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Extraterritorial Application of Canadian Foreign Investment Review

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I. Introduction

Foreign investment controls implemented by other nations have been a matter of rising concern in the United States. In particular, the United States has closely scrutinized Canadian controls on foreign investment because the economies of the countries are so intertwined.

Canada's Foreign Investment Review Act ("FIRA"),[1] which regulated foreign investment in Canadian business, caused much conflict between the two nations prior to its repeal in 1985. The United States objected to the Act because it restricted international economic development,[2] while individual investors voiced concern over the Act's extraterritorial application.[3] Further, Canadian courts extended FIRA's reporting requirements to parent companies whose changes in control had no direct effect on Canadian subsidiaries.[4]

Both internal and international pressure led Canada to replace FIRA in 1985 with the Investment Canada Act ("ICA" or "Act"),[5] which ostensibly lessened restrictions on international economic investment.[6] Comparison of the two acts, however, suggests that substantive change may be less than anticipated, particularly with respect to the Act's extraterritorial application.[7]

The ICA, which purportedly liberalized review of foreign investment, in fact reaffirmed the Foreign Investment Review Agency's role in reviewing extraterritorial transactions indirectly affecting control of Canadian business.[8] This Comment examines the policy implications of FIRA's and ICA's extraterritorial application, and concludes that it is unnecessary and counterproductive when direct control of Canadian

1 Act of December 12, 1973, ch. 46, 1973-74 Can. Stat. 620, *amended by* ch. 52, 1976-77 Can. Stat. 1274 [hereinafter FIRA].

2 *See infra* note 28 and accompanying text.

3 *See infra* note 30 and accompanying text.

4 *See infra* notes 94-96 and accompanying text.

5 Act of June 20, 1985, ch. 20, 1985 Can. Stat. 419 [hereinafter ICA]. *See infra* notes 31-32 and accompanying text.

6 *See infra* notes 36-38 and accompanying text.

7 *See infra* notes 111-17 and accompanying text .

8 *See infra* notes 112-17 and accompanying text.

business is unchanged, or when contractual liability follows a direct change of control.

II. FOREIGN INVESTMENT REVIEW TO INVESTMENT CANADA: AN HISTORICAL PERSPECTIVE

Canadians have been concerned with dependence on foreign investment almost since the country's birth.[9] United States investment, because of its overwhelming presence in the Canadian economy, has been the focus of particular attention.[10] Initial legislative efforts to control foreign investment were directed at specific areas of the economy (for example, banking and broadcasting).[11] However, in 1970 the Cabinet decided that more general legislation was needed, and asked Herbert Gray to submit a report and proposals for legislation pertaining to the control of foreign investment.[12] Gray's report[13] concluded that flexible intervention on a case-by-case basis would effectively deal with the problem of foreign direct investment.[14] This report provided the model which led to enactment of FIRA in 1973.[15]

A. The Foreign Investment Review Act

FIRA's stated purpose was that control of Canadian enterprises would be acquired by non-Canadians only if significant benefit to Canada

9 Prime Minister Sir John A. Macdonald took care to ensure, shortly after Canadian confederation in 1867, that the Canadian Pacific Railway was built and operated by a company controlled by British subjects rather than by United States citizens. *See* Donaldson & Jackson, *The Foreign Investment Review Act: An Analysis of the Legislation*, 53 CAN. B. REV. 171, 172 (1975).

10 At the time FIRA was passed (1973), the United States was responsible for 80% of foreign investment in Canada. Fifty-eight percent of the manufacturing sector and 61% of the top 100 corporations in resource production and utilities were controlled by foreign entities. *See* Turner, *Canadian Regulation of Foreign Direct Investment*, 23 HARV. INT'L L.J. 333, 336 n.16 (1983). *See also* Howarth, *Canadian Foreign Investment Review Policy*, 1 B.U. INT'L L.J. 11, 16 (1982).

11 The Bank Act, S.C. 1964-65 ch. 40 §§ 3, 30, 38; The Broadcasting Act, S.C. 1967-68 ch. 25 § 2(b). *See generally* Beck, *Law and Policy in the Operation of Canada's Foreign Investment Review Agency*, 45 SASK. L. REV. 183, 184 (1981).

12 H. GRAY, FOREIGN DIRECT INVESTMENT IN CANADA (1972). Gray was a minister without portfolio. The first paragraph of the Gray report described the reason for Canada's concern over foreign investment: "The degree of foreign ownership and control of economic activity is already substantially higher in Canada than in any other industrialized country and is continuing to increase." Beck, *supra* note 11, at 184.

13 *See* Howarth, *supra* note 10, at 12.

14 Foreign direct investment is defined as investment involving a significant measure of control over the enterprise in question, as opposed to passive investment of the portfolio type. *See* Tennier, *Canada's Foreign Investment Review Act*, in LEGAL ASPECTS OF DOING BUSINESS IN CANADA 439, 441 (B. Fisher ed. 1983).

15 FIRA, *supra* note 1, § 2(1).

was ensured.[16] Thus, FIRA enabled Canada to maintain effective control over its economy. FIRA established review of two types of transactions: entry into Canada by a nonresident direct investor for the first time, and entry into an unrelated business by a nonresident direct investor already carrying on another business in Canada.[17] Takeovers of Canadian businesses by nonresident investors were exempt from review if the gross assets of the Canadian business did not exceed Can. $250,000 and gross revenues did not exceed Can. $3,000,000.[18]

Nonresident direct investors, termed "non-eligible persons" for purposes of the Act, included foreign individuals, governments, and corporations.[19] Corporations were presumed to be non-eligible persons, regardless of the place of incorporation, if certain conditions were met. If any individual non-eligible person owned 5% of a corporation's shares, the corporation was also a non-eligible person. In addition, if 25% of the shares of a publicly held corporation or 40% of the shares of a privately held corporation were owned by one or more non-eligible persons,[20] those corporations were also non-eligible persons.

Non-eligible persons under FIRA were required to notify the Foreign Investment Review Agency prior to acquiring control over a Canadian business enterprise.[21] Control was defined as 5% or more of the voting rights of a publicly held corporation controlling the Canadian business, or 20% or more of the voting rights of a privately held corpora-

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[16] FIRA's purpose was "to establish a means by which measures may be taken under the authority of Parliament to ensure that . . . control of Canadian business enterprises may be acquired by persons other than Canadians, and new businesses may be established in Canada by persons, other than Canadians . . . only if it has been assessed that the acquisition of control of those enterprises or the establishment of those new businesses . . . is or is likely to be of significant benefit to Canada." *Id.* § 2(1).

[17] *Id.* § 2(1).

[18] *Id.* § 5(1)(c).

[19] FIRA defined non-eligible persons to include:

> a. an individual who is neither a Canadian citizen nor a permanent resident . . . and includes
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> > i. a Canadian citizen who is not ordinarily resident in Canada and who is a member of a class of persons prescribed by regulation for the purposes of this definition, and
> > ii. a permanent resident who has been ordinarily resident in Canada for more than one year after the time at which he first became eligible to apply for Canadian citizenship,
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> b. the government of a country other than Canada or of a political subdivision of a country other than Canada, or an agency of such a government; or
>
> c. a corporation incorporated in Canada or elsewhere that is controlled, in any manner that results in control in fact, whether directly through the ownership of shares or indirectly through a trust, a contract, the ownership of shares of any other corporation or otherwise, by a person described in paragraph (a) or (b) or by a group of persons any member of which is a person described in paragraph (a) or (b).

Id. § 3(1).

[20] *Id.* § 3(2).

[21] *Id.* § 8(1).

tion.[22] Canadian business enterprises were defined to include both Canadian businesses and Canadian branch businesses.[23]

When a non-eligible person proposing to acquire control of a Canadian business enterprise notified the Foreign Investment Review Agency, the agency would often recommend specific actions leading to potentially favorable review if the actions were included in the proposal.[24] The Minister of Industry, Trade and Commerce then reviewed the proposal to determine if the investment was likely to be of "significant benefit to Canada."[25] General factors to be considered were the acquisition's effect on the Canadian economy, as well as its effect on employment and competition within Canadian industries.[26]

The international community, and particularly the United States, responded unfavorably to FIRA's implementation. The Act was viewed as discriminatory and "inconsistent with open international investment policies and obligations."[27] The United States, promoting an open world trade policy, filed grievances under the Organization for Economic Cooperation and Development Declaration of 1976[28] and the General

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22 *Id.* § 3(3)(c).

23 *Id.* § 3(1). Canadian businesses included: 1) businesses carried on in Canada by Canadian citizens or permanent residents; 2) corporations incorporated in Canada with one or more establishments in Canada; or 3) any combinations of individuals or corporations, one of whom was a Canadian business, who either alone or jointly or in concert with one or more other individuals or corporations controlled or were in a position to control the conduct of the business. A Canadian branch business was a business carried on in Canada, by a corporation incorporated elsewhere, that maintained one or more establishments in Canada to which employees ordinarily reported for work.

24 *Id.* § 11. For a more complete discussion of the review process, see Beck, *supra* note 11, at 190-92.

25 FIRA, *supra* note 1, § 9.

26 The specific factors the Minister would look at included the following:

> a. the effect of the acquisition or establishment 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 utilization of parts, components and services produced in Canada, and on exports from Canada;
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> b. the degree and significance of participation by Canadians in the business enterprise or new business and in any industry or industries in Canada of which the business enterprise or new business forms or would form a part;
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> c. the effect of the acquisition or establishment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;
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> d. the effect of the acquisition or establishment on competition within any industry or industries in Canada; and
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> e. the compatibility of the acquisition or establishment with national industrial and economic policies, taking into consideration industrial and economic policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the acquisition or establishment.

Id. § 2(2).

27 Unger, *United States Response to Canadian Foreign Investment Policies*, 1 B.U. INT'L L.J. 19, 23 (1982).

28 Organization for Economic Cooperation & Development, Declaration on International Investment and Multinational Enterprises (June 21, 1976)[hereinafter OECD Declaration]. The

Agreement on Tariffs and Trade.[29] In addition to objections based on its impact on the operation of the free market, the United States also criticized FIRA's extraterritorial operation.[30] Acquisition of control of one foreign corporation by another foreign corporation triggered the review process if control of the first corporation's Canadian subsidiary was acquired in the process.

While extra-Canadian criticism of FIRA influenced its repeal, the recession in the Canadian economy during the early 1980s sealed FIRA's fate.[31] Concerns over employment and economic growth superseded

OECD Declaration provides that member countries (which include the United States and Canada) must grant to foreign-owned businesses from other member nations treatment no less favorable under domestic laws, regulations, and administrative practices, than that accorded to domestic enterprises. *Id.* § II(1). However, rights of members to regulate the entry of foreign investment are not restricted. *Id.* § II(4). The United States claimed, nevertheless, that FIRA violated the "national treatment" provision. *See* Vagts, *Canada's Foreign Investment Policy: An International Perspective,* 1 B.U. INT'L L.J. 27, 30 (1982). Canada claimed protection under the foreign investment review exception. Moreover, Canada had expressly reserved the right to enact measures affecting foreign investment when it signed the OECD Declaration. Macdonald, *Canadian Industrial Policy Objectives and Article III of GATT: National Ambitions and International Obligations,* 6 CAN. BUS. L.J. 385, 398 (1982). The issue was technically moot, however, because the OECD Declaration relies on voluntary compliance by the member nations. The OECD is a forum for discussion of international issues affecting trade. Its declarations are not treaties, and therefore are not legally binding. However, such declarations are indicative of international custom. *See* Vagts, *supra,* at 29; *see also* Macdonald, *supra,* at 399.

29 General Agreement on Tariffs and Trade, *opened for signature* Oct. 30, 1947, 61 Stat. A3. T.I.A.S. No. 1700, 55 U.N.T.S. 187 [hereinafter GATT]. GATT did contemplate a specific legal obligation, providing that the products of contracting parties were to receive treatment on a par with that of products of national origin. GATT provides that "[t]he products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favorable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use." *Id.* art. III(4). The United States brought a complaint to the Council of GATT, claiming that the commitments Canada sought to extract from foreign investors violated Article III of the agreement. *See* Arnett, *From FIRA to Investment Canada,* 24 ALBERTA L. REV. 1, 2 (1985) (citing GATT PANEL REPORT, CANADA: ADMINISTRATION OF THE FOREIGN INVESTMENT REVIEW ACT (L/5504) (1984)). The GATT council found that the solicitation of undertakings to purchase Canadian goods under FIRA was inconsistent with Article III(4) of GATT. *Id.* Canada accommodated this holding by asking that applicants agree to give Canadian suppliers a "full and fair opportunity to supply" rather than asking them to agree to give Canadian suppliers preferential treatment, as had been the previous practice. *Id.* at 2. *See also* GENERAL AGREEMENT ON TARIFFS AND TRADE, GATT ACTIVITIES IN 1983 39-41, Sales No. GATT/1984-2 (1984).

30 *See* Howarth, *supra* note 10, at 17. Howarth, a commissioner of the Foreign Investment Review Agency, described this as an extraterritorial "effect" of the law, rather than an extraterritorial application of the law. He analogized it to the effects on the Canadian economy of monetary policies pursued by the United States Federal Reserve Board. *See also* Unger, *supra* note 27, at 21 ("FIRA review of mergers between United States parent companies that involve transfer of ownership of a Canadian subsidiary has extraterritorial applicability and therefore the capacity to necessitate a forced sale of a Canadian subsidiary by the acquiring United States company.").

31 Arnett, *supra* note 29, at 2.

concerns over control of the Canadian economy by foreign investors.[32] The election of a Progressive-Conservative government under Prime Minister Brian Mulroney also helped secure FIRA's demise. The new government was ideologically more sympathetic to free market principles and maintaining strong ties with the United States than its predecessor.[33]

B. The Investment Canada Act

The ICA became Canada's foreign investment control statute[34] by replacing FIRA and the former law's emphasis on control of foreign investment. The new Act represented a change in philosophy, stressing economic growth and employment in its purpose statement rather than control of foreign investment.[35]

The ICA exempts certain transactions from review. When a new Canadian business will be established, or when control over a Canadian business will be acquired (formal review not being required),[36] the Investment Canada Agency (replacing the Foreign Investment Review Agency) need only be notified. This ICA notification contrasts with FIRA's complete review procedure for all new transactions,[37] and eases the burden on companies investing in Canada.

Foreign investments are subject to review under ICA when: 1) a non-Canadian business acquires control; 2) a Canadian business with assets greater than Can. $5,000,000 directly acquires control; or 3) a Canadian business with assets greater than Can. $50,000,000 indirectly acquires control.[38] The transaction is also reviewable if the foreign investor establishes or acquires control over a Canadian business related to "Canada's cultural history or national identity," when such review is in the public interest.[39] Where control of an ongoing business is being acquired, ICA's jurisdiction requirement based on a company's value is much higher than FIRA's was.[40] Furthermore, almost all new businesses are now exempt from review, leading many to laud ICA as a more

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32 *Id.*

33 *Id.* at 2-3.

34 ICA, *supra* note 5, § 46.

35 The specific language provides that the "purpose of this Act is to encourage investment in Canada by Canadians and non-Canadians that contributes to economic growth and employment opportunities and to provide for the review of significant investments in Canada by non-Canadians in order to ensure such benefit to Canada." *Id.* § 2. *But see* FIRA, *supra* note 1, § 2(1).

36 ICA, *supra* note 5, § 11.

37 *See supra* notes 16-17 and accompanying text.

38 ICA, *supra* note 5, § 14; *see* Arnett, *supra* note 29, at 3.

39 ICA, *supra* note 5, § 15; *see supra* note 16 and accompanying text.

40 *See supra* note 18 and accompanying text.

liberal regulation of foreign investment.[41]

Under ICA, non-Canadians are defined to include individuals, governments or other entities that are not Canadian.[42] Canadian is defined to include: 1) a Canadian citizen; 2) a permanent resident; 3) the Canadian government; or 4) an entity that is "Canadian-controlled" for purposes of the Act.[43] A complex series of escalating tests is used to determine whether an entity is Canadian-controlled.[44] Voting interest (both equitable interest and voting control)[45] in the company is the main criterion. This definition was developed to prevent circumvention of the law through creative drafting of purchase agreements.[46]

Jurisdiction under the ICA lies when the non-Canadian entity gains control of a Canadian business[47] by acquiring control of a Canadian corporation or business's voting shares or assets. A non-Canadian entity can also fall under ICA jurisdiction even when there is no acquisition of control of any corporation. Voting interest in a non-Canadian entity controlling (directly or indirectly) an entity in Canada carrying on a Canadian business will trigger ICA's jurisdiction.[48] Additionally, a non-Canadian acquires control of a Canadian business by gaining "voting in-

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41 *See generally* Arnett, *supra* note 29.

42 ICA, *supra* note 5, § 3.

43 *Id.*

44 The test for Canadian control is:

a. Where one Canadian or two or more members of a voting group who are Canadians own a majority of the voting interests of an entity, it is a Canadian-controlled entity;

b. Where paragraph (a) does not apply and one non-Canadian or two or more members of a voting group who are non-Canadians own a majority of the voting interests of an entity, it is not a Canadian-controlled entity;

c. Where paragraphs (a) and (b) do not apply and a majority of the voting interests of an entity are owned by Canadians and it can be established that the entity is not controlled in fact through the ownership of its voting interests by one non-Canadian or by a voting group in which a member or members who are non-Canadians own one-half or more of those voting interests of the entity owned by the voting group, it is a Canadian controlled entity; and

d. Where paragraphs (a) to (c) do not apply and less than a majority of the voting interests of an entity are owned by Canadians, it is presumed not to be a Canadian controlled entity unless the contrary can be established by showing that

i. the entity is controlled in fact through the ownership of its voting interests by one Canadian or by a voting group in which a member or members who are Canadians own a majority of those voting interests of the entity owned by the voting group, or

ii. in the case of an entity that is a corporation or limited partnership, the entity is not controlled in fact through the ownership of its voting interests and two-thirds of the members of its board of directors or, in the case of a limited partnership, two-thirds of its general partners are Canadians.

Id. § 26(1).

45 Voting interest is defined under the Act to mean a voting share, which is defined as "a share in the capital of a corporation to which is attached a voting right ordinarily exercisable at meetings of shareholders . . . and to which is ordinarily attached a right to receive a share of the profits, or to share in the assets of the corporation on dissolution, or both." *Id.* § 3.

46 Arnett, *supra* note 29, at 7.

47 ICA, *supra* note 5, § 14.

48 *Id.* § 28(1).

terests of an entity that controls, directly or indirectly, an entity in Canada carrying on the Canadian business," subject to certain reservations.[49]

ICA differs from FIRA both substantively and procedurally. Now, many transactions are merely noticeable rather than reviewable.[50] More importantly, the standard for review is also different. Under FIRA, the test for allowance was whether the proposed investment was likely to be of "significant benefit to Canada."[51] Under ICA, the investment need only be of "net benefit to Canada."[52] The factors to be considered in determining whether an investment is of "net benefit" are identical to those considered under FIRA, with the addition of one new consideration: "the contribution of the investment to Canada's ability to compete in world markets."[53] The *Fallbridge Holdings* case provides a useful model with which to examine the differing operations of FIRA and ICA.

III. *CANADA V. FALLBRIDGE HOLDINGS LTD.*

A. Factual Background

In *Canada v. Fallbridge Holdings Ltd.*,[54] brought under FIRA, two companies challenged the reviewability of a certain set of corporate transactions involving changes in the ownership of several Canadian and United States corporations.[55] Under FIRA, the Federal Court of Appeal of Canada ("Court of Appeal") held that the Foreign Investment Review Agency had jurisdiction to review the transaction.[56]

Two companies jointly owned the Ambassador Bridge (connecting Detroit, Michigan, and Windsor, Ontario).[57] Detroit International Bridge Company ("DIBC"), a United States corporation, owned the United States half of the bridge.[58] Central Transit Company ("CTC"), a

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[49] *Id.* § 28(1)(d). The reservations under this clause are unclear. They provide first that the clause applies where there "is no acquisition of control . . . of a corporation incorporated elsewhere than in Canada that controls . . . an entity in Canada carrying on the Canadian business." The second exception seemingly negates the first, because it provides that the clause applies "where there is an acquisition of control described in [the first clause]." The reservations would seem to cover all potential cases resulting in the primary clause being unconditional. Therefore, the language can be interpreted to mean that acquisition of control under the statute occurs whenever voting interests of an entity controlling the Canadian business are acquired.

[50] *See supra* notes 37-41 and accompanying text.

[51] FIRA, *supra* note 1, § 9.

[52] ICA, *supra* note 5, § 21.

[53] *Id.* § 20. *Compare* FIRA, *supra* note 1, § 9. For a more complete discussion of the procedural differences between FIRA and ICA, see Arnett, *supra* note 29, at 24-33.

[54] 63 N.R. 17 (Fed. Ct. App. Can. 1985).

[55] *Id.* at 17.

[56] *Id.* at 28.

[57] *Id.* at 18.

[58] *Id.*

Canadian corporation belonging to DIBC, owned the Canadian half of the bridge.[59] Thus, the bridge was owned directly or indirectly by United States companies. One quarter of DIBC was owned, in turn, by Central Cartage Company ("CCC"), a United States corporation.[60]

A two-stage transaction was proposed which would result in a CCC subsidiary's owning the United States half of the bridge and Fallbridge Holdings Ltd., a Canadian company, owning the Canadian half of the bridge.[61] Fallbridge initially acquired 24.9% of the outstanding shares of DIBC.[62] CCC continued to own 24.6% of DIBC.[63] The remaining 50.5% of shares were widely held.[64] Fallbridge bought its shares by paying Can. $7,579,200 borrowed from CCC,[65] giving CCC a non-interest-bearing promissory note payable on demand, secured by the purchased shares.[66] CCC borrowed the necessary funds from Toronto Dominion Bank, tendering as security an assignment of the pledged shares and the promissory note.[67] CCC's part in financing Fallbridge's purchase was to play a role in the subsequent court decision.[68]

After Fallbridge purchased the DIBC shares, the Foreign Investment Review Agency was informally notified of the transaction.[69] This notification triggered the agency's formal demand that Fallbridge and CCC give written notice of the investment in the manner prescribed by FIRA.[70] Fallbridge filed the requested information, but contended that its acquisition of CTC shares was not subject to review because Fallbridge was a Canadian corporation.[71] CCC rejected the agency's de-

59 *Id.*

60 *Id.*

61 *Id.* at 19.

62 *Id.* at 18. A further agreement was signed with the following terms:

> 1. CCC was to sell to Fallbridge its 24.6% of DIBC's shares for ten million dollars, plus an additional amount equal to the net current assets of CTC at the end of the month preceding the month in which the shares would be sold.
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> 2. To finance the purchase, McKinlay Transport Limited, a Canadian company wholly owned by CCC, was to purchase 97,000 Class B nonvoting shares of Fallbridge for $9,700,000. Fallbrook, Fallbridge's parent company, was to purchase 3000 Class A voting shares of Fallbridge for $300,000. The balance was to be secured by a promissory note, payable on demand.
>
> 3. The share conditions of the Class B shares provided that they would be converted to common voting shares subject to compliance with FIRA, if applicable.

Id.

63 *Id.*

64 *Id.* at 18.

65 *Id.* at 19.

66 *Id.*

67 *Id.*

68 *See infra* notes 75-84 and accompanying text.

69 *Fallbridge Holdings*, 63 N.R. at 20.

70 *Id.*

71 *Id.*

mand because as a United States company it was not within FIRA's jurisdiction.[72] The Federal Court of Canada Trial Division ("trial court"), in response to the agency suit,[73] enjoined Fallbridge and CCC from direct or indirect action relative to CTC pending approval of the investment pursuant to FIRA.[74]

B. The Trial Court Decision

The question before the trial court was whether the transaction contemplated by the parties was reviewable under FIRA.[75] CCC argued that the investment was not reviewable because there was no acquisition of control of a "Canadian business enterprise" by a "non-eligible person."[76] According to CCC, the relevant transaction to be considered was the purchase by Fallbridge of 24.9% of DIBC's shares.[77] Fallbridge, as a Canadian corporation, was not a "non-eligible person."[78] Therefore, its purchase of the shares could only be reviewed if Fallbridge was a part of a "group of persons any member of which is a non-eligible person."[79] CCC argued that its agreement with Fallbridge did not constitute group action.[80] Instead, it involved a divestiture of the investment of a non-eligible person (DIBC) so that an eligible person (Fallbridge) would own the Canadian half of the bridge.[81] The trial court ruled that Fallbridge and CCC acted in concert in acquiring effective control of CTC, and that the concerted action constituted group action for purposes of the statute.[82]

C. The Court of Appeal Decision

The Court of Appeal affirmed the trial court's decision and its rationale.[83] The Court of Appeal considered a number of factors, including the fact that CCC developed the plan and arranged for its financing.[84] The transaction involved greater than 20% of the shares carrying voting

72 *Id.*
73 *Id.*
74 *Id.* at 21.
75 *Id.*
76 *Id.* at 24.
77 *Id.*
78 *Id.*
79 *Id.* at 23.
80 *Id.*
81 *Id.* at 24.
82 *Id.* at 25.
83 *Id.* at 26.
84 *Id.*

rights, and therefore constituted "acquisition of control."[85] The Court of Appeal also looked to CCC documents filed with the United States Securities and Exchange Commission. According to those documents, "[t]he Company . . . has determined to seek to acquire jointly with Fallbridge, such control of DIBC as will enable them to acquire ownership of its assets."[86] The Court of Appeal's opinion stated that these documents, and others with similar assertions, indicated the "group aspect" of the dealings of the companies.[87] Consequently, the Court of Appeal found support for jurisdiction for purposes of review.[88]

D. Extraterritorial Application of the Act

The trial court's order explicitly stated that its exercise of jurisdiction over CCC was not intended to operate extraterritorially.[89] Nevertheless, CCC argued in its appeal that the trial court's regulation of CCC's activities was an extraterritorial application of FIRA and that such extraterritorial application was not provided for in FIRA.[90] The Court of Appeal responded that there was no attempt to apply the Act extraterritorially, but only to "regulate the acquisition of control of a Canadian business by persons other than Canadians."[91] The Court relied on *Dow Jones & Co. v. Attorney General*[92] for this proposition. In *Dow Jones*, the Court of Appeal held that the merger of RDI, Inc. (a United States subsidiary of Dow Jones) with another United States company, Richard D. Irwin, Inc. (which wholly owned a Canadian subsidiary, Irwin Dorsey Ltd.) triggered foreign investment review because control over the Canadian company had changed hands in the transaction.[93]

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[85] *Id.*

[86] *Id.*

[87] *Id.*

[88] *Id.* at 27.

[89] The trial court said:

> For greater certainty, this injunction is not intended to be an exercise of jurisdiction not provided for by the principles, laws and practice of private international law, and as a consequence it is hereby expressly stated that this injunction recognizes and acknowledges the comity between this court and the courts of the State of Michigan and this injunction does not have any effect so as to infringe the authority of the courts of the state of Michigan, and does not have extra-territorial effect, so that in respect of the respondent Central Cartage Company specifically, this injunction is not intended to have, and does not have, any extra-territorial operation, but instead is confined to whatever jurisdiction this court may have over Central Cartage Company insofar as any of its activities are carried on in Canada or have an impact in Canada.

Id. at 21 (citing Order of Gibson, J. on June 19, 1979, in the trial court).

[90] *Id.* at 27.

[91] *Id.* The Court further stated that the purpose of the Act was to "ensure that an attempt to change the control of a Canadian business enterprise is reviewable in Canada so that if it is proposed that control leave Canada, it must be shown to be of significant benefit to Canada." *Id.*

[92] 122 D.L.R.3d 731 (Fed. Ct. App. Can. 1981).

[93] *Id.* at 732.

The Court of Appeal based its decision on language in FIRA providing that control over a Canadian business enterprise could be acquired "by the acquisition of shares of the corporation to which are attached voting rights ordinarily exercisable at meetings of shareholders of the corporation . . . ."[94]

IV. Analysis of the *Fallbridge Holdings* Decision

In *Fallbridge Holdings*, the Court of Appeal found that FIRA's purpose was to ensure that attempts to change the control of Canadian businesses would be reviewable. Significant benefit to Canada would thus have to be demonstrated before control could pass to non-Canadian hands.[95] However, the court failed to explain how the statute's purpose would be served by the exercise of jurisdiction in this case.[96]

DIBC, the United States corporation owning the United States side of the bridge, effectively controlled CTC (the Canadian company owning the Canadian side of the bridge) both before and after the transaction in question.[97] Corporations are recognized as legal entities in both Canada[98] and the United States,[99] and in FIRA itself.[100] Corporations may enter into contracts and are the entities held liable for their breach.[101] Therefore, the Canadian interest in ensuring "benefits to Canada" while CTC was under foreign control was well protected regardless of DIBC's ultimate ownership.[102] Canada's relationship with DIBC as a corporate

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94 FIRA, *supra* note 1, § 3(3)(a)(i)(A).

95 *Fallbridge Holdings*, 63 N.R. at 27.

96 *See generally* Donaldson & Jackson, *supra* note 9, at 218 (review of extraterritorial transactions involving internal corporate reorganizations is unnecessary in terms of the objectives of the Act).

97 *See supra* notes 58-64 and accompanying text.

98 *See* Canadian Corporations Act, 1970 R.S.C., ch. 32, § 16. The corporation has the power to "enter into any arrangements with any government or authority . . . that may seem conducive to the company's objects, or any of them, and to obtain from any such government or authority any rights, privileges and concessions that the corporation may think it is desirable to obtain." *See also* Edwards v. Blackmore, 42 D.L.R. 280, 286 (Ontario Sup. Ct. 1918)("a corporation at common law has, as an incident given by law, the same power to contract, and subject to the same restrictions, that a natural person has.").

99 *See* Greenbay & Minnesota R.R. v. Union Steamboat Co., 107 U.S. 98, 100 (1882)("The charter of a corporation, read in connection with the general laws applicable to it, is the measure of its powers, and a contract . . . [which] may fairly be regarded as incidental to the objects for which the corporation is created, is not to be taken as prohibited."); *see also* W. Fletcher, Cyclopedia of the Law of Private Corporations ch. 25, § 2564 (1979)("the power to contract in like manner as a natural person need not be expressly conferred upon a corporation by its charter. It is always implied, in the absence of express restrictions, subject to the qualification that the contract must not be foreign to the purposes for which the corporation was created.").

100 FIRA, *supra* note 1, § 3(1).

101 *See supra* note 98 and accompanying text.

102 *See supra* notes 96-98 and accompanying text.

entity would not be affected by changes in DIBC's ownership, because DIBC's obligations to Canada rested with the corporation and not its owners.[103]

The court, in relying on *Dow Jones* to support its holding, ignored important factual differences between *Dow Jones* and *Fallbridge Holdings*. In *Dow Jones*, all of the property of Richard D. Irwin, Inc. (including the voting shares of Irwin Dorsey, its Canadian subsidiary) became the property of R.D.I., Inc., a United States subsidiary of Dow Jones. Richard D. Irwin, Inc. surrendered its corporate charter and ceased to operate as a corporate entity.[104] Consequently, in *Dow Jones* the shares of the Canadian corporation actually changed hands and the foreign corporate entity which had been doing business in Canada ceased to exist. Application of foreign investment review might have been justifiable on that basis.[105] However, the transaction was characterized by the court as a merger,[106] and consequently, liability under any agreement with Canada would have been assumed by the new corporation.[107]

Dow Jones is distinguishable from *Fallbridge Holdings* because the shares of CTC in *Fallbridge Holdings* were owned by DIBC both before and after the reviewed transaction. The Court based its decision in *Fallbridge Holdings* on a derivative change of ownership which changed "control" of CTC, the Canadian corporation.[108] However, DIBC continued to be the foreign corporation doing business in Canada, and no change in that relationship would have been necessitated by the change in DIBC's stock ownership.[109] Consequently, Canada had little reason to review the transaction. The *Fallbridge Holdings* decision exemplified the concerns expressed by foreign investors over extraterritorial application of FIRA. Although the ICA attempted to make the foreign investment review process more permissive, it failed to address investor's concerns regarding extraterritoriality.

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103 *Id.*

104 *Dow Jones*, 122 D.L.R.3rd at 731-732.

105 *Id.* In point of fact, Richard D. Irwin, Inc. established control over Irwin Dorsey prior to enactment of FIRA, and therefore was under no foreign investment agreement with Canada. *Id.*

106 *Id.* at 731.

107 *See* W. FLETCHER, *supra* note 99, ch. 61, § 7121 ("In case of a merger of one corporation into another, where one of the corporations ceases to exist and the other corporation continues in existence, the latter corporation is liable for the . . . contracts . . . of the former.").

108 *See supra* notes 83-88 and accompanying text.

109 *See* Donaldson & Jackson, *supra* note 9, at 226 ("In reviewing the legislative history of the Act . . . we have concluded that the legislation was primarily designed to apply to changes in ultimate *de facto* control of Canadian business enterprises and not with reorganizations . . . where there is no change in the underlying control of the Canadian business enterprise.").

V. Critique of the Investment Canada Act

The Investment Canada Act eliminated the concept of "group action" involving a non-eligible person, on which the *Fallbridge Holdings* decision turned.[110] Nevertheless, extraterritorial jurisdiction of the Act continues to be a troublesome issue for changes in control of foreign corporations with Canadian subsidiaries. The ICA rules for acquisition of control[111] are ambiguous and may be interpreted to have the same effect as FIRA with respect to extraterritorial jurisdiction.

The ICA does seek to address some of the issues of concern under FIRA regarding extraterritorial application of the Act. The Act expressly provides that it does not apply to "acquisition of control of a Canadian business by reason of amalgamation, a merger, a consolidation or a corporate reorganization following which the ultimate direct or indirect control in fact of the Canadian business, through the ownership of voting interests, remains unchanged."[112] This exception, standing alone, goes too far in exempting certain transactions where Canadian interests would not be fully protected, while failing to exempt transactions where Canadian interests are secure.[113] For example, after a corporate reorganization in connection with a foreclosure, the contracts of the old company would not be binding on the new business, absent express or implied agreement to honor such contracts.[114] Consequently, Canada would not be able to enforce the predecessor corporation's agreement against a new corporation.[115] Nevertheless, the transaction would be ex-

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110 *See supra* notes 85-88 and accompanying text.

111 *Supra* note 44, 49.

112 ICA, *supra* note 5, § 10(1)(e). These terms are not defined in the Act, but are defined in Black's Law Dictionary (5th Ed. 1979). An amalgamation is "a union of different corporations to form a new body." A merger is "the absorption of one corporation into another." A consolidation "extinguishes two or more corporations and creates a new body." A corporate reorganization is "an adjustment made in the capital structure of a corporation in which old securities and indebtedness are retired and new securities and bonds are issued."

113 The review process under ICA may include submission by the non-Canadian investor of "written undertakings to the majesty in right of Canada." ICA, *supra* note 5, § 19(c). These contractual undertakings are enforceable in a court of law. *See id.* § 39(1)(e), 39(2), 40(2).

In the United States, where one company sells or otherwise transfers all of its assets to another company, the second company is not accountable for the liabilities of the first except when: 1) the purchaser expressly or impliedly agrees to assume the debts; 2) the transaction constitutes a merger or consolidation; 3) the purchasing corporation is a continuation of the selling corporation; or 4) the transaction is entered into fraudulently for the purpose of escaping liability. Ladjevardian v. Laidlaw-Coggeshall, Inc., 431 F. Supp. 834 (S.D.N.Y. 1977). Therefore, liability of a United States corporation under a contract would continue in the event of an amalgamation, merger, or consolidation. However, liability would not necessarily follow in the event of a corporate reorganization. *See infra* note 115 and accompanying text.

114 Wiggins Ferry Co. v. Ohio & Mississippi Ry., 142 U.S. 396, 407 (1892).

115 *Id.*

empt from review under ICA.[116]

By contrast, ICA fails to exempt those corporate transactions where indirect control of the Canadian corporation is acquired through means other than those enumerated. For example, the direct purchase of 51% of the shares of a foreign corporation with a Canadian subsidiary would not qualify as an amalgamation, merger, consolidation, or corporate reorganization.[117] Canadian interests would be well protected under such a transaction, however, because the foreign corporation owning the Canadian subsidiary would continue to do business in Canada, and would continue to have an enforceable agreement with the government.[118] Nevertheless, foreign investment review of this transaction would be required.[119]

These illustrations demonstrate that Canada's interests would best be protected by exempting only those changes in control (direct or indirect) where the original corporation's agreement with Canada remains enforceable. ICA's review of extraterritorial transactions which indirectly affect Canadian business bears no rational relationship to the statute's purpose of "encouraging investment in Canada."[120] On the contrary, corporations will be loathe to invest in Canada, knowing that a change in control of the corporation with no direct implications for the Canadian branch of the business may trigger a long, complicated, and costly review process.[121]

VI. Policy Implications of Extraterritorial Review

Established principles of international law and comity[122] govern the extraterritorial application of a nation's laws. Comity has been characterized as a question of "the wisdom of exercising jurisdiction."[123] Nations generally may exercise extraterritorial jurisdiction when conduct

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116 *See supra* notes 111-13 and accompanying text.

117 *See id.*

118 *See supra* note 113 and accompanying text.

119 *See supra* notes 44-49 and accompanying text.

120 *See supra* note 35 and accompanying text.

121 *See supra* notes 47-49 and accompanying text.

122 "Comity is a recognition which one nation extends within its own territory to the legislative, executive, or judicial acts of another. It is not a rule of law, but one of practice, convenience and expediency." Somportex Ltd. v. Philadelphia Chewing Gum Corp., 453 F.2d 435, 440 (3d Cir. 1971). *See generally* Maier, *Extraterritorial Jurisdiction at a Crossroads: An Intersection between Public and Private International Law*, 76 AM. J. INT'L L. 280 (1982).

123 *See, e.g.*, U.S. v. Aluminum Co. of America, 148 F.2d 416, 443 (2d Cir. 1945); *see also* Gumpel, *The International Implications of Conglomerate Merger Legislation*, 22 VA. J. INT'L L. 715, 736 (1982).

outside their borders has effects within their borders.[124]

A primary focus of debate regarding extraterritorial jurisdiction has been United States antitrust law, which has often been applied extraterritorially. In antitrust cases, United States courts have interpreted comity to require a balancing of the interests of the United States and the foreign nation involved.[125] In *Timberlane Lumber Co. v. Bank of America,*[126] the court established a "jurisdictional rule of reason."[127] Determination of the point at which "the interests of the United States are too weak and the foreign harmony incentive for restraint too strong to justify an extraterritorial assertion of jurisdiction" is required.[128] Criteria to be used to determine that critical point have not been well articulated. In antitrust litigation, criteria have generally turned on "direct and substantial" effects on United States commerce (also known as the "effects doctrine").[129] In *Timberlane,* the court noted that the effects doctrine was not dispositive of the conflicts of laws issue, and that a "more comprehensive inquiry was needed."[130] The Court looked to the *Restatement (Second) of Foreign Relations Law,* which advocated the consideration of a number of factors in resolving jurisdictional issues between nations.[131]

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124 Maier, *supra* note 122, at 296. *See also* Gumpel, *supra* note 123, at 753-54 (characterizing comity as "the prudential considerations that may motivate a court or prosecutor to defer voluntarily to the interests of another state or the international system.").

125 Maier, *supra* note 122, at 296.

126 549 F.2d 597 (9th Cir. 1976).

127 *Id.* at 609. *But see* Kadish, *Comity and the International Application of the Sherman Act: Encouraging the Courts to Enter the Political Arena,* 4 NW. J. INT'L L. & BUS. 130 (1982).

128 *Timberlane,* 549 F.2d at 609.

129 *Id.* at 611. This direct and substantial effects doctrine has also been used by United States courts considering the extraterritorial application of United States securities laws. *See generally* Thomas, *Extraterritorial Application of the United States Securities Laws: The Need for a Balanced Policy,* 7 J. CORP. L. 189, 192 (1982). The *Fallbridge Holdings* trial court decision implicitly endorsed this "effects" doctrine in its decision. *See supra* note 89 and accompanying text.

130 *Timberlane,* 549 F.2d at 613.

131 RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 40 (1965) [hereinafter RESTATEMENT (SECOND)] provided that:

> Where two states have jurisdiction to prescribe and enforce rules of law and the rules they may prescribe require inconsistent conduct upon the part of a person, each state is required by international law to consider, in good faith, moderating the exercise of its enforcement jurisdiction, in the light of such factors as
>
> a. vital national interests of each of the states
>
> b. the extent and nature of the hardship that inconsistent enforcement actions would impose upon the person
>
> c. the extent to which the required conduct is to take place in the territory of another state
>
> d. the nationality of the person, and
>
> e. the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state.

For the assertion that § 40 requirements derive from a "rule of reason" analysis rather than being grounded in international custom or convention, see Maier, *supra* note 122, at 294.

The *Timberlane* Court identified the following as critical elements to be weighed in the analysis:

> [T]he degree of conflict with foreign law or policy, the nationality or allegiance of the parties and the locations or principal places of business of corporations, the extent to which enforcement by either state can be expected to achieve compliance, the relative significance of effects on the United States as compared with those elsewhere, the extent to which there is explicit purpose to harm or affect American commerce, the foreseeability of such effect, and the relative importance to the violations charged of conduct within the United States as compared with conduct abroad.[132]

In *Mannington Mills, Inc. v. Congoleum Corp.*,[133] the court utilized the balancing process called for in *Timberlane*, and substantially adopted its criteria.[134] The *Mannington Mills* court added several additional considerations, including:

> Availability of a remedy abroad and the pendency of litigation there; . . . Possible effect upon foreign relations if the court exercises jurisdiction and grants relief; . . . If relief is granted, whether a party will be placed in the position of being forced to perform an act illegal in either country or be under conflicting requirements by both countries; . . . Whether an order for relief would be acceptable in this country if made by the foreign nation under similar circumstances; . . . Whether a treaty with the affected nations has addressed the issue.[135]

A similar analysis to that used in *Mannington Mills* should be employed by Canadian courts in determining the wisdom of exercising extraterritorial jurisdiction in foreign investment review cases.[136] An initial matter for consideration would be the degree of conflict between the Canadian statute and United States law. United States statutes and policy have consistently favored an open trade policy.[137] Application of FIRA extraterritorially in the United States has exacerbated United States conflicts with Canada with respect to open trade.[138]

Although at present there is no United States statute directly con-

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132 *Timberlane*, 549 F.2d at 614. *Cf.* RESTATEMENT, *supra* note 131, § 40; *see also* Note, *The Use of Interest Analysis in the Extraterritorial Application of United States Antitrust Law*, 16 CORNELL INT'L L.J. 147 (1983); Thomas, *supra* note 129, at 193.

133 595 F.2d 1287 (3d Cir. 1979).

134 *Id.* at 1297.

135 *Id.* (footnote omitted).

136 Though the trial court in *Fallbridge Holdings* claimed not to be exercising extraterritorial jurisdiction, the matter being reviewed was the purchase by a Canadian corporation of a United States corporation's shares. *Compare supra* note 89 and accompanying text (the trial court's statement regarding extraterritorial jurisdiction in this matter) *with supra* notes 90-95 and accompanying text (discussion of the decision of the Court of Appeal).

137 For discussion of the United States position on FIRA, see *supra* notes 28-30 and accompanying text.

138 *See supra* note 30 and accompanying text.

flicting with ICA, it seems clear that further extraterritorial application of the statute could lead the United States to consider the passage of "blocking legislation."[139] Blocking statutes in the United States or elsewhere might lead to multiple inconsistent demands on corporations.[140] For example, if the United States passed a statute requiring United States corporations investing outside the United States to "buy American," while Canada required the same corporation to "buy Canadian," the corporation would be placed in an impossible situation. Such inconsistent demands could be minimized by limiting jurisdiction to transactions occurring within the respective countries, absent compelling reasons to extend jurisdiction outside the nation.

Canadian courts also need to consider the benefits expected to be derived from the exercise of extraterritorial jurisdiction. The ICA's purpose is not advanced by exercising extraterritorial jurisdiction when Canadian interests are protected by contracting with the immediate parent of the Canadian corporation, and the contract is not affected by the transaction. Further, overly broad foreign investment controls may act as a disincentive to foreign investment in Canada, an effect which would be directly opposed to the Act's stated purpose.[141]

VII. CONCLUSION

Canada clearly has a legitimate interest in regulating foreign investment within its boundaries. However, Canadian attempts to regulate extraterritorial transactions risk thwarting the very purpose that the Investment Canada Act was intended to further. Review of extraterritorial transactions does little to ensure that foreign investment will benefit Canada. Most of the corporations affected will already have a formal

139 Several foreign nations, in response to the extraterritorial application of United States antitrust law, have passed legislation blocking the exercise of United States jurisdiction in their countries. *See generally* Foer, *International Implications of Section 7 Enforcement*, 50 ANTITRUST L.J. 819 (1982).

140 For example, the Protection of Trading Interests Act, 1980, ch. 11 (U.K.), permits recovery of the part of multiple damages exceeding compensatory damages awarded by an overseas court for antitrust violations by persons or corporations from the United Kingdom, while United States law permits treble damages for antitrust violations. Clayton Act, 15 U.S.C. § 15(a) (1982).

141 Analogously, concerns have often been voiced regarding the effects of overly broad United States Securities and Exchange Commission ("SEC") reporting requirements for foreign issuers. *See, e.g.*, Note, *Foreign Securities: Integration and Disclosure Under the Securities and Exchange Acts*, 58 NOTRE DAME L. REV. 911, 924 (1983)(overly broad SEC reporting requirements result in "reduced international flow of capital and decreased investment opportunities in the United States."); *see also* Thomas, *supra* note 129, at 190 ("Application of domestic laws to foreign securities transactions (where foreign countries may have substantial interest in the transactions, and differing regulatory practices and national policies), may create antagonism and . . . ultimately may impede the free flow of capital and affect world commerce.").

agreement with Canada specifying the benefits that the corporation will provide to the nation. Imposition of an unduly burdensome regulatory scheme may have the effect of discouraging future foreign investment in the country. In sum, the purposes of the foreign investment statute would best be effectuated by imposing review on extraterritorial transactions only when direct ownership of the Canadian business changes, and contractual liability under the foreign investment agreement does not pass to the new owner.

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