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# The Regulation of Foreign Direct Investment by State-owned Enterprises in Canada

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# The Regulation of Foreign Direct Investment by State-owned Enterprises in Canada

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By Gail E Henderson\*

## Introduction

Canada's economy has always depended heavily on foreign direct investment. Perhaps dependence breeds resentment, because throughout Canada's history foreign investment has been welcomed only reluctantly.<sup>1</sup> Suspicion of investment by state-owned enterprises is only the latest chapter in this history.<sup>2</sup> On December 7, 2012, the Government of Canada begrudgingly approved the takeovers of two Canadian oil sands companies, Nexen Inc. and Progress Energy Resources Corp., by two foreign state-owned enterprises, the China National Offshore Oil Corporation (CNOOC) and Malaysia's PETRONAS, respectively. On the same day, the Government announced new guidelines for reviewing investments by state-owned enterprises and a new policy that further takeovers of oil sands companies by such enterprises would be approved only in "exceptional" circumstances.<sup>3</sup>

There are a number of troubling aspects to the Government's position. It ignores the important role state-owned enterprises such as Norway's Statoil, Abu Dhabi's National Energy Company and PetroChina Investment Co. have played in the Canadian oil industry, and the role they

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\* Assistant Professor, University of Alberta Faculty of Law, gail.henderson@ualberta.ca. I would like to thank Nicholas Emter for his able research assistance on this paper and for his insight on the topic of foreign direct investment.

<sup>1</sup> Andrea Mandel-Campbell, "Foreign Investment Review Regimes: How Canada Stacks Up" (2008) Conference Board of Canada at i ("Canada represents a unique and not necessarily conducive hybrid between two opposing policies toward inbound foreign direct investment: the unilateral liberalization favoured by the United Kingdom and the 'economic patriotism' embodied by France."). In addition to the review process for foreign investment discussed in this paper, Canada restricts foreign investment in certain sectors of the economy, including banking and telecommunications.

<sup>2</sup> A full recounting of the history of foreign direct investment in Canada is beyond the scope of this working paper, but see generally M Jacqueline Sheppard & Mungo Hardwicke-Brown, "Overview of the Investment Canada Act with a Focus on Investments in Canada's Upstream Oil and Gas Industry" (1992) 30 Alta L Rev 4.

<sup>3</sup> Statement by the Prime Minister of Canada on foreign investment, 7 December 2012, Ottawa, Canada; Industry Canada, Press Release: "Government of Canada Releases Policy Statement and Revised Guidelines for Investments by State-Owned Enterprises", 7 December 2012; Industry Canada, *Investment Canada Act Guidelines: Statement Regarding Investment by Foreign State-Owned Enterprises*. It is interesting that the Nexen deal helped to prompt this nationalistic response, since "a significant portion of Nexen's assets and operations are located outside of Canada": Michelle Lally et al, "New Rules for Foreign Investment by State-Owned Enterprises – Do They Strike the Right Balance?" (Osler, Hoskin & Harcourt LLP, December 9, 2012) at 13.

could play in the future.<sup>4</sup> It also appears to ignore the interests of Canada’s own public-sector pension funds, which are investing an increasing percentage of their assets abroad, sometimes in industries that carry foreign ownership restrictions or are publicly owned in Canada.<sup>5</sup> Apart from the possible economic impacts, in the era of government bail-outs and large public-sector investment funds, the distinction between state ownership and private ownership may be a poor basis for public policy, particularly in the area of foreign investment.

The paper will proceed as follows. Part I provides a brief general background on the Canadian foreign investment review process under the *Investment Canada Act*, including the “net benefit” test. Part II focuses on foreign direct investment (“FDI”) by state-owned enterprises (“SOEs”).<sup>6</sup> Section A reviews the concerns the Canadian Government and others have expressed regarding FDI by SOEs. Section B discusses how state ownership will affect the Government’s assessment as to whether a reviewable investment satisfies the net benefit test. Section C questions the logic of distinguishing between SOEs and privately-owned acquirers in its foreign direct investment review process.

## I. Background

### A. Overview of the Foreign Investment Review Process

The *Investment Canada Act* (“Act”) provides for review by the Minister of Industry of proposed investments that would result in an acquisition of control of a Canadian business valued above a threshold amount.<sup>7</sup> A non-Canadian is prohibited from implementing an investment subject to review under the Act unless “the Minister is satisfied...that the investment is likely to be of net benefit to Canada.”<sup>8</sup> The terms “Canadian business” and what will constitute an acquisition of control are defined in the Act; the thresholds are set by the Act and its regulations.

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<sup>4</sup> Matt Krzepkowski & Jack Mintz, “Canada’s Foreign Direct Investment Challenge: Reducing Barriers and Ensuring a Level Playing Field in Face of Sovereign Wealth Funds and State-Owned Enterprises” (2010) 3:4 University of Calgary School of Public Policy SPP Research Papers at 1 and 9.

<sup>5</sup> Mandel-Campbell, *supra* note 1 at 25-26 (“CPPIB [Canada Pension Plan Investment Board] has taken pains to explain to the international business community that...it operates at arm’s-length from the Canadian government. But to foreign governments, the difference might be academic, especially if they are seeking retribution for their own investments’ being blocked in Canada.”).

<sup>6</sup> I focus narrowly in this paper on state-owned enterprises. Although sovereign wealth funds have attracted similar concerns and suspicions, their intention is not necessarily to take over the management of the Canadian businesses in which they invest.

<sup>7</sup> In the interests of clarity and brevity, this overview focuses on how the Act applies to takeovers of or significant investments in Canadian businesses. In other words, the description here will assume the application of the Act to a proposed foreign investment and ignore the various exemptions. Generally, the exemptions apply to the taking of ownership interests by financial institutions that occur by reason of the institution realizing on a security interest, or by reason of a corporation’s bankruptcy.

<sup>8</sup> *Investment Canada Act*, RSC 1985, c. 28, ss. 16 and 24.

“Canadian business” means “a business carried on in Canada that has a place of business in Canada, an individual or individuals in Canada who are employed or self-employed in connection with the business, and assets in Canada used in carrying on the business”.<sup>9</sup> Under this definition, the category of investments subject to review is not restricted to Canadian-owned businesses.

The *Act* also sets out what will constitute an acquisition for control, which makes an investment reviewable under the *Act*. A foreign investor will be acquiring control, for the purposes of the *Act*, when the investor acquires a majority of the voting shares of a corporation carrying on business in Canada; a majority of the voting interests in an entity that carries on business in Canada or controls another entity carrying on business in Canada; or all or substantially all of the assets of a Canadian business.<sup>10</sup> A transaction is presumed to be an acquisition for control if the foreign investor is acquiring one-third or more of the voting shares in a corporation, unless the investor can prove that they will not control the Canadian business upon acquiring the voting shares.<sup>11</sup>

On December 7, 2012, the Minister announced that the Government will “progressively” increase, over the next four years, to \$1 billion the value thresholds for reviewable investments applicable to WTO members. This new threshold, however, will not apply to SOEs, for which the existing threshold of \$330 million will remain in place.<sup>12</sup> To give this threshold some context, the Nexen-CNOOC deal was valued at \$15.1 billion Canadian dollars and the Progress Energy-PETRONAS deal at \$6 billion.<sup>13</sup> The threshold for non-WTO members will remain \$5 million.<sup>14</sup> The way that the value of a transaction will be calculated under the *Act* will also change from asset value to enterprise value to “capture the increasing importance of the service and knowledge-based industries” to the Canadian economy.<sup>15</sup>

The original statement of purpose in the *Act* was “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 benefit to Canada.”<sup>16</sup> The statement of purpose was amended in 2009 to emphasize the “importance of protecting national security”. Although the

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<sup>9</sup> *Ibid*, s. 3.

<sup>10</sup> *Ibid*, s. 28.

<sup>11</sup> *Ibid*, s. 28(3)(c).

<sup>12</sup> Industry Canada, Press Release: “Government of Canada Releases Policy Statement and Revised Guidelines for Investments by State-Owned Enterprises”, 7 December 2012; Industry Canada, *Investment Canada Act Guidelines: Statement Regarding Investment by Foreign State-Owned Enterprises*.

<sup>13</sup> Marzena Czarnecka, “Top Deals of 2012”, *Lexpert* (January 2013) at 32 and 34.

<sup>14</sup> Lally et al, *supra* note 3 at 5. This threshold also will continue to apply to cultural businesses.

<sup>15</sup> Industry Canada, Press Release: “Government of Canada Releases Policy Statement and Revised Guidelines for Investments by State-Owned Enterprises”, 7 December 2012.

<sup>16</sup> Sheppard & Hardwicke-Brown, *supra* note 2 at 16.

revised wording of the purpose statement implies that foreign investments in Canada will be reviewed solely for possible “injurious” impacts on national security,<sup>17</sup> the “net benefit” test for foreign investments, discussed further below, has not been changed.<sup>18</sup>

The review process under the *Act* has been criticized extensively inside and outside Canada as a potential barrier to much-needed foreign investment.<sup>19</sup> Many have argued for greater transparency of the process,<sup>20</sup> including the publication of reasons for the Minister’s decision to allow or to reject an investment.<sup>21</sup> A number of commentators have suggested that this lack of transparency has helped to create the impression that Canada is hostile to foreign investment,<sup>22</sup> and that the process is highly politicized. In 2010, the Canadian Government blocked a hostile takeover bid for Potash Corporation by BHP Billiton, a privately-owned, publicly-listed Australian corporation, on the basis that the takeover was not “likely to be of net benefit to Canada.”<sup>23</sup> In accordance with standard practice, no reasons for this decision were issued,<sup>24</sup> but it is widely assumed that the federal government was responding to the vocal opposition of the Premier of Saskatchewan.<sup>25</sup> This decision and the surrounding circumstances reinforced concerns regarding politicization of the review process and increased calls for greater transparency.

## B. The “Net Benefit” Test

The most obvious manifestation of Canada’s suspicion of foreign investment is found in the *Act*’s “net benefit” test for approving inward foreign investments. In order for a reviewable

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<sup>17</sup> The purpose statement in s. 2 of the *Act*, *supra* note 8, reads as follows: “Recognizing that increased capital and technology benefits Canada, and recognizing the importance of protecting national security, the purposes of this Act are to provide for the review of significant investments in Canada by non-Canadians in a manner that encourages investment, economic growth and employment opportunities in Canada and to provide for the review of investments in Canada by non-Canadians that could be injurious to national security.”

<sup>18</sup> The provisions regarding national security review can be found in Part IV.1 of the *Act*, *ibid*.

<sup>19</sup> But see Lawrence Herman, “Investment Review in Canada – We Can Do Better” (2011) 4:10 University of Calgary School of Public Policy SRP Research Papers at 3, online: <http://www.policyschool.ucalgary.ca>, citing the report of the federal government’s Competition Policy Review Panel, *Compete to Win*.

<sup>20</sup> J Anthony VanDuzer, “Mixed Signals: What Recent Developments Tell Us About Canadian Foreign Investment Policy” 8 *Asper Review* 247 at 258. A Parliamentary committee review of the *Act* that might have led to greater transparency was terminated by the last federal election in 2011: Lawson A W Hunter & Susan M Hutton, “Foreign Investment Review in Canada: Be Careful What You Wish For” *Business Law Today*, 19 May 2011.

<sup>21</sup> Herman, *supra* note 19 at 12. Although reasons must be given to the foreign investor when an investment is rejected, reasons are not usually made public. See Philippe Bergevin & Daniel Schwanen, “Reforming the *Investment Canada Act*: Walk More Softly, Carry a Bigger Stick” (CD Howe Institute, December 2011) at 11; *Act*, *supra* note 8 s. 23.1.

<sup>22</sup> VanDuzer, *supra* note 20 at 266; Herman, *supra* note 19 at 12-13.

<sup>23</sup> Statement of then Minister of Industry Tony Clement, quoted in Herman, *ibid* at 3.

<sup>24</sup> *Ibid* at 3.

<sup>25</sup> The policy objectives of a provincial government and the possible effects of a takeover on those objectives are express criteria of the net benefit test: *Act*, *supra* note 8, s. 20(e).

investment to receive approval, the Minister must be satisfied that the investment will be of “net benefit” to Canada.<sup>26</sup> The *Act* imposes a 45 day time limit on the Minister to make this decision, once all of the required information has been received from the foreign investor.<sup>27</sup> According to Industry Canada Guidelines, “[a]n investment will be determined to be of net benefit when the aggregate net effect is positive, regardless of its extent.”<sup>28</sup> The burden is on the foreign investor to prove to the Government that its investment will create a net benefit to Canada.<sup>29</sup>

Section 20 of the *Act* sets out the “factors” that the Minister is to take into account, “where relevant”, in assessing whether a reviewable investment is a net benefit to Canada:

- (a) the effect of the investment on the level and nature of economic activity in Canada, including, without limiting the generality of the foregoing, the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada and on exports from Canada;
- (b) the degree and significance of participation by Canadians in the Canadian business or new Canadian business and in any industry or industries in Canada of which the Canadian business or new Canadian business forms or would form a part;
- (c) the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;
- (d) the effect of the investment on competition within any industry or industries in Canada;
- (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; and
- (f) the contribution of the investment to Canada’s ability to compete in world markets.

“Canadian” is defined in the *Act* as a Canadian citizen, permanent resident who has been eligible to apply for citizenship for less than one year, a Canadian government or government agency, or a Canadian-controlled entity.<sup>30</sup> In determining whether an investment constitutes a

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<sup>26</sup> *Ibid*, ss. 16 and 21(1).

<sup>27</sup> *Ibid*, s. 21(1), unless the Minister notifies the foreign investor that the Minister will require a 30-day extension: s. 22. If no notice is sent within the 45 day period, “the Minister is deemed to be satisfied that the investment is likely to be of net benefit to Canada”: s. 21(9).

<sup>28</sup> Industry Canada, *Guidelines – Administrative Procedures*.

<sup>29</sup> Industry Canada, Press Release: “Government of Canada Releases Policy Statement and Revised Guidelines for Investments by State-Owned Enterprises”, 7 December 2012; Industry Canada, *Investment Canada Act Guidelines: Statement Regarding Investment by Foreign State-Owned Enterprises*.

<sup>30</sup> *Act*, *supra* note 8, s. 2.

net benefit in the aggregate, relevant factors will be looked at individually, with any negative impacts weighed against positive ones.<sup>31</sup>

In the review process, foreign investors may offer, or the Government may prompt them to offer, “undertakings” that will be taken into account by the Minister in assessing net benefit.<sup>32</sup> The foreign investor also has 30 days to offer undertakings after notice has been given that the Minister is not satisfied that a proposed investment meets the net benefit test.<sup>33</sup> In order to obtain government approval of its takeover of Stelco, US Steel gave undertakings to maintain certain levels of employment and production in Canada. Usually, the specifics of these undertakings are not made public,<sup>34</sup> and, until recently, the provisions in the *Act* providing for the enforcement of these undertakings had never been used.<sup>35</sup> In 2009, however, the Government launched a law suit against US Steel for breach of its undertakings after US Steel laid off over 2,000 Canadian workers. The merits of the Canadian Government’s claim have yet to be decided.

Generally, the net benefit test can be read as an assertion of central government management over the Canadian economy out of concern that foreign investment may not result in the social benefits predicted by economic theory without help from the guiding hand of government. In other words, the test’s underlying assumption is that foreign investment does not necessarily produce a net social benefit, but rather will produce such a benefit only when screened and, in some cases, certain conditions imposed. The list of factors to be assessed to determine net benefit attempt to address specific domestic concerns regarding foreign investment, including loss of employment and the relocation of head offices and research and development.

Many Canadian critics view the list of factors in section 20 as unnecessarily arbitrary and subjective,<sup>36</sup> and “vague, elusive and contradictory”.<sup>37</sup> On the other hand, one commentator has argued that it provides “broadly objective factors...not adequately defined or sufficiently precise but nonetheless generally stated as legal criteria.”<sup>38</sup> Others defend the test’s vagueness on the grounds that a more specific test would have to be more rigidly applied, likely resulting

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<sup>31</sup> Industry Canada, *Guidelines – Administrative Procedures*.

<sup>32</sup> *Act*, *supra* note 8, s. 21.

<sup>33</sup> *Ibid*, s. 23. See also Industry Canada, *Guidelines – Administrative Procedures* (“in certain cases, specific undertakings may be helpful to provide greater assurances when issues, critical to the determination of net benefit, arise.”). This occurred in the Progress Energy-PETRONAS deal.

<sup>34</sup> Bergevin & Schwanen, *supra* note 21 at 11.

<sup>35</sup> *Act*, *ibid*, ss. 39(1)(d.1) and (3) and 40.

<sup>36</sup> See, e.g., Bergevin & Schwanen, *supra* note 21 at 17. See also Debra P Steger, “State Capitalism: Do We Need Controls?” 50 *Canada-Asia Commentary* (April 2008) at 11.

<sup>37</sup> Andrew Coyne, “The ‘net benefit’ test doesn’t need to be clarified, it needs to be abolished”, *National Post*, 12 October 2012, online: <http://fullcomment.nationalpost.com/2012/10/22/andrew-coyne-the-net-benefit-test-doesnt-need-to-be-clarified-it-needs-to-be-abolished> [Coyne, “Abolished”].

<sup>38</sup> Herman, *supra* note 19 at 5-6.

in a greater number of rejections.<sup>39</sup> Some authors have suggested that the Government publish more regulations and guidelines to help increase consistency and predictability in the application of the test.<sup>40</sup> The main problem with the test may be that it requires the Government to assess each proposed investment in isolation, whereas the “net benefit” of foreign investment is seen clearly in the aggregate. In any corporate reorganization, some jobs may be lost or moved, some R&D relocated. The evidence appears to show, however, that the aggregate effect of foreign investment on the Canadian economy has been a net positive one.

## II. Foreign Investment by State-owned Enterprises

### A. Canada’s Concerns Regarding FDI by SOEs

Canadians’ concerns regarding FDI are both general and specific to investment by SOEs. Generally, there has always been a fear that takeovers by foreign investors will “hollow out” corporate Canada by moving head offices elsewhere, leaving us mere ‘hewers of wood and drawers of water’.<sup>41</sup> Although hard evidence of this perceived “hollowing out” is hard to come by,<sup>42</sup> concerns were heightened in the last few years by “a series of rapidly concluded foreign takeovers” by some iconic Canadian corporations, including Inco Ltd. (by Brazil’s Vale) and Falconbridge Corp. (by Swiss-based Xstrata).<sup>43</sup> As noted above, the Canadian Government rejected a bid by BHP Billiton for Saskatchewan-based Potash Corporation after loud protests from the Saskatchewan provincial government and the Canadian public. Most recently, reaction to a proposed merger between the London Stock Exchange and TMX, which owns the Toronto Stock Exchange and TSX Venture Exchange was swift and primarily negative. TMX was purchased instead by the appropriately named Maple Group Acquisitions Corp., a consortium of Canadian banks and public-sector pension fund managers.

The primary concern regarding FDI by SOEs is that SOEs will not operate on a commercial basis; rather, decisions will be based on the interests of the SOE’s home government, and that these interests will be contrary to Canada’s own policies or interests.<sup>44</sup> There are also vaguely worded

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<sup>39</sup> Hunter & Hutton, *supra* note 20 at 4.

<sup>40</sup> Herman, *supra* note 19 at 6 and 13.

<sup>41</sup> Jackie VanDerMeulen and Michael J Trebilcock, “Canada’s Foreign Policy Response to Foreign Sovereign Investment: Operationalizing National Security Exceptions” 47 Can Bus LJ 392 at 400; Mandel-Campbell, *supra* note 1 at 1.

<sup>42</sup> Several commentators cite evidence that foreign owners create more head offices. Krzepkowski & Mintz, *supra* note 4 at 8; Steger, *supra* note 36 at 11.

<sup>43</sup> Herman, *supra* note 19 at 2. See also Mandel-Campbell, *supra* note 1 at 2.

<sup>44</sup> Statement by the Prime Minister of Canada on foreign investment, 7 December 2012, Ottawa, Canada (“The larger purposes of state-owned enterprises may go well beyond the commercial objectives of privately owned companies.”); Industry Canada, *Investment Canada Act Guidelines: Statement Regarding Investment by Foreign State-Owned Enterprises*. See also Herman, *ibid* at 10; Jeff Singer & Sandra Walker, “Canada’s Position: Sovereign Wealth Funds” (2008) 27 Int’l Fin L Rev 23 at 23; Bergevin & Schwanen, *supra* note 21 at 14 (“are, or can be, used



concerns regarding “political interference in the Canadian economy.”<sup>45</sup> To date, however, there is little evidence of Chinese SOEs “responding to the political dictates” of the Chinese Government.<sup>46</sup> Zhaofeng Wang reports that Chinese SOEs “are expected to advance the well-being of the entire Chinese nation in their governance and operations. From here derives their dual objective: improving the corporation’s performance and advancing national goals.”<sup>47</sup> That said, Wang also notes that the “main task” of SOE managers “is maintaining and increasing the value of the state-owned assets”, and that managers will be evaluated based “strictly” on performance. Although “performance” includes other factors, it is based primarily on profitability.<sup>48</sup> Margaret Cornish notes that the “single-minded focus on profitability” of SOE managers has been criticized in China.<sup>49</sup> Concerns about inefficiency within SOEs notwithstanding, Chinese SOEs have realized large profits in recent years.<sup>50</sup>

Concerns about political interference may stem from the perceived secrecy, or lack of transparency, of SOEs.<sup>51</sup> This perceived secrecy feeds “speculation...that sovereign investments may not be motivated by profit alone.”<sup>52</sup> They also may stem from the differences, actual and perceived,<sup>53</sup> in the governance of private, Western corporations and Chinese SOEs.<sup>54</sup> As VanDerMeulen and Trebilcock acknowledge, much of the trust of sovereign wealth funds and SOEs from countries such as Norway “is built on perceptions about the political and business

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by their home country to further its own politically-driven economic, security or other goals.”); Margaret Cornish, “Behaviour of Chinese SOEs: Implications for Investment and Cooperation in Canada” (Canadian Council of Chief Executives and Canadian International Council, February 2012) at 13 (China’s ascendancy as an international power leads to the concern that “SOEs may behave in hostile ways.”); Lally et al, *supra* note 3 at 1.

<sup>45</sup> Hunter & Hutton, *supra* note 20 at 5. See also VanDerMeulen & Trebilcock, *supra* note 41 at 393 (“foreign governments could use their SWFs and SOEs for various non-commercial purposes.”); and Bergevin & Schwanen, *ibid* at 13 (“concerns that national governments have expressed about takeovers of domestic companies by [SOEs]...are related...to concerns that another government might be able to exercise control over economic developments in the host country.”).

<sup>46</sup> Cornish, *supra* note 44 at 20.

<sup>47</sup> Zhaofeng Wang, “Corporate Governance under State Control: The Chinese Experience” (2012) 13 *Theoretical Inquiry in Law* 487 at 491.

<sup>48</sup> Wang, *ibid* at 491-92. See also Cornish, *supra* note 44 at 10. That SOE managers will be evaluated and rewarded based on performance is included in their contract, although contracts are “modified annually to reflect changes in state policy.” Wang, *ibid* at 493-94. SOE executives may in fact be more motivated to ensure SOEs perform well, given the potential reward of a good position in the Chinese Government: *ibid* at 492.

<sup>49</sup> Cornish, *ibid* at 9.

<sup>50</sup> Wang, *supra* note 47 at 495.

<sup>51</sup> VanDerMeulen & Trebilcock, *supra* note 41 at 393; Mandel-Campbell, *supra* note 1 at 23; Steger, *supra* note 36 at 3 (describing SWFs generally, including SOEs). Steger comments on the “irony” of this concern, given the lack of transparency of the review process under the Act. *Ibid* at 11.

<sup>52</sup> VanDerMeulen & Trebilcock, *ibid* at 409.

<sup>53</sup> Margaret Cornish notes the role that “misconceptions” about Chinese SOEs have played in formulating Government policy: Cornish, *supra* note 44 at 5.

<sup>54</sup> Wang, *supra* note 47 at 487 (“The governance of [Chinese SOEs] is strikingly different from that of corporations in capitalist systems”). For example, Chinese SOEs use a two-tier board structure, somewhat similar to Germany, versus the unitary board structure of Anglo-American corporations. *Ibid* at 490; Cornish, *ibid* at 8.

climate in these developed countries, rather than any substantive evidence that distinguishes these SWFs from their emerging economy counterparts.”<sup>55</sup> It is possible, however, that the actual differences are exaggerated or based on misconceptions.<sup>56</sup> In any event, our suspicious attitudes are likely to be rewarded in kind: “[t]he persistent negative characterization of intentions” of Chinese SOEs seeking to invest in North America “has led to some resentment and cynicism about western motives.”<sup>57</sup> It seems possible, at least, that concerns about SOEs arise from Western unease at China’s rising global influence.<sup>58</sup>

Much of the interest shown by SOEs in Canadian companies has been directed at the natural resource sectors.<sup>59</sup> With respect to SOE investment in this sector, concerns have been expressed that SOEs would manage Canada’s natural resources in accordance with the policies of the SOE’s home government “rather than purely commercial considerations or Canadian policy priorities.”<sup>60</sup> This includes the concern that “the SOE could buy up resources to fuel its home economy, rather than supply Canadian customers.”<sup>61</sup> In addition to a lack of evidence supporting this concern,<sup>62</sup> it is difficult to understand why it would be a concern at all. In Canada, extraction companies do not own the natural resource; rather, the province retains ownership of the resource and sells only the extraction rights. Although the provincial government’s ability to cut off extraction completely may be governed by trade and investment law regarding expropriation, it nonetheless retains the ability to control and to regulate extraction.<sup>63</sup> This includes the ability to assess royalties based on market price. An SOE that chose “to preferentially ship oil to its home state...would face the opportunity cost of doing so”,<sup>64</sup> trading off the benefits of greater profits against the benefits of cheap access to oil, although this trade off may be one that Chinese SOEs are willing to make. Such a move might still be prevented by “Canadian transfer pricing rules” which “are designed specifically to

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<sup>55</sup> VanDerMeulen & Trebilcock, *supra* note 41 at 402. See also Mandel-Campbell, *supra* note 1 at 24 (“Norway’s government pension fund...largely conforms to Western governance standards”); Cornish, *ibid* at 14 (“This suggests that the significant issue is their geopolitical distance rather than their ownership status.”) and 17.

<sup>56</sup> Cornish, *ibid* at 10.

<sup>57</sup> *Ibid* at 14.

<sup>58</sup> The American Government has expressed some displeasure regarding significant acquisitions by Chinese SOEs in “America’s backyard”: *ibid* at 14.

<sup>59</sup> VanDerMeulen & Trebilcock, *supra* note 41 at 398.

<sup>60</sup> VanDuzer, *supra* note 20 at 251-52.

<sup>61</sup> Singer & Walker, *supra* note 44 at 23. See also VanDerMeulen & Trebilcock, *supra* note 41 at 401 (“resource hoarding”); Cornish, *supra* note 44 at 11.

<sup>62</sup> Cornish, *ibid* at 11.

<sup>63</sup> Steger, *supra* note 36 at 12; Josh Wingrove, “Alberta pleased over Nexen, Progress approval, cautiously eyes limits on future takeovers” *Globe and Mail*, 7 December 2012, online: <http://www.globeandmail.com/news/politics/alberta-pleased-over-nexen-progress-approval-cautiously-eyes-limits-on-future-takeovers/article6126022>.

<sup>64</sup> Grant Bishop, “Why Canada needs to take the politics out of foreign investment” *Globe and Mail*, 14 January 2013, online: <http://www.globeandmail.com/report-on-business/economy/economy-lab/why-canada-needs-to-take-the-politics-out-of-foreign-investment/article7339244>.

prevent exports at below market prices.<sup>65</sup> Concerns about SOEs buying up too great a percentage of the companies operating in a particular natural resource sector<sup>66</sup> can be controlled by Canadian competition law.<sup>67</sup> A greater focus on enforcing competition laws would no doubt have positive effects on the economy as a whole.<sup>68</sup>

Hand-wringing over SOE investment in Canada may be due, in part, to Canada's negative past experience with domestic SOEs, which led to their privatization.<sup>69</sup> This experience has given rise to the concern that SOEs "may have negative effects on the efficiency, productivity and competitiveness" of the Canadian businesses they acquire.<sup>70</sup> Concerns arising from the presumed inefficiency of domestic SOEs do not necessarily apply equally to foreign SOEs. The purpose of domestic SOEs might be to protect the national interest in a particular industry or service, or to create jobs and encourage local economic development. When SOEs operate internationally it seems more likely that they will be purely profit-driven; why make investments abroad except for the purpose of generating returns on investment?<sup>71</sup> This distinction can be seen in the two-fold investment objectives of the Caisse de dépôt et placement du Québec, a Canadian public-sector fund manager: "to achieve an optimal return on [investment], while contributing to Québec's economic development."<sup>72</sup> In other words, when investing outside of Québec, the sole investment objective of the Caisse is to generate an "optimal" investment return. This may be why FDI is often criticized and feared on the basis that foreign owners will ruthlessly cut jobs and wages, and show less regard for any negative impacts on the surrounding community.<sup>73</sup> Furthermore, there is no reason to think that SOEs suffer from significantly greater bureaucratic inefficiency, conflicting goals or insufficient incentives to maximize profits than other types of large, multinational enterprises.

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<sup>65</sup> Cornish, *supra* note 44 at 17.

<sup>66</sup> Industry Canada, *Investment Canada Act Guidelines: Statement Regarding Investment by Foreign State-Owned Enterprises*.

<sup>67</sup> Cornish, *supra* note 44 at 17.

<sup>68</sup> Mandel-Campbell, *supra* note 1 at 28 (discussing the UK's approach to making the City of London a "gateway to Europe" and Canada's failure to become the "gateway to North America").

<sup>69</sup> Statement by the Prime Minister of Canada on foreign investment, 7 December 2012, Ottawa, Canada. See also VanDerMeulen & Trebilcock, *supra* note 41 at 403 (discussing SOEs in general).

<sup>70</sup> Industry Canada, *Investment Canada Act Guidelines: Statement Regarding Investment by Foreign State-Owned Enterprises*.

<sup>71</sup> Steger, *supra* note 36 at 3 ("The evidence so far...is that SWFs are driven principally by investment objectives rather than by political and strategic calculations.").

<sup>72</sup> Caisse de dépôt et placement du Québec, "Profile of the Caisse", online: <http://www.lacaisse.com/en/about-us/profile>. Québec is a province in Canada.

<sup>73</sup> Krzepkowski & Mintz, *supra* note 4 at 8 ("objections to increased foreign control have focused on...concerns that while domestic firms operate in the domestic interest, foreign companies do not."). Although evidence indicates there is no difference between Canadian-owned and foreign-owned corporations in this respect.

Another commonly expressed concern is that a possible motive of SOEs is to gain access to “sensitive” technologies for political, rather than commercial purposes.<sup>74</sup> Concerns about national security are not limited to SOEs, however. In 2007, the Canadian Government rejected a takeover of a division of MacDonald Dettwiler & Associates by privately-owned US firm Alliant Techsystems on the basis of national security concerns. The Canadian government was worried about losing control of “top-secret” satellite images.<sup>75</sup> In the case of a corporation based in a country perceived as hostile to Canada, whether the corporation is state-owned is unlikely to be very relevant to a determination that the investment should be blocked on national security grounds. In any event, national security concerns do not justify blocking all, or even most, investments by SOEs, given the potential costs to the Canadian economy.<sup>76</sup>

There is a valid concern that corporate assets will be diverted from the business to respond to the wishes of the SOE’s home government. The underlying concern is that to the extent an SOE’s assets are diverted for public policy purposes, there may not be sufficient capital “to maintain the Canadian business in a globally competitive position.”<sup>77</sup> There is some evidence to support this concern. According to Wang, the Chinese government can “make key business decisions for” SOEs in order “to advance...national goals.”<sup>78</sup> For example, in 2008, the China National Petroleum Corporation, Sinopec Corporation and the China National Offshore Oil Corporation wrote off about \$24 billion US in order to keep domestic oil prices stable after a spike in the international price of oil.<sup>79</sup> This role in stabilizing domestic prices affects the real returns on assets realized by SOEs.<sup>80</sup> But, again, concerns about diversion of assets or profits are not limited to SOEs: in 2004, OMERS, another Canadian public-sector pension fund, successfully sued the board of Ford Canada for allowing the US parent company to manipulate transfer prices to ensure profits were realized by the US parent rather than the Canadian subsidiary, in which OMERS had invested.<sup>81</sup>

## **B. The Impact of State-ownership on the Assessment of “Net Benefit”**

In 2007, the Abu Dhabi National Energy Company bought three oil sands companies; in response, the Canadian Government introduced new guidelines to address concerns regarding

<sup>74</sup> VanDerMeulen & Trebilcock, *supra* note 41 at 402.

<sup>75</sup> *Ibid* at 407. See also Krzepkowski & Mintz, *supra* note 4 at 1.

<sup>76</sup> VanDerMeulen and Trebilcock cite evidence that after the US Government blocked the DP World transaction, “foreign investment from the United Arab Emirates alone fell by over \$1 billion.” VanDerMeulen & Trebilcock, *ibid* at 428.

<sup>77</sup> VanDuzer, *supra* note 20 at 253.

<sup>78</sup> Wang, *supra* note 47 at 489. Although current policy is to remove “social burdens, such as schools, hospitals and employees’ housing services” from central SOEs, as has been done for local SOEs.

<sup>79</sup> *Ibid* at 497.

<sup>80</sup> *Ibid* at 498 (the real return on assets realized by SOEs was only 1.47% in 2009).

<sup>81</sup> *Ford Motor Co. of Canada Ltd v. Ontario (Municipal Employees Retirement Board)* (2004) 41 BLR (3d) 74, upheld on appeal, (2006) 79 OR (3d) 81.

SOE investments in Canada's natural resources sector.<sup>82</sup> Under the 2007 Guidelines, additional criteria would apply to the assessment of net benefit of reviewable investments by SOEs.<sup>83</sup> These factors included "the degree of state control, corporate governance, transparency, shareholder treatment", board independence and "whether the acquired entity will continue to operate on a commercial basis."<sup>84</sup>

Like the review process generally, the 2007 Guidelines for SOEs were criticized as vague and unclear.<sup>85</sup> Singer and Walker noted that the Guidelines failed even to define what level of ownership would make a corporation an SOE.<sup>86</sup> Some commentators suggested that additional guidelines for SOEs were unnecessary, that the existing net benefit test was broad enough for the Government to take concerns about SOEs into account.<sup>87</sup> Other commentators worried that the 2007 Guidelines would have a "chilling effect" on FDI from emerging economies.<sup>88</sup>

Despite these concerns, a number of investments by SOEs in Canadian natural resource companies were approved between 2007 and 2012.<sup>89</sup> Then, on December 7, 2012, the Government simultaneously approved two takeovers by SOEs and issued new, stricter Guidelines for SOEs. In his speech announcing these decisions, the Prime Minister of Canada appeared to "all but sla[m] the door" on further FDI by SOEs in Alberta's oil sands,<sup>90</sup> stating that the Nexen and Progress transactions were "the end of a trend", and that "going forward" reviewable investments by SOEs in the oil sands will be found to be of net benefit "only in an exceptional circumstance."<sup>91</sup>

In addition to taking a strong stand against further acquisitions for control of Canadian oil sands companies by SOEs, the Government also announced that the Minister of Industry will "carefully monitor" proposed SOE transactions in other areas of the Canadian economy. This is to include examination of "the degree of control or influence an SOE would likely exert on the Canadian business that is being acquired; the degree of control or influence an SOE would likely exert on the industry in which the Canadian business operates; and the extent to which a

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<sup>82</sup> Mandel-Campbell, *supra* note 1 at 2.

<sup>83</sup> VanDuzer, *supra* note 20 at 248.

<sup>84</sup> Herman, *supra* note 19 at 10.

<sup>85</sup> But see Bergevin & Schwanen, *supra* note 21 at 14 (describing the 2007 Guidelines as "provid[ing] a level of clarity").

<sup>86</sup> Singer & Walker, *supra* note 44 at 23.

<sup>87</sup> VanDuzer, *supra* note 20 at 253; Bergevin & Schwanen, *supra* note 21 at 11; Steger, *supra* note 36 at 9.

<sup>88</sup> Steger, *ibid* at 11.

<sup>89</sup> VanDuzer, *supra* note 20 at 249; Lally et al, *supra* note 3 at 11.

<sup>90</sup> Andrew Coyne, "Stephen Harper's foreign takeover policy no longer just murky, but totally incoherent", *National Post*, 12 December 2012, online: <http://fullcomment.nationalpost.com/2012/12/07/andrew-coyne-stephen-harpers-foreign-takeover-policy-no-longer-just-murky-but-totally-incoherent/>.

<sup>91</sup> Statement by the Prime Minister of Canada on foreign investment, 7 December 2012, Ottawa, Canada.

foreign state is likely to exercise control or influence over the SOE acquiring the Canadian business.”<sup>92</sup>

The new Guidelines define SOE even more broadly than the 2007 Guidelines as “an enterprise that is owned, controlled or *influenced*, directly or indirectly by a foreign government.”<sup>93</sup> It would seem that the addition of “influenced” to the definition is meant to include more than enterprises that are majority-owned by a foreign government, but how far this new, broader category extends is not clear. The Canadian Government could have borrowed the OECD definition, which includes enterprises in which the state has a “significant minority ownership” stake.<sup>94</sup> Assuming the Government was aware of this definition, it would seem that “influenced” is intended either to include an even greater number of enterprises, or to give the Government greater scope to label a foreign corporation as an SOE when it might be politically expedient to do so.

The new Guidelines require SOEs to address, in their plans and undertakings, their “inherent” susceptibility to state influence, by “demonstrate[ing] their strong commitment to transparent and commercial operations.”<sup>95</sup> SOEs remain subject to the net benefit test and the list of factors set out above. For SOEs, however, this assessment will incorporate the SOE’s “corporate governance and reporting structure”; specifically, whether the SOE “adheres to Canadian standards of corporate governance” with respect to transparency and disclosure, board independence, and treatment of shareholders, and the SOE’s adherence to “Canadian laws and practices, including...free market principles.”<sup>96</sup> The Guidelines also provide that the Minister will assess whether, following the acquisition by the SOE, certain decisions will continue to be made on a “commercial basis”, including not only decisions as to where to export and to process, but also decisions regarding the participation of Canadians in the SOE’s operations “in Canada and elsewhere”, and levels of research and development in Canada. Finally, the Minister also will consider “the impact of the investment on productivity and industrial efficiency in Canada” and whether the SOE will make “the appropriate level of capital expenditures to maintain the Canadian business in a globally competitive position.”<sup>97</sup> The main concern the Guidelines ostensibly address is the concern that managers of SOEs will base decisions on the political priorities of their home state, rather than what the Government of Canada calls a “commercial basis”, and that this will reduce productivity and competitiveness of the target Canadian business.

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<sup>92</sup> Industry Canada, *Investment Canada Act Guidelines: Statement Regarding Investment by Foreign State-Owned Enterprises*.

<sup>93</sup> Industry Canada, *Guidelines – Investment by state-owned enterprises – Net benefit assessment*.

<sup>94</sup> *OECD Guidelines on Corporate Governance of State-Owned Enterprises* at 11.

<sup>95</sup> Industry Canada, *Guidelines – Investment by state-owned enterprises – Net benefit assessment*.

<sup>96</sup> *Ibid.*

<sup>97</sup> *Ibid.*

The likely overall impact of the current Canadian Government policy is that SOEs will invest their assets elsewhere. Although the Canadian Government has stated that investments by SOEs in non-controlling, minority interests in Canadian businesses “will continue to be welcome”,<sup>98</sup> it is unclear why a ‘commercially-oriented’ SOE (in contrast with a passive investor like a sovereign wealth fund) would be willing to give up the option of acquiring managerial control. Acquirers pay a premium over market price for control for good, commercial reasons. So, while the Canadian Government might continue to welcome “non-controlling investments in the oil sands”,<sup>99</sup> it’s unclear whether a profit-maximizing SOE would view this as a worthwhile investment.<sup>100</sup>

### C. Private v. State-ownership: a Principled Distinction?

The policy stance of the Canadian Government, described above, evidences a “clear preference for private foreign investment over investment by SOEs”.<sup>101</sup> But is there a principled basis for this preference? Are separate Guidelines for SOEs necessary? Is this preference consistent with Canada’s foreign investment review process and the net benefit test? Is distinguishing SOEs from other sources of FDI coherent? My purpose in asking these questions is not to build an argument against the need for review of foreign investment generally, but rather to suggest that there may not be a principled basis for singling out state-owned enterprises for extra scrutiny.

#### 1. Are distinct Guidelines for SOEs necessary?

The Government of Canada justifies separate Guidelines for SOEs as necessary to protect free market principles. A number of commentators in Canada responded that separate Guidelines were unnecessary, that the factors for assessing “net benefit” are broad enough to take into account any concerns specific to SOEs. In fact, the factors to be considered in assessing net benefit under the SOE Guidelines look a lot like the net benefit test applicable to all reviewable investments; both sets of factors include the potential impact of the investment on productivity levels, the global competitiveness of the Canadian business and the ongoing participation of Canadians in executive positions. Arguably, any concern that SOEs will not operate on a commercial basis could be addressed by any or all of the factors under the existing net benefit test under the *Act*. Concerns about political interference in the management of the SOE or the Canadian business being acquired could be addressed by (e) – compatibility with policies of the

<sup>98</sup> Industry Canada, Press Release: “Government of Canada Releases Policy Statement and Revised Guidelines for Investments by State-Owned Enterprises”, 7 December 2012.

<sup>99</sup> Lally et al, *supra* note 3 at 2. They also argue that controlling investments by SOEs in shale gas and liquefied natural gas would be permitted, but these would be subject to review under the new Guidelines.

<sup>100</sup> But see *ibid* at 6-7 (listing SOE investments that were not subject to review under the *Act* either because they were less than the threshold amount or were for less than one-third voting share).

<sup>101</sup> *ibid* at 1.

Canadian Government. Concerns about buying up natural resources and shipping them home at below-market prices could be addressed by (e) and (a) – “the effect of the investment on the level and nature of economic activity in Canada.” The other point to make here is that Canadian domestic law would apply to Canadian businesses owned by foreign SOEs and these laws also could be used to address these concerns.

It seems strange, also, that the Government would develop its own, unique standards for SOEs, rather than adopt the OECD Guidelines for the Governance of State-owned Enterprises, which deal with concerns around political interference and transparency. The advantage of the OECD Guidelines is that although they discuss things like ensuring that SOEs act on a commercial basis and that they are not given a competitive advantage through access to cheap credit or government guarantees of liability, the OECD Guidelines presume the possibility of states behaving like other significant investors in a company, actively exercising their voting rights and monitoring management in order to ensure a good return on their investment. In a sense, the Guidelines legitimize state-owned enterprises as being able to operate compatibly in a free-market economy, whereas the Canadian Government’s policy questions this possibility. This attitude to FDI by SOEs may prove to be very detrimental to the Canadian economy in the long run.

## **2. Are the SOE Guidelines consistent with Canada’s approach to FDI generally?**

The Government has justified its position on FDI by SOEs as defending private enterprise and free market principles.<sup>102</sup> The problem with this justification is that it is inconsistent with the general approach to the review of foreign investment under the *Act*. One important principle of a free market, assuming that such a thing exists, is that assets end up in the hands of the party who will generate the greatest value from the asset, on the assumption that this party will pay the highest price for that asset. One concern with respect to SOEs is that access to cheap capital from their home state might allow SOEs to pay a lot of money for assets and then fail to use them to their highest value.<sup>103</sup> The net benefit test has similarly been described as having the effect of substituting “the government’s judgement of the proper allocation of resources to those of the players in the market.”<sup>104</sup> The Government may have good reasons for such apparent substitutions; nevertheless, the net benefit test demonstrates the hypocrisy inherent in the Government’s policy on FDI by SOEs.

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<sup>102</sup> Industry Canada, Press Release: “Government of Canada Releases Policy Statement and Revised Guidelines for Investments by State-Owned Enterprises”, 7 December 2012.

<sup>103</sup> Again, this concern does not appear to be supported by the evidence. See Cornish, *supra* note 44 at 12. See also Lally et al, *supra* note 3 at 8 (noting that “ready” access to capital was the reason for soliciting SOEs to invest in the oil sands).

<sup>104</sup> Coyne, “Abolished”, *supra* note 37.



This hypocrisy is also inherent in allowing SOEs to satisfy the net benefit test by committing to “undertakings” to appoint Canadians to the board, to employ Canadians in senior management positions and to list on a Canadian stock exchange. These undertakings are ostensibly related to greater transparency,<sup>105</sup> but the connection between transparency and promising to retain or to place Canadians in management positions is not obvious. With respect to “commercial orientation”, the Government may ask for undertakings to commit to a certain level of capital expenditures, for example.<sup>106</sup> The purpose of these sorts of undertakings cannot be to ensure that SOEs will operate purely on a “commercial basis”, since the whole purpose of requiring foreign investors to give undertakings under the *Act* is to require the new foreign owners of Canadian businesses to take certain actions<sup>107</sup> or to prevent them from taking others that the foreign investor otherwise would or would not take based on market factors alone.<sup>108</sup> If the Government’s court action to enforce undertakings against US Steel is successful, then these undertakings will have the effect of fettering the discretion of management, possibly to the detriment of the ability of the SOE’s Canadian business to operate on a commercial basis.<sup>109</sup> Whether or not such undertakings are a good thing or a bad thing generally, given their effect on managerial decision-making they cannot be justified as protecting or promoting “free market” principles.

### 3. Is distinguishing FDI by SOEs coherent?

Even if the Canadian Government were to move away from the net benefit test, its current attitude to FDI by SOEs assumes that “commercial” bases for decisions are easily distinguished from political ones. Home states frequently try to influence where their corporations choose to base operations, providing incentives in the form of tax breaks, relaxed regulations or government procurement policies. Canada is no different. In fact, this is precisely what the criteria for “net benefit” are aimed at. Depending on the state of their home economies, even privately-owned corporations may find it politically difficult to maintain or to move operations abroad rather than move or keep them at home. It is a mistake, therefore, to think that the behaviour of non-state-owned enterprises is never influenced by home governments. Nor is it correct to assume that private entities are never motivated by non-commercial factors: it is at least arguable that the original impetus behind the acquisition by TMX of the “Maple” Group

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<sup>105</sup> Lally et al, *supra* note 3 at 10.

<sup>106</sup> *Ibid* at 11.

<sup>107</sup> Undertakings made by CNOOC to secure the Nexen deal are reported to include an undertaking to support oil sands research at Alberta universities. *Ibid* at 14.

<sup>108</sup> Bergevin & Schwanen, *supra* note 21 at 8 (“If the federal government exacted the same types of undertakings from [a] Canadian acquirer, we would be correct in concluding that this constituted an ultimately ineffectual form of interventionist industrial policy.”).

<sup>109</sup> *Ibid* at 10.

was a patriotic concern to keep the iconic Toronto Stock Exchange in Canadian hands, and that the business case for the deal was made only after the fact.<sup>110</sup>

It is also difficult to understand how the Canadian Government could use the net benefit test or additional criteria for SOEs to create, unilaterally, a “level playing field”<sup>111</sup> in a globalized economy to prevent, for example, SOEs from having a competitive advantage from access to cheap capital. Like the idea of a clear line between commercial basis and non-commercial basis, the idea of a level playing field assumes the existence of an ideal politically-neutral marketplace. Such a market does not exist outside of economic theory. The operation of markets has always been heavily influenced not only by government regulation (or lack thereof), but also by international politics and popular attitudes. The Canadian Government’s attention would be better focused on ensuring a “level playing field” within Canada by enforcing Canadian laws and regulations, including standards of corporate governance, health and safety, and environmental protection, against all businesses operating in Canada.

The focus on the *motives* behind the decisions of SOEs is also interesting: does the market care about a buyer’s motives? After all, persons operating in a free market economy, individual or corporate, may have a variety of motives for engaging in transactions – economic, personal and ethical. So why should motives matter when the buyer is an SOE? Again, this concern assumes that profit-motives or commercial-motives are easily separated from non-commercial ones. The emphasis on ensuring that SOEs are motivated solely by profit maximization is particularly interesting given recent critiques of profit maximization in the private sector.<sup>112</sup> The mainstreaming of corporate social responsibility makes it harder to distinguish the mandate of Chinese SOEs, which “have social responsibility as an additional goal” to profit-making,<sup>113</sup> from those of private, Western corporations.<sup>114</sup> In fact, the social goals of Chinese SOEs sound very similar to Western ideas of corporate social responsibility: “treat employees well”; “serve as a model of good compliance with the law and fair trade with suppliers and retailers”; and “advance the interests of all of their stakeholders.”<sup>115</sup> These goals closely echo the latest pronouncements of the Supreme Court of Canada as to how the duty of directors of Canadian

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<sup>110</sup> Czarnecka, *supra* note 13 at 36 (“the patriotic name aside, [the banks and pension funds] are convinced that the business case for the transaction was worth all the regulatory headache.”).

<sup>111</sup> Krzepowski & Mintz, *supra* note 4 at 2.

<sup>112</sup> See, for example, this statement from the former U.K. Secretary of State for the Department of Trade and Industry, Patricia Hewitt: “What are companies for? The primary goal is to make a profit for their shareholders, certainly. But the days when that was the whole answer are long gone.” Quoted in Cynthia A. Williams & John M. Conley, “An Emerging Third Way?: The Erosion of the Anglo-American Shareholder Value Construct” (December 23, 2004), UNC Legal Studies Research Paper No. 04-09 at 29 (SSRN).

<sup>113</sup> Wang, *supra* note 47 at 488.

<sup>114</sup> See, e.g., Enbridge, Corporate Social Responsibility Policy, online: [http://www.enbridge.com/AboutEnbridge/CorporateSocialResponsibility/~/\\_media/www/Site%20Documents/About%20Enbridge/Corporate%20Social%20Responsibility/Policies/csr-policy.ashx](http://www.enbridge.com/AboutEnbridge/CorporateSocialResponsibility/~/_media/www/Site%20Documents/About%20Enbridge/Corporate%20Social%20Responsibility/Policies/csr-policy.ashx).

<sup>115</sup> Wang, *supra* note 47 at 491.

corporations to act “in the best interests of the corporation” ought to be understood.<sup>116</sup> Furthermore, like Chinese SOEs, corporations operating in Canada are expected to invest in economic growth, create jobs and engage in research and development.<sup>117</sup>

A more reasonable approach would focus on *behaviour* rather than motives. The ethical criteria employed by Norway’s Pension Fund Global to divest shares in certain companies has not raised significant concerns about the possible motives of the Norwegian government, perhaps because the ethical criteria are transparent and therefore knowable and known.<sup>118</sup> Concerns about motives are harder to justify when an SOE’s overall strategy, goals, governance, results and ethical guidelines are fully disclosed.

A better, more rational policy approach would be to apply the same criteria to all potential FDI.<sup>119</sup> Director independence, public disclosure and auditing not only protect against any possible “political interference” by SOE home states,<sup>120</sup> but also protect against shirking or looting by management of foreign corporations that would equally harm the profitability of the Canadian business and its ability to compete globally. On this point, Wang notes that Chinese SOEs face similar agency costs as those faced by private Western corporations in the sense that professional managers “can pursue personal benefits at investors’ expense.”<sup>121</sup> Wang’s criticism that SOE managers enjoy “almost unfettered discretion” in running the company “free of any supervision of investment decisions, use of profits, or compensation policy”<sup>122</sup> is a common complaint made of Anglo-American corporate managers. The high salaries earned by executives and the income disparity between executives and other employees are concerns shared by state owners and private investors alike.<sup>123</sup> Interestingly, oil industry executives, who have an inherent self-interest in protecting the corporations they run against takeovers, spoke in favour of Canadian Government protection of the sector from foreign investment.<sup>124</sup>

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<sup>116</sup> *BCE Inc v 1976 Debentureholders*, [2008] 3 SCR 560.

<sup>117</sup> Wang, *supra* note 47 at 499.

<sup>118</sup> VanDerMeulen & Trebilcock, *supra* note 41 at 409.

<sup>119</sup> Steger, *supra* note 36 at 14 (“Domestically, the government should...reduce existing restrictions on foreign investment and strengthen regulatory frameworks governing competition and good corporate governance in the marketplace.”).

<sup>120</sup> VanDerMeulen & Trebilcock, *supra* note 41 at 394. Wang recommends both greater board independence and better auditing of Chinese SOEs: Wang, *supra* note 47 at 501-02.

<sup>121</sup> Wang, *ibid* at 493. See also Cornish, *supra* note 44 at 8 (noting the separation of state ownership from management functions).

<sup>122</sup> Wang, *ibid* at 499.

<sup>123</sup> *Ibid* at 498 (“Indications of SOE inefficiency can be found, for example, in the...high salaries they pay.”).

<sup>124</sup> Shawn McCarthy & Jacquie McNish, “Protect Canadian ownership of oil sands firms, executives urge”, *Globe and Mail*, 25 September 2012, online: <http://www.theglobeandmail.com/news/national/protect-canadian-ownership-of-oil-sands-firms-executives-urge/article4568562/>.

## Conclusion

There may be some valid concerns arising from significant amounts of foreign investment by SOEs in capitalist economies. “Jittery Western countries”,<sup>125</sup> including Canada, should nonetheless ensure that their responses are not simply reactionary and do not create double-standards for investment by sovereign funds from developing countries that they do not expect to apply to their own funds when investing internationally. The reality is that the largest Chinese enterprises are either wholly or majority owned by the state.<sup>126</sup> The danger with reactionary policies or double-standards is that they may have the effect of raising the cost of capital for Canadian corporations.<sup>127</sup> Or, to put the matter more dramatically, maintaining the current policy could cause Canada to “miss out on the biggest investment boom of this century”.<sup>128</sup>

The real issues with the development of Alberta’s oil sands are not related to foreign ownership, sovereign or otherwise. They stem from mismanagement by the provincial government of both the natural resource and the revenues generated therefrom,<sup>129</sup> and with the massive environmental impact of developing this resource. Both problems are 100% made in Canada. SOEs, however, may form part of the solution. Rather than focusing on potential sources of conflict between Canadian Government policy and Chinese SOEs, greater study should be made of the potential coincidence of interest in environmentally sustainable natural resource development.<sup>130</sup> It is worth asking whether state-owned enterprises may be better able to invest for the long-term and ride out temporary dips in commodity prices without

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<sup>125</sup> Mandel-Campbell, *supra* note 1 at 23.

<sup>126</sup> Wang, *supra* note 47 at 489.

<sup>127</sup> Mandel-Campbell, *supra* note 1 at 27; Cornish, *supra* note 44 at 21; Lally et al, *supra* note 3 at 9. The Alberta provincial government is concerned that the Government of Canada’s approach will reduce the “pool of capital from which to finance development of the oil sands.” Bishop, *supra* note 64. It is also inconsistent with the Government of Canada’s prior statements “regarding the need for extensive foreign investment in the oil sands to achieve their full potential and the linkage between development of the Canadian resource sector and Canada’s future prosperity.” Lally et al, *ibid* at 2.

<sup>128</sup> Steger, *supra* note 36 at 11. See also VanDerMeulen & Trebilcock, *supra* note 41 at 434; Cornish, *supra* note 44 at 6.

<sup>129</sup> See, for example, the comments of former trade minister David Emerson: “It’s not foreign investment, so much as our own uncontrolled and unrestrained development of our resources that is the problem.” Dawn Calleja, “Foreign investment in Canada: opportunity + danger”, *Globe and Mail*, 28 March 2013, online: <http://www.theglobeandmail.com/report-on-business/economy/canada-competes/foreign-investment-in-canada-opportunity-danger/article10453367/?page=1>.

<sup>130</sup> See, e.g., Wang, *supra* note 47 at 492 (Chinese SOE managers evaluated in part “on the basis of success in...achieving sustainable development.”) and at 494 (Chinese SOE executives also evaluated on “energy conservation, and environmental protection” and efficient resource use); and Cornish, *supra* note 44 at 24 (regarding the capacity of SOEs to commercialize environmental innovations).

having to scale back development due to short-term cost concerns.<sup>131</sup> Furthermore, in the wake of the financial crisis, Western governments might be well served by some reflection as to whether our standards of corporate governance are really the best ones, or could not be made better. “One thing is for certain...Western governments and financial markets will have to get used to a new breed of investor whose business methods do not necessarily conform to the traditional Western model.”<sup>132</sup>

Given the importance of this issue to Canada’s long-term economic prosperity, further research on this topic is desirable. Ideally, this research would involve collaboration with Chinese corporate law scholars who can help to dispel misconceptions and answer questions about the governance of Chinese SOEs. Do they operate independently from government? Is decision-making driven primarily by commercial considerations? Are environmental and social responsibilities taken seriously by Chinese SOEs? What about when they operate abroad? Hopefully, research on these questions could help to form the basis of a future, more principled and coherent policy on FDI by SOEs in Canada.

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<sup>131</sup> Cornish, *ibid* at 13 (regarding the connection between SOEs’ long-term decision horizon and investments in research); McCarthy & McNish, *supra* note 123 (“Asian state-owned companies have a substantial competitive advantage over western firms, due to their lower cost of capital and longer investment horizons.”).

<sup>132</sup> Mandel-Campbell, *supra* note 1 at 24.