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Foreign Investment Restrictions on Canadian Energy Resources

Introduction

The Western world's dependence upon vast amounts of increasingly expensive non-renewable energy has become painfully evident in recent years. This already serious problem has become more acute because of increased political instability in the Middle East and because of soaring world oil prices. As a result, most energy resources also have increased in value many times over. Business managers from almost every developed nation are eager to participate in energy resource developments—both for investment purposes and to secure additional energy for import.¹

In the midst of this worldwide search for new energy resources to meet the energy shortage, managers have become aware that Canada has immense, untapped reserves of oil and gas in addition to coal, uranium and untapped hydropower sites.² For example, it is estimated that there may be up to 320 billion barrels of recoverable oil in Alberta province's tar sands alone.³ Also, newly discovered oil fields in the Arctic's Beaufort Sea⁴ and along the Newfoundland coast could prove to be of Middle East proportions.⁵ (The United States has proven reserves of 28.5 billion barrels of conventional oil.)⁶ Natural gas reserves in Canada run well into the hundreds of trillion cubic feet. The list of resources goes on.

Notwithstanding the great opportunity for energy resource development in Canada, many potential investors have been somewhat reluctant to invest

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¹Applications for foreign investment in Canadian energy resources under the Foreign Investment Review Act (FIRA) have come from the United States, West Germany, France, Japan, the United Kingdom, and the Netherlands. FIRA, Can. Stat. ch. 46 (1973), *reprinted in* 16 INT'L LEGAL MATS. 1136 (1973).

²TIME, Dec. 10, 1979, at 84-85.

³Paehlke, *Canada Oil Sands and Oil Companies*, 18 ENVIRONMENT 2-4 (1976).

⁴ALBERTA REPORT, June 20, 1980, at 16-17.

⁵TIME, Dec. 10, 1979, at 84-85.

⁶*Id.*

because of a misconception that Canadian foreign investment laws are very restrictive.⁷ While it is true that the Canadian government has attempted to regulate foreign investment, the legislation has not proven to be unduly restrictive. This paper will detail the extent to which present federal and provincial laws restrict foreign investment in the energy resources sector.

I. Background

Ever since the final third of the nineteenth century when businesses from the rapidly industrializing United States looked north to resource-rich Canada for raw materials, foreign investment has had a significant impact on the Canadian economy.⁸ The greatest direct investment in Canada came after World War II when Canada received massive infusions of American capital and exported huge amounts of Canadian resources to the United States.⁹

At first the subsidiaries of foreign companies established themselves in Canada to avoid the Canadian tariff rates.¹⁰ Between 1945 and 1967 direct investment in Canada increased from \$2 billion to \$17 billion (Canadian) while long-term investment increased from \$5 billion to \$28 billion (Canadian).¹¹ In 1968, a new wave of foreign investment began. Takeover of Canadian firms increased from fewer than ninety-three firms in 1967 to 1,963 in 1968. This trend has continued ever since.¹²

Initially, the government encouraged this foreign investment because it tended to increase the production of Canadian goods in Canada.¹³ As the amount of foreign investment began to grow, however, Canadians began to debate the value of foreign investment in their economy.¹⁴

As the debate raged, a rationale for strict control emerged. First, the policy of the foreign investors rather than Canadian policy influenced the structure and priorities of the Canadian economy. Second, the high level of foreign direct investment seemed to involve importation of non-Canadian cultural values. Third, foreign investment truncated Canadian enterprise because the management and technology required for the Canadian operations were supplied by the foreign parent company.¹⁵

⁷Interview with Ron Inouye, partner, Whitman and Ransom, in New York City, (Feb. 15, 1979).

⁸Toronto Star, Aug. 3, 1976, at 15, col. 1.

⁹Address by Thomas O. Enders, U.S. Ambassador to Canada, (April 26, 1978) [hereinafter cited as Enders].

¹⁰G. HUGHES, A COMMENTARY ON THE FOREIGN INVESTMENT REVIEW ACT 6 (1975) [hereinafter cited as COMMENTARY].

¹¹GOVERNMENT OF CANADA, FOREIGN DIRECT INVESTMENT IN CANADA 14 (1972) [hereinafter cited as DIRECT INVESTMENT].

¹²GOVERNMENT OF CANADA, REPORT ON FOREIGN OWNERSHIP AND THE STRUCTURE OF CANADIAN INDUSTRY 64 (1968) [hereinafter cited as the WATKINS REPORT].

¹³See COMMENTARY, *supra* note 10.

¹⁴Enders, *supra* note 9.

¹⁵FOREIGN INVESTMENT IN CANADA: A GUIDE TO THE LAW ¶ 5009 (1975) [hereinafter cited as GUIDE].

As a result of the debate over foreign investment, several task forces were commissioned to look into the subject. In 1968, the Watkins Report concluded:

- The major deficiency in Canadian policy has been not its liberality toward foreign investment per se but the absence of an integrated set of policies, partly with respect to both foreign and domestic firms, partly with respect only to foreign firms, to ensure higher benefits and smaller costs for Canadians from the operations of multinational corporations.¹⁶

In response to the Watkins Report, a task force was formed to examine the alternatives that would give greater control over the national economic environment to Canadians. This project culminated with the Gray Report.¹⁷

The Report examines three alternative types of control. The first is a review or screening process in which there is an administrative intervention. This review process is to be flexible and discretionary and applied on a case-by-case basis. The second alternative is the key sector approach whereby particular industries are singled out to receive special attention. The third alternative is the fixed rule approach which mandates that certain proportions of all firms of economic significance be owned by Canadians.¹⁸

The major thrust of the ensuing legislation¹⁹ has been the review approach. The Foreign Investment Review Act (FIRA) provides for review of many types of direct investment including takeovers of domestic corporations and new investment. However, there also have been attempts to use the key-sector²⁰ and fixed-rule approaches, but on a much more limited scale.

II. Foreign Investment Review Act

A. Overview

In analyzing the impact of the FIRA on foreign participation in energy resource development, it is first necessary to determine whether the proposed transaction is reviewable. If the proposed transaction is not reviewable, then the Act will have no impact on the transaction. If the proposed transaction is reviewable, then it may be desirable to search for an alternative form for the transaction to avoid the review process of the Act.

If there is no practical way to alter the transaction so that it will fall outside the Act, it will be necessary to file notice and application with the Foreign Investment Review Agency (the Agency) for review of the application.²¹ If at the completion of the review process, a transaction is considered to be of

¹⁶WATKINS REPORT, *supra* note 12, at 392.

¹⁷DIRECT INVESTMENT, *supra* note 11. The Hon. Mr. Herb Gray, author of the Gray Report is presently Minister of Industry, Trade and Commerce and is, therefore, the Minister in charge of FIRA, cited in note 1 *supra*.

¹⁸GUIDE, *supra* note 15, at ¶ 95,016-19.

¹⁹Foreign Investment Review Act, Can. Stat. ch. 46 (1973). [hereinafter cited as FIRA].

²⁰Frank & Gudgeon, *Canada's Foreign Investment Control Experiment: The Law, the Content, and the Practice*, 50 N.Y.U.L.REV. 76, 93-102 (1975).

²¹FIRA, *supra* note 19 at § 8(1).

significant benefit to Canada, then it is ultimately approved by the Cabinet, an Order-in-Council is issued, and the transaction is no longer subject to scrutiny under the Act.²² If the minister concludes that the transaction is not of significant benefit to Canada, the investor may provide new information and make further representations to the minister²³ or he may negotiate with the Agency to determine what undertakings or changes in the transaction must be made in order to receive approval.²⁴ If a suitable agreement cannot be reached, the transaction probably will be deemed impermissible and the application will be rejected by an Order-in-Council.²⁵

B. Determining Whether a Transaction is Subject to Review

FIRA affects a group of foreign investors referred to as "non-eligible persons" and governs two types of transactions:

1. acquisition of an existing Canadian business enterprise;²⁶ and
2. establishment of a new business in Canada.²⁷

1. STATUS OF THE INVESTOR—THE NON-ELIGIBLE PERSON

The first test in determining whether the transaction is reviewable is whether the investor is considered to be a "non-eligible person." If the investor is not a non-eligible person, then he is not affected by the Act, and none of his transactions will be reviewable. If the investor is a non-eligible person, then any transaction by him which falls into one of the above categories is subject to review.

A non-eligible person may be an individual, a foreign government or agent thereof, a corporation, or a group of investors.

An individual²⁸ who is a non-citizen is a non-eligible person if he is not a permanent resident of Canada²⁹ or is a permanent resident who has been in Canada for more than one year after he is eligible for citizenship.³⁰ An individual who is a Canadian citizen is a non-eligible person if he does not or-

²²*Id.* § 12(1); See GUIDE, *supra* note 15, at ¶ 33,004, 33,017, 33,018.

²³FIRA, *supra* note 19 at §§ 11(1), 11(2); See GUIDE, *supra* note 15, at ¶ 33,006-33,011.

²⁴GUIDE, *supra* note 15, at ¶ 2008-05, 33,012.

²⁵FIRA, *supra* note 19 at § 12(1); See GUIDE, *supra* note 15, at ¶ 33,015, 33,018.

²⁶FIRA, *supra* note 19 at § 8(1).

²⁷*Id.* § 8(2).

²⁸*Id.* § 3(1).

²⁹A permanent resident is defined as "a person who has been granted landing, has not become a Canadian citizen, and has not ceased to be a permanent resident . . . (through) deportation . . . or leaving Canada with the intention of abandoning Canada as his personal place of residence." Immigration Act of 1976, Can. Stat. ch. 52 §§ 2(1), 24(1) (1976).

³⁰A permanent resident who has resided in Canada for three years from the time he became a permanent resident is eligible for citizenship, so that an immigrant permanent resident would normally become a non-eligible person after residing in Canada for four years. Citizenship Act, Can. Stat. ch. 108, § 5(1) (1976). However, under the Citizenship Act, an applicant must be resident in Canada for three of the four preceding years in order to qualify for citizenship. Many permanent residents will not, therefore, be eligible for citizenship until sometime after three years. Thus, they will not automatically become non-eligible persons after four years but rather sometime later: one year after they meet all the eligibility requirements for citizenship.

dinarily reside in Canada and has applied for citizenship in another country³¹ or if he has resided outside of Canada for a period of time longer than that allowed by the regulations.³²

Foreign governments³³ and agencies of foreign governments are considered to be non-eligible persons.³⁴

A corporation is considered to be a non-eligible person if it is controlled in fact by a non-eligible person or by a group, any member of which is a non-eligible person.³⁵

"Control in fact" is the crucial test in determining whether the corporation is a non-eligible person. The Act looks not to the form but to the substance of control, and the Agency is able to look behind any scheme designed to conceal those who actually control the corporation.³⁶ Control in fact may result from ownership of shares, licensing agreements, directors' use of proxy machinery or any other method by which persons or groups of persons exercise de facto control.³⁷

The Act makes presumptions based upon specific tests to aid in the determination of control of the corporation. However, these presumptions are supplanted whenever the locus of control in fact can be determined without their use or where they are effectively rebutted by a showing that the non-eligible persons do not have de facto control of the corporation.³⁸

The Agency often will determine control on the basis of ownership of shares. There is a rebuttable presumption of control by non-eligible persons where:

³¹FIRA *supra* note 19 at § 3(1); Regulations Respecting the Establishment of New Businesses in Canada, P.C. 1975-1675, § 3(1)(a). See also Foreign Investment Review Regulations, 16 INT'L LEGAL MATS. 1469 (1977).

³²Under the regulations, a citizen becomes a non-eligible person when he has ordinarily been a resident outside of Canada for five or more consecutive years. Regulations Respecting the Establishment of New Businesses in Canada, P.C. 1975-1675, § 3(1)(b). A citizen who was ordinarily resident in Canada at the time he reached his sixtieth birthday does not become a non-eligible person until he has been ordinarily resident outside of Canada for ten or more consecutive years. *Id.* § 3(2)(b). A citizen who resides outside Canada in one or more of the following capacities does not become a non-eligible person under the Act and Regulations regardless of the period of residency outside Canada:

- (i) a full-time employee engaged in the conduct of a Canadian business enterprise;
- (ii) a full-time employee of the federal or a provincial government or agency thereof;
- (iii) a full-time student;
- (iv) a full-time employee of an international association or organization of which Canada is a member. *Id.* § 3(2)(a).

³³"Control by governments or government agencies will have particular relevance in today's investment climate where so much Arab oil money is being 'laundered' and channelled into investments around the world through investment corporations which are ultimately controlled by Arab governments." COMMENTARY, *supra* note 10, at 18.

³⁴FIRA, *supra* note 19 at § 3(1).

³⁵*Id.*

³⁶COMMENTARY, *supra* note 10, at 18.

³⁷*Id.*

³⁸*Id.*

- (a) Twenty-five percent of the voting stock of a public corporation³⁹ is owned by individual or government non-eligible persons or by corporations incorporated outside Canada;⁴⁰ or
- (b) Where 40 percent or more of the voting stock of a private corporation⁴¹ is owned by individual or government non-eligible persons or by corporations incorporated outside Canada;⁴² or
- (c) Five percent or more of the voting stock of any corporation is owned by a single individual or government non-eligible person or by corporations incorporated outside of Canada.⁴³

Where a group of shareholders, one or more members of which are non-eligible persons, has control of a corporation, the corporation will not be a non-eligible person unless the group acts in concert⁴⁴ in any matter on transactions affecting the corporation or its management and:

- (a) Less than 50 percent of the voting stock of the corporation is owned by group members who are not non-eligible persons; or
- (b) More than 20 percent of the group members are non-eligible persons or more than 20 percent of the total voting stock is owned by non-eligible members of the group.⁴⁵

However, where two or more persons who are not dealing at arms length are in a position to control a corporation, they are deemed to control the corporation⁴⁶ whether or not they are in fact a part of a larger group.⁴⁷

³⁹The Act does not use the term "public corporation" but rather "corporation the shares of which are publicly traded." "The shares of a corporation are publicly traded only if shares of the corporation, to which are attached voting rights ordinarily exercisable at meetings of shareholders of the corporation, are publicly traded by any member of the public in the open market . . . FIRA, *supra* note 19 at § 3(6)(a).

⁴⁰*Id.* § 3(2)(a).

⁴¹The Act does not use the term "private corporation" but rather "corporation the shares of which are not publicly traded." *Id.* § 3(2)(a).

⁴²*Id.*

⁴³*Id.* § 3(2)(b).

⁴⁴"Exactly what 'acting in concert' means is not clear. Presumably it means acting together with some common purpose in view, and this would exclude the simple action of shareholders voting together at shareholders meetings." COMMENTARY, *supra* note 10, at 22.

⁴⁵FIRA, *supra* note 19 at § 3(6)(b.1).

⁴⁶The following exemption applies to this presumption of control: "notwithstanding any other provision of this Act, where a corporation is controlled by a group of persons (in this paragraph referred to as "the group") and shares of the corporation to which are attached more than 50% of the voting rights ordinarily exercisable at meetings of shareholders of the corporation are held by members of the group who are not noneligible persons, in the absence of any evidence that the group includes one or more noneligible persons who (i) constitute more than 20% of the total number of members of the group, or (ii) hold shares to which more than 20% of the voting rights are ordinarily exercisable at meetings of the shareholders of the corporation, the corporation shall be deemed to be controlled by a group of persons consisting of those members of the group who are not noneligible persons and not by any other group of persons," *Id.* § 3(6)(b.1).

⁴⁷*Id.* § 3(6)(b).

Where the corporation is a subsidiary of a parent corporation which is ultimately controlled by a government or individual noneligible person, the subsidiary is also a noneligible person.⁴⁸

Where no one person or group of persons can be identified as controlling a corporation, either through the ownership of shares of the corporation or in any other manner, the corporation is presumed to be controlled by the board of directors. If more than 50 percent of the board is made up of noneligible persons, or if more than 20 percent of the board is made up of noneligible persons, some of whom act in concert, then the noneligible persons are deemed to control the corporation.⁴⁹

Where a corporation is controlled through a trust or contract⁵⁰ by noneligible persons, the corporation will be deemed a noneligible person.⁵¹

Once the investor is determined to be a noneligible person,⁵² any transaction it enters into will be subject to review if the deal involves the acquisition of an existing Canadian business enterprise or the establishment of a new business in Canada.

2. STATUS OF THE TRANSACTION

a. *Acquisition of Control of an Existing Canadian Business Enterprise.* The portion of the FIRA that attempts to review and regulate acquisitions of existing Canadian businesses went into effect on April 9, 1974,⁵³ and provides as follows:

Every noneligible person and every group of persons any member of which is a noneligible person, that proposes to acquire control of a Canadian business enterprise shall give notice in writing to the Agency [Foreign Investment Review Agency]⁵⁴ of such proposal in such form and manner and containing such information as is prescribed by the regulations.⁵⁵

The first test to determine whether a transaction will be reviewable as an acquisition of an existing Canadian business is whether there is a "business" involved. A "business" includes any undertaking or enterprise carried on in anticipation of making a profit.⁵⁶

The second test is whether the business is a "Canadian business enterprise." In order to be considered a Canadian business enterprise, the busi-

⁴⁸GUIDE, *supra* note 15, at ¶ 10, 036.

⁴⁹*Id.* § 3(7)(c).

⁵⁰"There will likely be very few instances in which a corporation will be controlled through a contract." GUIDE, *supra* note 15, at ¶ 10,032.

⁵¹FIRA, *supra* note 19 at § 3(1)(c); See GUIDE, *supra* note 15, at ¶ 10,027-10,031 & 10,032-10,035.

⁵²"Noneligible persons" includes noneligible individuals, noneligible groups, and noneligible governments and corporations.

⁵³COMMENTARY, *supra* note 10, at 40.

⁵⁴FIRA, *supra* note 19 at § 7.

⁵⁵*Id.* § 8(1).

⁵⁶*Id.* § 3(1).

ness must either meet the requirements of a "Canadian branch business" or of a "Canadian business."⁵⁷ Transactions in which assets or property not constituting a Canadian business enterprise are acquired are not subject to review.⁵⁸

A "Canadian branch business" is a business carried on in Canada by a corporation incorporated outside of Canada. However, a business does not qualify in this category unless it has one or more establishments in Canada to which employees of the corporation, employed in connection with the business, ordinarily report for work.⁵⁹

A "Canadian business" is a business carried on in Canada by one of the following:

1. a Canadian citizen or resident; or
2. a corporation incorporated in Canada with one or more establishments to which employees report for work; or
3. a combination of individuals and corporations where any member of the control group is a person described in (1) or (2) above.⁶⁰

The third test is whether there has been an "acquisition of control". An "acquisition of control"⁶¹ occurs where there is an acquisition of all or substantially all of the assets of a Canadian business enterprise⁶² or the acquisition of shares of a Canadian business carried on by a corporation⁶³ which in fact gives control of the business⁶⁴ to noneligible persons.

This test makes a distinction between a "Canadian business" carried on by a corporation either alone or in concert with others and a "Canadian business" carried on by a noncorporate entity or a "Canadian branch business."

⁵⁷*Id.*

⁵⁸*Id.*

⁵⁹*Id.* the Agency has interpreted this section very broadly. For example, if a foreign corporation having an undivided interest in producing oil properties does not have any employees in Canada because the other interest holders own the working interest, the sale of the undivided interest of the foreign corporation (vendor) would not be covered by the Act because the "business" would not be a Canadian branch business because it has no employees. Nevertheless, the Agency will probably attribute the employees of the other interest holders to the vendor thus giving the vendor's business the status of a Canadian branch business. Interview with Alan Hollingworth, partner, McLaws and Company, Calgary, Canada (July 14, 1980).

⁶⁰FIRA, *supra* note 19 at § 3(1).

⁶¹"It will be remembered that the definition of a noneligible corporation referred to 'control in fact', i.e., control whether exercised directly through the ownership of shares or indirectly through a trust, a contract and so on. In the case of non-eligibility, therefore, control of a corporation could be exercised by a variety of means including credit and loan, or pledge agreements, shareholder or voting agreements, or through management or licensing agreements. In the case of takeovers, however, the concept of control is not so broad: the Act stipulates that control can be acquired only through the acquisition of shares or the acquisition of property. This approach has the advantage of recognizing the legal distinctions between a takeover of a business carried on by a corporation and a takeover of one carried on by unincorporated individuals." COMMENTARY, *supra* note 10, at 33.

⁶²There is no "acquisition of control" if the investor already has control and is merely increasing ownership.

⁶³FIRA, *supra* note 19 at § 3(3)(a)(i)(A).

⁶⁴*Id.* §§ 3(3)(a)(i)(B), 3(3)(a)(ii).

Control of a Canadian business carried on by a corporation can be acquired by the acquisition of voting shares of the corporation or by acquisition of all, or a substantial proportion, of its property. Control of all other Canadian business enterprises⁶⁵ can be acquired only by the acquisition of all or substantially all of the property used in carrying on the business.

The Act makes a rebuttable presumption of acquisition of control through stock acquisitions where 5 percent or more of the voting stock of a public corporation⁶⁶ or 20 percent or more of the voting stock of a private corporation⁶⁷ are acquired by any person or group of persons.⁶⁸ An acquisition of more than 50 percent of the voting stock of a private or public corporation by any person or group of persons is deemed to be an acquisition of control of any business carried on by that corporation.⁶⁹

The Act exempts the following transactions by defining them as nonacquisitions of control:

- (a) acquisitions of less than 5 percent and 20 percent of the voting stock of public and private corporations respectively;⁷⁰ or
- (b) acquisitions of shares by security dealers;⁷¹ or
- (c) acquisitions of control of a corporation by a lender pursuant to an enforceable agreement to ensure repayment of an outstanding loan or to ensure a corporate obligation to redeem its shares;⁷²
- (d) acquisitions of shares by persons ordinarily carrying on the business of providing venture capital in Canada.⁷³ However, an investor who qualifies under this exemption must meet certain terms and conditions which require a gradual reduction in the proportion of Canadian holdings over a period of time.⁷⁴

A determination of whether there has been an acquisition of all or substantially all of the property⁷⁵ of the business is a factual question that may be very difficult to define with specificity. The acquisition of a leasehold interest in any business property is deemed to be an acquisition of that property.⁷⁶

Any person who has a contractual right, either absolute or contingent, to acquire or dispose of shares or property is deemed to be in the same position as if he owned the shares or property.⁷⁷

⁶⁵This includes sole proprietorships, partnerships, and businesses carried on by foreign corporations. GUIDE, *supra* note 15, at ¶ 20,019-20,029.

⁶⁶See *supra* note 39.

⁶⁷See *supra* note 41.

⁶⁸FIRA, *supra* note 19 at § 3(3)(c).

⁶⁹*Id.* § 3(3)(d).

⁷⁰*Id.* § 3(3)(b)(i).

⁷¹*Id.* § 3(3)(b)(ii).

⁷²*Id.* § 3(3)(b)(iv); see GUIDE, *supra* note 15, at ¶ 20,083-20,088.

⁷³FIRA, *supra* note 19 at § 3(3)(b)(iii).

⁷⁴GUIDE, *supra* note 15, at ¶ 20,063; see Appendix A.

⁷⁵"Property used in carrying on a business includes goodwill in connection therewith . . ."
FIRA, *supra* note 19 at § 3(1).

⁷⁶*Id.* § 3(6)(e).

⁷⁷*Id.* § 3(6)(c).

Amalgamations are considered to be acquisitions of control of the businesses of the amalgamating corporations by the amalgamated corporation.⁷⁸ The Act provides exemptions for the following transactions:

- (a) Corporate reorganizations where the amalgamated corporation is controlled by the same person or group of persons that control each of the amalgamated corporations;⁷⁹
- (b) Amalgamations where the business of the amalgamating corporation was carried on jointly with other persons who are not amalgamating corporations.⁸⁰

Under the small business exemption,⁸¹ acquisitions of certain Canadian business enterprises are not reviewable if, at the time the business is acquired, the noneligible person is carrying on a related business in Canada.⁸² This exemption is not available if the acquired business has gross assets in excess of \$250,000 or has an annual gross revenue in excess of \$3,000,000 (Canadian).⁸³

b. *Application of Section 8(1) to Undeveloped Mineral Interests in Energy Resource Development.* There are two common types of transactions in the oil and gas industry that could constitute the acquisition of an existing Canadian business enterprise. The first type of transaction is the acquisition of shares of an existing Canadian business involved in oil and gas exploration and development. The second type of transaction is the acquisition of an undivided interest in oil and gas rights.

The acquisition of an oil and gas lease constitutes acquisition of property which in turn may be an acquisition of a Canadian business enterprise. In Canada an oil and gas lease is *profit à prendre*,⁸⁴ not a legal lease.⁸⁵ Such profits in turn are interests in land that give the holder a right to take oil and gas from a specified area.⁸⁶ Acquisition of working interests in an oil and gas lease also constitute the acquisition of property under the Act. The holding of a working interest in an oil and gas lease is a common way in which a group of individuals and/or corporations can participate in one oil and gas property. The working interest holder has an undivided interest in the lease of the property which is producing or may produce oil or gas. The working interest may be subject to overriding royalties to predecessors in title.⁸⁷

The Agency has published *Guidelines Concerning Acquisition of Interests*

⁷⁸*Id.* § 3(3)(e).

⁷⁹*Id.* § 3(3)(c); See Guidelines Concerning Corporate Reorganizations in the FIRA.

⁸⁰FIRA, *supra* note 19 at § 3(6)(c); see GUIDE, *supra* note 15, at ¶ 20,093.

⁸¹FIRA, *supra* note 19 at §§ 5(1), 31(3).

⁸²See text accompanying notes 116-125, *infra*.

⁸³FIRA, *supra* note 19 at § 5(1).

⁸⁴H. WILLIAMS & C. MYERS, *MANUAL OF OIL AND GAS TERMS* 353 (3d ed. 1971) [hereinafter cited as *MANUAL*].

⁸⁵J. Laycraft & I. Head, *Theories of Ownership of Oil and Gas*, 2 OIL AND GAS REP. 1223, 1228

⁸⁶GUIDE, *supra* note 15, at ¶ 2001.

⁸⁷*Id.*

in *Oil and Gas Rights*,⁸⁸ describing various exemptions given to investors for acquisitions of certain types of oil and gas interests.

The guidelines make a distinction between properties at the exploration stage and those already in the production stage.⁸⁹ The guidelines further state that in determining whether the property is in the exploration or production stage, a certain amount of production taken from exploratory wells may not necessarily alter the exploratory nature of activities being conducted.⁹⁰

(1) Acquisition of exploration rights and interests in oil and gas for exploratory properties. Acquisition of exploration rights for oil and gas under grants by way of permit, license, reservation, lease or otherwise is not acquisition of a business within the meaning of the Act.⁹¹

Likewise acquisition of interests in the oil and gas not yet discovered by way of purchase or assignment relating to property at the exploratory stage does not normally constitute acquisition of a business.⁹²

At such time as production is commenced on the exploration properties, the producing property will be presumed to be a business.⁹³ However, as a matter of administrative policy, if the producible oil or gas result from the exercise of the exploration rights, the transaction is not reviewable as an acquisition of control of a Canadian business enterprise under section 8(1) of the FIRA.⁹⁴ It may, however, qualify as the establishment of a new business under section 8(2). Even so, it probably would be exempt under the related business exemption.⁹⁵

Transactions in which there is an acquisition of interests in oil and gas for a number of exploration properties do not lead to a different result unless the magnitude of the interest is such that it comprises all or substantially all of the oil and gas rights of the vendor.⁹⁶ However, if the vendor is involved in the business of purchasing and selling exploration properties, the acquisition of all or substantially all of the vendor's interests in exploration properties would not be an acquisition of a business unless it was a step in the winding up of the vendor's brokerage business.⁹⁷

Acquisition of large undeveloped tracts of oil sands or heavy oil acreages might be reviewable under a contemplated new government policy.

Oil sands tracts often are very large and are relatively easy and inexpensive to discover. Therefore, the risk of not discovering oil is much higher when dealing with conventional oil reserves than with oil sands.

⁸⁸See Appendix B; these guidelines do not have the force of law.

⁸⁹*Id.* at guideline 2.

⁹⁰*Id.*

⁹¹*Id.* at guideline 3.

⁹²*Id.* at guideline 4.

⁹³*Id.* at guideline 5.

⁹⁴GUIDE, *supra* note 15, at ¶ 66-4.

⁹⁵See text accompanying notes 116-125, *infra*.

⁹⁶See Appendix B at guideline 4.

⁹⁷*Id.*

A nonproducing oil sands property is not an "exploratory" property in the same sense that a nonproducing conventional oil property is. Thus the acquisition of an oil sands tract seems to be a cross between the reviewable acquisition of a property containing discovered and producible oil and gas and the acquisition of "exploratory" properties which is not reviewable. The federal government presently is considering whether the purchase of oil sands tracts is a reviewable transaction under the FIRA, and if so, whether the review process will be used to increase Canadian participation in future oil sands and heavy oil developments.⁹⁸

Other transactions common in the oil and gas industry are the "farm-out" and joint operating agreements. The formation of these agreements before or during exploration does not constitute the acquisition of a business.⁹⁹ In a farm-out agreement a lease holder who does not desire to drill at the time of the agreement may agree to assign the lease, or some portions of it, to another operator who does wish to drill on the tract. The primary characteristic of the farm-out is the obligation of the assignee to drill a well as a prerequisite to completion of the assignment to him.¹⁰⁰

In a joint operating agreement concurrent owners of the leasehold agree to share in the expense of operations and in the proceeds from production.¹⁰¹ A joint operating agreement usually forms part of the farm-out agreement.

(2) Acquisition of undivided interests in oil and gas for producing properties. An acquisition of 100 percent of the working interest in oil and gas rights in producing properties¹⁰² is an acquisition of a business if the acquired property comprised all or substantially all of the vendor's business¹⁰³ or if it can reasonably be expected to sustain a separate business.¹⁰⁴

Acquisition of a partial working interest or other partial undivided interest does not so clearly constitute the acquisition of a business. If "substantially all of the property" means "all of the essential property" then acquisition of less than one hundred percent of the working interest would not be acquisition of the business because the essential property is the entire working interest.¹⁰⁵ This would be true even though the investor acquired de facto control because the test is not acquisition of "de facto control" but rather acquisition of "substantially all of the property."

However, if substantially all of the property means "a large portion of the property," then something less than 100 percent¹⁰⁶ which would tend to give

⁹⁸GUIDE, *supra* note 15, at ¶ 66-4.

⁹⁹See Appendix B at guideline 4.

¹⁰⁰MANUAL, *supra* note 84, at 167.

¹⁰¹*Id.* at 234.

¹⁰²This includes all properties containing discovered and producible oil and gas resources.

¹⁰³FIRA, *supra* note 19 at § 3(a).

¹⁰⁴*Id.* § 3(6)(a).

¹⁰⁵See GUIDE, *supra* note 15, at ¶ 2,001.

¹⁰⁶Some scholars have suggested that ownership of an eighty-five percent undivided interest might be the threshold limit constituting substantially all of the property under the quantitative test.

to investor control of the property such as any major working interest (or other large undivided interest) would probably be an acquisition of a business. This would be especially true where the acquired interest was substantially all of the property used in carrying on the vendor's business,¹⁰⁷ e.g., where a small oil company owns only an undivided interest on certain oil properties; or where it could reasonably be expected to sustain a separate business,¹⁰⁸ e.g., where the working interest holder markets his share of production directly to the purchaser.

It is important for the investor who wishes to acquire oil and gas interests in producing property to be careful that the transaction does not appear to be an acquisition of the vendor's business assets or a separate business in and of itself. If an investor is in doubt as to the applicability of the FIRA to any proposed transaction, he may request a ruling from the Minister of Industry, Trade and Commerce that will be binding for two years.¹⁰⁹

Pooling, unitization, joint operating, and other similar arrangements which enable owners to combine their rights into a common project, are not considered to be acquisitions of businesses because they represent a way of furthering the exploration or production activities of the participants. This is true even where the interests of the participants increase because of a change in respective work commitments.¹¹⁰

c. *Establishing a New Business in Canada.* The portion of the FIRA that deals with the establishment of new businesses went into effect on October 15, 1975.¹¹¹ It provides that every noneligible person, or group of persons containing a noneligible person, must give notice in writing to the Agency if it proposes to establish a new business in Canada that is unrelated to its current Canadian operations.¹¹²

There are three tests to determine whether a transaction will come under the control of this section of the Act:

1. The first test is whether the transaction involves a "business." A business is defined as an undertaking carried on in anticipation of profit.¹¹³
2. The second test is whether a business has been established. This test is met only if there is an establishment in Canada to which one or more employees report for work in connection with the business.¹¹⁴
3. The third test is whether the business is a new business, unrelated to the current Canadian operations of the investor. This provision affects transactions in which:

¹⁰⁷FIRA, *supra* note 19 at § 3(3)(a).

¹⁰⁸*Id.* § 3(6)(g).

¹⁰⁹*Id.* § 4(1).

¹¹⁰See Appendix B at guideline 6.

¹¹¹Murray, *FIRA: In a Nutshell*, CURRENT LEGAL ASPECTS OF DOING BUSINESS IN CANADA 10 (A.B.A. ed. 1976).

¹¹²FIRA, *supra* note 19 at § 8(2).

¹¹³*Id.* § 3(1).

¹¹⁴*Id.* § 3(4).

- (i) an investor does not have any existing business in Canada and is seeking to establish a new business; or
- (ii) an existing business expands into an area unrelated to its present operations.

If the activity is merely an expansion of the existing business it will not be considered to be a new business.¹¹⁵ An activity is considered to be an expansion if the goods or services produced are substantially similar to goods and services produced by the existing business. If the goods or services are not substantially the same, the business might be considered to be an expansion of an existing business because of the following factors:

1. The degree of difference in the goods or services produced; and
2. The extent to which the business activity has changed by reason of the additional business.¹¹⁶ This might include determining whether new premises are used.¹¹⁷

A business also is considered to be an expansion of existing operations if all of the services or goods produced by the new activity are used to carry on the established operations.

If the activity cannot qualify as an expansion of existing business operations, it may still be exempt from review if the activity is related to existing business. "Related business" has been defined quite broadly. A business will be considered "related" if any of the following requirements are met:

1. Vertical integration from a service-producing business. The test is whether at least one-half of the services produced from the new business are used in production of services in the established business.¹¹⁸
2. Vertical integration of a goods-producing business. The test is whether one-half of the goods produced from the new business are used by the established business in the production or distribution of its goods, or alternatively, whether the new business receives at least one-half of its materials and components from the established business.¹¹⁹
3. Production of a directly substitutable product or service. This test is met if the goods or services can be substituted directly for those produced by the established business.¹²⁰ There is no requirement that new production displace old production.
4. Production by similar technology or production processes. This test is met if both the technology and production process are essentially the same as in the established business, and the additional goods are pro-

¹¹⁵GUIDE, *supra* note 15, at ¶ 25,005-1.

¹¹⁶*Id.* at ¶ 25,022-1.

¹¹⁷*Id.* at ¶ 25,022-3.

¹¹⁸*Id.* at ¶ 58,004-1.

¹¹⁹*Id.* at ¶ 58,004-2.

¹²⁰*Id.* at ¶ 58,004-3.

duced with equipment or by personnel similar to those used in the established business. The established business must continue to be the significant activity compared with the magnitude of the new business.¹²¹

5. Production results from research and development in Canada.¹²²
6. Both the new business and the established business are in the same group as defined by the Canadian Standard Industrial Classification (SIC).¹²³ SIC divides all Canadian economic activities into twelve divisions and within each division are several categories. As long as the proposed new business or activity falls within the same category as the established business, the businesses are considered to be related.¹²⁴

Even if the activity meets none of the above requirements, it may still be considered related if it is:

1. customary, essential or complementary business to the established business; or
2. horizontal diversification of the established business; or
3. related to the established business on some other basis.¹²⁵

If the activity does not qualify as an expansion of an established business or as the establishment of a related business, it will be considered to be a new business and will be subject to review by the Agency.

d. *Application of Section 8(2) to Energy Development.* The SIC is somewhat flexible with regard to investment in energy resource development. It breaks down mineral exploration into the following categories:

1. metal mines and associated exploration;
2. uranium mines and associated exploration;
3. petroleum and natural gas and associated exploration;
4. non-metal mines, quarries and pits, and associated exploration;
5. contract drilling for petroleum;
6. other contract drilling;
7. miscellaneous services incidental to mining.

Once again, if both the new and the established businesses fit into the same category, then the transaction will not be subject to review. For example, a newly opened metal mine would be related to an established metal mining business but unrelated to an established uranium mining business. If the investor were involved in an established coal mining business, the establishment of a new coal exploration business would be considered related because the businesses fall within the same SIC category.

The system is very flexible where the investor is involved in mineral exploration but is not engaged in mineral extraction. In that case, the investor is

¹²¹*Id.* at ¶ 58,004-4.

¹²²*Id.* at ¶ 58,004-5.

¹²³*Id.* at ¶ 58,004-6.

¹²⁴STATISTICS CANADA, STANDARD INDUSTRIAL CLASSIFICATION MANUAL, Catalogue No. 12-501 (rev. 1970).

¹²⁵GUIDE, *supra* note 15, at ¶ 25,023.

not restricted to any one category of mineral exploration. However, when the investor establishes or acquires a mineral extraction business, he becomes restricted to extraction and exploration within that category of minerals. For example, once the investor has discovered petroleum and begins extraction, he is no longer entitled to explore for coal.¹²⁶

e. *Nonreviewable Alternatives.* If it is determined that the investor is a noneligible person and that the transaction he proposes is reviewable, the investor should search for reasonable alternatives which would make the transaction non-reviewable if he wishes to avoid the review process.

(1) Change in status of the investor. The first alternative is to "Canadianize" the investor so that he is no longer a noneligible person because transactions of eligible investors are not reviewable. If the investor is an individual, he must either become a permanent resident or form a private corporation which he does not control.

If the investor is a corporation, then it must somehow turn over the control of the corporation to eligible persons. This can be done in three ways.¹²⁷

First, all the noneligible shareholders can become eligible themselves by becoming permanent residents. Second, the noneligible shareholders can dispose of their controlling shares to eligible persons. This could be done.

- (a) by sale of the controlling shares (Most foreign shareholders would find this method unsatisfactory because they would lose all their equity interest in the corporation.);
- (b) by purchase of the shares by the corporation for cancellation thus giving the Canadian shareholders control (This method is often not acceptable because of the tax implications.);
- (c) by conversion of voting shares held by noneligible shareholders into nonvoting common shares or preference shares, thus giving eligible persons with voting shares control over the corporation;¹²⁸ or
- (d) by exchange of the shares for shares in a new corporation which is controlled by eligible persons.¹²⁹

Third, each noneligible person could transfer his voting rights to an eligible person (or persons) while retaining his rights to dividends and a share of the corporate equity. However, the Agency does not favor this method and may not consider it sufficient to take the corporation out of the noneligible status.¹³⁰

(2) Restructuring of the transaction. The second alternative is to structure the transaction so that it will not be an acquisition of control of a Canadian

¹²⁶See Appendix C.

¹²⁷GUIDE, *supra* note 15, at ¶ 2,005-3.

¹²⁸The attempt to "Canadianize" would fail if the preference shareholders regain voting rights after dividend payments have been omitted or if they convert the preference shares back into voting shares. GUIDE, *supra* note 15, at ¶ 2,005-8.

¹²⁹Conversion of shares and sale of shares to a new corporation gives the noneligible shareholders rights to participation in dividends and in the winding up procedures.

¹³⁰GUIDE, *supra* note 15, at ¶ 2,005-11.

business nor the establishment of a new Canadian business. For example, if an investor wishes to purchase a producing oil property, his purchase of an undivided interest which is not substantially all of the property of the vendor's business or is not capable of being operated as a separate business will prevent the transaction from being characterized as the acquisition of control of an existing Canadian business.¹³¹ If the investor wishes to purchase shares in an existing corporation, then he should structure the transaction so that noneligible persons do not, in the aggregate, have control of the corporation.

C. The Review Process

Once a transaction becomes subject to review, the investor must file an application with the Agency. Upon review of the application, the Agency must prepare and submit to the minister a confidential recommendation in which it presents its opinion as to whether the transaction should be allowed based on an analysis of its benefits to Canada.¹³² The Minister must make an independent determination of whether the transaction will be of significant benefit to Canada by assessing the Agency's recommendation along with the following:

- (a) any other information submitted to him by any party to the proposed transaction;
- (b) any written undertakings to the government which relate to the proposed transaction by any party thereto which is conditional upon the allowance of the investment;¹³³ and
- (c) any representations by a province likely to be affected by the proposed transaction. The Minister must recommend to the cabinet, which has final approval authority, that the transaction be allowed or rejected and must submit a summary of the information and written undertakings upon which his recommendation was based.¹³⁴ The cabinet then may issue an Order-in-Council allowing or disallowing the transaction.¹³⁵

1. SIGNIFICANT BENEFIT TEST

In assessing whether the activity or transaction is of significant benefit to Canada, the following factors are considered:¹³⁶

¹³¹See text accompanying notes 105-108, *supra*.

¹³²GUIDE, *supra* note 15, at ¶ 33,002.

¹³³Sometimes these undertakings are the result of negotiations between the Agency and the applicant; See GUIDE, *supra* note 15, at ¶ 33,012.

¹³⁴Foreign Investment Review Act, c. 46, §§ 10,11 (1973).

¹³⁵*Id.* § 12.

¹³⁶In the Summary Assessment of Significant Benefit to Canada of Allowed Transactions the government takes into account ten specific forms of significant benefit as follows: increased employment; new investment; increased resource processing or use of Canadian parts and services; additional exports; Canadian participation (as shareholders, directors, and managers);

- (a) The effect of the activity or transaction on the level and nature of economic activity in Canada and the level of exports from Canada;
- (b) The extent to which Canadians will be able to participate in the management and in equity financing either of the subsidiary or the parent company;
- (c) The effect on productivity, industrial efficiency, technological development, product innovation and variety;
- (d) The effect of competition with any Canadian industry; and
- (e) The compatibility of the activity or transaction with national economic policy as well as with local policies in the provinces affected.¹³⁷

2. EXPERIENCE UNDER THE REVIEW PROCESS

Transactions relating to the energy resource industry have had very favorable treatment under the FIRA's review process. These transactions as a class generally provide the following benefits: (a) greater level of employment; (b) injection of new investment capital into the economy; (c) increased level of resource processing in Canada and promotion of the use of Canadian parts and services.

Upon examination of applications for the review under FIRA, it appears that many transactions involving energy resources development in Canada can pass FIRA's scrutiny. This may be due to the inherent benefits to Canada of the transactions themselves or the benefits of the accompanying written undertakings.¹³⁸

Eighty-six percent of the applications for acquisition of control of businesses involving energy resource exploration and production were approved. Some of the 14 percent of the applications that were not approved were rejected because the application was filed after the transaction was completed and not because the transaction was not of significant benefit to Canada. Some of the other rejected applications were acquisitions of control of producing oil properties which are almost always considered not to be of significant benefit to Canada.

The approval rate for acquisitions of control of businesses providing goods and services to the resource industry was also very high but lower generally than the average approval rate.

improved productivity and industrial efficiency; enhanced product variety and innovation; beneficial impact on competition; compatibility with industrial and economic policies. *GUIDE*, *supra* note 15, at ¶ 500.

¹³⁷FIRA, *supra* note 19 at § 2(2).

¹³⁸Sometimes the "inherent" benefits of the transaction may not be sufficient to pass the "significant benefit" test. In those instances the investor must alter the transaction or commit to certain undertakings that will increase the benefits to Canada. The following paragraphs, found in the *GUIDE*, *supra* note 15, are releases by the government describing reasons for allowing certain approved transactions: ¶ 1013; ¶ 1017; ¶ 1025; ¶ 1048; ¶ 1051; ¶ 1078; ¶ 1080. It will be noted that sometimes the transactions were accompanied by extensive lists of undertakings on the part of the investor which may have been the result of negotiations with the government.

Ninety-five percent of the applications for establishment of businesses involving energy resource exploration and production were approved also.

There was a comparably high approval rate for establishment of businesses providing goods and services to the resource industries.¹³⁹

D. FIRA'S Future

Although the FIRA review process has not been a major impediment to foreign investment in the past, there are indications that the future might not be as rosy. On February 17, 1980, Pierre Trudeau's Liberals regained control of the Canadian Parliament which signalled a probable change in the administration and coverage of the FIRA. The Liberal government has proposed an extension of the FIRA's mandate to include periodic review of all large foreign firms to assess their performance in such areas as export promotion, and research and development; publication of proposed takeovers by noneligible persons beyond a certain size before any transaction is approved to give eligible persons a chance to compete for the takeover; and government guarantees of bank loans to assist Canadian companies to compete for foreign takeovers or to repatriate foreign-owned assets.¹⁴⁰

The government confirmed its intentions to examine foreign-owned corporations for compliance with the Principles of International Business Conduct,¹⁴¹ a set of principles relating to such factors as retaining sufficient earnings in Canada, striving for international markets, technological innovation, upgrading natural resources in Canada, and fostering Canadian outlook in management.¹⁴²

Recently in the throne speech, the government repeated its intention to extend the coverage of the FIRA and to examine the performance of foreign corporations. It also introduced its policy of reduction of foreign ownership of Canada's petroleum industry from 75 percent to 50 percent by 1990.¹⁴³

E. Summary

If the investor is an eligible person, then none of his transactions will be subject to review. If the investor is a noneligible person but the transaction is not covered by the Act (i.e., the transaction does not meet the requirements for acquisition of control of an established Canadian business or for establishment of a new business in Canada), it will not be subject to review.

If the investor is noneligible and the transaction comes within the provisions of the Act, the transaction will be subject to review and will be rejected unless it is of significant benefit to Canada.¹⁴⁴

¹³⁹See Appendix D.

¹⁴⁰GUIDE, *supra* note 15, at ¶ 64-1.

¹⁴¹*Id.* at ¶ 61,600.

¹⁴²*Id.* at ¶ 65-1.

¹⁴³Wall St. J., April 15, 1980, at 15.

¹⁴⁴Foreign Investment Review Act, c. 46, § 2(1) (1973).

If the investor wishes to avoid the review process, he may choose a nonreviewable alternative to the proposed transaction. For example, the investor may become an eligible person or the transaction may be restructured so that it does not constitute the acquisition of an existing Canadian business nor the establishment of a new business in Canada.

However, as a practical matter, the investor need not be overly concerned with the review process. In the past, 95 percent of new businesses directly involved in energy resource development have been accepted. Eighty-six percent of the acquisitions of control of existing Canadian businesses involved with energy resource development have also been accepted. Furthermore, there was an unusually high rate of acceptance for almost every category of new business involved in providing services or goods for the energy resource industry. Acquisitions of control of existing Canadian businesses involved in providing those services or goods have had an acceptance rate lower than the general average but still relatively high.

In the future, the review process may be used to implement what appears to be a stricter foreign investment policy by the federal government.¹⁴⁵

III. Other Statutes Affecting Foreign Investment

Both federal and provincial Canadian statutes create additional requirements that may affect some transactions in the energy resource industry. Transactions affected by these statutes must meet not only the requirements of the FIRA but also the requirements of any applicable statutes.

A. Federal Legislation

Two statutes and a national policy restrict foreign investment in energy resources development to some extent. The statutes affect only the Territories. Since the lion's share of energy development is outside of their jurisdiction, the impact of the legislation on foreign investment in energy has been minimal. However, as the Territories become a greater source of energy, these provisions may have a powerful impact on future foreign participation in frontier energy development.¹⁴⁶

¹⁴⁵See text accompanying notes 140-43 *supra*.

¹⁴⁶See GUIDE, *supra* note 15 at ¶ 66-1. In the future there may be more foreign investment legislation. In the throne speech, the government announced that it intends to pass a new Canada Oil and Gas Act. This Act probably will control the issue of production licenses for the production of oil and gas in the Yukon, Northwest Territories, and the submerged portions on Canada's ocean borders. It has been reported that the legislation will require the applicant for the license to first obtain a ruling under the FIRA that it is not a non-eligible person or to have a Canadian participation rate of a specified percentage, probably thirty-five percent. Such a rate would exclude many of the major oil companies whose Canadian participation rate is considerably lower than thirty-five percent.

1. TERRITORIAL LANDS ACT¹⁴⁷

This Act applies only to Crown lands not presently incorporated into any of the provinces. This includes all lands vested in the Crown in the Northwest Territories and in the Yukon Territories.¹⁴⁸ Under the Act, the Cabinet is authorized to make regulations concerning mineral rights on territorial lands.¹⁴⁹ Although the main thrust of the Act was not the implementation of federal foreign investment policy, some of the regulations that have evolved under the Act are specifically intended to restrict foreign investment in exploration, mining, and oil and gas development on territorial lands.

The first set of such regulations is the *Canadian Mining Regulations*. These regulations prohibit the granting of a lease to mine in the Northwest Territories unless the investor is one of the following:

- (a) a Canadian citizen; or
- (b) a corporation in which at least 50 percent of the shares are owned by Canadian citizens or corporations that have their shares listed on a recognized Canadian stock exchange; or
- (c) a corporation that has its shares listed on a recognized Canadian stock exchange so that Canadians can participate in the development; or
- (d) a corporation wholly owned by one of the above corporations.¹⁵⁰

The other set of regulations which restricts foreign investment is the *Canada Oil and Gas Regulations*, which requires that oil and gas leases be granted only to Canadian citizens or types of corporations described in the *Canadian Mining Regulations*.¹⁵¹

These regulations give an advantage to Canadian citizens in the development of the North and differ from FIRA in several ways.

First, the regulations are not intended to be an all encompassing restriction on foreign investment in Canada because they apply only to territorial lands.

Second, the regulations use a fixed-rule approach to restrict the foreign investment.¹⁵² If the investor is not eligible for a lease, then he is automatically denied the lease. There is no review of the merits of the transaction nor is there any determination of whether the transaction would be of significant benefit to Canada.

Third, the regulations affect a larger class of individual investors which includes all noncitizens. FIRA, on the other hand, primarily affects nonresidents and only a limited class of resident noncitizens.¹⁵³

Fourth, the regulations affect a smaller class of corporate investors. Under

¹⁴⁷CAN. REV. STAT., ch. T-6 (1970).

¹⁴⁸*Id.* § 2.

¹⁴⁹*Id.* § 8.

¹⁵⁰STAT. O. & R. 61-86, 62-249, 66-80.

¹⁵¹STAT. O. & R. 61-253, 69-415, 73-13.

¹⁵²See text accompanying *supra* note 15.

¹⁵³FIRA affects permanent residents only if they have lived in Canada for more than one year after being eligible for Canadian citizenship. See text accompanying note 30, *supra*.

FIRA, a corporation becomes noneligible if it is controlled by noneligible persons. Thus, a business might be subject to review under FIRA if as little as 5 percent of the shares is owned by a single foreign investor or if 25 percent of the shares is owned by foreign investors. However, under the regulations, the test is not control but rather whether 50 percent of the corporation is owned by foreign investors or whether the corporation is listed on a recognized stock exchange. Thus, corporations which might be noneligible and hence, reviewable under FIRA, might be eligible under the regulations.

Finally, a noneligible corporation can easily avoid the regulations by becoming "Canadianized" i.e., listing stocks on an appropriate stock exchange or soliciting Canadian ownership until the 50 percent stock ownership minimum is reached. Under FIRA, it may be more difficult to actually transfer control of the corporation to eligible persons.¹⁵⁴

As has been noted already, the regulations act as a second, more restrictive screen for individual investors. For example, a permanent resident might be eligible under FIRA, but would not be eligible for a lease under the regulations. Furthermore, all individuals deemed noneligible under FIRA, will usually be ineligible under the regulations.¹⁵⁵ Conversely, all corporations which are eligible under FIRA will be eligible for a lease under the regulations. However, some noneligible corporations, whose proposed transactions successfully survive FIRA,¹⁵⁶ will not be eligible for leases if they do not become Canadianized. For example, if a corporation which is 51 percent owned by foreign investors proposes to purchase an oil and gas lease on properties which are at the exploratory stage, the transaction is exempt from review under FIRA even though the investor is noneligible.¹⁵⁷ However, the corporation would not be eligible for an oil and gas lease in the Northwest Territories until it met the regulations' eligibility requirements.

The scope of the regulations is restricted to territorial lands. To date, this has not had an extreme effect on foreign investment in energy resources because most of the energy resource development has been in Alberta.¹⁵⁸ Recently, however, there have been major discoveries of oil and gas in the Canadian Arctic.¹⁵⁹ As the importance of energy resources increases, the territorial lands will become increasingly important as energy resource sites, and therefore, the impact of the regulations on potential foreign investments could be quite significant in the future.

¹⁵⁴See GUIDE, *supra* note 15, at ¶ 2,005.

¹⁵⁵The only exception is a citizen who is not resident in Canada for more than five years.

¹⁵⁶A transaction can survive the FIRA if the transaction involved is not reviewable or if it is approved by the Cabinet.

¹⁵⁷See text accompanying *supra* note 91.

¹⁵⁸TIME, Dec. 10, 1979, at 84-85.

¹⁵⁹ALBERTA REPORT, June 20, 1980, at 16-17.

2. APPROPRIATION ACTS

The Northern Mineral Exploration Assistance Regulations were authorized by the *Appropriation Acts*.¹⁶⁰ The regulations permit the Minister of Indian and Northern Affairs to grant financial assistance to qualifying investors conducting exploration on their holdings in Northern Canada. In order to qualify for the assistance, the investor must be one of the following: (a) a Canadian citizen; (b) a corporation in which at least 50 percent of the shares are owned by Canadian citizens or corporations that have their shares listed on a recognized Canadian stock exchange; (c) a corporation that has its shares listed on a recognized Canadian stock exchange so that Canadians can participate in the development; or (d) a corporation wholly owned by one of the above corporations.

The intent of the regulations is to encourage domestic investment rather than to restrict foreign investment. However, the regulations would discriminate against foreign investors holding oil and gas or mining leases on Northern lands that do not come within the meaning of territorial lands, because foreign investors, as noneligible persons, cannot qualify for the assistance.

3. FEDERAL POLICY REGARDING OWNERSHIP OF URANIUM PROPERTIES

As a result of a proposed takeover in which a substantial ownership interest in Canada's largest uranium company was to pass into non-Canadian hands, the Canadian Government began its attempt to limit foreign investment in Canadian uranium properties.¹⁶¹ Its first action was a proposed amendment to the *Atomic Energy Control Act*¹⁶² and proposed regulations under the amended Act.¹⁶³ The proposed regulations limited foreign ownership of properties capable of producing substantial quantities of uranium to thirty-three percent in the aggregate and to ten percent for any single investor. Exemptions under the above rule are listed as follows:

- (a) Foreign owners of Canadian companies that owned producing mines as of March 2, 1970, are not affected except when the property interests are sold, they must be sold to Canadian investors until the above limitations are met.¹⁶⁴
- (b) Foreign investors with undivided interests in mineral rights who were engaged in exploration as of March 2, 1970, had until March 2, 1976 to prove commercial viabilities of the properties. If this was done, the companies were entitled to retain their ownership. Failure to prove commercial viability of the mineral interests by March 2, 1976 takes the

¹⁶⁰STAT. O. & R. 61-404, 67-584.

¹⁶¹GUIDE, *supra* note 15, at ¶ 63,101.

¹⁶²CAN. REV. STAT. ch. A-19 (1970).

¹⁶³GUIDE, *supra* note 15, at ¶ 63,100.

¹⁶⁴*Id.* at ¶ 63,101.

investor outside of the exemption.¹⁶⁵

- (c) There is no restriction on uranium exploration but when there is a discovery of a reserve capable of substantial production, the investor bringing the property into production must meet the general limitations with the exception that any single investor may own the entire 33 percent limit.¹⁶⁶

The proposed regulations were never enacted. On September 18, 1970, however, the Minister of Energy, Mines and Resources announced that special legislation would be passed in place of the regulations.¹⁶⁷ This special legislation too, has never been passed. However, the proposed regulations have become firm policy rules for the Canadian government.¹⁶⁸

B. *Provincial Legislation*

Two provinces have legislation which tends to restrict foreign investment in energy resources development.

1. BRITISH COLUMBIA

The Mineral Act¹⁶⁹ provides that no person shall prospect or explore for, locate, mine, produce minerals, or acquire title to a mineral¹⁷⁰ claim or leasehold unless he is a free miner.¹⁷¹ A free miner certificate can be issued only to Canadian residents or Canadian corporations.¹⁷² A resident is defined as a person, other than a corporation, who is a Canadian citizen ordinarily resident in Canada, or a noncitizen who has resided in Canada for more than eight years. A Canadian corporation is defined as a company in which at least 50 percent of the directors are residents.¹⁷³

The Mineral Act differs from the FIRA in that it affects a relatively narrow group of transactions. It affects the establishment or acquisition of businesses involved with exploration or development of coal or uranium in British Columbia only. Like the federal statutes, this statute acts as a second restriction on foreign investment. This Act also takes the fixed-rule approach. Therefore, noneligible persons under the Act are barred from obtaining free miner certificates regardless of whether the transaction they propose is of significant benefit to Canada. This Act further differs from the FIRA in that some individuals who are noneligible under the FIRA might be eligible under the Mineral Act and vice versa. For example, a permanent resident who has resided in Canada for less than four years would be eligible under the FIRA but would not be eligible for a free miner certificate under the Mineral Act.

¹⁶⁵*Id.* at ¶ 63,102.

¹⁶⁶*Id.* at ¶ 63,103.

¹⁶⁷*Id.* at ¶ 63,104.

¹⁶⁸*Id.* at ¶ 63,100.

¹⁶⁹B.C. Stat., ch. 54, § 2(1) (1977).

¹⁷⁰"Mineral" under the Act does not include oil and gas. *Id.* § 1.

¹⁷¹*Id.* § 2(1).

¹⁷²*Id.* § 2(3).

¹⁷³*Id.* § 2(2).

The same is true of corporations. Rather than looking to actual control of the corporation, which is often determined on the basis of stock ownership, the Mineral Act looks solely to the composition of the board of directors. Thus, a corporation which is controlled by eligible shareholders but which has a majority of "nonresidents" on the board of directors would be eligible under FIRA. However, the same corporation would be ineligible for a free miner's certificate and would, therefore, be barred from establishing or acquiring control of a business involved with exploration or development of coal or uranium in British Columbia.¹⁷⁴

2. QUEBEC

The Mining Act authorizes the Minister of Natural Resources to place restrictions on those who apply for exploration permits.¹⁷⁵

The holder of an exploration permit must give preference in employment to mining engineers, geologists, and administrators graduated from Quebec universities and schools and must give Quebec residents preference for labor-type positions.¹⁷⁶ This regulation applies to New Quebec and to all alluvial deposits.¹⁷⁷ This regulation affects all exploration companies regardless of whether they are involved in exploration of coal, uranium, or oil and gas.¹⁷⁸

These regulations apply to both domestic and foreign companies, and although they were not intended to restrict foreign investment, they do discriminate against foreign corporations as a practical matter. Domestic companies probably meet the regulations' employment requirements because they are located within the province. Foreign corporations, on the other hand, are not able to use their regular employees but must hire new employees when expanding operations into Quebec. This may tend to discourage some transactions.

C. Summary

The fact that a foreign investor successfully passes FIRA's requirements does not mean that the investor is immune to additional restrictions from federal and provincial statutes and regulations which act as a second restriction on foreign investors.

Foreign investors wishing to acquire or establish an oil and gas or hard mineral exploration or production business in the Northwest Territories will have to comply with eligibility requirements under the Canada Mining Regulations and the Canada Oil and Gas Regulations.¹⁷⁹

¹⁷⁴It is important to note that recently a seven year moratorium was placed on all uranium production in British Columbia. This moratorium, however, applies equally to domestic and foreign corporations.

¹⁷⁵Que. Stat., ch. 34 (1965).

¹⁷⁶Order-in-Council 864 as amended by Order-in-Council 1497.

¹⁷⁷Order-in-Council 428.

¹⁷⁸Order-in-Council ____.

¹⁷⁹The regulations apply only to lands that are vested in the Crown. Therefore, private owner-

Foreign investors wishing to acquire or establish a coal or uranium exploration business must first obtain a free miner's certificate. In order to obtain this certificate the investor must meet the eligibility requirements.

Any investor interested in acquiring or establishing a uranium production or exploration business should be aware of and be prepared to comply with the federal government's uranium policy.¹⁸⁰

Conclusion

The future of Canada's energy resource industry looks very promising. However, vast amounts of capital will be needed to develop these resources at the rate necessary to meet domestic and foreign energy needs. It has been estimated that over the next decade there will need to be more than \$200 billion (Canadian) in capital investment in energy resources development in Canada with an additional investment of \$60 billion (Canadian) in operating expenses.¹⁸¹

In the past investors generally have had little difficulty under the FIRA in participating in the development of Canada's vast energy resources. In addition, foreign investments in Alberta are not governed by any additional restrictive legislation. This is significant because Alberta contains roughly 85 percent of Canada's proven oil and gas reserves, half of its coal, and the lion's share of its oil sands.¹⁸² There are, however, some federal and provincial statutes providing additional restriction on foreign investment in Quebec, British Columbia and the Territories, all of which have vast energy resources. However, these statutes are relatively easy to comply with and should present no major obstacle to foreign corporate investors.

The future may not be quite as rosy for foreign investors, particularly in the petroleum industry. The government has adopted a wait-and-see approach to the expansion of the coverage of the FIRA and a tougher administration of its review process. In addition, the government may introduce new types of foreign investment legislation. It will be important for the potential investors to keep abreast of the latest governmental decisions with respect to foreign investment legislation.

ship of mineral rights does not come under this restriction. As a practical matter, though, almost all of the land in the Northwest Territories comes within the regulations' restrictions because almost all of it is vested in the Crown.

¹⁸⁰See note 174, *supra*.

¹⁸¹Address by Ed Brown, Solicitor, Dome Petroleum Ltd., (March 21, 1980).

¹⁸²TIME, Dec. 10, 1979, at 85.

Appendix A

Terms and Conditions For The Venture Capital Exemption

2. For the purpose of these terms and conditions, an investor shall be considered to be in the business of providing, in Canada, venture capital, where:
- (a) in the ordinary course of his business he makes available in Canada what is commonly known as venture capital;
 - (b) he provides the venture capital substantially through the purchases of shares of common stock or through other unsecured investments or loans that are subordinate to all financing other than common and preferred shares in the corporation;
 - (c) he does not normally acquire a majority of the shares of the corporations carrying on Canadian businesses in which he invests;
 - (d) he does not invest more than \$10 million in any single corporation carrying on a Canadian business;
 - (e) no single venture capital investment at original cost normally constitutes more than 20 percent of his total venture capital portfolio;
 - (f) he normally sells the shares of any corporation in which he has purchased shares within five to ten years after their acquisition.

Appendix B

Guidelines Concerning Acquisitions of Interests in Oil and Gas Rights

1. These Guidelines are issued under the provisions of subsection 4(2) of the Foreign Investment Review Act. That subsection authorizes the Minister to issue guidelines with respect to the application and administration of any provision of the Act. These Guidelines deal with the manner in which the notice requirements of section 8(1) of the Act, relating to the acquisition of control of a Canadian business enterprise, generally apply to various transactions in oil and gas rights.

2. In considering the proper treatment of transactions in oil and gas rights under the Act, it is useful to distinguish between two different types of activity which may be carried on upon the same land. The first of these activities is that of exploration for oil and gas; the second is the production of oil or gas on a regular basis following exploration and development of the land. It is recognized that production may be taken from exploratory wells while exploration continues. Such production does not necessarily alter the exploratory nature of the activities being conducted.

3. Exploration activities are conducted on properties the oil and gas rights in which are acquired from the Crown or a freehold owner under grants by way of permit, licence, reservation, lease or otherwise. Acquisitions of rights for exploration purposes under such grants are not regarded as constituting acquisitions of businesses, within the meaning of the Act, and therefore are not reviewable.

4. 'Farm-outs' and similar transactions are characteristic of exploration activity. These transactions typically involve the disposition to another person, the 'farmee', of an interest in oil and gas rights by the holder of those rights, the 'farmor.' In order to earn that interest, the farmee normally undertakes to carry out drilling or other exploratory work on the properties involved. A 'joint operating agreement' or 'operating procedure' normally forms part of a farm-out agreement. An ordinary transaction of this type, before or during exploration, does not constitute an acquisition of a business and is therefore not reviewable. Similarly, the acquisition of an interest in the oil and gas rights relating to a particular exploration property, by way of purchase or assignment, does not normally constitute an acquisition of a business and is therefore not reviewable. Where interests in a number of properties are involved in the transaction, that will ordinarily not lead to a different result, but where the magnitude of the interests is such that they comprise all or substantially all of the oil and gas rights of the vendor, there could be an acquisition of a business, except as provided in paragraph 6. Where, however, the vendor is engaged in the lease brokerage business (i.e. the purchase and sale of exploration properties as inventory), a disposition of the interests of that vendor in exploration properties would not normally amount to the transfer of a business unless it is a step in the winding-up of the brokerage business.

5. A property which is at the stage of production will ordinarily be presumed to be a business if it can reasonably be expected to sustain a separate business, by reason, for example, of the existence of proven reserves.

6. It is common for the owners of neighbouring rights to enter into 'joint operating', 'pooling', 'unitization' or similar arrangements, either before or during the stage of production. The purpose of these arrangements is to enable the respective owners to combine their rights into a common project. The interest of each participant in the

sharing arrangement is proportionate to the agreed value of the rights which he brings into the arrangement. The acquisition of an interest in this type of project in this way is a means of furthering the exploration or production activity of the participant, and is not to be considered as an acquisition of a business. Similarly, where the interest of a participant increases by reason of a change in the agreed value of his participation because of the respective work commitments of the participants or a default by one of them, there is no acquisition of a business.

Appendix C

3. Mineral Exploration and Extraction

The SIC system distinguishes between and classifies separately the activities of exploration for minerals and the extraction of minerals. However, owing to the practical operating circumstances in the mineral resource sector and the purposes for which a classification system is used in these guidelines, a number of the business categories listed in this Annex pertaining to the mineral resource sector comprise both the exploration for and the extraction of particular groups of minerals. (See List 1 for details). Thus category 6—Metal Mines (except Uranium Mines) and associated Exploration—comprises the activities of metal mining (and milling) and the exploration for metals. The way in which this classification system applies is indicated in the following paragraphs:

- (a) a new acquired business engaged in a mineral resource category is related to an established business in the same category but unrelated to an established business in a different mineral resource category. For example, a new or acquired metal mining business is related to an established metal mining business, but unrelated to an established coal mining business or to an established quarry;
- (b) an established metal mining business of a non-eligible person is deemed to be engaged also in the exploration for metals, but only for metals,
- (c) where a non-eligible person is engaged in mineral exploration but is not engaged in mineral extraction, the mineral exploration business of that person is not deemed to be engaged in exploration for any particular mineral or group of minerals until such time as that person establishes or acquires a mineral extraction business. Thereafter, the principle in the immediately preceding paragraph will apply, i.e. if a non-eligible person engaged in exploration discovers a metallic mineral deposit and proceeds to open a metal mine, thereafter that person will be deemed to be engaged in the exploration for metals,
- (d) a new coal mining business of a non-eligible person is considered unrelated to an established metal mining business of that person notwithstanding the fact that the discovery or delineation of the coal deposit upon which the new coal mining business is based may have resulted from exploration undertaken by the established metal mining or exploration business of that person.

Appendix D

Summary of Applications¹

I. Energy Resource Exploration and Production (including corporations which secure capital for exploration and production)

	ACQUISITIONS (57) ²		NEW BUSINESSES (40)	
	CASES	%	CASES	%
Approved	49	86	38	95
Rejected	8	14	2	5

Summary of Principal Factors of Benefits

	ACQUISITIONS (47)		NEW BUSINESSES (38)	
	CASES	%	CASES	%
Increased Employment	32	68	30	79
New Investment	45	96	38	100
Resource Processing	37	79	30	79
Additional Exports	11	23	2	5
Canadian Participation	28	60	31	82
Improved Productivity	33	70	0	—
Technological Development	19	40	5	13
Improved Product Variety	0	—	0	—
Competition	5	11	2	5
Compatibility with Policies	47	100	38	100

¹Compilation current through April 8, 1980. Compiled by author.

²The bracketed numbers represent the total number of applications considered in that category.

II. Primary Exploration Services (including data gathering services)

	ACQUISITIONS (9)		NEW BUSINESSES (7)	
	CASES	%	CASES	%
Approved	6	67	7	100
Rejected	3	33	0	—

Summary of Principal Factors of Benefits

	ACQUISITIONS (6)		NEW BUSINESSES (7)	
	CASES	%	CASES	%
Increased Employment	4	67	7	100
New Investment	4	67	7	100
Resource Processing	4	67	3	43
Additional Exports	1	17	1	14
Canadian Participation	3	50	3	43
Improved Productivity	3	50	4	57
Technological Development	3	50	3	43
Improved Product Variety	3	50	1	14
Competition	4	67	3	43
Compatibility with Policies	6	100	7	100

III. Primary Production Services (including rental businesses)

	ACQUISITIONS (24)		NEW BUSINESSES (16)	
	CASES	%	CASES	%
Approved	21	88	13	81
Rejected	3	12	3	19

Summary of Principal Factors of Benefits

	ACQUISITIONS (17)		NEW BUSINESSES (12)	
	CASES	%	CASES	%
Increased Employment	14	82	12	100
New Investment	16	94	12	100
Resource Processing	10	59	5	42
Additional Exports	5	29	1	83
Canadian Participation	13	77	9	75
Improved Productivity	10	59	6	50
Technological Development	9	53	6	50
Improved Product Variety	9	53	3	25
Competition	7	41	6	50
Compatibility with Policies	17	100	12	100

IV. Secondary Services
(including transportation, refining, storage,
marketing of energy resources)

	ACQUISITIONS (8)		NEW BUSINESSES (7)	
	CASES	%	CASES	%
Approved	7	88	7	100
Rejected	1	12	0	—

Summary of Principal Factors of Benefits

	ACQUISITIONS (5)		NEW BUSINESSES (6)	
	CASES	%	CASES	%
Increased Employment	5	100	6	100
New Investment	5	100	6	100
Resource Processing	5	100	2	33
Additional Exports	2	40	3	50
Canadian Participation	2	40	3	50
Improved Productivity	4	80	3	50
Technological Development	2	40	1	17
Improved Product Variety	4	80	1	17
Competition	3	60	2	33
Compatibility with Policies	5	100	6	100

**V. Manufacturers of Goods Used in the
Energy Resource Industry**

	ACQUISITIONS (14)		NEW BUSINESSES (10)	
	CASES	%	CASES	%
Approved	13	93	10	100
Rejected	1	7	0	—

Summary of Principal Factors of Benefits

	ACQUISITIONS (12)		NEW BUSINESSES (10)	
	CASES	%	CASES	%
Increased Employment	12	100	10	100
New Investment	9	75	10	100
Resource Processing	11	92	8	80

Additional Exports	11	92	6	60
Canadian Participation	10	83	7	70
Improved Productivity	4	33	3	30
Technological Development	5	42	8	80
Improved Product Variety	9	75	6	60
Competition	4	25	4	40
Compatibility with Policies	12	100	10	100

VI. Summary of All Applications

	ACQUISITIONS (1197)		NEW BUSINESSES (1163)	
	CASES	%	CASES	%
Approved	1084	91	1088	94
Rejected	113	9	75	6

Summary of Principal Factors of Benefits

	ACQUISITIONS (932)		NEW BUSINESSES (866)	
	CASES	%	CASES	%
Increased Employment	650	70	828	96
New Investment	634	68	821	95
Resource Processing	532	57	554	64
Additional Exports	347	37	278	32
Canadian Participation	485	52	532	61
Improved Productivity	583	63	184	21
Technological Development	246	26	158	18
Improved Product Variety	422	45	362	42
Competition	231	25	282	33
Compatibility with Policies	932	100	866	100