OPEN FOR BUSINESS? – LESSONS LEARNED FROM THE LAND DOWN UNDER FOR REGULATING INVESTMENTS BY STATE-OWNED ENTERPRISES IN THE OIL SANDS

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I. INTRODUCTION

On December 7, 2012, immediately following the Minister of Industry's (the Minister) approval of the $15.1 billion acquisition of Nexen by the Chinese state-owned enterprise (SOE), China National Offshore Oil Company (CNOOC), the Government of Canada announced revised guidelines for investments by SOEs in the Alberta oil sands. Prime Minister Stephen Harper announced that the investment by CNOOC marked "the end of a trend and not the beginning of a trend" and that "when we say Canada is open for business, we do not mean that Canada is for sale to foreign governments".[1] The Statement Regarding Investment by Foreign State-Owned Enterprises detailed the government's policy towards such transactions by SOEs:

> Under the [*Investment Canada Act*], the burden of proof is on foreign investors to convince the Minister that the investment is likely to be of net benefit to Canada.... Each case will be examined on its own merits; however, given the inherent risks posed by foreign SOE acquisitions in the Canadian oil sands the Minister of

1 Laura Payton, "Government OK's foreign bids for Nexen, Progress Energy", *CBC News* (7 December, 2012), online: <www.cbc.ca/news/business/>.

> Industry will find the acquisition of control of a Canadian oil sands business by a foreign SOE to be of net benefit to Canada on an exceptional basis only.[2]

Shortly after the "Statement and the Guidelines – Investment by state-owned enterprises – Net benefit assessment" (the Revised Guidelines)[3] were issued, Bill C-60[4] was tabled containing several proposed amendments to the *Investment Canada Act* (*ICA*).[5] The amendments were subsequently approved on June 26, 2013 and were enacted with retroactive effect to April 29, 2013.[6] Since coming into force, the amendments to the *ICA* and the Revised Guidelines have been heavily debated and criticized within legal, political, and industry circles.[7] Criticism of the new rules has centered on the following points: "[that] Asian SOEs … have been specifically targeted; that the rules are intentionally ambiguous in order to allow an element of political discretion into the process;"[8] and that the rules create an obvious disjuncture between the ends and means of Canada's policy towards foreign direct investment (FDI).

Following the amendments, foreign direct investment (FDI) in the oil sands, in which SOEs play a critical role, all but stopped. FDI in Canada's energy industry declined 92%, from $27 billion in 2012, to $2 billion in

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2 Industry Canada, "Statement Regarding Investment by Foreign State-Owned Enterprises", (7 December 2012), online: <www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81147.html> [Industry Canada, "Investments by Foreign SOEs].

3 Industry Canada, "Guidelines – Investment by state-owned enterprises – Net benefit assessment", (7 December 2012), online: <www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2> [Industry Canada, "Guidelines – Investment by SOEs"].

4 Bill C-60, *An Act to implement certain provisions of the budget tabled in Parliament on March 21, 2013 and other measures*, 1st Sess, 41st Parl, 2013, div 6.

5 *Investment Canada Act*, RSC 1985, c 28 (1st Supp) [*ICA*].

6 Alicia K. Quesnel, "The chilling effect of uncertainty – foreign direct investment by state owned enterprises in Canada's resources sector" (November 2013) 131 Financier Worldwide 38, online: <www.financierworldwide.com>.

7 Lawson A.W. Hunter Q.C., Susan M. Hutton & Michael Kilby, "Canada creates further uncertainty for investments by State-Owned Enterprises" (7 May 2013), The Competitor, online: <www.thecompetitor.ca>.

8 Frank Turner & Peter Glossop, "The Year the Music Stopped – The Precipitous Decline in SOE Investment in Canada's Oil and Gas Sector in 2013" in Clay Horner, Frank Turner & Douglas Marshall eds, *2014 Capital Market Report* 10 at 13, online: (2014) Osler Guides – Capital Markets Report <www.osler.com/NewsResources/Publications/Guides>.

2013.[9] While correlation does not equal causation, the steep decline of FDI in the oil sands following the amendments to the *ICA* is not a mere coincidence.[10]

China has been a particularly prominent source of FDI in the oil sands. Since 2003, approximately one third of all foreign investments in the oil sands have come from China.[11] Between January 1, 2005 and June 30, 2013, Chinese inflows to Canada totalled $37.6 billion.[12] The vast majority of China's outward global investment takes place through SOEs.[13] Canada has not, however, historically been the primary destination for large-scale Chinese investment. For transactions over $100 million between January 1, 2005 and June 30, 2013, Australia has ranked as China's top destination for investment, followed by the United States and then Canada,[14] despite Canada having far more proven reserves at year end of 2013.[15] Arguably, this is because Canada's regulatory regime is not as conducive to receiving FDI as the regimes in place in Australia and the United States. Indeed, Canada ranks significantly higher than Australia and the United States on the Organization for Economic Cooperation and Development's (OECD) FDI Restrictiveness Index.[16] This is problematic as FDI is an essential source of capital to develop and maintain the oil sands. If the recent amendments are actually inhibiting crucial FDI from entering the country, we have an interest in reversing this action.

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9 Sebastian Gault, "Jim Prentice says the tone must change for Canada to attract more foreign investment", *Alberta Oil* (2 December, 2013), online: <www.albertaoilmagazine.com> [Gault, "Tone must change for Canada"].

10 The effect of other macro factors, such as increasing capital and operating costs, delays in critical infrastructure for market access, increasing environmental regulation and other investment opportunities outside of the oil sands, can certainly have an impact on FDI, though the timing of the amendments and the scale of the decrease in FDI suggest that the decline can largely be attributed to the change in policy.

11 Patrycja Romanowska, "Will Canada's new foreign investment rules kill oil sands development?", *Alberta Oil* (1 March 2013), online: <www.albertaoilmagazine.com> [Romanowska].

12 Wendy Dobson, "China's State-Owned Enterprises and Canada's FDI Policy", online: (2014) 7:1 SPP Research Papers at 12 <http://policyschool.ucalgary.ca/?q=research>.

13 *Ibid* at 10. SOEs accounted for 69 percent of China's stock of outward investment.

14 *Ibid* at 12.

15 British Petroleum, "BP Statistical Review of World Energy June 2014" (2014) at 6.

16 Organisation for Economic Co-Operation and Development, "FDI Regulatory Restrictiveness Index", (2013), online: <www.oecd.org/investment/fdiindex.htm>.

In this paper I suggest that parallel Australian policy and legislation on SOEs should be used as a model in order to prompt the flow of foreign capital to the oil sands. I argue that a comparison between the Australian and Canadian regulatory regimes—and the ways in which the markets have reacted to these regimes—supports the conclusion that the *ICA* ought to be amended so as to treat all foreign investors equally, remove the Minister's broad deeming powers, clarify the test to be met in the review process, and further encourage FDI. In particular, I focus on Chinese FDI to support my arguments due to the significant role Chinese SOEs play within the oil sands.

This paper proceeds as follows. Part II sets the background, looking at the global energy picture and the oil sands, Chinese SOE investment in the oil sands, and public concerns and policy issues surrounding SOE investment in the oil sands. Part III reviews the Canadian regulatory framework for FDI. Part IV discusses the effects which can be attributed to the recent amendments to the Canadian regulatory framework. Part V reviews the Australian regulatory framework for FDI, draws comparisons to the Canadian framework, and provides recommendations for amendments to the Canadian framework to reduce ambiguity and encourage FDI from SOEs. Part VI draws finals conclusions.

II. BACKGROUND

A. The Global Picture and the Oil Sands

In its International Energy Outlook 2014 Reference case, the U.S. Energy Information Administration projects that world liquid fuels consumption will increase by more than 33 percent between 2010 and 2040.[17] Non-OECD Asia and the Middle East are expected to account for 85% of the increase in world liquid fuels demand.[18] With decreasing conventional oil supplies and increasing global consumption, the need for a secure supply from unconventional resources such as Alberta's oil sands will continue to grow and therefore presents a significant economic opportunity for Alberta and Canada.

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17 U.S. Energy Information Administration, "International Energy Outlook 2014: World Petroleum and Other Liquid Fuels" (2014) at 4.

18 *Ibid*.

Between 2014 and 2038, Canadian employment related to the oil sands, including direct, indirect, and induced Canadian jobs is projected to grow from the current level of 514,000 jobs to a peak of 802,000 jobs by 2028.[19] During the same time period, indirect, personal and corporate oil sands related taxes are expected to pay $574 billion (in 2013 dollars) to the Canadian federal government.[20] Furthermore, $302 billion in oil sands related taxes are expected to be paid to the Alberta provincial government during this time.[21] With such figures, the importance of the oil sands to both Alberta and Canada cannot be overstated.

Oil sands operations are capital-intensive. In order to fuel the projected economic growth in the oil sands, it is expected that the sum of initial capital, sustaining capital and capital required for operations will equal an average of $55 billion (in 2013 dollars) per year between 2014 and 2038.[22] Canada's capital markets however, are relatively small, and companies today compete not only for access to the best reserves but also for capital.[23] The differential between demand for capital and its availability makes access to foreign capital more crucial than ever to ensure the continued development of the oil sands.

B. Chinese SOE Investment in the Oil Sands

The OECD defines Foreign Direct Investment FDI as, "a category of cross-border investment made by a resident entity in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise … that is resident in an economy other than that of the direct investor".[24] Generally speaking, FDI is viewed in a positive light. The benefits of FDI for host countries include portfolio diversification using foreign capital, access to international supply chains and technologies, and

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19 Dinara Millington, "Oil Sands Economic Outlook" (Presentation delivered at the Oil Sands Symposium, 25–26 November 2014), Canadian Energy Research Institute at 18.

20 *Ibid.*

21 *Ibid.*

22 *Ibid.*

23 Geoffrey Morgan, "Why junior oil and gas companies still struggle to find cash", *Alberta Oil* (1 November 2013), online: <www.albertaoilmagazine.com>.

24 Organisation for Economic Co-Operation and Development, *OECD Benchmark Definition of Foreign Direct Investment*, 4th ed (Paris: OECD Publishing, 2008) at 22 (ISBN 978-92-64-04573-6).

increased domestic competition from foreign companies – all factors that ultimately encourage efficient resource allocation and thereby foster economic growth.[25] Most significantly, FDI can make up for a deficit of domestic capital. Since the start of the oil sands boom in 2003, FDI has played a significant role in supplying the capital to develop this vital Canadian resource. However, several large investments by Asian SOE investors, particularly Chinese SOEs raised significant public concern, though none so much as China National Offshore Oil Corporation's (CNOOC) $15.1 billion dollar acquisition of Nexen Inc.[26]

C. Public Concern and Policy Issues

The CNOOC-Nexen deal placed the presence and role that Chinese SOEs play in the oil sands under the microscope. Chinese SOE investments in the oil sands are primarily fuelled by the Chinese Government's ambitious strategy to secure the resources necessary to fuel China's rise to an economic super-power.[27] Following the global downturn of 2008, distressed assets presented acquisition opportunities at reduced prices.[28] Given Canada's political stability, the oil sands represent a relatively safe hedge against other energy investments made by Chinese SOEs in riskier regions around the globe.[29]

Yuen Pau Woo, president and CEO of the Asia Pacific Foundation of Canada, an independent think tank, accurately articulates the concern held by many Canadians: that Chinese SOEs "will import their bad habits, bad governance or bad environmental practices into the country."[30] The fear is that Chinese SOEs, as late entrants into the oil sands with government-backed balance sheets, will fail to apply market principles in their strategic and operational decisions and will therefore distort the market.[31]

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25 Dobson, *supra* note 12 at 16.

26 Payton, *supra* note 1.

27 Dobson, *supra* note 12 at 10.

28 *Ibid.*

29 Sebastian Gault, "Alberta Oil in China: Concerns over Canadian investment regulation linger", *Alberta Oil* (9 January 2014), online: <www.albertaoilmagazine.com>.

30 Alberta Oil Staff, "Alberta Oil in China: Do Canada's new investment rules go too far?", *Alberta Oil* (22 January 2014), online: <www.albertaoilmagazine.com>.

31 Dobson, *supra* note 12 at 11.

Governance of SOEs can be best described as opaque[32] and many people hold principled objections to Chinese FDI based on their tarnished human rights record.[33] The biggest concern however is undoubtedly national security. Dobson observes, "perceptions about political rather than commercial decision-making underlie national security concerns".[34] The concern is that SOEs acting as agents of the Chinese government could undermine Canada's national sovereignty, particularly in light of China's 2006 policy decision to expand the role of SOEs in its "go-out" strategy to secure key resources. National security concerns have been further magnified by U.S. reports tracing cyber-attacks on government and enterprise networks back to China's military.[35]

The unease felt by many boils down to a concern that the market will somehow become distorted. I would submit this is not a warranted concern for three reasons. First, SOEs have an interest in maintaining a favourable reputation among industry players (who they will inevitably need to do business with) and consumers, and will therefore behave accordingly.[36] Second, competition laws designed to discipline intentional market-distorting activity, such as exporting goods at below market prices, will provide a check on a SOE's activities.[37] Finally, evidence shows that Chinese SOEs are becoming more efficient and profitable, despite their status as late-comers faced with a steep learning curve.[38]

Overall, it appears the majority of the public concern and scrutiny regarding Chinese SOE investment in the oil sands is rooted in misunderstandings and misassumptions. The reality of oil sands operations is they require massive injections of capital in order to develop, amounts that domestic companies may not have. China's sovereign wealth of approximately $3 trillion represents a key source to meet the demand for

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32 *Ibid* at 7.

33 Kate Lunau, "Our Chinese oil sands", *Maclean's* (8 August 2012), online: <www.macleans.ca/economy/business/our-chinese-oil-sands/>.

34 Dobson, *supra* note 12 at 11.

35 *Ibid.*

36 Margaret Cornish, "Behaviour of Chinese SOEs: Implications for Investment and Cooperation in Canada", (Toronto: Canadian International Council, 2012) at 17 (ISBN 978-0-9866175-5-3).

37 *Ibid.*

38 Dobson, *supra* note 12 at 6.

capital necessary for the oil sands to continue to operate as a key driver in the Canadian economy.[39] With a primarily resource-based economy, Canadian portfolios are also inherently weighted towards natural resources.[40] Investment from Chinese SOEs can therefore serve as a hedge to Canadian portfolios by reducing exposure to volatile commodities.[41] In addition, FDI fuelling development in the oil sands can put pressure on the Canadian government to approve critical infrastructure projects such as TransCanada's Energy East Pipeline that will provide access to overseas markets. This will in turn reduce the pricing differential between Western Canadian Select and West Texas Intermediate resulting from the oil sands' landlocked nature[42] and will ultimately create greater returns for Canadian investors. Despite these obvious benefits, I would argue that the recent amendments to the *ICA* have the potential to cause SOEs (Chinese SOEs, in particular) to look elsewhere to invest their capital.

III. INVESTMENT CANADA ACT

A. Foreign Investment Review Under the ICA

The *ICA* provides the legislative framework for the Minister of Industry to review proposed investments exceeding a threshold value that would result in an acquisition of control of a Canadian business by a non-Canadian.[43] Under the *ICA*, a non-Canadian cannot implement an investment subject to review unless "the Minister is satisfied or deemed to

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39 Gault, "Tone must change for Canada", *supra* note 8.

40 Michael Grant, *Fear the Dragon? Chinese Foreign Direct Investment in Canada* (Ottawa: The Conference Board of Canada, 2012) at 12 (www.casselsbrock.com.cn/files/file/docs/FearTheDragon.pdf).

41 *Ibid*.

42 Alberta Innovates – Energy and Environment Solutions, "Energy Technologies – Improving the competitiveness of Alberta's oil sands products", online: <www.ai-ees.ca >.

43 *ICA*, *supra* note 5, part IV. It should be noted that part IV.1 of the *ICA* provides the framework for review of a proposed investment that could be injurious to Canada's national security. Concerns regarding national security, however, are not limited to SOEs and are therefore beyond the scope of this paper. Furthermore, the national security jurisdiction was enacted in 2009, over 3 full years prior to the CNOOC-Nexen deal. *ICA*, *supra* note 5, part IV.1.

be satisfied that the investment is likely to be of net benefit to Canada."[44] A "Canadian business" is defined in the *ICA* as "a business carried on in Canada that has a place of business in Canada, an individual or individuals in Canada who are employed or self-employed in connection with the business, and assets in Canada used in carrying on the business".[45]

The *ICA* also establishes what will be considered an acquisition of control that will bring a proposed investment under the purview of ministerial review. Under the legislative framework, a non-Canadian will acquire control when it acquires: a majority of the voting shares of a corporation carrying on a Canadian business; a majority of the voting interest in an entity that is carrying on a Canadian business or controls, directly or indirectly, another entity carrying on a Canadian business; or all or substantially all of the assets of a Canadian business.[46] The *ICA* also establishes the presumption that "the acquisition of less than a majority but one-third or more of the voting shares of a corporation or of an equivalent undivided ownership interest in the voting shares of [a] corporation"[47] is an acquisition of control, unless the investor can prove that the acquisition will not result in the control of a Canadian business.[48]

B. Revised Guidelines and ICA Amendments

In the Statement Regarding Investment by Foreign State-Owned Enterprises released on December 7, 2012, the Government announced that it will increase "the review threshold under the *Investment Canada Act* to $1 billion in enterprise value over four years only for private sector investors. The review threshold for foreign SOEs will remain at $330 million in asset value."[49] The threshold for review for 2016 is $375

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44 *Ibid*, s 16(1). See also *Ibid* ss 21(9), 22(4), 24.

45 *Ibid*, s 3.

46 *Ibid*, ss 28(1), 28(2).

47 *Ibid*, s 28(3).

48 *Ibid*, ss 28(6.1), 28(6.2).

49 Industry Canada, "Investments by Foreign SOEs, *supra* note 2.The threshold for non-WTO investors is $5 million: Industry Canada, "*Thresholds*", (15 January 2013), online:.< https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk00050.html#p3> [*Thresholds*]. "The basis for the calculation of the threshold [was] changed from asset value to enterprise value to more accurately reflect the market value of businesses and capture the increasing importance of the service and knowledge-based industries of [the Canadian] economy." See Government of Canada, News Release, "Government of

million.[50] The fact the threshold for non-SOE investors was increased substantially demonstrates an obvious preference. The timing of the Statement Regarding Investment by Foreign State-Owned Enterprises (i.e. immediately following the approval of CNOOC's acquisition of Nexen, and Malaysia's Petronas' $5.2 billion acquisition of Progress Energy) further lends credibility to the criticism that the *ICA* amendments and Revised Guidelines are specifically targeted at Asian SOEs.

C. "Net Benefit"

The *ICA*'s "net benefit" test strongly supports the criticism that the legislation is intentionally ambiguous to allow for political discretion in the review process. A proposed investment subject to review under the *ICA* must satisfy the Minister that the investment will be of "net benefit" to Canada prior to being approved.[51] The Minister has a 45 day time limit to determine whether the "net benefit" test is met.[52] The Minister may, with notice to the investor, extend the time period by an additional 30 days. Further extensions may also be allowed if both the Minister and the investor both agree.[53] The Minister ultimately must provide reasons to the investor if he is not satisfied that the investment is likely to be of net benefit to Canada.[54] The Minister may provide reasons to the investor when notifying the investor of an extension in the review time period or when notifying the investor that he is satisfied that the investment is likely to be of net benefit to Canada.[55]

The factors to be taken into account in determining "net benefit" are set out in section 20 of the *ICA*.[56] Ambiguity is created however as weights are not assigned to the factors: "Depending upon the nature of and the circumstances surrounding the investment, some of the… factors will be

Canada Releases Policy Statement and Revised Guidelines for Investments by State-Owned Enterprises" (7 December 2012), online: <http://news.gc.ca/web/article-en.do?nid=711489>.

50 *Thresholds*, *supra* note 49.

51 *ICA*, *supra* note 5, s 16.

52 *Ibid*, s 21(1).

53 *Ibid*, s 22.

54 *Ibid*, s 23.1.

55 *Ibid*.

56 *Ibid* s 20.

given more weight than others."[57] The Revised Guidelines also state that the Minister will consider whether, following an acquisition, a Canadian business acquired by a SOE will likely be operating on a commercial basis with regard to:

> [W]here to export; where to process; the participation of Canadians in its operations in Canada and elsewhere; the impact of the investment on productivity and industrial efficiency in Canada; support of on-going innovation, research and development in Canada; and the appropriate level of capital expenditures to maintain the Canadian business in a globally competitive position.[58]

D. Further Ambiguity – SOE Defined and Deeming Provisions

The *ICA* now has an expanded definition of an SOE. The new definition captures "an entity that is controlled or <u>influenced</u>, directly or indirectly, by a government or agency [of a foreign state]" as well as "an individual who is acting <u>under the direction</u> of a government or agency… or who is acting under the <u>influence</u>, directly or indirectly, of… a government or agency"[59]. Whereas the concept of "control" is established in sections 28 and 29, "influence" and "under the direction" remain broad and without guidance. This is problematic from the perspective of potential foreign investors based in countries where the state has far reaching and often intrusive powers. The expanded definition of SOE could be used to classify an otherwise private investor in a political regime such as China, to be "influenced, directly or indirectly… or… acting under the direction of a government or agency."[60]

Adding an even further layer of ambiguity, the Minister now has the power to determine that an investor is "controlled in fact" by one or more SOEs, despite otherwise qualifying as a Canadian-controlled entity.[61] Similarly, the Minister may deem a proposed investment to be an acquisition of "control in fact" by a SOE, even where the "acquisition of

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57 Industry Canada, "*Frequently Asked Questions*", (8 March 2013), online:.<https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk00007.html>.

58 Industry Canada, "Guidelines – Investment by SOEs", *supra* note 3.

59 *ICA*, *supra* note 5, s 3 [emphasis added].

60 *Ibid*.

61 *Ibid*, ss 26(2.1), 26(2.11), 26(2.31).

control" threshold is not met.[62] The result of either situation is that an otherwise non-reviewable transaction will be reviewable and subject to approval and in making such determinations, the Minister can consider "any information and evidence"[63] before him.

E. National Security Review

While beyond the scope of this paper, it is prudent to briefly discuss the national security review framework under Part IV.1 of the *ICA*.[64] The scope of the national security review provisions is significantly broader than that of the other review provisions contained within the *ICA*. Leading Canadian practitioners have commented that transactions in the oil and gas industry are likely to come under increased scrutiny on national security grounds as technological advances are made and applied in the oil sands.[65] "An investment is reviewable under [Part IV.1] if the Minister … considers that the investment could be injurious to national security and the Governor in Council, on the recommendation of the Minister, makes an order… for the review of the investment."[66] The most notable difference here is that there is neither a financial threshold, nor an acquisition of control requirement, before a review can be triggered. This provides the Minister with an immense amount of discretionary power. To add even further ambiguity, "national security" is not defined. While the Revised Guidelines specifically addressed the oil sands, no such industry has been particularly identified as likely to come under scrutiny for national security, nor has any single type or origin of investor been identified.

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62 *Ibid*, ss 28(4), 28(4.1), 28(6.1).

63 *Ibid*, ss 26(2.1), 26(2.11), 26(2.31), 28(4), 28(4.1), 28(6.1).

64 *Ibid*, ss 25.1–25.6.

65 Angela Avery, Peter Glossop & Paula Olexiuk, "Foreign Investment in Canada's Oil and Gas Sector: New and Emerging Challenges" (2013) 51:2 Alta L Rev 343 at 358 (QL).

66 *ICA*, *supra* note 5, ss 25.3(1).

IV. Effects of Amendments to the ICA and Revised Guidelines

A. Recent SOE Investment Activity

An investor interested in making an investment in the range required in a capital-intensive industry such as the oil sands needs a degree of likelihood that the investment will eventually yield a positive return. The prospect of spending millions of dollars pursuing a target for a merger or acquisition, then being subject to review under the *ICA*, bearing the onus to prove a "net benefit" to Canada, and potentially being told publicly that the transaction will not be allowed is not an appealing hurdle to a foreign investor. For the Chinese, not only does this mean a potential loss of millions, but a loss of face as well.[67] With so much uncertainty for foreign SOEs as a whole, investment by Chinese SOEs at virtually a standstill, and the current price of WTI oil floating at approximately $40/barrel,[68] one has to ask where today does Canada stand regarding investment by SOEs in the oil sands? Furthermore, in what situations is the Minister of Industry likely to use his deeming powers and under what "exceptional" circumstances will a proposed transaction be found to be of "net benefit"?

Since the Revised Guidelines and amendments to the *ICA*, only three SOE transactions subject to review have occurred in the petroleum, natural gas, and oil sands sectors.[69] The first transaction involved a SOE acquiring a 40 percent undivided partnership interest in a natural gas business through a joint venture partnership; the second transaction involved a SOE acquiring a 100% interest in natural gas assets; and the third transaction involved one SOE acquiring a 100 percent interest in oil sands assets from another SOE.[70] Each of the three transactions exceeded $1 billion in value.[71]

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67 Romanowaska, *supra* note 11.

68 As at 4:59pm ET, May 9, 2016, the price of crude oil (WTI) was $43.24USD/bbl: Bloomberg, "Bloomberg Markets" (9 May 2016), online: <www.bloomberg.com/markets>.

69 Alicia K. Quesnel, "SOE transactions within Canada's petroleum and natural gas sector – acquisitions of control" 44 (November 2014), online: <www.financierworldwide.com>.

70 *Ibid.*

71 *Ibid.*

This third and most recently approved transaction, completed May 28, 2014, involved Statoil and PTT Exploration and Production (PTTEP).[72] Statoil and PTTEP were parties to a joint venture, with respective 60 percent and 40 percent interests.[73] The transaction resulted in the two companies dividing their joint venture interests, with Statoil and PTTEP each owning respective 100 percent working interests in separate projects and areas. The Minister did not release a statement in connection with his approval of the transaction, though I would note that Statoil, a Norwegian SOE, is aligned with a government that subscribes to the same democratic and free-market principles as Canada. PTTEP, on the other hand, is a Thai SOE and cannot be similarly characterized. This is the first transaction involving the oil sands since the amendments to the *ICA*. Since neither the Minister nor the parties are obligated to disclose any commitments made to obtain approval, and the Minister has not made any comments on the transaction, what specifically qualified this transaction as an "exceptional circumstance" remains unknown.[74] Perhaps, at least, approval of this transaction suggests that the Canadian government has not completely closed off the oil sands from investment by SOE investors.

B. Eroded Shareholder Value

As previously stated, there has been considerable debate regarding the extent to which the Revised Guidelines and amendments to the *ICA* can be said to have caused the drastic decline of foreign investment in the oil sands—as opposed to many other factors such as increased production and operating costs, and delays in the approval of critical infrastructure. Until recently, evidence as to the effects of the policy and legislation on the oil sands has been limited to anecdotal evidence.[75] In June, 2014, Professor Eugene Beaulieu of the University of Calgary School of Public Policy and Matthew M. Saunders completed an empirical event study analysis suggesting the Revised Guidelines and *ICA* amendments have had a negative impact on the stock returns of companies operating in the oil

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72 *Ibid* at 45.

73 *Ibid*.

74 *Ibid*.

75 Eugene Beaulieu & Matthew Saunders, "The Impact of Foreign Investment Restrictions on the Stock Returns of Oil Sands Companies" (2014) 7:16 SPP Research Papers at 2 (<http://policyschool.ucalgary.ca/?q=research>).

sands.[76] The negative impact was found to be significantly greater for smaller oil sands companies (juniors) relative to the impact for mid-size and large firms operating in the oil sands.[77] This finding is consistent with the authors' hypothesis that juniors are more vulnerable to financing risk as they have less internal cash flows to offset the need for external inflows of capital.[78] Finally, the findings are also consistent with the authors' hypothesis that juniors have been adversely impacted by the effect of the Revised Guidelines and *ICA* amendments on joint ventures.[79]

These results are particularly interesting as they demonstrate an indirect negative consequence of policy and legislation aimed at controlling foreign ownership and control in the oil sands.[80] Due to the capital-intensive nature of the oil sands, joint ventures are a common method of meeting capital requirements.[81] A common provision of a joint venture agreement is that, in the event of default by a party, the non-defaulting party is compensated by absorbing the defaulting party's interest in the venture. This ultimately results in the non-defaulting party acquiring control. An acquisition of control however, now requires "net benefit" to be established and will only be granted approval on an exceptional basis only. This requirement under the *ICA* therefore may be preventing SOEs from investing capital in the oil sands through joint ventures because they are unsure of whether they will trigger the *ICA* review threshold if the other party defaults.[82]

With empirical evidence suggesting the Revised Guidelines and *ICA* amendments have eroded shareholder value for oil sands companies, claims that the resulting regulatory uncertainty for SOEs has not had a cooling effect on FDI cannot be maintained. The price of oil is at a critically low level and FDI is required more than ever to ensure the continued development and economic contribution of the oil sands. There has only been one transaction requiring ministerial approval for acquisition of control by an SOE in the oil sands since the amendments and no guidance

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76 *Ibid* at 11.

77 *Ibid* at 10.

78 *Ibid* at 3, 10.

79 *Ibid.*

80 *Ibid* at 10.

81 *Ibid* at 2.

82 *Ibid.*

from government. Something must change in order to clarify the murkiness of the *ICA*.

Given the amount of uncertainty for foreign SOEs as a whole, investment by Chinese SOEs at virtually a standstill, and the current price of WTI oil floating at approximately $40/barrel[83], one has to ask where Canada stands today regarding investment by SOEs in the oil sands. Former Premier of Alberta, Jim Prentice said, "the policy announcement has been misunderstood, and in some quarters misinterpreted. I think we need to be exceedingly clear that we are open for foreign investment."[84]

V. CHANGING THE RULES

To signal clearly to foreign SOEs that the oil sands are open for their investment, I propose the rules must change. Australia's parallel regulatory framework for foreign investment is much better at balancing national interests and the need for foreign investment. Indeed, as previously stated, Australia has been the primary recipient for Chinese FDI, at least in part because of this investor-friendly scheme. Similar to Canada, Australia is a Commonwealth resource exporter. I therefore contend that Canada should use the Australian framework as a model in developing legislation that is more effective in promoting FDI, particularly from SOEs.

A. Australia's Regulatory Framework

The *Foreign Acquisitions and Takeovers Act 1975*[85] (*FATA*) and Australia's Foreign Investment Policy[86] (the Australian Policy) regulate foreign investment in Australia.[87] The *FATA* provides the legislative framework,

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83 *Supra* note 69.

84 Gault, "Tone must change for Canada", *supra* note 9.

85 *Foreign Acquisitions and Takeovers Act 1975* (Cth), superseded, including amendments up to Act No 180, 2012. [*FATA*].

86 Department of Treasury Foreign Investment Review Board, *Australia's Foreign Investment Policy* (2013) Foreign Investment Review Board [Australian Policy].

87 The analysis in this paper is based on the *FATA* as in force from December 11, 2012 to November 30, 2015. Amendments effective December 1, 2015 to the *FATA*, and pursuant to the *FATA*, the Australian Policy, resulted in two changes that apply to the scope of this paper: (1) a $25,000 application fee for potential investors; and (2) an increase in the threshold for an interest in a company deemed "substantial" from 15% to 20%. These amendments however, do not bear weight on the analysis or

while the Australian Policy imposes obligations further to those under the *FATA*, particularly for foreign investors.[88] The Federal Treasurer (the Treasurer), with the assistance of the Federal Investment Review Board, is responsible for administering the *FATA* in accordance with the Australian Policy.[89] This regulatory framework empowers the Treasurer to block investment proposals that are contrary to Australia's "national interest".[90] In assessing whether the "national interest" test is met by a proposed transaction, the Treasurer may impose conditions that he views as necessary to ensure the test is met.[91] However, the "national interest" test is a negative test and the onus is on the Treasurer to prove to the applying foreign investor that the transaction is not in Australia's "national interest".[92] Decisions made by the Treasurer are final, as the *Administrative Decisions (Judicial Review) Act 1977* exempts decisions made under the *FATA* from judicial review.[93]

The *FATA* sets out the requirement to give notification to the government by application for approval prior to making a direct investment above a threshold value.[94] The threshold value for 2016 is AU$252

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recommendations of this paper. First, a $25,000 application fee is not material in the context of transactions that have historically ranged in value from hundreds of millions to even billions of dollars. Second, the increase in the substantial interest threshold operates to make the regime less restrictive. The fact that Australia received more Chinese investment than the US or Canada during a period when its regime was more restrictive than its current form further suggests there are lessons to be learned from Australia's regulatory regime for foreign investment. The *FATA* was amended again, effective April 15, 2016. These most recent amendments are not relevant to the scope of this paper.

88 The scope of review of the Australian regulatory framework is limited to the extent that it could apply to the oil and gas industry and is relevant to the scope of this paper. The *FATA* and the Australian Policy also apply to interests in rural/agricultural land and real estate. See *FATA*, *supra* note 85, s 12A; *supra* note 86 at 4.

89 Australian Policy, *supra* note 86 at 1, 2.

90 *Ibid* at 2.

91 *FATA*, *supra* note 85, s 25(1A).

92 *Ibid*, ss 18(6), 19(6); Vivienne Bath, "*Foreign Investment, the National Interest and National Security – Foreign Direct Investment in Australia and China*" (2012) 34:1 Sydney L Rev 5 at 17.

93 *Administrative Decisions (Judicial Review) Act 1977* (Cth) schedule 1(h).

94 *FATA*, *supra* note 85, ss 26, 26(A).

million.[95] The Australian Policy however, imposes further requirements on SOEs and on investments in prescribed sensitive sectors. The Australian Policy states:

> All foreign government investors must notify the Government and get prior approval before making a direct investment in Australia, regardless of the value of the investment.
>
> Foreign government investors also must notify the Government and get prior government approval to start a new business or to acquire an interest in land, including any prospecting, exploration, mining or production tenement.[96]

Applications under the policy are reviewed on a case-by-case basis against the national interest.[97] Under the Australian Policy, when a foreign government entity—or its agencies—has a 15 percent[98] interest or more in an entity; several foreign governments and their agencies have a direct or indirect aggregate interest of 40 percent or more in an entity; or when an entity is otherwise controlled by foreign governments or its agencies, or could be controlled by them as part of a controlling group, the Federal Investment Review Board will consider the entity to be a foreign government investor.[99]

Any investment of an interest of 10 percent or more in an entity is considered to be a direct investment.[100] An interest below 10 percent may be considered a direct investment if the investor is building a strategic stake in the target or can use the investment to influence or control the target.[101] Furthermore, if an investment includes preferential, special or veto voting

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95 Foreign Investment Review Board, "Monetary Thresholds", online: < https://firb.gov.au/exemption-thresholds/monetary-thresholds/>.

Consistent with Australia's free trade agreements, a higher threshold of AU$1,094 million applies for prescribed investors (Chilean, Japanese, Korean, Chinese, New Zealand and American investors), except in certain prescribed industries or investments by entities controlled by the government of any of the aforementioned countries, to which the AU$252 million threshold applies: Australian Policy, *supra* note 86, at 3; *FATA*, *supra* note 85, ss 17F, 17G.

96 Australian Policy, *supra* note 86, at 2.

97 Australian Policy, *supra* note 86 at 1.

98 See above, note 87. The threshold was increased to 20% in December, 2015.

99 Australian Policy, *supra note 86*at 17.

100 *Ibid* at 16.

101 *Ibid*.

rights; director or asset manager appointment rights; contractual agreements including but not limited to agreements for loans, provision of services and off take agreements, or involves building or maintaining a strategic or long-term relationship with a target entity, the investment will be considered a direct investment.[102]

With foreign investment, the Australian Government assesses the national interest by looking at a range of factors including national security, competition, other Australian Government Policies such as taxation and the environment, the impact on the economy and the community, and the character of the investor.[103] When considering an application from a foreign government investor, the Australian Government also considers if the investment is commercial in nature or if broader political or strategic objectives are involved.[104] This includes an assessment of whether the government investor's governance arrangements could facilitate actual or potential government control, including through funding arrangements. The Australian Policy also explicitly sets out mitigating factors that assist in a determination that proposed investments from foreign government investors are not contrary to the national interest. These include external partners or shareholders in the investment; the level of non-associated ownership interests; governance arrangements; ongoing arrangements to protect Australian interest from non-commercial dealings; and whether the target will remain publicly listed on a securities exchange.[105]

For private FDI exceeding the notification threshold, the Treasurer has 30 days to consider the application and make a decision once an application has been lodged.[106] The Treasurer however may publish an interim order to extend this period by up to a further 90 days.[107] Once the Treasurer has made a decision, he has ten days to notify the applicant.[108] The Treasurer's decision will: raise no objections and approve the transaction; impose mandatory conditions; or block the transaction.[109] For applications under

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[102] *Ibid* at 16–17.

[103] *Ibid* at 7–8.

[104] *Ibid* at 9.

[105] *Ibid* at 10.

[106] *FATA* , *supra* note 85, s 25(2); Australian Policy, *supra* note 86, at 5.

[107] *FATA*, *supra* note 85, s 22; Australian Policy, *supra* note 86, at 5.

[108] *FATA*, *supra* note 85, ss 24, 25(2); Australian Policy, *supra* note 86, at 6.

[109] *FATA*, *supra* note 85, s 25; Australian Policy, *supra* note 86, at 5.

the Australian Policy, there is no time limit for applications but the Government aims to remain within the 30 day time limit as for transactions under the *FATA*.[110] Finally, any order made by the Treasurer must be published in Australia's *Gazette*.[111]

B. Comparing the Regulatory Frameworks

1. SOEs and Foreign Government Investors

Although the *ICA* and Revised Guidelines use the term "SOE", while the *FATA* and the Australian Policy use "foreign government investor", both terms are intended to capture investors under foreign government control. The key difference between the two terms, as defined by Canada and Australia, is that Canada makes use of broad, vague language, while Australia uses a percentage threshold of interests as discussed above. While the definition of foreign government investor does include "entities that are otherwise controlled by foreign governments, their agencies or related entities, and any associates, or could be controlled by them including as part of a controlling group"[112], giving the Treasurer some discretion, the percentage thresholds provide some clarity and guidance as to what will be classified as an SOE. Canada on the contrary, uses the broad wording, "controlled or influenced, directly or indirectly"[113] without providing any interpretive guidance, resulting in a lack of clarity and significant uncertainty for foreign investors – particularly in China where state influence is pervasive.

2. Thresholds for Review and Acquisition of Control

Under the Australian Policy, all SOE investment, regardless of the value, requires prior approval.[114] Canada has set a review threshold at $375 million in asset value, a value far below any recent SOE investments in the oil sands.[115] The *ICA* also has the "less than a majority but one-third or

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110 Australian Policy, *supra* note 86 at 5.

111 *FATA*, *supra* note 85, s 24.

112 Australian Policy, *supra* note 86 at 15.

113 *ICA*, *supra* note 5, s 3.

114 Australian Policy, *supra* note 86 at 2.

115 Industry Canada, "Thresholds for Review", *supra* note 50.

more"[116] presumption regarding voting shares that is rebuttable by the investor. The Minister's power to make control in fact determinations of potential investors and transactions however, is likely the greatest cause of uncertainty as to whether an investment will be subject to review. The *FATA* essentially provides absolute certainty in terms of reviewability of potential investments as all SOE investments are subject to review.

3. Net Benefit and National Interest

Both countries have their respective subjective tests which remain undefined. Both Canada and Australia provide factors that are considered for FDI, with additional factors to be considered when the investor is an SOE. The critical difference between the legislation and policy of the two countries is who bears the onus of meeting the test. In Australia, the onus is on the government to prove the proposed investment is not in the national interest, whereas in Canada, the onus is on the investor to satisfy the Minister that the investment is likely to be of net benefit to Canada. Further confusion is added to the Canadian regime in the government's specific treatment of the oil sands, which requires exceptional circumstances for the Minister to be satisfied as to the net benefit test. Finally, the Treasurer is required to publish orders made under the *FATA* in the *Gazette*. This public disclosure can provide guidance to potential investors as to any commitments required to be made and also to the weight given to the various factors considered under the national interest test.

C. Recommendations

Both Canada and Australia have complex regulatory regimes in order to control FDI by SOEs. Generally speaking, Australia's *FATA* is a more complex and convoluted piece of legislation than the *ICA*. While both countries' regulatory framework allow for political discretion in the review process, the *FATA* provides for a lesser amount of discretion than the *ICA*, thereby creating greater clarity and certainty for SOEs. Confusion as to Canada's regulatory regime is based primarily upon two things: what will trigger a review and what is required for approval once review is triggered? Based on my comparison of the two regulatory regimes, I recommend the following changes to encourage the flow of foreign capital from SOEs.

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[116] *ICA*, *supra* note 5, s 28(3).

1. Equal Review Thresholds

"Net benefit" review can be triggered by a transaction exceeding a certain monetary threshold. The prejudicial treatment of SOEs through a lower review threshold should be eliminated in the *ICA* and Revised Guidelines. Reason suggests that SOEs will act according to commercial principles, rather than basing operating decisions on political strategy. Moreover, investments in the oil sands require massive amounts of capital and are inherently long term in nature. Therefore, decisions based on anything other than market principles raise reputational risks with industry and government and threaten the long-term viability of investments. This logical assumption is supported by evidence suggesting SOEs have improved their efficiency and are generating positive returns on their investment.[117] By setting the threshold for SOEs equal to that for private FDI, uncertainty resulting from the vague language in the definition of SOE in the *ICA* is no longer relevant as the threshold for review is certain regardless of the nature of the investor.

2. Removal of Control In Fact Power

"Net benefit" review can also be triggered by an acquisition of control by a foreign investor. Both Australia and Canada primarily make use of percentage thresholds of voting power held by an entity, though the *ICA* gives the Minister broad discretion to make control in fact determinations. This creates significant uncertainty as to whether a transaction resulting in an acquisition of voting interests, otherwise below any percentage thresholds, will trigger review. I therefore recommend that the *ICA* be amended to remove this broad discretionary power and limit acquisition of control determinations to percentage thresholds as in the Australian legislation.

3. Publish Decisions and Orders and Clarify "Exceptional Circumstances"

Particularly problematic is the unique treatment of the oil sands in the Revised Guidelines which allows for SOE investment "on an exceptional basis only".[118] The *FATA* has identified "prescribed sensitive sector[s]"[119] to

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117 Dobson, *supra* note 12 at 6.

118 Industry Canada, "Investments by Foreign SOEs, *supra* note 2.

119 *FATA*, *supra* note 85, s 17H.

which lower thresholds apply for private FDI (SOE investment always requires notification), but has otherwise not imposed additional obligations in respect to particular industries for investors to meet the "national interest" test. I recommend that the government ought to issue guidance as to what constitutes "an exceptional basis" and that decisions and orders ought to be published to the extent confidentiality between the transacting parties is not breached so as to provide context to "exceptional basis" and provide an indication of how factors are weighed in the "net benefit" test.

4. Other Recommendations – Reverse Onus and Encouraging Investment

Finally, I recommend the onus of meeting the "net benefit" test be reversed and placed on the Government of Canada. Under the Australian regime, the onus is on the government to show that a proposed investment is contrary to the "national interest" of Australia.[120] The Canadian regulatory regime should be similar, placing the onus of the Government of Canada to show that a proposed transaction does not meet the "net benefit" requirement. This would reduce the amount of work and capital required of a potential investor prior to submitting an investment proposal for review to the Minister.

As former Premier Jim Prentice suggests, Canada's tone toward foreign investment must change.[121] Though the *ICA* is the statutory vehicle for review of FDI, part of its purpose is to encourage investment.[122] Read as a whole in conjunction with the Revised Guidelines, and considering the effects since the amendments, it appears the *ICA* is doing the opposite. The factors considered in making a decision as to "net benefit" under the *ICA* and the Revised Guidelines appear to be primarily concerned with investor behaviour following an acquisition of control. I recommend these factors be considered with less scepticism and scrutiny so as to facilitate SOE investment. The concerns outlined in the factors are better dealt with through orders requiring commitments prior to approval (such as the acquired entity being listed on the TSX as in the Nexen-CNOOC

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[120] Australian Policy, *supra* note 86.

[121] Gault, "Tone must change for Canada", *supra* note 9.

[122] *ICA*, *supra* note 5, s 2.

transaction[123]) and through other legal instruments (requirements under the *Securities Act*[124] and *Competition Act*[125] for example).

VI. CONCLUSION

The Alberta oil sands are a critical resource for Canada's future. While the extent to which SOE investment is allowed is ultimately a matter of policy, Canada's capital markets are relatively small and foreign capital is crucial to developing the oil sands. With approximately $3 trillion in sovereign wealth, China represents a significant source of capital. Recent amendments to the *ICA* and Revised Guidelines have significantly decreased the flow of SOE investment in the oil sands. Perhaps $40/barrel oil constitutes the "exceptional basis" under which SOE investment will be allowed in the oil sands but this remains to be proven with FDI at an almost standstill. To ensure that foreign capital once again flows to the oil sands, the rules under the *ICA* and Revised Guidelines must change. As the number one destination for Chinese FDI, Australia's legislation and policy provides a useful model as to how the *ICA* and Revised Guidelines ought to be changed.

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123 The Canadian Press, "CNOOC to begin trading in Toronto as part of Nexen takeover", *The Globe and Mail* (18 September 2013), online: <www.theglobeandmail.com/report-on-business/>.

124 *Securities Act*, RSO 1990, c S 5.

125 *Competition Act*, RSC 1985, c C-34.