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U.S. Investment in Canada: The Foreign Investment Review Act (FIRA) and Provincial Incentives

*by Arthur R.A. Scace**

These are two topics to which other seminars may often devote entire days, so the best I can do is to give you a very quick gloss. Personally, I am not upset about this because, as Alan said, I am a one hundred percent tax lawyer and what appears in my notes is really the sum of my knowledge of this particular topic.

I feel today much as I did about 20 years ago at Oxford when I had to take an oral exam. At that time, everybody studying law at Oxford had to take Roman law. One had to be able to reproduce or translate multitudinous pages of Latin on the exam. I spent months memorizing this garbage, but unfortunately I did not have time to really understand what it meant. When the time came for the oral exam, I told the professor that I had memorized and translated the Latin perfectly, but I did not know what it meant. He replied, "Come now, Mr. Scace, you are being unduly modest." He asked me about three questions, and then he said, "Mr. Scace, you weren't being unduly modest."

By way of introduction, it is important to note that Canadian industry is substantially foreign-owned. Concern with this foreign domination is not new. It started during the Confederation and railroad-building years. But due to the scandals and corruption that came to pass, people lost sight of foreign domination.

After World War II, the concern arose again, became especially acute in the 1960's and early 1970's, and resulted in the promulgation in 1974 of the Foreign Investment Review Act (FIRA). Basically, the Act enunciates certain procedures for the review of direct foreign investment in Canada. It identifies two types of direct foreign investment subject to review. The first type concerns the acquisition of control of a Canadian business, by a non-eligible person. Such control may be acquired either by means of an acquisition of shares of a corporation or by means of acquiring all or substantially all of the assets of a business. The second type relates to the establishment of a new business in Canada by a non-eligible person who has no related existing business in Canada.

The statute contains a number of definitions, some of the more important of which I shall briefly review. "Non-eligible person" includes individuals who are not citizens or permanent residents of Canada, govern-

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ments of foreign nations or subdivisions thereof, and corporations controlled directly or indirectly by any of the aforementioned non-eligible persons. In addition, there are various presumptions of non-eligibility raised by the statute. For example, if any single non-eligible person owns five percent or more of the voting shares of a corporation, there arises a rebuttable presumption that the corporation is non-eligible. The acquisition of a significant number of shares in a corporation is presumed, subject to rebuttal, to constitute an acquisition of control of that corporation.

The second type of direct foreign investment which may be subject to review under the Act is the establishment of a new business by a non-eligible person. If a non-eligible person has not carried on any business in Canada prior to the time of his proposal to establish the new business, that new business is clearly reviewable. However, if the non-eligible person is already carrying on a business in Canada, the proposal to add the additional activity may or may not be reviewable. If the additional activity is merely an expansion of an existing business, then it is not reviewable. If the additional activity amounts to more than expansion and, in fact, amounts to the establishment of a new business, it will be reviewable.

Some controversy has developed as to what constitutes a "related business." That term is not defined in the Act. However, guidelines have been issued which are intended to provide some direction as to how the Foreign Investment Review Agency (hereinafter the Agency) is to apply the law. These guidelines are general and non-binding in the sense that the Agency may exercise some discretion in applying them.

In general, a business will be considered related if there is a backward vertical integration for a service-producing business or a vertical integration for a manufacturing operation where there is direct suitability of the product. If the companies have similar technology and production, and, most importantly, have established a number of categories appearing in the index, then they will be deemed related.

That is the background. After the determination of the existence of a reviewable transaction, one then comes to the review criteria. This area is more important, I think, because of certain developments within the last few weeks.

Among the Agency's general criteria is that the takeover of the new business must be of significant benefit to Canada. There are six specific criteria for assessing that benefit: the effect of the acquisition; the nature and level of the economic activity in Canada; significant Canadian participation in the business; the effect of the acquisition on industrial efficiency, productivity, and so forth; the effect on competition in Canada; and, finally, compatibility with the enunciated policy objectives of all levels of government. In addition, the Agency has established a number of guidelines. Although these guidelines are not binding, the non-eligible person must prove to the Agency that the takeover or the establishment of the new business is beneficial to somebody by reason of, for instance,

increased employment or increased capital expenditure.

To be considered in conjunction with these statutory guidelines is a concept called "principles of international business conduct," first articulated in July, 1975, by Mr. Gillespie, the then Minister of Trade and Commerce.

According to these principles, what the Canadian Government looks for in a foreign-controlled enterprise is a certain degree of autonomy in the decision-making, retention of capital investment, and participation of Canadians in the top management.

There have been several very important recent developments in the area of direct foreign investment review. First, Mr. Herb Gray, one of the chief proponents of the FIRA legislation in the early 1970's, has been appointed to the Cabinet. Concerned, as he was, during the latter part of the 1970's that the FIRA had not been as effective as it should have been, Mr. Gray will certainly be instrumental in the continued development of the Act.

Second, the Liberal government recently issued its "throne speech," which outlined government policy and strategy for the next year. Two changes to the FIRA legislation were proposed. One proposal pertains to periodic performance reviews of large foreign firms. We do not know what a large foreign firm is, but I suspect Exxon, Imperial Oil, Gulf, and many other companies would qualify. Further, "periodic" has not been defined. In any case, this proposal represents a major policy departure.

Until this point, the review procedure operated only when there was a takeover or when a new business was established. Under the new proposals Exxon, for example, might not have acquired any business in Canada during the last 20 years, but would nevertheless be subject to review. Apparently the principles of business conduct referred to above will be considered in making that review. There is not yet any indication, however, as to what sanctions, if any, might be taken against those large foreign firms which do not measure up to the Agency's standards.

The second proposal contemplates the introduction of new FIRA provisions to ensure that, at the completion of the review procedure, major acquisition proposals by foreign companies will be publicized prior to any government decision. The Canadian Government intends thereby to assist Canadians in repatriating assets and participating in takeover bids. In addition, the Government will provide assistance in the form of guarantees, equity investments, loans, and so forth. These proposals raise considerable potential for a conflict of interest since the Agency allegedly reviewing the proposal to acquire a Canadian company will at the same time say to its own nationals, "if you want to make a competing bid, we will assist you." How can one hope to achieve impartiality in such a situation? In any event, that is what appears to lie in the future, and it would seem to represent a very significant departure.

In conclusion, just a few brief words on the review procedure. If a transaction is reviewable, reams of information and forms must be filed

with the Agency. The Agency reviews this material and submits a recommendation to the Cabinet which ultimately approves or disapproves the proposal.

During the review process the Agency will often require that the non-eligible person undertake to achieve a certain level of employment, capital investment, and so forth. These undertakings are binding and enforceable obligations of the non-eligible person.

Finally, the enforcement provisions contained in the Act have a significant deterrent effect. There are both broad powers to investigate non-eligible persons who fail to comply with the Act's provisions and procedures whereby an injunction can be obtained.

Now, having said all that, the review procedure is not all that bad and the statistics are interesting. From January 1, 1975 to February 29, 1980, there were 2,394 applications, of which 2,238 were successful. These figures are a bit misleading, however, since many applications are withdrawn when rejection becomes a foregone conclusion and are, thus, not reflected in the statistics.

In any event, foreign direct investment in Canada is still growing. The most recent figures indicate that in 1979 it is booming. I think it is fair to say that U.S. affiliates in Canada are going to spend more in Canada than in any other jurisdiction, and that investment far exceeds that of any other country.

Finally, there is the matter of provincial incentives. There are 10 provinces in Canada, and all offer such incentives. Keep in mind that there is a substantial amount of money available, both at provincial and federal levels. Ontario is a case in point. In early 1979, the Government of Ontario established the Ontario Employment Development Fund, which is a \$200 million temporary program to stimulate jobs and business investment in the Province. It is nominally run by five Cabinet ministers, whose purpose is to improve economic conditions in Ontario. Various guidelines have been established to give effect to that goal.

There is a large pool of capital available for all firms, domestic and foreign, competing for Canadian business. The Ford situation is illustrative. Ford was considering two locations, Lima, Ohio and Windsor, Ontario, for a new plant. The Ontario Government and the Federal Government, after weighing the tax revenue and employment benefits, offered Ford a grant of \$68 million, out of the \$550 million necessary for the project. Ford located the new plant in Windsor. This resulted in slightly strained Canada-U.S. relations for some time. It may be poetic justice, but as part of Ford's cutback on its North American automobile production, 50,000 workers are being laid off, including 1,500 from the Ford plant in Oakville and 1,000 from Windsor. Ford has closed down its Windsor casting plant, transferring those jobs to Michigan and Ohio. Having just acquired approximately 2,000 jobs, Canada stands to lose about that many jobs, as well as its \$68 million investment.

In the future, I think government money will still be readily availa-

ble, but I hope that the provincial and Federal governments will be a little more aggressive and impose some conditions on plant closures, as well as plant openings. All levels of government are prepared to do this. Mr. Clark, while he was Prime Minister, was prepared to offer Ford \$30 or \$40 million to locate a new plant in Quebec. Negotiations are pending between Chrysler and the Governments of Ontario and Canada concerning subsidies for Chrysler's Windsor operations.

As far as foreign direct investment in Canada is concerned, I think it is clear that responsible foreign investment is very welcome.