Experience with the review function of Investment Canada

EXPERIENCE WITH THE REVIEW FUNCTION

OF INVESTMENT CANADA

April 1991
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Introduction

The Investment Canada Act was proclaimed on June 30, 1985. The Act and the new agency it created constitutes a dramatic change from the previous treatment of foreign investment.

Under its predecessor the Foreign Investment Review Act (FIRA), 435 investments representing some 6% of the 7242 investment proposals received over the period 1974 to 1985 were refused. Further, over the period FIRA was in force, 643 investment proposals, representing 9% of the total investor submissions, were withdrawn.[1] This record, together with the introduction of the National Energy Policy (NEP) in 1980, had convinced many in the international and Canadian investment communities, including the governments of our major trading and investing partners, that foreign investment was unwelcome in Canada. Indeed, based on interviews with senior executives of international corporations, the Conference Board concluded in a major study in 1984-85 that "it is reasonable to infer that FIRA has deterred foreign investment from entering Canada".

Foreign investment policy following the election of the Progressive Conservative Administration in 1984 represented a more balanced approach between the benefits of foreign investment and the need for a mechanism to protect Canada's interests. The severity of the 1981-82 recession underscored the importance of economic growth and competitiveness. In addition, statistics indicated that there had been a steep decline in the relative degree of foreign participation in the Canadian economy (from a peak level of foreign control of 37 per cent in 1971 to 24 per cent in 1984). The government concluded that an "open for business" policy toward foreign investment was timely. Indeed, a much more outward orientation was seen by the government as key to adjusting to global forces. A New Direction For Canada: An Agenda for Economic Renewal, released by the government in November, 1984, stressed greater reliance on market forces and deregulation so as to avoid unnecessary constraints on private initiative. The Investment Canada Act was the first major legislation passed by the Conservative Government.

1. It should be noted firstly, that at least 1/3 of refused investments were approved following a second review and that in the case of withdrawals (by some estimates as many as 50%) were for commercial reasons, unrelated to the screening process.

Mandate of Investment Canada

Investment Canada's mandate has three dimensions:

i) to promote investment in Canada by Canadians and non-Canadians;

ii) to undertake research and provide policy advice on matters relating to investment;

iii) to review major foreign investments to determine if they are likely to be of net benefit for Canada.

"Recognizing that increased capital and technology would benefit Canada, the purpose of this Act is to encourage investment in Canada by Canadians and non-Canadians that contributes to economic growth and employment opportunities and to provide for the review of significant investments in Canada by non-Canadians in order to ensure such benefits to Canada." (Investment Canada Act, 1985)

The budget and person year allocation of Investment Canada reflects the above order of priority: of total non-administrative resources of the Agency, investment promotion accounts for over 50 per cent of the person years and 65 per cent of non-salary expenditures; research and policy functions account for 23 per cent of the person years and approximately 25 per cent of non-salary expenditures; the review function accounts for 24 per cent of the person years but less than 10 per cent of non-salary expenditures.[2]

While investment promotion dominates the activities of the Agency, there can be little doubt that the review function is the raison d'etre for maintenance of an agency independent of other departments. It is also apparent that the review function receives most publicity and scrutiny. For these reasons, and the fact that the promotion activities are discussed in a separate annex (Annex III), what follows is limited to an appraisal of the foreign investment screening process.

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[2]. It should be noted that the Office of the Corporate Secretary of Investment Canada examines and certifies all notifications and applications submitted by investors and performs other functions primarily related to the review mandate of the Agency. As such, it could be argued that the resources of the Corporate Secretary should be involved in any measure of review activities. This would augment the person year allocation related to review to 34 per cent and non-salary expenditures to 15 per cent.

Regulatory Provisions of the Investment Canada Act

The review provisions of the Investment Canada Act apply virtually only to foreign acquisitions of Canadian businesses; notification provisions apply to new business proposals and takeovers below the review thresholds.

The Act does not apply to business expansions of existing foreign controlled businesses in Canada or to investments by foreigners in Canadian businesses that do not result in a change in control. It is noteworthy that there were over 450,000 corporations in Canada in 1987, slightly more than 5,000 of which were foreign owned. It is also noteworthy that 68 per cent of the growth in the stock of foreign direct investment in Canada between 1980 and 1988 was accounted for by reinvested earnings. Most foreign investment in Canada, in short, is not subject to review. The intent of the legislation, rather, is to review only takeovers of significant Canadian businesses to ensure that they are of benefit to Canada.

The general provisions of the Act which determine reviewability of an investment are as follows:

- direct takeovers of Canadian businesses with assets of $5 million or more;
- indirect takeovers of Canadian businesses with assets of $50 million or more;
- indirect takeovers of Canadian businesses with assets of $5 million or more when the value of the Canadian business represents more than 50% of the value of the total international transaction;
- **exceptions** - small direct and indirect acquisitions (i.e. less than $5 million in asset size) and new business proposals in the cultural industries may be subjected to review 'in the public interest'.[3]

The review requirements have been further liberalized under the Free Trade Agreement between Canada and the United States, where special rules govern investments in Canada by U.S. investors and by third country investors who acquire control of a Canadian business controlled by U.S. interests. Under the FTA, which took effect on January 1, 1989, the asset thresholds for review of direct acquisitions increase in 4 annual increments: to $25 million; $50 million; $100 million; and to $150 million where the

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[3]. Foreign investments in the cultural industries (i.e., the publication, distribution or sale of books, magazines, periodicals, newspapers, film or video products, audio or video music recordings, or music in print or machine readable form) are reviewed only if the Minister considers the public interest to warrant review and if the Governor in Council issues an order to that effect within 21 days of the date when a completed notice was filed. If the order is not made, the investment is deemed not to be reviewable.

threshold is capped in 1992 constant dollars. Similarly, the thresholds for the review of indirect acquisitions increase in 4 annual increments: to $100 million; $250 million; $500 million; in the fourth year the reviews of indirect acquisitions are terminated, unless the assets of the Canadian business represent more than 50 per cent of the value of the total assets acquired in the international transaction. In the latter case, the transaction is reviewable at the same threshold that applies to direct acquisitions.

It should be noted, too, that acquisitions of control of Canadian businesses in the following sectors are not eligible for treatment under the FTA higher thresholds: upstream oil and gas businesses; uranium; financial services except insurance; businesses providing transportation services; and businesses in the cultural industries. Direct and indirect takeovers of these excluded businesses are triggered at the general $5 million and $50 million thresholds.

For the vast majority of small acquisitions and new business proposals by foreign investors which are not reviewable, the filing of a simple two page notification form constitutes full compliance under the Act. Moreover, notifications of investments may be filed up to 30 days following the implementation of the investment.

Experience With The Act

In the four and a half years to December 31, 1989, Investment Canada has processed 4370 notifications and reviewable investments, with an aggregate asset value of $82.6 billion. Of these, 3009 (69%) involved proposals to acquire Canadian businesses and 1361 (31%) were proposals to establish new businesses.

Acquisitions are recorded under the Act according to the corporation's most recently audited financial statements, rather than on the basis of the purchase price. In book value terms, takeovers have amounted to $75.8 billion in assets. New business proposals accounted for planned investment of $6.8 billion. The value of new business start-ups, however, are significantly understated because they were recorded on the basis of the planned amount of investment at the end of the first full year of operation. Beginning in 1989, investment in new businesses is recorded for two years.

As noted earlier, only acquisitions over a specified threshold size or involving sensitive sectors are subject to review. Since June 30, 1985, 789 acquisitions with an aggregate asset value of nearly $68 billion were reviewed and all were approved. Fifty-eight per cent by of the acquisitions (worth $39.3 billion) are attributable to investors from the United States. Investors from the European Community were responsible for an additional 193 takeovers ($16.1 billion) and 55 takeover proposals ($2.6 billion) were made by Japanese investors.

Fifty-three per cent of the reviewed acquisitions involved takeover targets in Ontario (415 acquisitions valued at $34.1 billion). British Columbia experienced 123 takeovers ($5.9 billion) and Quebec experienced 108 takeovers ($12.1 billion).[4] It can be seen from Chart 1 that Ontario and Quebec collectively account for 72% of investments by number and over 67% by asset value.

As shown in Chart 2, most reviewable takeovers occurred in the manufacturing sector - 377 proposals valued at $29.4 billion. The wholesale/retail trade sector attracted 106 proposals ($6 billion). The primary resources sector was the target for 88 acquisitions valued at $19.5 billion.

In terms of overall coverage of foreign investments (i.e. takeovers and new business proposals), the review process, while screening only 18% by number, captures 82% by asset value.

Table 1 sets out the annual number of proposals submitted to Investment Canada since 1985. As is shown in the table, the number of takeovers has increased each year, reflecting increased takeover activity generally throughout the industrialized world. The throughput of takeover proposals under the Investment Canada Act is approximately double the throughput under the FIRA legislation.

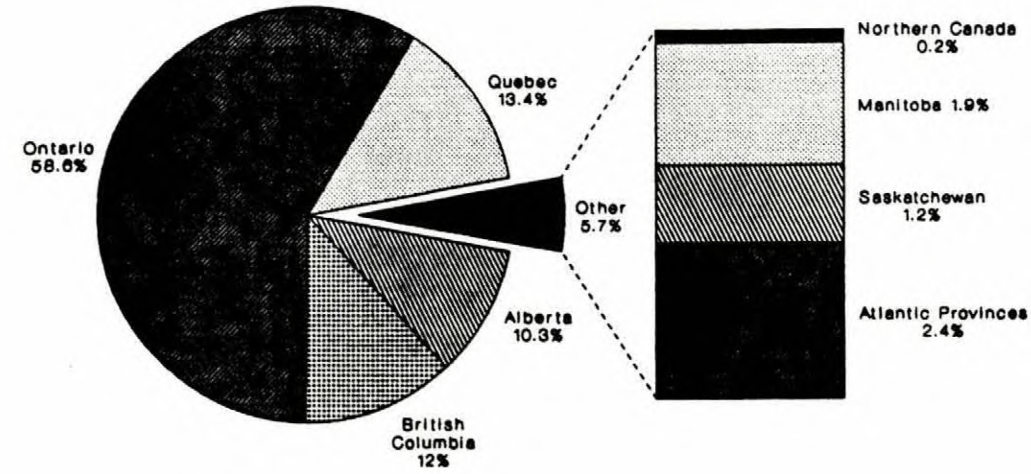
The table also shows a marked decline between 1985 and 1989 in the number of new business proposals. This is believed to be largely due to under-reporting (i.e., investors are not submitting the required notifications). There is no penalty for non-filing. Data on individual investor countries suggest that the U.S. is responsible for the largest decrease in filings of new business proposals. Whereas there were approximately 250 new business proposals by U.S. investors in FY 1985/86, in FY 1989/90 they are expected to number only 110-120. With the FTA, U.S. investors may feel less inclined to file their new business notifications.

4. The distribution of foreign investments that come under the purview of the Investment Canada Act are assigned to the province with the largest number of employees.

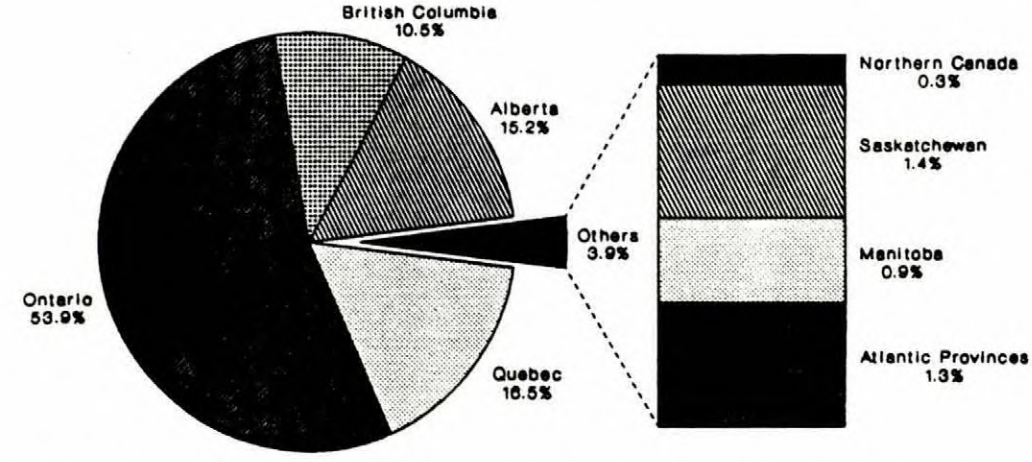
Chart 1
Provincial Distribution of Investments

5,266 INVESTMENTS BY DESTINATION *

JUNE 30, 1985 - DECEMBER 31, 1990



TOTAL VALUE: $98.7 billion



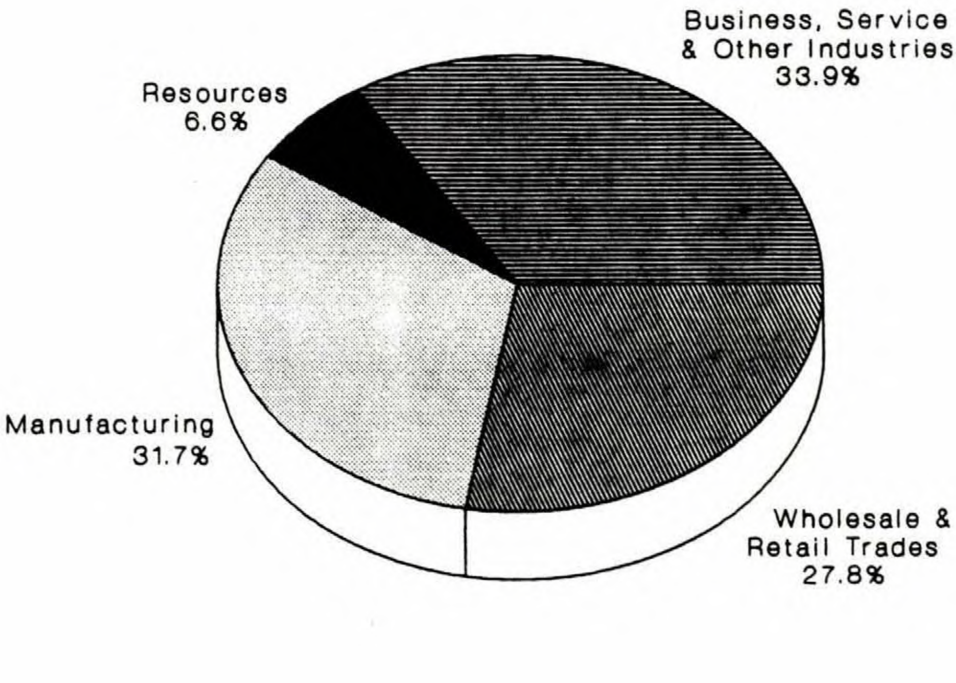
*For statistical purposes, investments are recorded to the province with the largest share of employees of the business concerned. In the case of acquisitions, the acquired business is frequently active in more than one province, thus the charts above do not fully reflect the provincial distribution of foreign acquisition activity.

Source: Investment Canada
(cumulative data 850630 - 901231)

Chart 2

Distribution of Investments by Sector
(June 30, 1985 to December 31, 1990)

5,266 Investments



Source: Investment Canada

Table 1

NUMBER OF INVESTMENTS UNDER INVESTMENT CANADA
JUNE 30, 1985 - DECEMBER 31, 1989
(by Fiscal Year)

YEAR		TAKEOVERS	NEW BUSINESSES	TOTAL	%*
1985/86	(9 months)	475	318	793	40
1986/87		642	313	955	33
1987/88		662	275	937	29
1988/89		668	276	944	29
1989/90	(9 months)	562	179	741	24
Total		**3009**	**1361**	**4370**	**31**

* NB/Total

The declining number of new business proposals being filed and, at the same time, the significantly increased filings of takeovers suggests a sharp decline in the ratio of new business proposals to total investments. Indeed, publicly-released Investment Canada data indicate the ratio has declined steadily since 1985 from 40 per cent to 24 per cent. Critics of the "open for business" policy cite this as evidence of "selling Canada out".

Correcting for this misinterpretation could be addressed by various options, including a penalty for non-compliance or simply dropping the notification requirement. Since a penalty would be at cross purposes with the welcome intended for foreign investors, and since the option of dropping the notification requirement would exacerbate difficulties in collecting data on foreign investment, administrative efforts to encourage greater compliance may be the more desirable option. For example, Investment Canada has drawn the problem of under-reporting to the attention of lawyers and request that they assist in ensuring that their clients comply with the Act.

Aside from the under-reporting problem, there have been no major difficulties respecting administration of the Investment Canada Act.

Relative to the FIRA process, the following improvements have occurred:

- overall the process is much more streamlined and the time frame for reaching a final decision on proposals has been considerably shortened;

- the rules for determining investor status and the presumed time of acquisition of control have been simplified;

- the review process is much more transparent, and the ambiguous 'significant benefit test' under FIRA has been replaced; under Investment Canada's net benefit test, investors need only demonstrate that, on balance, the investment is likely to have a positive impact;

- far fewer demands are made of foreign investors; in most cases the plans and intentions of foreign investors are sufficient to satisfy the net benefit test;

- raising the review thresholds in respect to indirect acquisitions and allowing their implementation prior to review has alleviated international sensitivities; also, under provisions of the FTA, virtually indirect acquisitions by U.S. investors or U.S. vendors will not be subject to review after January 1, 1992.

To be sure, a number of minor improvements could be made to clarify the wording of certain sections of the Act, including the anti-avoidance provision of subsection 39)1)(g). Such improvements, however, can be postponed until the Act is opened up for major amendment.

The Review Process

The primary responsibility for the evaluation of investors' proposals and for providing the Minister with advice as to the merits of individual proposals falls to the Investment Review Division of the Agency. The volume of reviewable investments has typically been well over 200 a year. With the implementation of the FTA provisions, the number of reviewable cases is expected to fall to between 180 to 190 in 1990/91 and to between 145 to 150 in 1991/92.[5]

The Division, headed up by a Vice President, has a total staff complement of 18 persons, including two directors: one responsible for investment proposals in the resources

[5]. As a result of the FTA thresholds, 68 investments with asset values totalling $977 million were exempt from review in 1989. Fifty of these takeovers involved formerly Canadian-controlled businesses.

and manufacturing sectors; the other for cases in the services sector, construction and investment proposals in the cultural industries. Each director has 4 review officers, who in turn, manage a portfolio of reviewable investment proposals. They also monitor at regular intervals the performance of past approved investments to ensure that investors carry out the plans and/or undertakings given in support of their proposals at the time of review.

Six review factors are applied by the Review Division:

- the effect of the investment on the level and nature of economic activity in Canada, including the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada and on exports from Canada;

- the degree and significance of participation by Canadians in business or related industry;

- the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;

- the effect of the investment on competition within any industry or industries in Canada;

- the compatibility of the investment with national industrial, economic and cultural policies, including those enunciated by the government or legislature of any province likely to be significantly affected by the investment;

- the contribution of the investment to Canada's ability to compete in world markets.

The investor's submission, complete with the business plans, is sent to the provinces which would be directly affected by the investment. Depending on the extent to which the business being acquired has operations in more than one location, one or perhaps as many as all ten provinces and both territories may be consulted. The case is also referred to those federal departments which have policy responsibilities for the industry sectors relevant to the investment proposal in question. The departments most frequently consulted are: Industry, Science and Technology (manufacturing and services sectors); Communications (cultural industries); and Energy, Mines and Resources (minerals, especially oil and gas). All investment proposals are referred to the Bureau of Competition Policy for its views on the likely effects of the investment proposal on the level of competition.

Depending on the nature and significance of the investment, one or more meetings may be required with the investor so that he/she may elaborate on the plans, or otherwise address elements of the proposal which touch on policy concerns. The review process may also involve a visit to the business being acquired and separate discussions with the vendor and/or knowledgable third-parties. All information submitted by investors in support of their proposals is held in confidence.

To ensure timely reviews, the Act places the onus on the Agency and the Minister to complete and decide the outcome of reviews within strict time limits. The Minister must notify the investor within 45 days after a complete application has been received that:

(a) he is satisfied that the investment is likely to be of net benefit to Canada; or

(b) he is unable to complete the review, in which case the Minister may unilaterally take a further 30 day extension to complete the assessment (unless he and the investor agree to a longer time period); or

(c) he is not satisfied that the investment is likely to be of net benefit to Canada, in which case, the investor has the right to make representations and to submit undertakings within 30 days (or, by mutual agreement, any further period).

Following the expiry of the 30-day period (or agreed extension), the investor must be notified that the Minister is either satisfied or unsatisfied that the investment is of net benefit to Canada. In the latter case, the investor may not proceed with the investment. If the investment has already been implemented, the investor must divest control of the Canadian business. Although there have been several instances in which investors were given notice that the Minister was not satisfied that their proposals were likely to be of net benefit, investors have, in the course of the extension period, successfully addressed the identified shortcomings. To date, no proposals have been refused.

As described more fully in Annex X, the Act provides the Federal Government with discretionary authority to review investments in sectors related to Canada's cultural heritage and national identity, irrespective of their small size. Since the Act came into force on June 30, 1985, a total of 115 foreign proposals in the cultural sector with an aggregate asset value of $664 million have been submitted. Of these, 77 with asset values of $212 million were notifiable only; the remaining 38 were reviewed (valued at $454 million). While total overall foreign activity in the cultural industries is relatively modest - the number of reviewable cases in the sector represent only 4% of the total and about half of one per cent by value - they tend to take an inordinate amount of time and effort to resolve, especially those involving book publishing and distribution.

The Oil and Gas Acquisitions Policy is also implemented through the review provisions of the Investment Canada Act. Since June 30, 1985, Investment Canada has reviewed some 50 acquisitions involving oil and gas related interests.

Provincial Consultations

There are no provisions in the Act requiring the Agency to consult with the provinces on reviewable investments. By virtue of subsection 20(e), however, the Act does require that the industrial, economic and cultural policy objectives of any province likely to be significantly affected by the investment be taken into account in the determination of 'net benefit'. By longstanding convention, any province in which the Canadian business being acquired has employees is consulted. As part of the consultative process, the relevant provinces receive a full copy of the investor's submission to the Agency, including subsequent major changes to the investor's plans, if any, coming out of the review process. The provinces, in turn, are asked to provide their views on the proposal so that they may be taken into account. The provinces' views are made known to the Minister responsible for Investment Canada.

Table 2 shows that concerning the 798 reviewed and approved investments to the end of January, 1990, 1451 consultations were held with those provinces affected by the investments. The table also shows that there were only 16 occasions - about 1% of total consultations to date - when provincial views were negative.

Table 2

Consultations With Provinces On Investment Proposals*

	Number of consultations	% distn.	Provincial views at odds with case decision
British Columbia	238	16	-
Alberta	201	14	-
Saskatchewan	88	6	-
Manitoba	107	7	9
Ontario	396	27	3
Quebec	227	16	1
New Brunswick	61	4	1
Nova Scotia	79	5	1
Prince Edward Island	11	<1	-
Newfoundland	2	2	-
Yukon	5	<1	1
Northwest Territories	6	<1	-
Totals	**1451**	**100**	**16**

* Based on 798 investments for period June 30, 1985 - January 31, 1990

The unusually high number of occasions (9) in which Manitoba responded negatively reflects, at least in part, the somewhat ambiguous wording of the viewpoints expressed (e.g., "we do not see that this investment would be of net benefit to Canada").

By and large, the consultation process with the provinces appears to work very well. All provinces and territories are anxious to attract foreign investment and, as a result, have been very cooperative in the review process, especially in respecting commercial and statutory deadlines.

From time to time, provinces lay down conditions for approval of reviewable investments. Typically, these have to do with: the maintenance of the employment level of the business being acquired; and, in certain cases, to maintain the headquarters of the Canadian business being acquired in the province.

In summary, the views of the provinces, especially those of the province primarily affected by a given investment proposal, are given considerable weight in the review process. Provinces do not, however, have a veto respecting the final disposition of reviewable investments.

Profile of Cases

A very large proportion of investment proposals can be classified as being of a 'routine' nature and with no policy consequences. Included in this category are most real estate transactions, most indirect acquisitions (21% of the acquisitions reviewed to date, valued at $19.8 billion), a number of acquisitions, technically direct but which are incidental to larger international transactions (16% of the acquisitions reviewed to date, valued at $4.4 billion) and the majority of the remaining direct acquisitions in non-sensitive sectors. For the most part, these investments have not required extensive negotiations to ensure net benefit to Canada. By and large, they have been approved on the basis of the investor's plans and intentions.

In the case of the sale of commercial real estate, for example, the investor's undertaking or plan to use a Canadian management company to operate the business will suffice in demonstrating net benefit to Canada. Even in the resources and manufacturing sectors, straightforward cases can often be processed via telephone or teleconferencing with applicants. It is also worthwhile noting that roughly half of these routine acquisitions involved the transfer of control from one foreign investor to another (i.e., these transactions have no effect on the overall levels of foreign ownership and control of the economy). The median time for dealing with routine cases has been 40 days.

The acquisition in 1989 by Dent & Company of Barrincorp Industries of Toronto is a good example of a routine case. Barrincorp is a small Canadian manufacturer of automotive parts and accessories, employing approximately 250 persons, all in Ontario. The sale took place by way of a cash tender offer for 100% of the issued and outstanding shares. There were no competing bids and the Canadian controlling shareholder supported the acquisition.

The application did not touch on any specific policy areas or raise any sensitive issues. Nor did it raise any competition issues since the investor does not own other businesses of a similar nature in Canada. The departments of ISTC and CCA were consulted for their views, as was the Province of Ontario. There were no problems or objections raised by the relevant departments or the Province in the course of the review period.

To date, only a relatively small number of transactions, roughly 5% of the total, have attracted widespread public attention or raised sensitive issues. These have included a number of relatively large transactions, for example, the acquisitions of Dome Petroleum by Amoco and of Texaco Canada by Imperial Oil (oil & gas), of Consolidated Bathurst (pulp & paper) by Stone Container, of Hiram Walker (liquor and spirits) by Allied-Lyons and of Cadillac Fairview (real estate) by JMB Realty. Still others involved the acquisition of important high technology companies such as Mitel (communications equipment) by British Telecom, Leigh Instruments (aerospace) by Plessey, Lumonics (lasers) by Sumitomo and Connaught BioSciences (biotechnology- vaccines) by Institut Merieux.

Predictably, there have been a number of high profile transactions in culturally sensitive sectors, notably in book publishing and distribution. These include, Gulf+Western's acquisition of Prentice Hall, Ginn and GLC; Longman's acquisition of Copp Clark Pitman, Penguin's acquisition of New American Library and W.H.Smith's acquisition of Classic Bookshops. Finally, other acquisitions have attracted considerable regional attention. These included Ultramar's acquisition of the eastern refining and marketing assets of Gulf Canada which involved the closing of the Gulf refinery in Montreal East and the acquisition of West Kootenay Power and Light, a hydro utility in Southeastern British Columbia, by a U.S.-based utility.

In contrast to the 'formula' type treatment of routine cases, the demands made on Investment Canada's resources as a result of the scope of reviews carried out on significant cases, is considerable. The recent acquisition of Connaught BioSciences is instructive in terms of the depth and the extent of the research, analysis, consultations and negotiations required to bring the matter to a decision. There were several strategic issues underpinning the two foreign bids to acquire Connaught BioSciences (by Ciba-Geigy/Chiron, a joint venture between a giant Swiss pharmaceuticals manufacturer and a leading U.S. biomedical corporation, and Institut Mérieux, controlled by Rhone-Poulenc which in turn is controlled by the French Government):

- the issue of foreign control of the Canadian business by a foreign government;

- the impact on Connaught BioSciences' autonomy and Canadian equity participation;

- the effect on the level and nature of R&D and technology, especially in the case of an acquiror who is also a direct competitor;

- the public health and defence concerns about the security of supply and self sufficiency in vaccines;

- the effect on Canadian production and marketing activities.

Over the six month review period, there were several initiatives, all unsuccessful, to put together a Canadian alternative buyer of Connaught BioSciences. Each initiative was evaluated.

In addition to the normal consultative process with concerned provinces (Ontario and Quebec) and federal departments (ISTC, Health and Welfare, DSS, DND, National Research Council and the Bureau of Competition Policy), a leading U.S. consulting firm was engaged to study international developments in biotechnology and to evaluate the takeover bids for Connaught BioSciences, including the Canadian initiatives. Canadian and French law firms were engaged to provide advice on voting equity participation in French government-controlled enterprises.

The University of Toronto, which was involved in litigation with Connaught BioSciences over the sale to a foreign investor, was also consulted at length, as were key directors and major Connaught BioSciences' shareholders (e.g. Caisse de Depot et de Placement du Quebec.). As well, the Canadian scientific community was consulted on technological aspects. Finally, because of the significant domestic and international implications of the proposals, External Affairs and PCO were consulted and kept fully briefed.

The proposals were referred to Cabinet six times during the review process.

Although the Minister responsible for Investment Canada has issued several subsection 23(1) notices in the past (in effect, a notice advising an investor that his/her proposal does not meet the test of net benefit but giving the investor additional time to address the shortcomings of the proposal prior to a final decision), this was the first occasion that the subsection was cited concerning the proposed takeover of a publicly traded company. Consequently, trading on Connaught BioSciences was temporarily suspended.

There were approximately a dozen meetings held separately in Ottawa with Institut Merieux and Ciba-Geigy/Chiron. The government's private sector consultant visited the Merieux operations in Lyon, while Investment Canada staff visited the Chiron facilities in San Francisco. Approximately half a dozen meetings were held separately with the Chairman of Connaught BioSciences and key staff in Toronto and Ottawa. Negotiations spanned 6 months in the case of Institut Merieux and three months in the case of Ciba-Geigy/Chiron. The scope of the negotiations covered numerous aspects of the proposals, several highly technical in nature.

The substance of all of the undertakings were released to the media and inevitably evaluated by the press. The case was given comprehensive coverage in the popular and business press and quickly moved to the editorial pages. This generated considerable activity in the House which, in turn, called for a greatly increased level of Investment Canada support for the Minister in the carrying out his parliamentary responsibilities.

The Use and Frequency of Undertakings in the Review Process

In the Connaught Biosciences case, as in the case of all 'significant' or policy sensitive foreign investments, the Agency has negotiated legally binding commitments by the investors in order to safeguard Canadian interests. The foreign investor is required to provide stronger commitments or "undertakings" than reflected in the business plan before receiving approval for the acquisition. Examples of undertakings include: commitments to maintain a specified level of Canadian participation in the management of the Canadian subsidiary; to spend a specified sum or percentage of revenues on R&D or, in the case of investments in the resource sector, on oil exploration; to maintain production of a particular product in Canada; and to retain and further develop a particular technology and related products in Canada. Undertakings are really an extension of the business plan, and are negotiated in the context of requiring greater assurance.

Understandably, business plans may require subsequent amendment if market conditions change substantially from those originally projected. As a result, business plans may be revised and undertakings may be renegotiated to take into account unforeseen economic developments. In principle, however, the government can sue and require, for example, specific performance or even divestiture. In most cases foreign investors meet (or exceed) the conditions of approval. In those cases where an investor has not met the conditions of approval, for reasons beyond the investor's control, Investment Canada is usually able to renegotiate a new set of mutually acceptable undertakings.

Over the 4 year period June 30, 1985 to June 30, 1989, a total of 696 acquisitions were reviewed by Investment Canada. Of these 696 cases, undertakings were negotiated in 77 cases (i.e., 11% of the total). The total number of undertakings negotiated was 276, or an average of 4 per case.

The 276 undertakings have been classified in a matrix format according to:

· the 6 factors of assessment used in the "net benefit" test (see page 9 for a description of these factors);

· the reason for negotiating the undertaking.

For the majority of undertakings, only one factor of assessment was relevant; in some cases, however, more than one factor was relevant and 40 undertakings have been classified according to two or three assessment factors. Because of this necessary double accounting, the 276 undertakings are relevant to the assessment factors some 359 times.

The reasons for negotiating undertakings are as follows:

- Certainty: Undertakings obtained from the investor for greater assurance (i.e., that investor will carry out agreed condition).

- Specific Policy: Undertakings obtained from the investor in compliance with a specific government ownership policy (i.e., oil and gas acquisitions policy, book publishing policy).

- Substantive Negotiations: Undertakings obtained from the investor which are substantive and essential to a determination of net benefit, and which were not in the investor's original business plans.

- Voluntary: Undertakings which were volunteered by the investor (i.e., which Investment Canada would not have required in order to recommend approval on the basis of net benefit).

- Public Interest: Undertakings obtained from the investor which are required to address a particular Canadian public or policy interest.

Undertakings were also ranked in terms of their importance to the determination of net benefit. The ranking was based on a scale of 1 to 10, with 1 representing undertakings least important to the net benefit test and 10 representing undertakings essential to the net benefit test (i.e., without the undertaking, a finding of net benefit would not have been possible).

The analysis is presented in Tables 3 and 4. These tables present the distribution of undertakings by factor of assessment and reason for negotiating. Table 3 shows this distribution by the actual number of observations and Table 4 shows this distribution weighted by the average importance of the undertakings.

In terms of factors of assessment, Table 3 indicates that most undertakings (162 out of 359 observations) are to strengthen business plans related to overall economic activity. The second most important category of undertaking relates to compatibility with government policy (95 out of 359 observations). In terms of the rationale for requiring these undertakings, the most often was the need to address a specific government policy (167 out of 359 observations). The desire to reinforce the likelihood that business plans would be carried out was the second most important rationale (113 out of 359 observations).

Table 4 presents the same distribution as Table 3, but according to the average weight of importance (i.e., on the basis of the 1 to 10 scale outlined above). The Table shows the relative importance of the 6 factors of assessment and the 6 categories of rationale in the assessment of net benefit.

In terms of the rationale for undertakings, voluntary undertakings received the lowest weight (1.1) while undertakings secured to meet specific government policies received the highest (8.8). While Table 3 indicated a large number of undertakings were negotiated, for greater certainty, the smaller number of undertakings secured through substantive negotiation received a much higher weight (7.5 compared to 5.1).

Table 3

DISTRIBUTION OF UNDERTAKINGS BY FACTOR OF ASSESSMENT AND REASON FOR NEGOTIATING

	Category of Rationale					
Factors of Assessment	**Cert**	**Specific Policy**	**Subst. Neg.**	**Volt**	**Int**	**Total**
Econ. Activity	71	50	17	20	4	162
Cdn. Participation	24	23	9	4	0	60
Productivity	16	0	5	1	1	23
Competition	0	0	5	0	0	5
Gov't. Policy	2	90	0	0	3	95
Int. Competitiveness	3	4	6	1	0	14
Total	116	167	42	26	8	359

Table 4

DISTRIBUTION OF UNDERTAKINGS WEIGHTED BY AVERAGE IMPORTANCE OF UNDERTAKINGS

	Category of Rationale					
Factors of Assessment	**Cert**	**Specific Policy**	**Subst. Neg.**	**Volt**	**Int**	**Total**
Econ. Activity	4.8	9.3	7.6	1.1	7.5	6.1
Cdn. Participation	4.6	7.9	6.4			5.8
Productivity	6.1		8.8	1.0	8.0	6.6
Competition			6.4			6.4
Gov't. Policy	7.0	8.8			5.7	8.7
Int. Competitiveness	7.7	7.0		8.3	5.0	7.6
Total	5.1	8.8	7.5	1.1	6.9	6.8

Turning to the factors of assessment, Table 4 shows that government policy is ranked higher than the other factors (8.7) while the lowest ranking factors – economic activity (6.1) and Canadian participation (5.8) are still assigned relatively high weights.

Additional information from this analysis includes the following:

- Specific government ownership policies in the oil and gas and cultural sectors accounted for a large number of undertakings (158 out of 359 observations) and were also assigned a high level of importance (average weight of 8.9);

- "High profile" cases also accounted for a large number of undertakings. These cases included acquisitions of large companies (e.g., Consolidated Bathurst, the merger of Molson and Carling O'Keefe) and takeovers of important high technology companies (e.g., Mitel, Lumonics, Connaught).

Monitoring of Approved Investments

The Minister has a statutory responsibility to ensure that investments approved under the Act are implemented in a manner consistent with the terms under which they were approved. Investment Canada monitors performance 18 months after the implementation of the investment or as required. The performance is judged according to overall results and, if deemed satisfactory, no further monitoring takes place. If the monitoring determines that the performance has been less than satisfactory, further follow-ups occur. While all plans and undertakings are monitored, those having major significance for the net benefit test receive most attention.

To indicate the degree to which investors have fulfilled the terms of approval, an analysis has been conducted of the follow-ups by Investment Canada Review Officers in 1989. The investments monitored took place in 1987 or 1988. What follows is a summary of this analysis.

As in all cases subject to review, business plans were submitted by the investors denoting how the proposed investments would be of net benefit to Canada. The plans cover a wide range of concerns, including employment, capital investment, increased exports and continued Canadian management. Each of the plans were classified according to the six factors of assessment (see pp. 16-17), indicating thereby the conformity of the plans to the assessment criteria and which criteria are most frequently cited. Because the first assessment criterion (Economic Activity) is so all-encompassing, it has been broken down into its key components (i.e., employment, capital expenditure, exports and sales).

To give an indication of the degree to which investors have fulfilled their commitments at the time of investment approval, a simple rating system was applied: 'one' if the investor had not met its plans; 'two' if the investor had met its plans; and 'three' if the investor had exceeded its plans. As a rule of thumb, 15% below or above what the plan called for would result in the assignment of a 'one' or 'three'.

Since employment, capital expenditures, exports and sales data provide quantitative measures on how successfully the investor has met its plans, economic activity indicators were not only judged on the simple 1,2,3 scale; for these indicators, the percentages above or below the investors' plans were also calculated.

There were 308 follow-ups in 1989 but only 224 of these could be evaluated (either because information from the investor had not yet been received, the company acquired had gone out of business, the company had been sold to a Canadian, or the case had been deferred). The follow-ups evaluated included investments in the manufacturing, service, resource and cultural sectors.

Judging by the survey results contained in Tables 5 and 6, companies have generally either met or exceeded the plans that they forwarded at the time of the acquisition.

- the rank of 'two' or better applies in all categories, which infers that investors on average fully meet the factor of assessment;

- employment expectations were met or exceeded 84 per cent of the time; on average, the companies surveyed exceeded their employment plans by 10 per cent;

- export expectations were met or exceeded 72 per cent of the time; on average, the companies surveyed exceeded their export plans by 19 per cent;

- sales expectations were met or exceeded 86 per cent of the time; on average, the companies surveyed exceeded their sales plans by 27 per cent;

- capital expenditures were met or exceeded 88 per cent of the time; on average, the companies surveyed exceeded their capital expenditure plans by 24 per cent.

Table 5

SUMMARY OF OVERALL RESULTS

FACTOR OF ASSESSMENT	NO. OF CASES	NO. OF INDIV. PLANS	AVERAGE WEIGHT	NO. (%) EXCEEDING	NO. (%) MEETING	NO. (%) FAILING TO MEET
ECONOMIC ACTIVITY	194	632	2.2	219 35%	290 46%	123 19%
CANADIAN PARTICIPATION	80	89	2.1	32 36%	38 43%	19 21%
PRODUCTIVITY AND ECONOMIC EFFICIENCY	36	43	2.2	17 39%	18 42%	8 19%
COMPETITION	1	1	2.0	0	1 100%	0
GOVERNMENT POLICIES	31	52	2.0	7 13%	40 77%	5 10%
INTERNATIONAL COMPETITIVENESS	10	11	2.5	7 64%	2 18%	2 18%

Table 6

SUMMARY OF RESULTS FOR ECONOMIC ACTIVITY

ECONOMIC ACTIVITY	NO. OF CASES	NO. OF INDIV. PLANS	AVERAGE WEIGHT	NO. (%) EXCEEDING	NO. (%) MEETING	NO. (%) FAILING TO MEET
EMPLOYMENT	167	209	2.2	77 37%	120 49%	30 14%
EXPORTS	65	74	2.0	23 30%	31 42%	20 28%
SALES	46	48	2.4	25 52%	16 34%	7 14%
CAPITAL EXPENDITURES	111	128	2.3	53 41%	60 47%	15 12%

The Value of the Review Process

Canadians have traditionally viewed foreign direct investment with a certain ambivalence. An example of this ambivalence is Canadian concern about foreign ownership in the cultural, resource and financial services sectors. The coincidence of a number of major mergers and acquisitions early in 1989 fuelled fresh debate about both corporate concentration in Canada and foreign acquisitions. Among the more prominent transactions were Imperial Oil's (U.S.) acquisition of Texaco Canada, the merger of Molson and Carling-O'keefe (Australia) brewing operations, Canadian International's (Canada) acquisition of Wardair and Stone Container's (U.S.) acquisition of Consolidated Bathurst. The occurrence of these transactions soon after the coming into force of the Canada - U.S. Free Trade Agreement, and indications that major foreign companies were turning their attention to 'undervalued' acquisition prospects in Canada, served to heighten public concern.

Another factor has been the increasing concern about the loss of Canadian ownership and control of leading high technology companies. Annex XII addresses the issue of foreign investment in Canada's high technology companies, but it is useful to recall here the cases that have caught public attention. Mitel Corporation was acquired by British Telecom in 1986 and Leigh Instruments was acquired by Plessey in 1987. In 1989, Sumitomo of Japan acquired Lumonics and the Institut Merieux of France acquired Connaught BioSciences. In each case, Investment Canada negotiated undertakings relating to R&D spending, world product mandates and the maintenance in Canada of the core activities of research and development. Nevertheless, the loss of Canadian ownership and control of these key companies is seen by some as a failure of government policy.

Yet another area of concern is real estate investment, particularly by Japanese and Hong Kong investors. Japanese acquisitions of three hotels in Banff, accounting for about 12 per cent of available rooms in the resort, sparked considerable public opposition and demands that the Government prohibit foreign investment in national parks. Most Hong Kong purchases of residential properties are being made by potential immigrants.

There can be little argument about the fact that many Canadians are uncomfortable about a high level of foreign investment in the country. Indeed, public opinion polls have consistently shown that a substantial majority of Canadians (more than 80 per cent) believe that the federal government should introduce legislation to encourage greater Canadian ownership of industry. A poll in late 1988 indicated that 60 per cent of Canadians favour a reduction in the number of foreign takeovers allowed. At the same time, Canadians believe that the world economies are becoming increasingly interdependent, and that an isolationist path would be counter-productive.

The question, then, is whether or not the current foreign investment policy of the Government strikes the proper balance between nationalist concerns and the need for Canada to be outward oriented. More directly, does the review process provide value in protecting the interests of Canadians?

There is no hard and fast answer to this question, for a great deal depends upon how foreign investment itself is judged. Critics argue that foreign-owned firms pay less attention to creating jobs for Canadians, that they import more and export less, that they spend less on R&D, and that they generally follow corporate strategies that benefit the home country at the expense of the host country. Supports of foreign investment, on the other hand, cite the benefits - including access to markets, technology transfers, management expertise and tax revenues from foreign capital. The academic literature indicates, for the most part, that foreign investment is highly beneficial.

Still, there is room for honest differences of opinion in respect to the value of the review process. The fact that all foreign investment proposals have been approved is taken evidence by the critics that Investment Canada is nothing but a 'paper tiger'. Most investors (except those interested in investing in sensitive sectors) appear to find the review process tolerable.

The argument that Investment Canada has negotiated undertakings and, thereby, substantially altered foreign investment plans is more difficult to evaluate. If undertakings do cause foreign investors to alter their business plans, as some critics would allege, the cost of so doing is likely borne at least in part by the original Canadian owner. In short, undertakings could negatively affect the capitalized value of Canadian assets. As such, undertakings may detract from Canadian entrepreneurship and other forms of domestic initiative.

Investment Canada's view, however, is that undertakings are secured to provide better assurances that investors will carry out their business plans and are part and parcel of Investment Canada's "due diligence" test on foreign proposals, rather than an attempt to wring out more or larger benefits out of an investor than he originally wished.

Again, the issue is one of balance. Few would advocate wholesale elimination of either the foreign investment review process or the anti-trust review process. Only those with a very dated sense of the objectives would argue for a considerable tightening up of the regulatory provisions. There is a real danger, however, that anecdotal evidence will accumulate to the point where the Government may be forced to offer up some compromise to the critics. Since the premise of Investment Canada is so firmly anchored in a positive view of foreign investment, whatever the compromise it should not be at the expense of Canada's efforts to participate in globalization.

Annex A

NOTIFICATION AND REVIEW OF FOREIGN DIRECT INVESTMENTS IN THE CULTURAL SECTOR

INTRODUCTION

Canadian concern about foreign investment in the cultural sector is of long-standing and has been focused mainly on the potential disadvantages of high levels of foreign ownership. The incorporation of public concerns in policies on foreign ownership has been shaped by the character of the individual industries producing and distributing "cultural" products, as well as the broader forces shaping foreign investment priorities. The approach adopted under the Investment Canada Act reflects this experience.

Legislation setting maximum limits on foreign ownership in broadcasting was enacted in the late 1950's and subsequently extended to cover the newcomer, cable. During the period 1974 - mid 1985, foreign investments in cultural industries (outside broadcasting) were dealt with under the provisions of the Foreign Investment Review Act. The Foreign Investment Review Agency used its authority to review all foreign-controlled investments - small and large - to monitor and review direct investment in this sector. While cases in the cultural domain received extra attention, reflecting their significance over and above the levels of economic activity involved, the monitoring and regulation employed was not specific to them. Several provincial policies respecting foreign ownership also developed during the 1970's, particularly in Ontario and Quebec, where the bulk of these industries are located.

NICH NOTIFICATIONS

With the Investment Canada Act, the special attention given to foreign direct investment in the cultural sector is made explicit. The limitation of the scope of the review process with the use of minimum size thresholds and the exclusion of new businesses, is qualified under section 15 of the Act. This section provides for the review of investments involving a small transaction or a new business where the investment is related to "Canada's national identity or cultural heritage" <u>and</u> when the Government specifically orders a review in the public interest.

This "NICH" process works through the notification requirement to which <u>all</u> foreign direct investments are subject. The "cultural" investments, which are vetted at the notification stage, are defined by regulation to encompass certain industries:

1. Publication, distribution or sale of books, magazines, periodicals or newspapers in print or machine readable form.

2. Production, distribution, sale or exhibition of film or video products.

3. Production, distribution, sale or exhibition of audio or video music recordings.

4. Publication, distribution or sale of music in print or machine readable form.

These industry groups are, therefore, the cultural demarcation for purposes of the Act.

The notification requirement brings essentially all investments in the above industry categories under consideration for review. Indeed, in the cultural area, compliance with the notification requirement is reinforced by active surveillance on the part of the Canadian industry which generally supports the foreign investment review policy. The Agency is likely to be alerted of any possible cases of non-compliance.

During the period, June 30, 1985 to the end of 1990, a total of 157 NICH notifications were received by the Agency. Of these, 144 were certified and a decision was taken as to whether a review was required or not; the remainder were withdrawn during the consideration process. The first NICH category (i.e., printed media) accounts for most of the notifications (Table 1), followed closely by the second (i.e., film and video). Two thirds of the cases in the former category involved acquisitions, whereas four-fifths of the cases in the latter were new businesses.

Upon receipt of a NICH notification, there is a period of 21 days within which the Government determines whether it would be in the public interest to require a formal review through an Order in Council. In formulating a recommendation to the Minister, the Agency seeks the views of the federal Department of Communications and the Provincial Government(s) hosting the investment, and may well seek further information from the investor in order to ascertain better, the nature and scope of the business at issue. Thus the NICH process ensures comprehensive monitoring of foreign direct investment, and identifies those cases where further scrutiny is warranted.

Given the sifting purpose of the NICH process, it is not surprising that an order for review was made on only one-third of the "cultural" notifications. The incidence of an order to review was highest for notifications in the fourth and the first NICH categories (i.e., music publishing; and book, magazine and newspaper publishing and distribution) and, overall, it was considerably higher for acquisitions than for new businesses.

The transactions for which no review was required have tended to fall into one of three categorized: proposals to produce in Canada films for U.S. television or theatrical markets; proposals to acquire or establish businesses engaged in the production of technical, business or special interest publications; and proposals to establish or acquire businesses in which the production or sale of "cultural products" was an insignificant part of the total business operation.

INVESTMENT REVIEWS

From mid 1985 through to December 31, 1990, 59 applications for review have been submitted by foreign investors, 48 of which have been carried through to resolution. Of the remainder, 6 were subsequently withdrawn and 5 were under review at the end of the period. Table 2 shows the breakdown by NICH/industry category.

It should be noted that some of the applications received were larger acquisitions automatically reviewable under the regulations of the Act. Some of the applications have concerned completed transactions; since, unlike takeover proposals, the Investment Canada Act requires notification within 30 days after the establishment of a new business or the completion of an indirect acquisition or a direct acquisition. Just over 40% of the applications received pertained to indirect acquisitions.

Policy Directives

As with reviews of investments in other sectors of the economy, applications are evaluated according to the net benefit factors set out in section 20 of the Act. In the cultural area, however, typically the critical criterion is factor (e), "the compatibility of the investment with national industrial, economic and cultural policies, taking into consideration industrial, economic and cultural policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the investment". The differences in the focus of the reviews across the cultural industry categories are largely shaped by the distinct policies, particularly at the federal government level, which apply.

The major industry-specific federal policies and approaches which bear on the reviews are as follows:

1 (a) The Baie Comeau Policy, enunciated shortly after implementation of the Investment Canada Act, on July 6, 1985, establishes comprehensive and restrictive guidelines for reviewing investments in book publishing and distribution. (i) In the case of direct investment in the form of a new business or a proposal to acquire a Canadian-controlled business, only a joint venture controlled by Canadians is permitted. (ii) Direct acquisition of a

foreign-controlled Canadian business would be allowed only given a commitment to divest control to Canadians within two years at fair market value. (iii) Indirect acquisition (i.e., where a foreigner purchases another foreign company owning an affiliate located in Canada,) is acceptable if the transaction does not significantly lessen competition by Canadians in any segment of the book market and if a commitment is given to divest control to Canadians within two years at fair market value.

1.(b) For newspapers and magazines, there exist no special federal government directives for investment reviews. However, foreign investment is discouraged by the provisions established under section 19 of the Income Tax Act which limit the deductibility of magazine and newspaper advertising expenditures to that portion spent in publications with at least 80% Canadian content and 75% Canadian ownership.

2. The policy on foreign investment in the Canadian film and video distribution sector, which was enunciated by the Minister of Communications in May 1988, sets out comprehensive guidelines: i) takeovers of Canadian owned and controlled distribution businesses will not be allowed: ii) new distribution businesses will only be allowed for importation and distribution activities pertaining to proprietary products (i.e., the importer owns world rights or is a major investor in that specific film); iii) indirect and direct takeovers of foreign-controlled distribution businesses in Canada will be allowed only if the investor undertakes to reinvest a portion of its Canadian earnings in accordance with national and cultural policies.

3. The Minister of Communications announced the Sound Recording Policy in 1986. It established the Sound Recording Development Program to support and strengthen the role that Canadian record producers, record labels and artists play in their own national market and the access they have to this market. Initiatives such as revision of the Copyright Act, hearings on CRTC radio policy and music content requirements, as well as the Sound Recording Development Program are intended to ensure that the Government's goals for Canadian recorded music and music publishers are achieved.

The negotiating goals for Investment Canada applications centre on recording companies signing and promoting Canadian artists, and being receptive to distributing the product of Canadian independent labels on commercially reasonable terms. For retailers, the goal has been to have them agree to carry and accord reasonable promotion to Canadian artists.

Resolution of Applications

Given the importance of ensuring an investment in a firm in a cultural industry is compatible with public policy, an integral part of the Agency's evaluation of an application is the consultations with the federal Department of Communications, which is responsible for the formulation of cultural policy, and with the relevant Provincial Governments. Reviews of the applications are likely to entail discussions and negotiations with the investor concerning plans for the Canadian business since the net benefit to Canada hinges on the investor's performance in furthering enunciated policy goals of enhancing Canadian-origin production and sales.

Some 75% of the investment approvals to date are linked to legally enforceable undertakings made by the investor. Approvals involving undertakings typically involve more intensive consultations and negotiations than do those approved on the basis of the investors plans for the business. As shown on Table 4, the lapse of time between application and resolution typically was longer in such cases. The relationship between the duration of the review and the size of the transaction was much less pronounced, however. Most of the approvals which did not involve undertakings were in the NICH 1 category and concerned either newspaper or magazine investments.

In the case of the investments involving books effected after the enunciation of the Baie Comeau Policy in July 6, 1985, the undertaking normally involves divestiture of control of the business to Canadians. In fact, 4 such approvals have occurred. These cases have required considerable amounts of Agency time and resources despite the rule guiding the review process. Moreover, the subsequent follow-ups by the Agency to ensure fulfilment of the undertakings have demanded extraordinary attention due to the difficulties of implementing compulsory divestiture. Almost all the unresolved applications also fall into this area.

For other cultural cases, Canadian participation typically focuses on company management and direction. Commitments to employ exclusively, or almost exclusively, Canadian executives and strong participation by Canadians as members of the board of directors are standard features of investment applications. Undertakings frequently concern performance in developing, producing and marketing Canadian cultural products. The commitment of support for Canadian cultural objectives may be an integral part of the Canadian business, such as specific rates of publication of Canadian-authored titles or investment in defined new creative projects. The commitment may also be indirect, through patronage of Canadian-controlled businesses in complementary activities, for example, or financial contributions to the educational base or other facets of the industrial infrastructure. Negotiation of these commitments entails a sound appreciation of the business and the market environment and close consultation with those responsible for governmental policy in the industry. Regular follow-ups are made on all these cases, and these have contributed to the Agency's industry knowledge base as well as ensuring fulfillment of commitments.

CONCLUSION

Regulation of foreign direct investment in the designated "cultural" industries under the Investment Canada Act is, on the one hand, comprehensive in scope and, on the other, implemented on a case-by-case basis. All foreign investments in these industries are examined, via the NICH notification route, if not via an application triggered by the threshold. Of those meriting formal review and approval, a substantial number are subjected to exhaustive evaluation and negotiation concerning the substance of the investment, which is mainly guided by specific sectoral cultural policies. The others, which are judged on the basis of the detailed information supplied by the investor in the application and consultations to not have any negative impact on the cultural sector, are given more straightforward treatment. Thus the process established by the Act provides the scope and the flexibility to safeguard Canadian interests in this key realm. Irritants can arise, however, where the sectoral policy and the economic situation, both of which must be factored into the review, are at odds. The challenge to the Agency and to the investor is to seek a solution which respects the imperatives of both parties.

TABLE 1

Nich Notification [1]

July 1985 - December 31, 1990

Nich type	Order to Review	No Review	Total Notifications	New Business	Acquisitions
1	26	38	64	22	42
2	14	48	62	50	12
3	3	9	12	8	4
4	5	1	6	1	5
All Nich	48	96	144	81	63

1 Excludes 13 notifications which were withdrawn prior to a decision being taken by the Minister.

2 See text for definition of industry categories.

Source: Investment Canada

Table 2

Applications for Review

July 1985 - December 31, 1990

A. Category	
Nich 1	27
Nich 2	19
Nich 3	9
Nich 4	4
Total Received	59
B. Type of Transaction	
New business	11
Direct acquisition	24
Indirect acquisition	24
C. Outcome	
Withdrawn	6
Approved:	48
with undertakings	36
with plans only	12
Unresolved at end period	5

Source: Investment Canada

Table 3

Application Review Process

Days elapsed from certification to approval

	45 or less	46 - 75	Over 75
A. Approval conditions			
With undertaking	6	7	23
Without undertaking	6	4	2
B. Value of Transaction			
Under $5 million	7	8	15
Over $5 million	6	2	10

Source: Investment Canada

Annex B

THE OIL AND GAS ACQUISITIONS POLICY

INTRODUCTION

Foreign investment policies for certain resource sectors are implemented through the review process of the Investment Canada Act. One of these is the Oil and Gas Acquisitions Policy.

BACKGROUND ON THE POLICY

The dominance of foreign companies in the upstream oil and gas industry has been a high public profile issue since the 1950s, when foreign ownership was over 90 per cent. Canadian ownership and control of the industry increased steadily in the 1970s and early 80s. In 1985/86 both Canadian ownership and control peaked at close to 50 per cent. Since then there has been a marked decline, particularly in Canadian control. Canadian ownership fell to 43 per cent by the end of 1989, while Canadian control slipped to about 39 per cent.

The Government's goal is to attain 50 per cent Canadian ownership. It is a long-standing goal, first stated by the Clark Government in 1979. The Mulroney Government has endeavoured to balance the objective of increased Canadian ownership and control with other objectives - a favourable environment for foreign investment, robust economic activity, and fairness to investors. The Government has two instruments designed to increase Canadian participation - the Canada Petroleum Resources Act (CPRA), and the Oil and Gas Acquisitions Policy.

CANADA PETROLEUM RESOURCES ACT (CPRA)

The CPRA requires projects on federal lands to be at least 50 per cent Canadian-owned in order to qualify for a production licence, or that a plan satisfactory to the Minister be submitted for the attainment of this goal. The Canadian ownership requirement applies only to projects arising from discoveries made after March 1982, and as such does not apply to Hibernia and Venture. The Government, however, has taken steps to attain 50 per cent Canadian ownership of these projects.

OIL AND GAS ACQUISITIONS POLICY

The current acquisitions policy was approved by Cabinet in 1985. The Policy prohibits foreign acquisitions of healthy Canadian-controlled petroleum producers. Acquisitions of Canadian-controlled producers in financial difficulty, or of foreign-controlled producers, may be allowed subject to conditions which at a minimum include commitments on increased Canadian ownership and investment spending.

The Acquisitions Policy is administered through the Investment Canada Act (IC Act). The Act stipulates that the acquisition of control of businesses operating in Canada by a foreign interest must be reviewed and approved by the Minister responsible for the Act. A proposed acquisition is approved if it is determined that the acquisition would likely be of net benefit to Canada. One of the factors used to assess net benefit is compatibility with the government's sectorial policies, including the Oil and Gas Acquisitions Policy. Compatibility with the Acquisitions Policy is a necessary but not sufficient condition for Investment Canada approval.

TREND IN CANADIAN OWNERSHIP AND CONTROL

The most significant factors leading to the increase in Canadianization during the 1970's were the enactment of the Foreign Investment Review Act (FIR Act) in 1974, and the creation of Petro-Canada in 1975. The number of foreign acquisitions of Canadian-controlled companies fell significantly, while Petro-Canada acquired two major foreign-controlled companies.

The substantial increase in Canadianization during the 1980's was largely due to the National Energy Policy (NEP). The policy had three Canadianization goals: at least 50 per cent Canadian ownership of oil and gas production by 1990; Canadian control of a significant number of large oil and gas firms; and an early increase in government ownership of the oil and gas sector. Acquisitions of foreign companies by the government and private sectors accounted for about one-half of the increase in both Canadian ownership and control during this period.

The Conservative Government elected in late 1984 dismantled the NEP through a series of initiatives. It also replaced the FIR Act with the IC Act, and the previous Government's approach to oil and gas acquisitions with the current Acquisitions Policy. These initiatives were designed to be more receptive to foreign investment. While Canadian ownership and control increased in 1985/86, they have since slipped significantly. The reasons for the increase and then the decrease in the degree of Canadianization are explored latter in this annex.

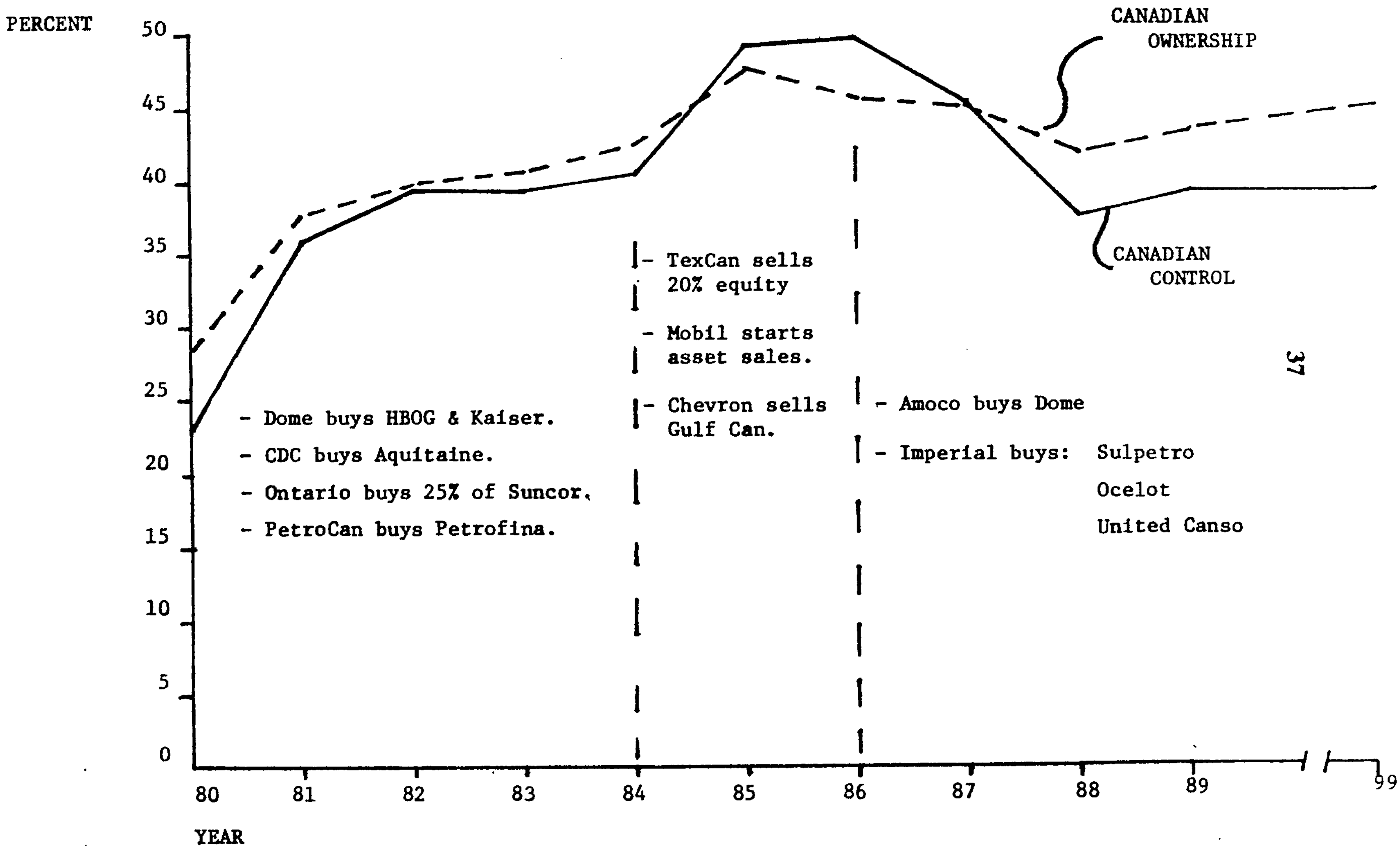
The chart illustrates the outlook for Canadian ownership in the upstream oil and gas industry over the next ten years.

Canadian ownership is expected to rise moderately from 43.4 per cent in 1989 to 45 per cent by the end of the decade because of undertakings given to the government from earlier acquisitions to Canadianize and taking into account the privatization of Petro-Canada with the 25 percent limitation on foreign ownership. Included in the undertakings to Canadianize are Amoco Canada's commitment to sell 20 per cent of its equity to Canadians within ten years and asset sale commitments from Esso Resources and Kerr McGee.

The level of Canadian control would likely remain unchanged or move up slightly.

CANADIAN OWNERSHIP AND CONTROL OF THE PETROLEUM INDUSTRY

(Based on upstream revenues)



RATIONALE FOR A CANADIANIZATION POLICY

Public Perceptions and Policy Making

Canadians have historically been concerned about foreign domination of the petroleum industry. They have, at times, mistrusted foreign multinationals, who were often seen to operate in the best interests of their parents' worldwide operations, to the detriment of the Canadian national interest. Canadians continuing concern about the degree of foreign ownership of the industry was evidenced by the debate over Amoco's acquisition of Dome in 1987/88.

Behaviourial Differences Between Canadian and Foreign Companies

Canadian-controlled firms are generally perceived to be more responsive than foreign-controlled firms to the Canadian social and political environment. To the extent there is a difference in behaviour, a significant presence of Canadian-controlled companies in the industry affects its balance and character.

However, reports of the Petroleum Monitoring Agency do not, in general, support the contention that differences in behaviour reflect the nationality of controlling shareholders. Rather, differences tend to reflect differences in corporate philosophy regardless of ownership.

Collection of Economic Rents

Canadian ownership is a means of ensuring that Canadians share in the economic rents earned from the exploitation of natural resources. This line of argument was persuasive in the early 1980's. At that time, oil prices and rents were high, and the general expectation was that both would continue to escalate.

In today's environment, this rationale is much less valid. Oil prices have fallen sharply, in nominal and real terms, and the outlook is for continued low prices for the foreseeable future. Moreover, Canada's conventional oil reserves are being depleted quite rapidly - Canada is becoming one of the highest cost producing regions in the world, leaving little room for economic rents.

ASSESSMENT OF THE CANADIANIZATION PROVISION OF THE CANADA PETROLEUM RESOURCES ACT

The Canadianization provision of the CPRA - which requires 50 per cent Canadian ownership of frontier production - has not yet come into play and is unlikely to do so in the near term. In the longer term, however, oil and gas production from the frontier is expected to account for a large share of the Canadian total, at which time the CPRA as a Canadianization policy instrument would have an impact.

The CPRA ensures 50 per cent Canadian ownership of production at one point in time only - when the production licence is issued. Subsequent transactions could change the Canadian ownership of a project. The disposition or transfer of an interest in a licence would be reviewable under the CPRA, but the Act does not require that 50 per cent Canadian ownership be maintained. Major market transactions in the shares of the sponsors - those resulting in a change in control - would not be reviewable under the CPRA, but would be reviewable under the IC Act. The Government would, therefore, have the opportunity to negotiate a Canadianization commitment.

ASSESSMENT OF THE ACQUISITIONS POLICY

Profile of cases reviewed by Investment Canada

Since its inception, Investment Canada has reviewed some 54 acquisitions involving oil and gas related interests. These include companies, or parts of companies, involved in exploration and drilling, production, transportation, and refining and marketing activities. The asset size of acquisitions ranges way from just over the $5 million review threshold, usually for small property transactions, to $4.9 billion in the case of Amoco Canada's takeover of Dome Petroleum. Increasingly prevalent today are acquisitions relating to the rationalization now going on in the industry, where companies are spinning off their smaller or minority interests in certain oil and gas fields in order to focus development in those areas where they have control.

Of the acquisitions reviewed by the agency, some 18 involved Canadian companies in financial distress. Most significant among these are the Amoco/Dome transaction and the purchase of Sulpetro and Ocelot assets by Esso Resources. As noted in the introduction, Canadian ownership has dropped about 5 percentage points in recent years, while Canadian control has fallen about 10 percentage points. The financial distress acquisitions accounted for about 2.4 percentage points or close to half the decrease in Canadian ownership in 1987 and 1988. These acquisitions also accounted for 7.5 percentage points of the slippage in Canadian control, 6.6 percentage points of which resulted from the Amoco/Dome acquisition.

Financial distress acquisitions have fallen off sharply and appear now to be restricted to companies primarily involved in oil and gas drilling which remains in a depressed state. Excluding the Dome acquisition, the assets in the remaining cases totalled $1.6 billion. Assets involved in the acquisition of foreign-controlled businesses totalled $6.6 billion. The purchase of Texaco Canada by Imperial accounted for $4 billion of that amount.

When reviewing an oil and gas acquisition, Investment Canada normally seeks assurances from the investor that it will reinvest a high proportion of cash flow (typically more than 75 per cent) from the Canadian business in Canadian oil and gas operations and that it will maintain Canadian employment and management of the business. Undertakings are also sought concerning increased Canadian ownership, either in the form of the sale of equity or the sale of oil and gas assets to Canadians. In the case of the acquisition of Dome Petroleum, for example, Investment Canada received an undertaking from Amoco to sell 20 per cent of its equity to Canadians within five years. More recently, in the Texaco case, Imperial Oil agreed to sell $350 million worth of upstream assets to Canadians within five years. As well, other benefits such as R&D spending may be sought. This was the case with the Amoco/Dome and Imperial/Texaco transactions.

Criticisms of the Acquisitions Policy

With the dismantling of the NEP, and the pending privatization of Petro-Canada, the Government has very few means at its disposal, if any, to encourage increased Canadian ownership in the oil and gas industry. Consequently, the Investment Canada Act, the only means by which the Government can apply its acquisitions policy, is becoming an increasing centre of focus for the 50 per cent Canadianization objective. As such, Investment Canada is an increasing source of irritation to foreign investors and to Canadian owned oil and gas producers anxious to attract foreign capital.

The Oil and Gas Acquisitions Policy has maintained a generally open environment for non-Canadian investment while preventing the takeover of healthy Canadian-controlled companies. It has even accommodated major investments in Canadian companies e.g., the Hong Kong investment in Nova and the British Gas investment in Bow Valley. However, as the policy does not include measures to encourage investment by Canadians, it seems unlikely to achieve its primary objective - that of increasing the level of Canadian ownership to 50 per cent.

Furthermore, the policy as it presently exists may actually work to discourage investment by Canadians in the oil and gas sector. By effectively taking healthy

Canadian companies "off the table" as far as potential foreign investors are concerned, the market value for those companies is potentially lessened. This could make it generally more difficult for them to raise new capital, particularly equity capital. Further, the policy does not differentiate between companies that are wholly foreign owned and those that have a significant degree of Canadian ownership. This means that foreign-controlled firms have no reason or incentive to provide for Canadian equity participation.

A third problem relates to the capacity of Canadian equity markets to absorb issues required to meet equity commitments given by foreign acquirors. Outstanding commitments now total about $1.7 billion, most of which is Amoco's commitment to sell 20 per cent of its equity to Canadians. The pending privatization of Petro-Canada adds a further dimension to the problem. The sale of Petro-Canada (approximately $4 billion) could overwhelm Canadian equity markets, which have only raised about $2.0 billion over the past four years for the oil and gas industry. The potential sale of 25 per cent of Petro-Canada to non-Canadians will, of itself, reduce Canadian ownership by two percent. This loss could be offset however to the degree that Petro-Canada, acting as a private company, decides to acquire foreign-owned, Canadian assets.

Finally, the policy as now structured applies to all acquisitions that are reviewable under the Investment Canada Act. It applies equally to acquisitions of small oil and gas producers or properties, with assets just above $5 million to large companies, like Imperial Oil.[13] Obviously, the impact of the acquisition of a small producer or property would have a negligible effect on Canadian ownership, yet the policy does not permit such considerations. This has been a source of some irritation to Canadian and non-Canadian companies alike in that it encumbers small asset reallocations which is a routine and ongoing part of the business.

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[13]. The $5 million review threshold, which applies to all acquisitions subject to the IC Act, continues to apply to American oil and gas acquisitions despite the investment provisions of the FTA. Non oil and gas acquisitions involving American investors are currently subject to a $100 million review threshold.

Annex C

FOREIGN INVESTMENT IN REAL ESTATE

For purposes of the Investment Canada Act, real estate is defined to include the following: businesses managing and/or owning non-residential properties, buildings, leases, etc.; businesses engaged in the construction and development of all types of real estate; and businesses acting as real estate brokerages. The Act does not apply to residential real estate or farms.

Since its inception in June 1985 to the end of December 1990, Investment Canada was informed of 233 acquisitions of real estate businesses with a value of $7.8 billion. Of these, 133 with an asset value of $7.4 billion were reviewable. These real estate cases represent 15 per cent of all cases reviewed by Investment Canada and for 9 per cent of all assets acquired by foreign investors since the Agency began operations. Of the 133 cases, over half involved the purchase of non-residential commercial properties, one third involved the purchase of hotels and motels and the remainder were property developers, recreational clubs or apartment buildings.

The attached charts show the number and value of direct real estate and related acquisitions received by Investment Canada in the last five years. Charts 1 and 2 show that the number and value of real estate acquisitions by foreigners increased sharply in the first four years before dropping in 1990. Acquisitions by Hong Kong and Japanese investors are highlighted. Chart 3 shows that Japanese acquisitions have accounted for more transactions than other countries. By value, however, the United States has been the dominant player (Chart 4). This is explained by one very large transaction, the acquisition of Cadillac-Fairview by JMB. Chicago-based JMB was looking for a conservative investment vehicle for the pension funds it administered and purchased Cadillac-Fairview, which at the time had assets in Canada of just over $1.6 billion.

THE EXTENT OF REAL ESTATE HOLDINGS IN CANADA BY FOREIGN INVESTORS

Data on real estate holdings in Canada by foreign investors are very limited. Some insight into the extent of foreign participation is gained by reference to data collected by the Canadian Real Estate Association. In 1989, the Association, whose members handle 80 per cent of real estate transactions in Canada, recorded residential transactions worth $47.9 billion and non-residential transactions worth $7.7 billion. In that year Investment Canada was apprised of foreign investment in non-residential real estate worth $1.8 billion, or 23 per cent of the total handled by CREA. In 1990, CREA handled $4.5 billion of non-residential transactions and Investment Canada was apprised of $642 million of non-residential transactions for 14% of the total. The actual percentages may be larger, given the fact that there is at least some underreporting of foreign investment in real estate. Roughly, foreign investment appears to account for some 15 - 20 per cent of total transactions in Canada involving non-residential real estate.

Canada has long been an attractive location for foreign real estate investors. Swiss, German and British investors have had substantial real estate holdings in major Canadian centres since the early fifties. In the mid-seventies a number of reports described the situation as threatening. For example, in a 1978 book entitled, "City For Sale" author Henry Aubin outlines foreign investment in Montreal real estate. He states that, "Montrealers have been disenfranchised from their own city." In "Vancouver Ltd." (1975), Donald Gutstein wrote "Foreigners are reluctant to reveal their interests, for if the extent to which British Columbia is foreign owned was made public, there would be a massive outcry and pressure for restrictive legislation". As a result of these and other reports a number of provinces introduced restrictive measures against foreign investment in real estate. Ontario placed a 20 per cent tax on land sales to foreigners, Quebec proposed a 33 per cent tax and Saskatchewan prohibited the sale of agriculture land to foreigners.

Data on Asian real estate investment in Canada are extremely limited and only scattered information of the sort listed below is available. It should be noted that Investment Canada has not attempted to verify the estimates made:

- Mead Ventures Inc. estimates the value of Hong Kong real estate holdings in Vancouver at $2 billion or more;

- Coldwell Banker, an international real estate broker, estimates that 50 per cent of the apartment transactions in Vancouver in 1989 involved offshore money;

- Goldyear Realty Ltd. estimates that in 1988 Hong Kong immigrants invested $2.7 billion in real estate in Toronto;

- in Calgary, Descon Construction reported that 45 houses out of 120 in one development were sold to Hong Kong buyers;

- the U.S.-based International Real Estate Institute reported in 1989 that over $US 50 billion of Hong Kong money was invested in Canadian real estate;

- the Japanese Finance Ministry estimates that about 5 per cent of Japanese direct investment in Canada is in the real estate sector, most of it invested in the past five years; according to the Ministry, real estate holdings account for 10 per cent of Japanese investment abroad;

- about 60 per cent of the hotel rooms in Whistler and 20 per cent in Banff are owned by foreign investors; since 1988, Investment Canada has reviewed the acquisition of six hotels in Whistler by the Japanese and Hong Kong investors; investors from these countries have also acquired six hotels in Banff Park.

In regards to the latter point, the Canadian Parks Service negotiates separately with the prospective purchasers of leases in National Parks before the leases are reassigned. The Parks Service has begun to require the foreign investor to commit to reserving 30 per cent of the rooms for Canadian residents and Canadian tour operators until a specific date in advance of the tourist season. This commitment is consistent with the National Parks Act, which requires that National Parks be reserved for the enjoyment of Canadians.

Japanese investments in hotels and resort properties appear to be largely motivated by a desire to serve the increasing flow of Japanese tourists to Canada. Hong Kong investments in commercial real estate are, for the most part, motivated by a desire to transfer wealth to a safe haven in advance of the reversion of the Crown colony to China in 1997. It is believed that most Hong Kong purchases of residential properties are being made by intending immigrants. Vancouver and Toronto have both experienced substantial Hong Kong investment in residential properties.

CANADIAN REACTION TO FOREIGN INVESTMENT IN REAL ESTATE

The sharp increase in Asian, largely Japanese and Hong Kong, investments in Canadian real estate has fuelled public debate about foreign acquisitions. Western Canadians, in particular, have expressed ~~strong hostility~~ to the current level of foreign investor activity.

There was a considerable amount of negative press in 1988 and early 1989 concerning takeovers of hotels in the Banff National Park. Articles featured the following headlines: "Japanese Investments Casting Shadow over Banff"; "Tourism Takeover Feared"; "Banff: When is Enough Enough?". Local concerns raised include the large number of Japanese signs in shops and restaurants in Banff, the number of Japanese signs along the roadways, and the concern that the Park is promoting Japanese tourists at the expense of Canadian and U.S. tourists. This concern was expressed again very recently when the Canadian owners of the prestigious Sunshine Village Ski Resort in Banff announced that they planned to sell this business. All indications point to a foreign buyer, likely Asian. With Japanese ownership of hotels at the Banff National Park approaching 20 per cent of motel room capacity, there is growing concern that these establishments will cater to Japanese visitors almost exclusively, and that there would be vertical integration of accommodation, shopping, transportation, restaurant, etc. services through Japanese ownership links. This pattern, which has been observed in Hawaii and the Gold Coast of Australia, could be to the detriment of existing businesses.

Similarly, there is controversy in Vancouver over the inflow of Hong Kong money. Vancouver real estate prices have increased markedly over the past year and it was thought that this was largely attributable to Hong Kong investors. However, two recent studies by the Laurier Institute show that in-migration from other Canadian provinces together with the general ageing and prosperity of the Vancouver population are far greater contributors to rising land values than is off-shore migration. Nevertheless, sentiment remains strong in Vancouver that Hong Kong immigration and investment have inflated real estate prices. Further, Vancouverites are deeply concerned about the Hong Kong tendency to demolish existing housing stock in favour of so-call "monster" homes.Toronto is another city receiving substantial amounts of Hong Kong immigration and investment. The impact in Toronto has not been as great as Vancouver because Toronto has a much larger population and housing base. Real estate agents talk of packaging "Hong Kong Starter Kits" (a strip mall, two rental condominiums and a lavish house) for Hong Kong investors. Other real estate people have stated that one-third of the shopping centres in Toronto are owned by Hong Kong investors and on a per square foot basis land in Toronto's Chinatown is more expensive than any other part of Toronto. Negative reaction in Toronto to Asian real estate investment has not been as great as in Vancouver but it is still evident from time to time.

Sharp increases in foreign investment in real estate have in the past generated public outcries, but these tend to be short-lived. For example, press reports on the Banff investment issue during 1989 have been much more moderate in tone. Some press comments, in fact, have been critical of those who would seek to restrict foreign investment. It should be noted, also, that the general public appears to cloud the distinction between foreigners and persons who hold permanent resident status. To illustrate, Oie Hong Leong (formerly of Singapore), the new owner of the B.C. Enterprise Centre (the Expo 86 parcel), holds permanent resident status.

POLICY CONSIDERATIONS

The Investment Canada Act applies to purchases of commercial properties that can be characterized as businesses. Excluded from consideration are purchases of farms, residential properties or undeveloped land. It should be noted that it was not the intention of the Government to have Investment Canada review real estate acquisitions. It was through an amendment proposed by the opposition and passed by a small number of members that commercial real estate was classified as "businesses".

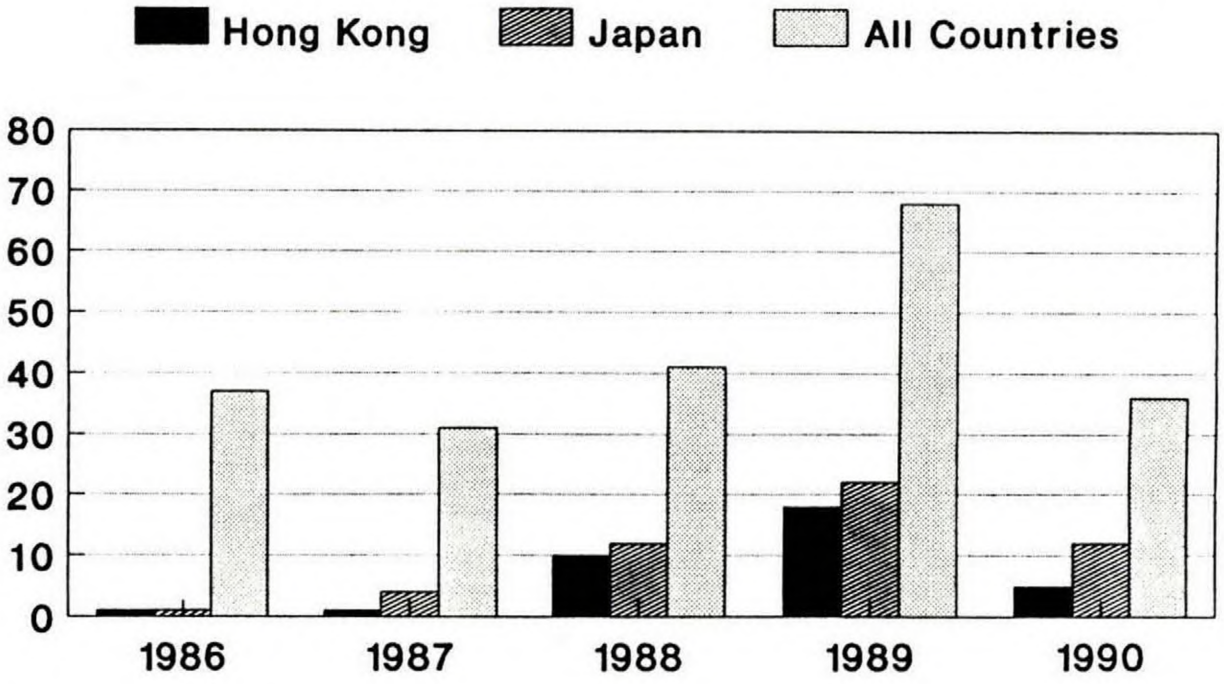
However, real estate which come under the purview of the Act does not lend itself particularly well to the review criteria. Such investment is a conventional form of low risk investment and, by virtue of sales to foreigners, frees up scarce capital that can be employed elsewhere in the economy. As a matter of current practice, Investment Canada recommends approvals of reviewable real estate transactions provided that the investor is willing to give a commitment to use a Canadian management company to operate the business.

Experience under the Investment Canada Act has confirmed that little useful purpose is served in reviewing most foreign acquisitions of commercial real estate. Such investments do not give rise to the public policy concerns that may attend foreign acquisitions of other types of businesses.

Chart 1

Real Estate

Number of Direct Acquisitions

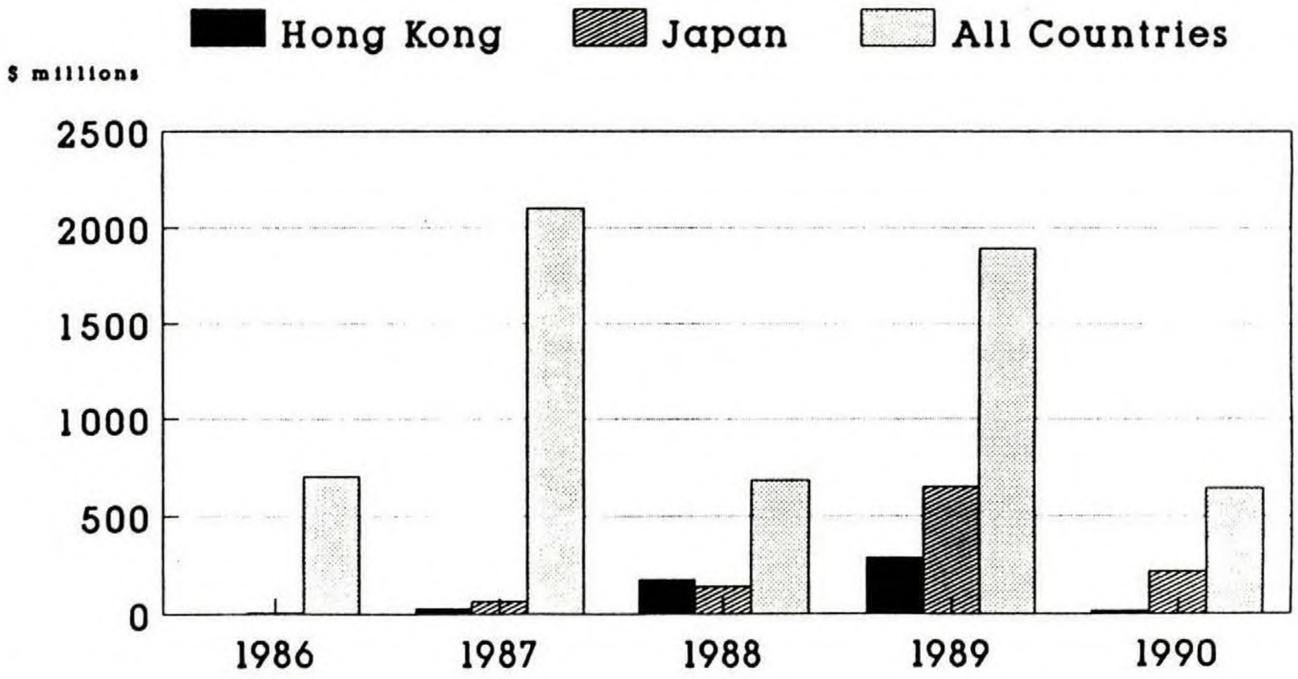


	1986	1987	1988	1989	1990
Hong Kong	1	1	10	18	5
Japan	1	4	12	22	12
All Countries	37	31	41	68	36

Chart 2

Real Estate

Value of Direct Acquisitions



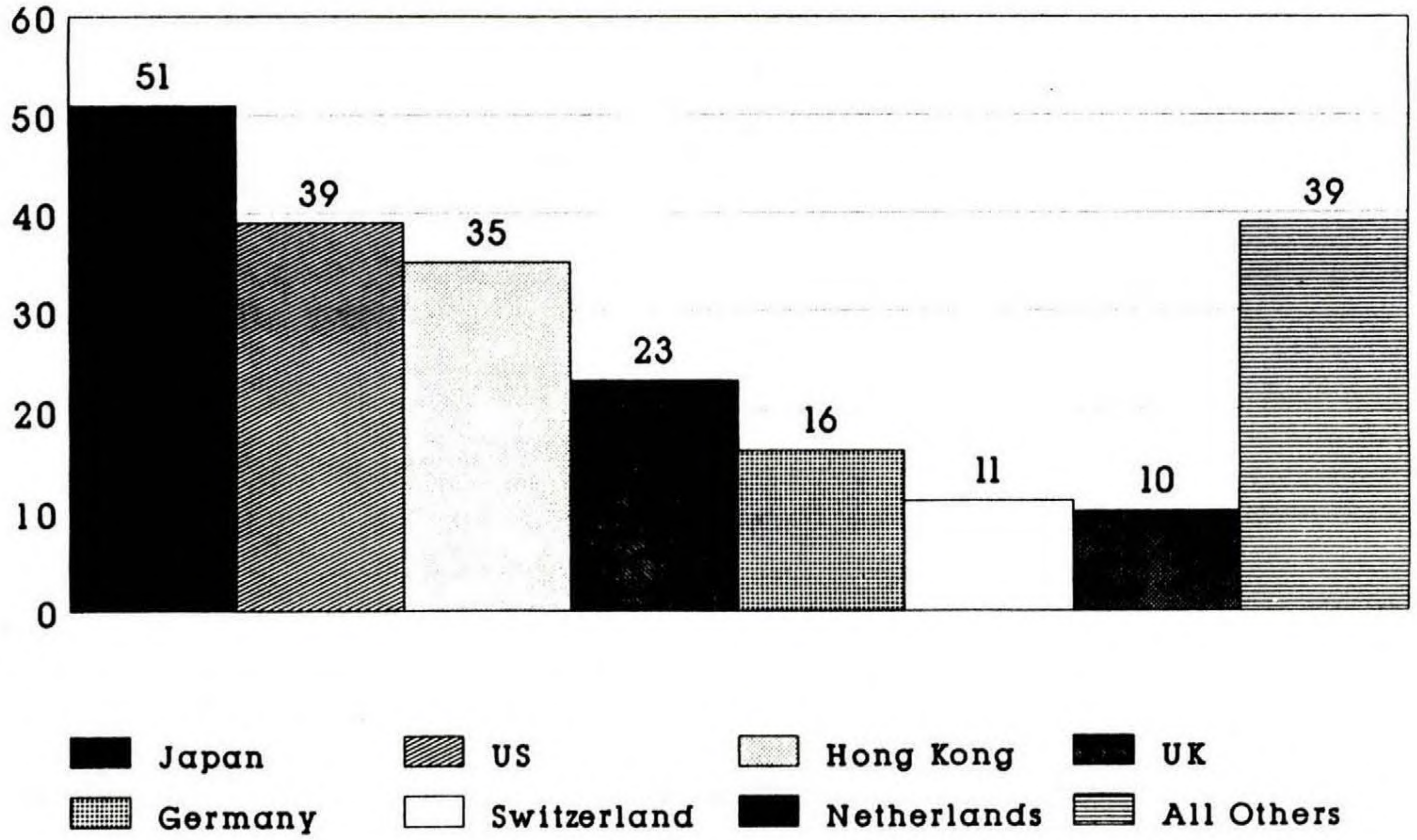
	1986	1987	1988	1989	1990
Hong Kong	0.9	29.5	174.1	287.3	15.7
Japan	6.6	66.2	138.3	649.7	217.3
All Countries	704	2098.9	684.8	1893.5	642.4

1987 includes JMB-Cadillac Fairview

Chart 3

Real Estate

No. of Direct Acquisitions, 7 Countries

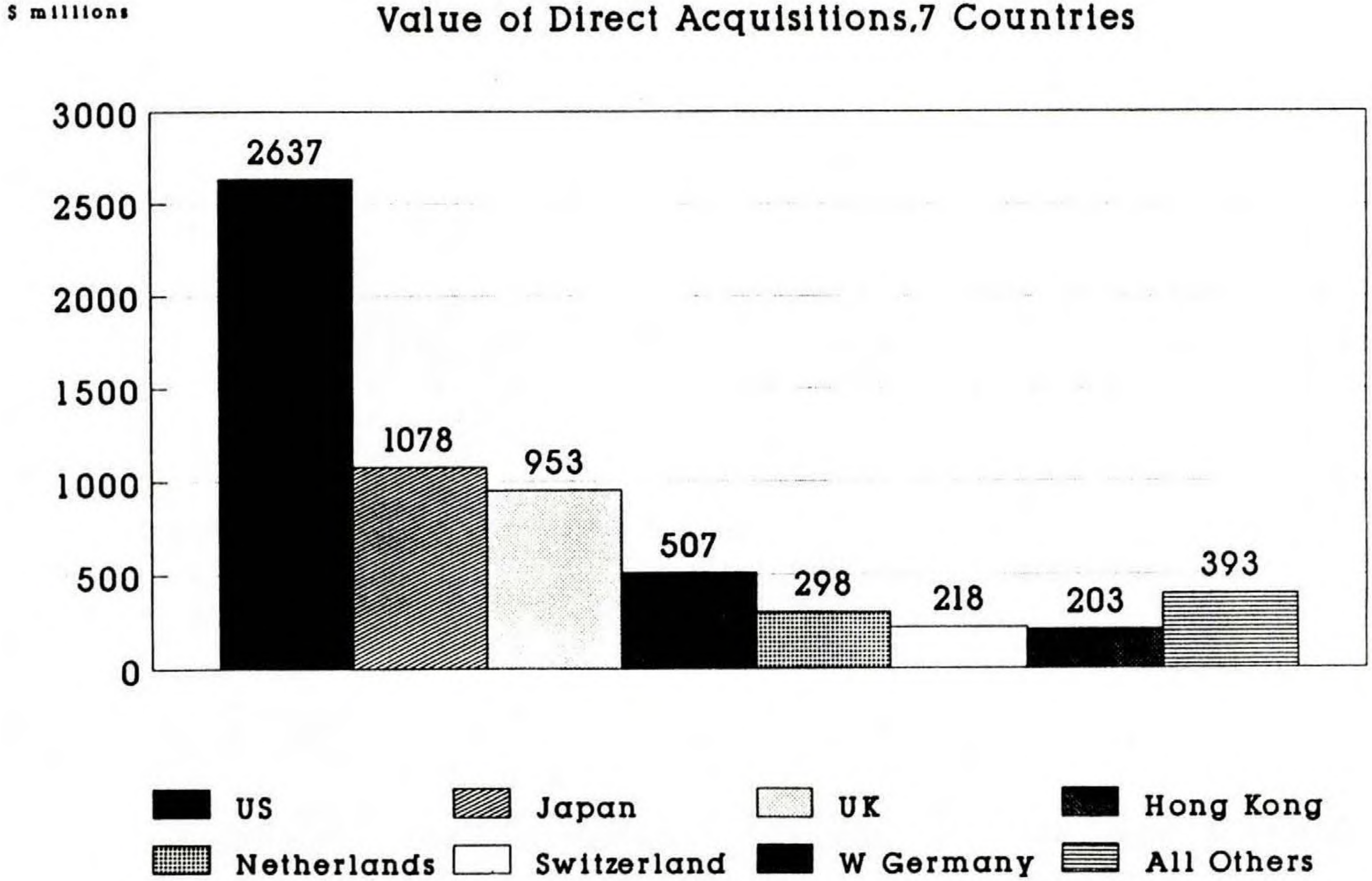


June 30, 1985 - Dec. 31, 1990

Chart 4

Real Estate

Value of Direct Acquisitions,7 Countries



June 30, 1985 - Dec. 31, 1990

Annex D

FOREIGN ACQUISITIONS OF TECHNOLOGY-INTENSIVE CANADIAN COMPANIES

Investments reviewed under the Investment Canada Act to determine whether they are likely to be of net benefit to Canada are assessed on their merits by reference to the factors of assessment set out in Section 20 of the Act. In the review of the acquisition of technology-intensive Canadian companies, Investment Canada seeks evidence of the investors' intention to build the Canadian business as an internationally competitive enterprise. To this end, the Agency requires the submission of comprehensive plans, including the strategic direction, for the development of the Canadian business over the medium-term. More particularly, in such cases the Agency typically seeks from the non-Canadian investor:

- assurances that the investor has and is prepared to commit the resources required for the Canadian business to grow as an internationally competitive enterprise including financial, research, technological, production, marketing and management resources;
- a commitment to the growth of the business from a Canadian base;
- assurances, despite foreign control, that the Canadian company will have meaningful autonomy and freedom to act;
- assurances of high levels of Canadian participation in the direction, management, and where appropriate, ownership of the Canadian company;
- a commitment to significant levels of R&D spending in Canada;
- a commitment, where appropriate, to world product mandates for specified products and services (from R&D through manufacturing and marketing);
- a commitment to provide quality employment opportunities for Canadians;
- assurances that any transfer of technology between the Canadian business and the Investor or its affiliates will be on an arms length basis;
- assurances that any commitments that may have been given to the Crown in connection with loans or grants of public funds will be honoured by the new owners of the business; and
- a commitment to high standards of environmental protection.