whether a given acquisition of control of real property constitutes the acquisition of a business. In determining whether business properties or circulating assets constitute a business, the terms 'economically or commercially significant' are used in such determination and (notwithstanding the much lower threshold amounts of the small business exemption) the guidelines note that if either the gross value of the property or the consideration to be given in respect of its acquisition exceeds $10,000,000,

the property may be considered to be a business and consequently subject to review under the Act.

6. There may be some question whether the application of the Act to certain transactions, such as the purchase and sale of properties, are constitutional, on the basis that they exceed the powers of the federal authority by invading the field of property and civil rights. It is probable, however, that the federal jurisdiction can be substantiated on the basis of federal control over "naturalization and aliens".[6]

7. Under section 20 of the Act, the Minister may ask a superior court to render an investment nugatory (i.e. invalid) in cases where the investment has been made in violation of the Act, and to effectively reverse to the extent possible the offending transaction. There is limited protection given to an innocent party who was not a party to the transaction, except where "he ought reasonably to have known" of the illegality. This provision may have a serious effect on title to property since there is no time limit on the Government's right to attack an illegal investment. The Act's protection of innocent third parties may well be illusory because of the "ought reasonably to have known" limitation. An interesting analogy can be drawn here to the problems confronting lawyers pursuant to section 24 of The Gas Utilities Act and the saving provisions concerning "ordinary course of business." Henceforth any purchaser of petroleum and natural gas properties should take steps to be satisfied that in the chain of title of the assets being acquired, no non-eligible person acquired title without the permission required under the Act.

8. Another question of some importance to lawyers is the extent of the Minister's powers of investigation under section 16 of the Act. Are the files and records of a solicitor privileged, or can the Minister have access to them? Section 16(1)(b) of the Act provides as follows:

> 16(1) For the purposes of an investigation under section 15, the Minister may:
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> (b) authorize any person designated by him to carry out the investigation to enter any premises on which the Minister believes there may be evidence relevant to the proposed or actual investment and examine anything on the premises or copy or take away for further examination or copying any book, paper, record or other document that in the opinion of the person so designated may afford such evidence.

Section 17(2) requires the investigating official to produce a certificate from a Judge, which may be obtained on *ex parte* application by the Minister, authorizing the search. Section 17(3) requires the person in control of the premises being searched to permit the investigation and the removal of all documents. Section 18 makes all such documents admissable in evidence in any prosecution for an offence under the Act. It would appear from the foregoing that there is no privilege protecting solicitors' files and records.

9. There is some evidence that the approach of the Agency will be to interpret the Act broadly, rather than restrictively. The Agency has apparently taken the position that if a non-eligible party purchases all or substantially all of the product produced from a Canadian business enterprise (say a chemical plant), then such non-eligible party may be deemed to have established a new business in Canada. If this interpretation is sound, the Agency would then presumably be entitled to review such a contract under section 8(2), and if such contract is not of significant benefit to Canada, disapprove the same. It would appear that the basis of the Agency's view on this point lies in section 3(6)(h) and

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[6] For a discussion of this issue, *see* Arnett, *Canadian Regulations of Foreign Investment*, (1972) 50 Can. Bar Rev. 213.

paragraph (c) of the definition of "non-eligible person". These provisions are almost identical. Section 3(6)(h) provides as follows:

> (h) a business carried on by a corporation that is controlled in any manner that results in control in fact, whether directly through the ownership of shares or indirectly through a trust, *a contract*, the ownership of shares of any other corporation or otherwise, by another corporation shall be deemed to be carried on by the controlling corporation as well as by the corporation by which the business is in fact carried on.

It may be assumed, therefore, that in the Agency's view the non-eligible purchaser of the product has, by virtue of the product sales contract, such influence over the vendor that it in fact controls the vendor. I would submit that the reference in section 3(6)(h) to a *contract* might more logically be taken as a reference to a voting trust, an agreement to place directors on a Board, or some similar such agreement, rather than to a product sale contract.

In conclusion I can perhaps do no better than to refer to the concluding remarks of Heward Stikeman in his March 12, 1974 article on the Act:

> The importance of this legislation to the Canadian business community is enormous, scarcely less than that of the Income Tax Act itself. At the time of writing, the position is extremely fluid and it is most difficult to surmise how the Act will be applied, both substantively and procedurally. Considerable cooperation will be required from the public in order to prevent the Agency from becoming an administrative bottleneck and, similarly, considerable restraint and flexibility will be required from the Minister in order to prevent the complexities and intricacies which Parliament has introduced into the Act and Regulations from undermining its real purpose. It is to be hoped that all concerned will work together to enable the Act to be applied in a fair and consistent manner, rather than its application turning into a political imbroglio or an administrative nightmare.

It is my impression, however, from the position being taken by Agency officials on certain of those matters raised for their consideration to date, that their tendancy is to interpret the Act in an extremely broad manner so as to enhance their powers, beyond what the language of the Act permits, to implement what they conceive to be the general intention of the Government. There is not, therefore, evidence to date of the restraint and flexibility which Mr. Stikeman hoped would emerge.