Intelligence MEMOS

From: John Knubley and Lawson Hunter

To: Navdeep Bains, Minister of Innovation, Science and Industry

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Re: **Three Principles for Tougher Foreign Takeover Reviews**

A parliamentary committee is examining recent changes to the administration of the Investment Canada Act, the federal regime for reviewing foreign acquisitions of Canadian businesses.

The pandemic-inspired changes include "enhanced scrutiny" of foreign takeovers of Canadian firms that are "distressed," according to an April ministerial statement from Navdeep Bains, Minister of Innovation, Science and Industry.

And, he said, the national security review provisions of the act may be used at the government's discretion. As well, Ottawa would be especially diligent regarding takeovers in the "health sector and other critical sectors," and all transactions by state-owned enterprises – of whatever value – would receive special attention.

Although the changes are well intended, some elements need further consideration.

Our main concern is that economic factors will be given short shrift in the more opaque national security review process at a time when efficiency and timeliness will be crucially important.

The April statement set a $1 billion threshold for net benefit reviews, which are broad-based and largely economic in nature. And, it said, the government may also conduct national security reviews, which typically take longer and apply to any size of transaction.

Most G7 countries and Australia subject foreign direct investment to an economic review. The United States is the only major country that relies primarily on national security reviews, although they are led by the economy-focused Treasury Department.

It goes without saying that our economy – and businesses – will continue to need infusions of foreign capital, as well as a lot of Canadian investment, too. The challenge for the government in conducting more stringent reviews will be in finding the right balance. Stopping foreign investment or imposing a moratorium would make little sense when so many firms may be distressed. Sometimes it will be best to keep firms Canadian. But to save jobs and companies we will, as in the past, need foreign investment.

Subject to reasonable conditions to protect and favour Canada, many foreign takeovers should be approved.

That includes takeovers from China. Some commentators would ban deals with Chinese entities but it is magical thinking to believe we can ignore what by some measures is already the world's largest economy.

Canada is not the only country increasing its scrutiny of foreign investment because of the pandemic. Australia, Germany, France and Italy have all made similar announcements. Most other countries have significantly lowered the review threshold and specified which sectors are of most concern. Germany has also created a fund to help its firms fight opportunistic takeovers.

We believe enhanced reviews will work better for Canada if three goals are met:

First, speedy decisions on acquisitions of distressed assets. Most enhanced scrutiny reviews will use a national security test that is opaque and can take 200 days or longer. And if these really are distressed assets, and if there are lots of them, we will need more timely decisions to save firms and the jobs associated with them.

Second, transparency around the definition of "critical sector" and about issues raised in the review process. Australia openly declared all sectors critical, while France listed such areas as food safety, defence, energy, AI, quantum computing and cyber security, among others. In Canada, we have left "critical sectors" undefined beyond health.

Third, keeping economic security at the forefront. The legal basis for enhanced reviews will fall almost exclusively under the national security provisions of the act, not the economic-based "net benefit" rules. Are takeovers of distressed firms national security or economic issues? We think economic security is mainly at play, even when Chinese firms target technology businesses or specific elements of the energy sector.

National security reviews are led by the deputy minister of public security. But in the case of distressed firms, a better approach would be to have the deputy minister of finance or innovation chair, or at least co-chair, the review. In most other countries, including the US and Germany, economic agencies lead the foreign investment review process with input from other relevant government departments.

It is important we get this right. We want the economy and our firms to thrive. Enhanced reviews of foreign takeovers will need speed and agility. The reviews will also need transparency so foreign investors can have a clearer sense of areas of concern to the government and then better understand where they can invest. The reviews will also need to be driven more by economics and less by national security. This is especially true if we are to get the balance right in the recovery from the pandemic.

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