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Potash and BlackBerries:

Should Canada Treat All Foreign Direct Investment the Same?

by Laura Dawson

Introduction

Foreign direct investment (FDI) provides capital for economic growth and expansion, and access to new technologies, markets, supply chains, and production methods. In previous decades, the transfer of technology and know-how from foreign investors was seen as a central benefit of FDI and one that helped Canadian firms build value-added in a commodity-based economy. Today, Canada has home-grown advantages in both the resource and information technology sectors but we still need investors with networks to link Canadian producers to foreign customers and help create the economies of scale necessary to transform a promising Canadian company into a competitive global enterprise.

Foreign investment is not without trade-offs. The pursuit of global competitiveness may mean moving some or all of a company's operations outside the country. Canada offers many commercial advantages, but with a population of less than 35 million dispersed over a 9.9-million km^2 landmass, access to a concentrated customer base is not one of them.

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Recent attempts by foreign entities to acquire Canadian assets have ignited debate about the desirability of foreign ownership. Some of the high profile cases include TMX, U. S. Steel, and Nortel. With the acquisition of Viterra in the offing, and Chinese investment in the Alberta oil sands growing exponentially, the Harper government has been under pressure to clarify (if not strengthen) its screening regime for foreign investment.

The rules governing foreign acquisition or control of a Canadian enterprise are set out in the Investment Canada Act (ICA).[i] The test for admissibility focuses on whether an investment provides such 'net benefits' to Canada as increased domestic production, employment, or technology transfer.

The ICA has been used twice to block the proposed takeover of a Canadian company by a foreign entity. In 2008, the ICA was used to stop Alliant Techsystems' bid for MacDonald, Dettwiler and Associates. In 2010, PotashCorp (Saskatchewan) was on the verge of a hostile takeover by Australian mining giant BHP Billiton, but the company withdrew its bid on good evidence that then-Minister of Industry Tony Clement would disallow the application if it went forward.

Although more than 1600 foreign investments have been approved since 2005, the high-profile rejection of the Alliant and BHP Billiton applications have led to questions about whether the government is caving in to political pressure to disallow certain investments to the detriment of national economic welfare. The counterargument is that the government laxity on FDI screening is allowing important Canadian assets to fall into foreign hands and contributing to the perceived hollowing out of Canada's corporate base.

Much of the concern seems to focus on certain types of investors or types of investment. Chinese state-owned enterprises have enormous market power and are relatively untested in the global investment market. Foreign development of Canadian commodities is perceived to threaten Canada's territorial sovereignty. Perhaps we need to move beyond general questions of whether Canada should be more open or more closed to FDI and instead tailor the rules based on who the investor is and the nature of their intended target. Should an investment by a state-owned-enterprise be subject to different levels of scrutiny than an investment by a privately held firm? Does it make a difference whether the investment is targeting a relatively immobile asset such as ore in the ground versus a mobile asset such as telecommunications patents, which can easily be relocated to other jurisdictions?

This paper will explore the current regime for foreign investment screening in Canada to assess the adequacy of the net benefits test and to see if a case can be made for adding new rules to differentiate between types of investors and types of investment. It will also attempt to distinguish some of the myths from reality in Canada's national FDI debate.

What's changed? The evolution of investment screening in Canada

Canada's commodity exports have been an economic mainstay since first European contact, but development of value-added manufacturing beyond the export of raw materials has been difficult. Canada's early economic policy was based on high tariff walls to keep out foreign competition while small domestic firms took root.

Foreign companies (usually from the United States) looking to sell their products to Canadian consumers without high import taxes could only do so by establishing a branch plant in Canada. Well-known companies such as General Electric (1892), Ford (1904), General Motors (1908), Kraft (1916), and Chrysler (1925) all established a foothold in Canada by acquiring fledging domestic industries. Under this arrangement, benefits flowed in both ways: US companies gained access to Canadian consumers and Canadian products were launched in new markets through new capital and supply lines provided by the parent company.

Branch plant industrialization was not without controversy. Even as Canada was generating its own multinationals, including Canadian Pacific, Seagrams, International Nickel, and Algoma Steel, successive governments debated the merits of foreign ownership.[ii] Kari Levitt's 1970 book *Silent Surrender: The Multinational Corporation in Canada,* and the NDP splinter organization, the Committee for an Independent Canada, warned that too much US influence over Canadian business decisions would lead to assimilation. This outpouring of economic nationalism generated a backlash against foreign ownership that continued through the Trudeau era and spawned the creation of the Foreign Investment Review Agency (FIRA) in 1974.

Large and small transactions were captured by the FIRA net. Although FIRA's rejection rate was less than 15 percent,[iii] the review process had a chilling effect on investment because of long waiting times (up to six months in some cases),[iv] administrative costs, and the imposition of performance requirements on approved investments.[v] By the late 1970s, the government faced stiff criticism for subjecting investments of even a few thousand dollars to detailed scrutiny. Eleven percent of potential investors polled by the Conference Board of Canada during this period said that the country's foreign investment control regime was a deterrent to investing in Canada.[vi]

New barriers to foreign investment were particularly prevalent in the oil and gas sector where Ottawa sought to control both supply and prices by offering preferential treatment to Canadian investors. Under the 1980 National Energy Policy, the federal government retroactively claimed a 25 percent interest in oil found on Crown lands and severely limited the participation of foreign investors in exploration activities. Against the backdrop of a national unity challenge in Quebec, the Trudeau government sought to nationalize the national energy sector, with Alberta taking the hardest hit.[vii]

By 1981, inflation in Canada was running at about 12.4 percent and unemployment ranged around 8 to 9 percent – double what it had been two decades before. Growth was sluggish and lack of efficient access to foreign investment did not help recovery. Public opinion polls indicated that nearly 70 percent of Canadians supported bringing more FDI into Canada and nine out of ten provincial premiers called for FIRA to be scrapped.[viii]

Canada's turnabout on foreign investment began in the final years of Trudeau's leadership and was sharply amplified after the election of Brian Mulroney's Progressive Conservatives in 1984. Canada's declining global competitiveness could not be ignored. If Canada was going to be a global player it had to become more efficient through exposure to global competition. It also needed the growth that a greater volume of trade and capital flowing through the economy could provide.

The Mulroney government streamlined the foreign investment review process by replacing FIRA with the 1985 Investment Canada Act (ICA). The ICA set new threshold levels so that only high-value investments would be subject to automatic review. The threshold value for 2012 stands at $330 million for most investors seeking acquisition or majority control of a Canadian enterprise, and the amount is increased annually.

Under the re-organized ICA system, unless an investment is above the threshold level or in a specially designated sector,[ix] only a routine submission of information describing the investment and the investors is required. Because the streamlined review mechanism reduced transaction costs to investors and increased Canada's appeal as an investment destination, the reforms produced results almost immediately. FDI flows tripled between 1984 and 1987, far outstripping growth in global production or merchandise exports.[x]

As Canada transitioned from a branch plant model of growth, that is, import-substituting industrialization to export-oriented industrialization, the problem changed from how to limit FDI to reduce foreign dominance to how to promote capital inflows to a newly self-confident Canada. The challenge for policy makers today is how to restrict investments that are not in Canada's national interests while avoiding a chilling effect stemming from the fact that more constraints added to the ICA (and related transaction costs) make Canada appear to be unfriendly to investment.

Common Complaints about Foreign Investment Screening

Improving foreign investment screening in Canada depends on separating myths from reality. Among the most common complaints:

1) Foreign investment has a hollowing-out effect on Canada, moving jobs and capacity offshore.

2) The net benefits test is opaque and has a chilling effect on investors.

3) State owned enterprises are motivated by non-market considerations and should be subject to different rules than other investors.

4) We need different rules for investment in different sectors (high tech, resources, strategic sectors).

This section evaluates these propositions to determine which should be discarded and which have a factual basis that could contribute to reforms to Canada's foreign investment regime.

1) Foreign investment has a hollowing-out effect on Canada, moving jobs and capacity offshore.

Every time there is a proposed take-over of a well-known Canadian business or brand, there is a public debate over whether foreign investment 'hollows out' corporate Canada. This argument is based more on populist rhetoric than evidence. A 2008 study of more than 30 mergers and acquisitions by Michael Grant and Michael Bloom indicated that companies that are acquired may lose out in terms of corporate governance and senior management functions but they often gain in terms of employment, operations, capital, and community relations.[xi] Data from Statistics Canada provides quantitative support to this argument. Desmond Beckstead and W. Mark Brown found that between 1999 and 2005, Canada experienced a net increase in the number of head offices and *all new offices* and 60 percent of new jobs were created by foreign-controlled firms.[xii]

The dynamics of acquisition are much more nuanced than simple questions of investor origin. Grant and Bloom argue that nationality does not matter – both foreign and domestic firms are driven by commercial considerations. Canadian firms do not behave in a more benevolent way towards their countrymen. In fact, hollowing out is more likely to occur in within-country acquisitions because local competitors will acquire each other to try to build market share.[xiii]

Assessment: Myth. There is no evidence that FDI contributes to hollowing out or that domestic investors are more inclined to promote national welfare. Nevertheless, foreign investment is often a component of the reorganizations undertaken by firms in order to maintain or enhance competitiveness in a global economy – including the movement of certain productive activities to lower-cost markets. The challenge for Canada is to ensure that as low-value added assembly and service activities move out of the country, Canada has made the R&D and human resource investments necessary to continue to supply innovative products and services at the high-value-added end of the supply chain.

2) The net benefits test is opaque and has a chilling effect on investors.

The primary instrument used to assess and, if necessary, restrict foreign investment is the net benefit test contained in Section 20 of the ICA. These measures were strengthened by the addition of rules related to national security (2007) and state-owned enterprises (2009).

Canada’s practice of screening foreign investment on the basis of net benefits is unique among industrialized countries. Most have restrictions for sensitive sectors and many reserve the right to intervene on the basis of national security and/or national interest criteria but none has an across-the-board mechanism that screens on the basis of benefits to the home economy.

The effect of the net benefits test on Canada’s competitiveness for global investment dollars is debated by academic and business analysts,[xiv] but the existence of the net benefits test does not necessarily mean that Canada is relatively more closed to foreign investment than its OECD counterparts. In a study that evaluated the impact of sectoral restrictions, screening mechanisms, operational and management restrictions, and special treatment of government owned entities, Andrea Mandel-Campbell found that Canada is no more restrictive than Germany, France, or Italy, although it trails the United Kingdom and the United States in FDI openness.[xv]

The major factors used to assess net benefit can be grouped into five broad focus areas:

1. *Extent of Canadian content* including employment and use of Canadian inputs;

2. *Significance of Canadian participation*. Implicit here is whether Canadians are going to be substantive or bit players in the resulting entity;
3. *Effects on economic capacity* including productivity, innovation, and global competitiveness;
4. *Compatibility with federal industrial, economic, and cultural policies*, taking into account policy objectives enunciated by provincial governments and legislatures; and
5. *Effects on domestic competition.* Will the investment improve the terms of competition and reduce market concentration?

While the ICA goes to some lengths to identify the key focus areas, the efficient application of the net benefits test (or at least public understanding of its application) is hampered by lack of specificity in language and processes. Lawrence Herman argues that when the government uses terms like "economic productivity" and "efficiency," it ought to provide clear definitions of what the terms mean and what metrics should be used to measure economic activity.[xvi]

Derek Burney and Kevin Ackhurst agree that vague terminology contributes to uncertainty that hurts both foreign investors and Canadian businesses. They note that opaque language and processes provides the government with cover for its decisions, but this politicization comes at a cost: "The concern is that Canada has become protectionist and will review transactions through a political lens with a sharp domestic-preference focus, rather than an international business and investment focus."[xvii]

Lack of public understanding of how the government applies the net benefit criteria contributes to the perception of an opaque, non-transparent process. Explanations for why investment applications are rejected can be pieced together by inference but the Industry Minister claims that business confidentiality prevents him from releasing a public assessment on individual applications.

When the costs to investors increase, Canada becomes a less attractive place to invest. Bergevin and Schwanen argue that the onus of the net benefits test should be reversed. [xviii] Rather than require the investor to demonstrate a net benefit to the economy, the government should be required to demonstrate that an investment would act against the national interest before it could be disallowed.

Assessment: Mixed. More detail about how the net benefits criteria is applied would contribute to a greater understanding of the ICA by the public and potential investors. In spelling out exactly what it looks for in a foreign investment, the government cannot conceal political considerations under the cloak of net benefits.

As for the chilling effect caused by FDI screening, the net benefits test and the administrative improvements of the ICA are a great improvement over the FIRA. The rejection of only a few investments from a pool of several thousand reviewed should not send a "closed for business" signal to foreign investors. However, it is difficult to get reliable data from businesses regarding investments they didn't make. We should therefore assume some disincentive effect from the ICA review process and balance it against any net benefits actually generated. The RIM/Nortel and Potash cases presented later in this paper will help shed light on our understanding of this trade-off.

3. State-Owned Enterprises are motivated by non-market considerations and should be subject to different rules than other investors.

Investments by state-owned enterprises (SOEs) are treated with greater scrutiny because of concern that government-controlled entities will put the interests of their home country ahead of commercial objectives. These home country interests may include stockpiling resources, territorial expansion, and military security. Concerns that Canada may be hurt by these kind of actions led to the addition of SOE-specific reforms to the ICA. The SOE Guidelines, issued in December 2009,[xix] advise that in addition to the net benefit criteria, the Minister will consider:

1. The corporate governance and reporting structure of the SOE including commitments to transparency, independence of board members, independent audit committees, and equitable treatment of shareholders; and
2. Commercial orientation of the proposed business, especially regarding decisions about
    - where to export;
    - where to process;
    - the participation of Canadians in its operations;
    - support for innovation, research, and development; and
    - capital expenditures to maintain the Canadian business in a globally competitive position.

For the most part, Canada's concerns about SOEs are focused on Chinese investment in the extractive sector. China's Sinopec owns nearly 10 percent of Syncrude, one of Canada's largest joint ventures in the oil sands. Recent Chinese acquisitions include Petrochina's purchase of the MacKay River Project from Athabasca Oil Sands Corp., Sinopec's acquisition of Calgary-based Daylight Energy Ltd, and CNOOC's acquisition of the oil sands technology company OPTI.

Since these acquisitions have all passed the federal net benefits test, including the additional considerations for state-owned enterprises, it seems likely that Chinese investment applications in Canada will continue to be approved. However, to date, none of these acquisitions have been tested by a major dispute similar to Canada's 2009 lawsuit against U. S. Steel, or Abitibi Bowater's 2008 complaint against Newfoundland for the expropriation of its hydroelectric assets.

In a recent paper for the Canadian Council of Chief Executives, Margaret Cornish argues that Canadian fears of Chinese SOEs are overblown. She argues that preponderance of political risk with respect to any asset 'in the ground' is borne by the foreign investor and not the host country.[xx]

Cornish argues that there is no known case of a Chinese SOE responding to the political dictates of the Communist Party or bureaucracy. SOEs would incur massive reputational damage internationally if they were perceived to be tools of the state. But, at the same time, it is hard to ignore a recent *Economist* report noting that all the senior appointments to Chinese SOEs are made by the state, as well as recent media stories of jaw-dropping corruption at the highest levels of the Chinese government.[xxi]

Wenran Jiang explains that contradictory dynamics are at play.[xxii] First, not all Chinese SOEs behave the same way. Secondly, because Chinese SOEs must compete against each other and other foreign investors in external markets, there is a strong incentive to operate according to commercial principles, not political ones. But, at the same time, China is undergoing major transitions in its commercial and governance regimes and the next few years will be characterized by uncertainty and a few surprises. Thus, the mantra for Canada when dealing with Chinese SOEs should be "Trust, but verify."

In early 2012, Canada concluded a Foreign Investment Protection Agreement (FIPA) with China. What impact will this have on investment screening? Very little. A FIPA protects an investor's rights in a foreign country by ensuring that investment by the signatories will be treated the same as domestic investment, and it provides mechanisms for repatriation of capital, dispute settlement, and compensation in the event of expropriation.

A FIPA may list a number of exceptions not covered by the agreement but these tend to be very broad, such as Canada's exclusions on investment in the cultural sectors, but these are not firm specific. Also, FIPAs do not differentiate between private sector investors and state-owned enterprises. While the China FIPA is expected to provide transparency and clarity to investment flows in both directions, it will not provide much additional guidance on the conditions of investment. This will remain the job of the Investment Canada Act.

This reinforces the point that a profitable relationship between the investor and the host country is held together by a network of rules and institutions. No single instrument does the whole job. The Investment Canada Act serves as gatekeeper for investors seeking to enter the country, but Canada and its provinces and municipalities must maintain and enforce adequate health, safety, environmental, and commercial laws that apply to all businesses, regardless of the nationality of the owners.

In an uncertain world where trans-border crime and espionage are commonplace and where new powerful entrants to the global economy are playing by different rules, Canada cannot afford be a Boy Scout when dealing with entities who may use nefarious means to gain an advantage. In 2009, Canada added new measures to the ICA (Part IV.1) that enshrine the Industry Minister's right to disallow an investment or apply special conditions if the Minister has reasonable grounds to believe that the investment could be injurious to national security.[xxiii] However, just as with the net benefits test, the definition of national security is left open-ended, providing a wide scope for interpretation.[xxiv]

In order to clarify the concepts of injury and national security, Canada could look to other national models. The United States, for example, provides a very specific framework for evaluating national security risks. The Committee on Foreign Investment in the United States (CFIUS) is an interagency committee that operates under the authority of the President and is tasked with reviewing proposed foreign acquisitions on national security grounds. If CFIUS believes a proposed transaction threatens US national security interests, it may demand that parties to the transaction take action to mitigate such threats. CFIUS can also recommend that the President prohibit or suspend a transaction that threatens to impair US national security.[xxv]

CFIUS looks at three broad criteria when evaluating potential threats to national security:[xxvi]

1) Acquisitions that would make the home country dependent on a foreign-controlled supplier for access to goods and services critical to the function of the home economy (including the defense industrial base);
2) Acquisitions that would allow the transfer of technology or expertise that could be deployed in a manner harmful to the home country's national interests; and
3) Acquisitions that would enable the capability for infiltration, surveillance, or sabotage of the home economy (including the defense industrial base).

Because foreign investment in the United States is not automatically subject to government review, potential investors are not required to submit notifications to CFIUS, but failure to do so leaves a transaction vulnerable to post-completion remedial action. All proposed investments by state-owned enterprises must be submitted for review.

Assessment: True. The market power of state-owned enterprises in the international economy and their relative newcomer status suggests it would be wise to give them a second look to ensure that they are playing by market-based rules and are not engaged in practices that would compromise Canada's national security. However, the existing rules – with some improvements – should be adequate to deal with new players and new practices in the global investment market.

As for the new SOE provisions, it is quite likely that they will also need to be clarified in order to make it easier and cheaper for foreign companies to comply and to ensure that the rules are effective in defending and promoting Canadian interests. Where necessary, these should be used in tandem with Canada's enhanced national security rules.

4) We need different rules for investment in different sectors.

The terms "strategic asset" and "strategic resource" do not appear in the ICA or its interpretive documents, but they are heard with increasing frequency to justify government intervention to prevent foreign acquisition of Canadian companies.[xxvii] Special rules are already in place to limit the ability of foreign entities to invest in financial services, telecommunications, air transport, and uranium mining and the ICA rules provide a number of lenses with which to evaluate incoming investment. Do we need to add even more exceptions to the policy mix? The Nortel/RIM and PotashCorp cases help us to understand whether different sectors really do need to be treated differently.

Karen Mazurkewich argues that politicians are overlooking the damage being done to Canada's innovative capacity when foreign companies are allowed to acquire Canadian patents. She argues that while Canada spends more on R&D per capita than almost any other developed nation, our assets don't stay in the country and foreign companies are targeting Canada's IP-rich start-ups. Research conducted for the Canadian International Council shows that of the 137 venture- backed Canadian businesses that changed hands between 2006 and 2010, the ownership of no fewer than 79 – almost 60 percent – left the country, along with as many as 200 highly valuable patents.[xxviii] According to Mazurkewich, the loss of Canadian IP means job loss and brain drain as innovators follow their inventions to other countries.

However, the report also concedes that the problem may be less about foreigners absconding with Canadian IP than with domestic difficulties bringing innovative ideas to market. Mazurkewich notes Canadian universities (where many of these patents were created) are not particularly adept at developing private sector partnerships to commercialize their research. Other factors contributing to low commercialization include Canada's weak venture capital industry and an out-of-date legal regime for IP protection and enforcement. The greatest limitation is the small size of the Canadian market. Because of the time required to file a patent and differences between regimes, innovators are inclined to register patents in larger markets where they can get more bang for their buck. The Canadian Intellectual Property Organization (CIPO) reports that two thirds of all Canadian IP holders choose to first apply for patents in other jurisdictions such as the United States. [xxix]

CIPO director Konstantinos Georgaras warns that keeping foreigners out of the Canadian market could stifle domestic innovation since the majority of patent applications filed in Canada come from foreign companies. The real challenge, says Georgaras, is for Canada to streamline the application process and work to reduce differences in national regimes.

Walid Hejazi similarly rejects the claim that inward FDI weakens the Canadian economy and makes Canadian firms more dependent on foreign technology. He argues that there is a positive correlation between FDI and higher levels of domestic research and development: "Spillovers from R&D and technology work in both directions, and one of the attractions of locating in a research intensive country is to benefit from the fruits of its R&D intensity."[xxx]

Mazurkewich recommends using public funds to salvage IP when tech firms go bankrupt and reducing taxes on income derived from patents to make it more attractive for inventors to stay in Canada. In fairness, providing incentives to retain IP locally is not the same as keeping foreign investors out of the market.[xxxi] The Mazurkewich report stops short of calling for foreign investment restrictions in the IP sector, but her argument echoes the one made by RIM's former co-CEO Jim Balsillie during the 2009 Nortel patent auction when he asked that Nortel's patents be declared a strategic resource to prevent foreign acquisition. Says Mazurkewich:

> Canadian politicians sit up and take note when foreign interests set their sights on something that is either tangible, such as Saskatchewan's potash, or high-profile, such as Toronto's stock exchange. But the persistent acquisition of Canada's most important modern resource merits next to no comment—even though the loss of intellectual property is arguably far greater.[xxxii]

When Research in Motion (RIM) went up against suitors from around the world during the Nortel patent auction, the company claimed that the loss of Canadian ownership of Nortel's wireless businesses could "significantly, adversely affect national interests, with potential national security implications, and that the Government of Canada should review the situation closely."[xxxiii] Balsillie proposed to take over the Nortel technologies in order to retain them in Canada and keep RIM on the forefront of the global wireless market. RIM eventually acquired a sizeable number of Nortel patents at auction but to raise sufficient capital, RIM had to join a consortium of foreign bidders that included Microsoft and Apple.

Three years later, RIM itself is nearing the chopping block and looking at the foreign investment net benefit debate from the perspective of the acquired. In the past year, BlackBerry's US market share has declined from 14 to 8 percent and share prices have tumbled nearly 80 percent.[xxxiv] Analysts suggest that if RIM cannot soon right itself in the market, the most likely scenario is that the company will be broken up for the value of its IP assets, estimated at somewhere between $4 and $5 billion.[xxxv]

Because the RIM enterprise value will be greater than the $330 million ICA threshold, a RIM acquisition attempt will trigger a federal review. Companies such as Microsoft, Nokia, Amazon, Samsung, and Icahn have been touted as suitors for RIM assets. *Financial Post* editor Terrence Corcoran wonders whether any foreigner would be allowed to take over a company that has done so much to promote its Canadian roots,[xxxvi] but sometimes nationalism comes at a cost. During the Nortel auction, the province of Ontario demanded that Ottawa block foreign bids, even as Nortel's beleaguered Canadian creditors and pensioners sought a global auction that would ensure the highest possible bids.[xxxvii]

Initially, we expect that Ottawa would try to protect the firm and keep it in one piece. In December 2011, Stephen Harper admitted that RIM was an important company and "a point of pride for the Canadian government."[xxxviii] But if, like Nortel, a single-buyer solution cannot be found, there will be no option but to break the company into smaller parts. There will certainly be symbolic damage if Canada's flagship IP company left the country or faded into obscurity like the Atari or the Betamax, but national pride weathered the disintegration of Nortel and the relocation of Alcatel to France. It would certainly survive the end of RIM.

RIM is headquartered in Waterloo, Ontario and its software, marketing, and corporate operations are based there. Spending nearly $1.4 billion in 2011, it is Canada's largest corporate R&D contributor.[xxxix] Manufacturing is divided between Canada, Mexico, Hungary, and Malaysia. The vast majority of its 16,000 plus employees are based in Canada. In order to meet the net benefit test, suitors for RIM will likely have to commit to keeping the head office in Canada and continue to operate RIM as an independent entity.

If RIM were to be sold, analysts say it would be quite unlikely that the company could remain intact. At minimum RIM's failing handset business would be severed from the company's much more valuable enterprise services and secure global network of servers. The more fragmented RIMs assets become, the less likely it is that substantive, Canada-based enterprises will emerge as successors.

The government would obviously prefer that the offspring of RIM meet the Canadian location, competition, employment, and value-added objectives set out in the net benefits test. Ottawa might even be prepared to work with the province of Ontario to provide incentives to desirable investors but in the end, market forces will determine the shape of the final deal(s) and the extent of asset fragmentation.[xl] The only real stick Ottawa has is veto power on national security grounds.

BlackBerry is widely acknowledged as having the most secure operating system and is the only mobile messaging device certified by the US government to handle sensitive information.[xli] Despite high profile departures of the US Government Services Agency and others to other mobile devices, tens of thousands of US government employees still use BlackBerry.

If the company were to be broken up, it is likely that given the widespread use of BlackBerry technologies by the US Government, the United States would apply pressure on Canada to apply CFIUS-type standards to ensure that RIM's IP does not fall into the 'wrong hands.' The Canadian test of what is "injurious to national security" remains undefined, but using a CFIUS model, an acquisition of substantial amounts of RIM technology by a non-NATO country would raise alarms in all three defined threat areas: Dependence on a foreign supplier for a service critical to the function of the home economy or defense industrial base; transfer of technology that might be deployed to harm the home country's national interest; and insertion of potential capability for infiltration, surveillance, or sabotage.

As a creator of innovation and IP, Canada wants FDI that improves our prospects to sell our technology to wider international markets. If remaining in Canada does not make economic sense we must focus on compensating shareholders adequately for their investment in the innovation. (A more challenging question is whether or not a debt is owed to taxpayers who contribute to the domestic R&D funding schemes that support innovation.)

While we await the fate of RIM, lower-profile acquisitions in the high-tech sector are taking place all the time. Last year, US based Sterling Partners acquired Canada's Mosaid Technologies. Mosaid owns thousands of semiconductor memory and wireless patents. About 70 percent of its revenues come from IP license fees. Mosaid claims that the acquisition should not be seen as a loss of Canadian-owned intellectual property since the company will remain headquartered in Ottawa, operating as it always has, except with a US owner.[xlii]

The Potash Corporation of Saskatchewan was established as a provincial Crown Corporation in 1975. In the early 1980s the company struggled, accumulating $800 million in debt. In 1989 the Saskatchewan government decided to privatize. The newly formed PotashCorp expanded through the 1990s by acquiring several US potash companies and today owns assets in Canada, the United States, Brazil, and the Middle East. By 2008, PotashCorp was producing about one third of the world's supply of potash with market capitalization valued at almost $63 billion.

In August 2010, PotashCorp became the subject of a hostile takeover bid by Anglo-Australian mining company BHP Billiton. The bid was widely expected to win approval until Saskatchewan Premier Brad Wall launched a public opposition campaign, demanding that Ottawa "stand up for Canada" to prevent the loss of a "Canadian icon" and a "strategic resource."

On November 3, 2010, Industry Minister Tony Clement announced that he was blocking the BHP bid because he did not feel the purchase would yield a net benefit for Canada. Under the law, BHP had 30 days to make additional representations, but Clement made it clear that the government was unlikely to change its mind.

To convince Ottawa of the merits of the deal, BHP Billiton offered a number of undertakings including:

- Re-establish BHP's global potash headquarters in Saskatchewan;
- Maintain pre-existing levels of employment in Canada and add at least 200 new jobs;
- Maintain current job levels at PotashCorp's Canadian mines for five years and increase overall employment in Canadian potash businesses by 15 percent in that time;
- Remain in Canpotex, the export arm of PotashCorp, for five years;
- $450 million investment in new exploration and development;
- $370 million additional spending on infrastructure in Saskatchewan and New Brunswick;
- $250 million (USD) performance bond to ensure the company fulfilled its undertakings; and
- $8 million a year in spending on community programs in Saskatchewan and New Brunswick and new endowments to the University of Saskatchewan.[xliii]

BHP also emphasized its good corporate citizenship elsewhere in the country.
As the owner of the EKATI diamond mine in the Northwest Territories, the company provided $3.4 billion in spending to local suppliers and 10,000 jobs.[xliv]

In spite of the many incentives offered by the company, two factors quashed the BHP deal. First, the acquisition would mean the elimination (albeit gradual) of Canpotex, the world's largest export cartel for the potash industry.[xlv] Domestic cartels are prohibited under most domestic competition legislation because they elevate prices but there are no binding international regimes that effectively counter export cartels.[xlvi] From an economic perspective, it is good to be a producer protected by a cartel but not so good to be a consumer buying from one. Collectively, Canpotex and the Belarusian cartel BPC control 70 percent of global potash exports.

Within Canpotex, the three Canadian producers have the ability to restrict global supply to keep prices high. Responsible for 55 percent of the group's exports, if PotashCorp were to leave the cartel the other two Canadian companies would be negatively affected by market volatility and the lower prices that would be expected when BHP ramps up global output.

The second reason for Saskatchewan to reject the deal was because BHP had already invested (and would continue to invest) billions of dollars to develop the Jansen Mine. Located 140 kilometres east of Saskatoon, the mine is set to become the world's largest potash mine by the end of the decade. If BHP were allowed to acquire PotashCorp, then it would be able to deduct the capital cost of its new mine against PotashCorp's existing profits. By establishing Jansen as a new business, BHP has to wait until profits are flowing before it can deduct capital costs. Saskatchewan estimated that early write-offs would have cost the province between $3 and $6 billion in provincial tax revenue.

The economic costs of the demise of Canpotex and the Jansen Mine write-offs combined with the political force of Premier Wall's populist campaign left the minority Conservative government with no option but to reject the BHP application.

Although Minister Clement never publically released the reasons for his decision, it can be justified by the ICA net benefit test. BHP's undertakings promised good outcomes in employment and Canadian participation at the firm level, but the demise of Canpotex would negatively affect Canada's global pricing power in the potash sector overall and the loss of provincial tax revenue would certainly be construed as incompatible with provincial policy objectives. The net benefits test includes consideration of an investment's compatibility with "national industrial, economic, and cultural policies, *taking into consideration…policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the investment"* (emphasis added).[xlvii] As well, provincial constitutional authority over non-renewable natural resources would have provided more weight to Brad Wall's demands.

What about the effect of the rejection on future decisions by prospective investors? Is Canada or Saskatchewan perceived as hostile to FDI? In the PotashCorp case, demand for a valuable commodity seems to have outweighed any chilling of potential foreign investment. Instead of walking away from Saskatchewan, BHP redoubled its efforts to develop the Jansen project. So far it has spent more than $2 billion of a total expected to exceed $15 billion. PotashCorp, Agrium, and Mosaic are mid-way through a $13 billion expansion.[xlviii] For now at least, Saskatchewan has the commodities the world wants. It has come out looking like a province unwilling to be cowed by foreign investors. However, this kind of chutzpah may not prove effective in sectors and regions where the competition for access is not as strong.

Assessment: Myth. We do not need different rules for investment in different sectors. Canada's net benefits test provides the flexibility necessary to deal with a variety of conditions, investors, and motivations for investment.

Earlier, Cornish observed that when assets are in the ground, the investor bears the majority of the risk. The corollary is that when assets are highly mobile, the greater risk is born by the host country. There is no way to ensure that investors in Canadian IP will keep an enterprise in Canada, yet prohibiting investment will turn Canada into a pariah as foreign companies seek more contestable markets in which to do business. The most productive area of intervention is to facilitate conditions that create an enabling environment for innovation through such measures as R&D spending and tax incentives,[xlix] but even these may not be enough to keep enterprises in Canada through the entire product lifecycle. We must find ways to capitalize on our ability to incubate new talent, even if it does not always remain here.

Reforming the ICA

In late 2010, the Industry Minister promised to provide some general principles to help clarify the criteria for the net benefit test. The issue was referred to the House of Commons Industry Committee. That work was just getting started in 2011 when an election was called. The issue appeared dormant for several months, prompting claims that with a possible RIM takeover in the works, the government didn't want to reduce its scope to influence a foreign takeover of Canada's flagship high-tech firm.[l]

A number of changes were finally announced in the spring of 2012. The government announced that it will allow the Minister to publicly disclose that he has notified a company that he is "not satisfied that the investment is likely to be of net benefit." [li] The minister will also be able to discuss reasons for the notice, as long as such disclosure does not harm the investor or the Canadian business.

Next, the government announced plans to accelerate the increase of the investment review threshold.[lii] Between 2012 and 2014, it will increase from $330 million to $600 million for two years, then to $800 million for two years, settling out at $1 billion. The government will also evaluate the threshold level according to a company's enterprise value – based on market capitalization rates – rather than asset value, which considers only the value of hard assets. Enterprise value is believed to provide a more accurate evaluation of the worth of high-tech and knowledge-based companies, which have relatively fewer hard assets.

Finally, Ottawa created a formal mediation process, which will provide a voluntary means of resolving disputes when the minister believes a foreign buyer has failed to live up to its obligations. Foreign investors will also be able to provide security bonds as a guarantee towards contractual and performance commitments. While there has been no additional progress on definitional clarity, these changes are important signals that Canada is friendly to foreign investment.

Conclusion

Overall, the ICA provides an adequate balance between encouraging foreign investment and defending national interests. Canada has added enhanced rules for national security and state-owned enterprises that provide a framework for closer scrutiny of certain types of investors and sectors with potential security vulnerabilities. We must keep in mind that good screening goes hand in hand with a strong domestic legal regime to ensure continuing good behaviour by investors

In cases where national security is not at issue, we do not need different rules for different sectors but we do need to manage expectations about investor behaviour under different circumstances. Not every Canadian asset is a national treasure that must be guarded from foreign hands. Sometimes we must take the best deal available. In those cases where we do have a high-demand asset, it makes sense to hold out for the best deal possible.

In the case of Nortel, the business had to be sold for its IP components because there were no viable bidders for the full enterprise. The government could not hold out for full realization of the net benefits test. This will likely be the case for RIM. In the case of PotashCorp, maintaining the status quo was a better alternative to a foreign takeover. The company was profitable and already delivering net benefits to Canada. To accept the BHP offer would have delivered individual shareholder benefits but not the collective gains set out in the net benefits test.

The challenge with determining net benefit in cases like RIM and Nortel is that a firm has a give-and-take relationship with the community it inhabits. Firms may benefit from subsidized R&D, tax breaks, and other incentives, but they give back through philanthropy and the contribution to the Canadian "brand." Both Nortel and RIM have been generous donors to social and educational causes in Canada and elsewhere in the world.[liii] However, community benefits have to be balanced against shareholder returns.

This paper has argued that FDI is good for Canada and the current provisions for foreign investment screening are adequate – helping to balance public policy and economic interests while placing minimal restrictions on FDI flows and private commercial decisions. [liv]

The alternative of completely unregulated FDI is not in Canada's interest given its relatively small size in the global economy and the high-level of demand for its resource assets. Having a mechanism to assess the trade-offs between foreign ownership and domestic competitiveness strikes the right balance between openness and stewardship of economic resources. However, our FDI decisions must be based on a confident assessment of interests, not a fear of foreigners. The lessons of the 1960s taught us that shielding the domestic market erodes competitiveness and hurts longer-term prosperity. We must be confident in Canada's ability to produce the high-quality assets that the world wants and needs.

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[i] *Investment Canada Act* and related regulations available at http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk00012.html.
[ii] Some of the formal commissions and inquiries to emerge during this period were the 1957 Gordon Commission, the 1968 Watkins Commission, and the 1970 Wahn Commission. For an account of the development of Canadian multinational enterprises, see: C.J. Maule and I.A, Litvak. 1981. *The Canadian Multinational.* Toronto: Butterworth & Co.
[iii] Russell Deigan. 1991. *Investing in Canada: The Pursuit and Regulation of Foreign Investment.* Scarborough: Thomas Professional Publishing, pages 5-7.
[iv] Deigan, 7, n. 18.
[v] Some of the performance requirements included transfer of a specific percentage of production to Canada and use of local suppliers.
[vi] Duncan MacDowell. 1984. "A Fit Place for Investment? Foreign Investors' Perceptions of Canada in a Changing World." *Conference Board Study No. 81*. Ottawa.
[vii] J.L. Granatstein and Norman Hillmer. 1991. *For Better or for Worse: Canada and the United States to the 1990s.* Mississauga: Copp Clark Pittman Ltd, page 274.
[viii] *The Economist*, September 18, 1982, 83; Michael Doyle, August 27, 1982, "Ten Premiers Seek Summit on Economy," *Winnipeg Free Press*.
[ix] Investment in financial services, telecommunications, air transport, and uranium mining are subject to lower threshold values. Investment in the cultural industries is subject to review by the Department of Canadian Heritage.
[x] Robert Thomas Kudrle. 1994. "Regulating Multinational Enterprises in North America." In Lorraine Eden's (editor) *Multinationals in North America*. Ottawa: Supply and Services Canada, page 405.
[xi] Michael Grant and Michael Bloom. 2006. *Hollowing Out — Myth and Reality: Corporate Takeovers in an Age of Transformation.* Volume 2, Conference Board of Canada, page 6.
[xii] Desmond Beckstead and W. Mark Brown. 2006. "Head Office Employment in Canada, 1999 to 2005/" *Micro-Economic Analysis Division, Statistics Canada.*
[xiii] Grant and Bloom, 8.
[xiv] See, for example, Competition Policy Review Panel, 2008, *Compete to Win*, Final Report. http://www.ic.gc.ca/eic/site/cprp-gepmc.nsf/vwapj/Compete_to_Win.pdf/$FILE/Compete_to_Win.pdf.

[xv] Andrea Mandel-Campbell. 2008. *Foreign Investment Review Regimes: How Canada Stacks Up.* Conference Board of Canada.
[xvi] Lawrence L. Herman. 2011. "Investment Review in Canada — We Can Do Better." *University of Calgary School of Public Policy Research Papers*, page 7.
[xvii] Derek Burney and Kevin Ackhurst. 2011. "Canadian Protectionism? Political and Legal Considerations for Foreign Investment in Canada." *Policy Options*, page 58.
[xviii] Philippe Bergevin and Daniel Schwanen. 2011. "Reforming the *Investment Canada Act:* Walk More Softly and Carry a Bigger Stick." *CD Howe Institute Commentary 337*, page 15.
[xix] http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#state-owned.
[xx] Margaret Cornish. 2012. "Behaviour of Chinese SOEs: Implication for Investment and Cooperation in Canada." *Canadian Council of Chief Executives and Canadian International Council*, pages 20-21.
[xxi] *The Economist.* January 21, 2012. "Special Report on State Capitalism." Page 6; *New York Times*. May 20, 2012. "Leader's Fall in China Puts Allies in Peril."
[xxii] Presentation by Wenran Jiang to C.D. Howe Institute, International Economic Policy Council, March 27, 2012.
[xxiii] In 2008, the acquisition of the Information Systems Business of Canada's MacDonald, Dettwiler and Associates Ltd. by US-based Alliant Techsystems Inc. received strong negative signals from the Industry Minister, stemming from concerns about losing Canadian control over key satellite imaging technology and creating security vulnerabilities. It is no surprise that the ICA national security provisions were put in place a year later.
[xxiv] Herman, 14.
[xxv] James K. Jackson. 2011. *Foreign Investment, CFIUS, and Homeland Security: An Overview*. Congressional Research Service.
[xxvi] Theodore H. Moran. 2009. "Three Threats: An Analytical Framework for the CFIUS Process." *The Peterson Institute for International Economics Policy Analyses in International Economics* 89 (August).
[xxvii] During the attempted takeover of PotashCorp by BHP Billiton, Saskatchewan Premier Brad Wall and Agriculture Minister Gerry Ritz declared potash a strategic resource. NDP MP Pat Martin referred to strategic sectors. May 25, 2011. *Fasken Martineau Antitrust/Competition & Marketing Bulletin*, "Conservative Majority Government: Implications for the *Investment Canada Act*, Foreign Ownership Rules in Telecommunications, and the *Competition Act*." See also http://www.cbc.ca/news/business/story/2012/03/12/viterra-glencore.html.
[xxviii] Karen Mazurkewich. 2011. *Rights and Rents: Why Canada must harness its intellectual property resources*. Canadian International Council, page 93.
[xxix] Jameson Berkow. October 7, 2011. "Canada's Patent Problem." *National Post*.
[xxx] Walid Hejazi. 2010. "Dispelling Canadian Myths About Foreign Direct Investment." *IRPP Study*, page 25.
[xxxi] Assessment of the utility of new incentives for domestic IP holders is beyond the scope of this paper.
[xxxii] Mazurkewich, 41.
[xxxiii] *Globe and Mail*. July 20, 2009. "RIM cries foul over Nortel auction."
[xxxiv] Samsung, the largest manufacturer using the Android operating system, saw its US market share rise from 9 to 23 percent. Apple's share rose from 16 to 24 percent.
[xxxv] *Bloomberg News.* April 4, 2012. "Despite cheap valuation, RIM deal doubted as losses add up."
[xxxvi] Terence Corcoran. October 3, 2011. "Intellectual potash: RIM's new poison pill?" *National Post*.
[xxxvii] *Globe and Mail.* July 27, 2009. "Ontario urges PM to block foreign Nortel sale."
[xxxviii] December 29, 2011. "Despite RIM Takeover Talk, Hurdles Would Be High." *New York Times*.
[xxxix] Canada's Top 100 Corporate R&D Spenders: http://www.researchinfosource.com/media/2011Top100List.pdf.
[xl] Federal approval for an investment can be conditioned on undertakings by the investor to meet certain local employment and production targets. However, such performance requirements are frowned upon by the WTO and difficult to enforce, such as in the recent U. S. Steel case where the US company acquired Hamilton-based Stelco in 2007 just before the bottom dropped out of the global steel market and the company was unable to meet its agreed-upon undertakings.
[xli] David Gilbert. March 30, 2012. "Why RIM will not be sold off." *International Business Times*.
[xlii] Mosaid Press Release. http://www.mosaid.com/corporate/investor-relations/sterlingpartnersbid.php.
[xliii] Tim Kiladz. November 15, 2010. "BHP Billiton's $1 billion Promises." *Globe and Mail*.
[xliv] BHP Billiton statement regarding comments by the Government of Saskatchewan, www.bhpbilliton.com, (October 2010).
[xlv] PotashCorp is the largest member of Canpotex, which also includes Agrium and Mosaic.
[xlvi] For a critique of Canada's participation in the global potash cartel, see Michael Trebilcock. September 30, 2010. "Cartel hypocrisy." *Financial Post.*
[xlvii] ICA Article 20(e).
[xlviii] Claudia Cattaneo. November 12, 2011. "The Revenge of Jansen." *Financial Post.*

[xlix] A thorough review of the factors necessary to create an enabling environment for innovation is beyond the scope of this paper but the relationship between support, competition, and innovation is covered well in: Tom Jenkins. 2011. "A Simple Solution to Canada's Innovation Problem," *Policy Options* (September).

[l] *Globe and Mail.* January 16, 2012. "Ottawa stalls foreign takeover review."

[li] *Globe and Mail.* April 27, 2012. "Ottawa to lift veil on reviews of foreign takeovers."

[lii] The total package of reforms was released between March and May. They are explained in detail on the Industry Canada website: http://news.gc.ca/web/article-eng.do?nid=676779.

[liii] RIM founders Jim Balsille and Mike Laziridis have used their personal fortunes to fund the Institute for Quantum Computing, the Perimeter Institute for Theoretical Physics, the Centre for International Governance Innovation, the Canadian International Council, and the Balsillie School of International Affairs.

[liv] This concept is borrowed from the WTO principle that permits countries to take exceptions for the preservation of public policy goals such as security and the protection of human and environmental health, as long as the exceptions are applied in the least-trade restricting manner possible.

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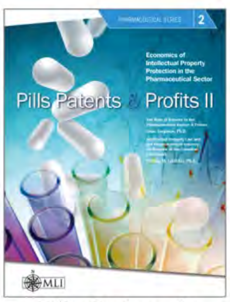

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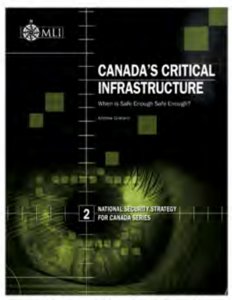

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