NET BENEFIT

Canada’s Policy on Foreign Investment in the Book Industry

A Research Report for the Association of Canadian Publishers

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Executive Summary

The Association of Canadian Publishers (ACP) commissioned this report as a longitudinal study of Canadian government policy on foreign investment in the book industry. The report focuses on the policy's current iteration, the *Revised Foreign Investment Policy in Book Publishing and Distribution (1992)*. It examines the policy's implementation by successive governments over the past 25 years, summarizes the resulting impacts on the domestic book industry, and analyzes the policy's effectiveness in achieving its objectives. The report concludes with broad observations about the policy's use and abuse by both Conservative and Liberal governments in the past.

The current policy originates in two earlier iterations going back 18 years. In 1974 the Liberal government, stating that "the major segment of the book publishing industry in Canada should be owned by Canadians," adopted regulations to prevent foreign takeovers of Canadian-owned firms, as well as the entry into Canada of new foreign-controlled ventures. Indirect takeovers, where a foreign investor acquires a foreign-controlled subsidiary, would be reviewed by the Foreign Investment Review Agency (FIRA) to ensure "net benefit to Canada." The report describes how FIRA rulings in two cases, Pocket Books / Simon & Schuster (1976) and Bantam Books (1977), produced significant net benefit for, respectively, Canadian-owned publishers General Publishing and McClelland & Stewart.

The subsequent Conservative government welcomed foreign investment and pursued free trade with the United States, replacing FIRA with a new agency, Investment Canada. Yet it maintained the Liberal policy on foreign investment in the book industry; and in regard to indirect takeovers, it went considerably farther. The so-called Baie Comeau Policy, announced in 1985, required foreign investors buying a foreign-owned subsidiary to sell a majority interest to Canadians within two years. The report describes how the government adopted this policy as political cover but lacked the political will to implement it. This contradictory situation resulted in the policy's death by attrition and its replacement in 1992 by the current policy, which represents in many ways a return to the 1974 "net benefit" approach.

The policy's stated objective is strengthening Canada's book publishing and distribution sector by requiring that new foreign investments be "compatible with national cultural policies" and "of net benefit to Canada and to the Canadian-controlled sector." After examining the policy's methodology and guidelines, the report surveys 13 cases reviewed under the policy between 1992 and 2017. Of these, one was reviewed by the Mulroney Conservative government, three by the Chrétien Liberal government, four at different stages by both the Chrétien Liberal and Harper

Conservative governments, four by the Harper government alone, and one is currently under review by the Trudeau Liberal government.

The findings show broad disparities and inconsistencies in the policy's implementation, depending on the nature of the transaction, the government in power, and the political and economic context of the day. In several cases, rulings favoured expansion of the foreign investment in stages, beyond limits previously approved – a process that the ACP has likened to the "camel in the tent" analogy. Only two rulings – Indigo / Borders (1996) and Prentice-Hall / Addison Wesley (1999) – provided significant net benefit to Canada and the Canadian-controlled sector. A partial case could also be made for rulings in a third transaction. The remaining 10 rulings strengthened primarily or exclusively the interests of the foreign investors. They accomplished little or nothing for Canada or the Canadian-controlled sector, sometimes doing the sector demonstrable harm.

The unavoidable conclusion is that the policy has been effective in achieving its objectives only rarely. In more recent years its implementation has been largely ineffective and, indeed, counter-productive – the result of successive rulings that circumvented the policy's core purpose by providing foreign investors with unjustified "exceptions" to its guidelines.

Nonetheless, the foreign investment policy remains on the books. With a relatively young government in power, the ACP has an opportunity to influence policymakers to set a new, bolder and more productive course.

Purpose of Report

The report's purpose is to examine the issue of foreign ownership in Canada's book industry, specifically in regard to federal policy on foreign investment in book publishing, distribution and retailing. The central focus is the policy's current iteration, the *Revised Foreign Investment Policy in Book Publishing and Distribution (1992)*. The report will consider the policy's objectives, guidelines and methodology, review its application by successive governments over 25 years, summarize the resulting impacts on the domestic book industry, and analyze the policy's effectiveness in achieving its objectives.

The Association of Canadian Publishers has commissioned this report at a time when the Department of Canadian Heritage is re-evaluating the cultural policy tools at its disposal, including measures to regulate foreign investment in the creative industries. The renegotiation of the North American Free Trade Agreement, with its crucial exemption for culture, is also ongoing. Although the previous government conducted a lengthy study of the foreign investment policy in 2010, that review produced no public findings and made no changes to the policy. Meanwhile successive rulings have continued the practice of approving new foreign investments as “exceptions” under the policy, raising serious questions about government intentions toward the policy and its goals. The report is intended to inform and assist the Association’s future advocacy work in this area.

Introduction

More than any Western nation, Canada has developed a matrix of policies and programs to strengthen its domestic book industry. By making strategic financial investments complemented by sound public policy, government has fostered an environment in which private-sector publishers produce a rich and diverse body of Canadian writing and market it successfully at home and abroad. Canadians in both official languages and every part of the country have benefited from this cultural and economic achievement.

Such a policy matrix is needed less, if at all, in other countries: particularly those where a large domestic market allows book publishing to be inherently more profitable. In Canada, our English- and French-language markets are relatively small and fully open to competition from the world’s largest book-exporting nations, the U.S., the U.K. and France. Accordingly, both federal and provincial governments play a critical role in sustaining the viability, productivity and competitiveness of the book industry.

Nationality of ownership has been central to federal publishing policy from the start. In 1972, when the government first funded the Canada Council for the Arts to create grant programs for publishing, funding was designated solely for Canadian-authored books published by Canadian-owned firms. In 1979 the government again used criteria of domestic ownership and control when it launched a considerably larger initiative, the Canadian Book Publishing Development Fund. Now known as the Canada Book Fund and administered by the Department of Canadian Heritage, the program is a source of vital operating capital to strengthen the industry and its technological and professional infrastructure.

Federal funding programs prioritize Canadian ownership for both cultural and economic reasons. Domestic publishers’ primary and often only focus is originating Canadian-authored books. By contrast, the prime directive of foreign-owned publishers in Canada is the profitable business of importing their parent company’s American, British or French books into the Canadian market. Multinational subsidiaries enjoy advantages of scale and ready access to capital. Most Canadian-owned publishers, on the other hand, are small to medium-sized independent businesses operating within narrow margins and severe financing constraints. Federal programs support these firms’ competitiveness in a difficult, constantly changing business environment.

Government regulation of foreign ownership in book publishing, distribution and retailing flows naturally from, and complements, the objectives of the funding programs.

1. Evolution of Foreign Investment Policy for the Book Industry, 1974-1992

1.1 Policy Origins

Foreign ownership was, in fact, the catalyst for government involvement with the book industry. Prior to 1970, government policy and programs for publishing did not exist. In that year American takeovers of two long-established Toronto publishers brought the issue into sharp focus. Gage and Ryerson Press were acquired by Scott Foresman and McGraw Hill respectively, setting off widespread public concern that Canadian ownership of English-language book publishing was in jeopardy.

An "Emergency Committee of Canadian Publishers" was formed to advocate for government action to strengthen the domestic industry. This ad hoc group became the nucleus of the Independent Publishers Association (IPA), later the ACP. In 1970 Ontario responded to the issue by creating the Royal Commission on Book Publishing, and early the next year the Progressive Conservative Ontario government provided a million-dollar loan to the country's best-known domestic publisher, McClelland & Stewart, which was experiencing severe financial difficulties. This was followed by a provincial loan-guarantee program for Ontario-based, Canadian-owned publishers, and a block grant program administered by the Ontario Arts Council.

Vigorously lobbied by the IPA and the Quebec publishing industry, the federal government followed suit. In 1972 it provided $1.2 million for book publishing to the Canada Council and $500,000 to Books Canada, a new export marketing agency. Regulation of foreign ownership in the book industry was introduced two years later with the advent of the Foreign Investment Review Agency (FIRA).

The IPA's cultural nationalism was in tune with the times and politically influential. In its constitution the Association asserted that "a vigorous, Canadian-owned and -controlled book publishing industry is essential to the educational, cultural, social and economic life of a united Canada." When Secretary of State Gérard Pelletier announced the first federal measures for book publishing, he declared Canadian ownership and control of the industry were "essential to the cultural development of Canadians."

1.2 *Foreign Investment Review Act*: 1974-84

Prime Minister Pierre Trudeau's Liberal government created the Foreign Investment Review Agency in 1973 to screen proposed large foreign investments in the Canadian economy. Investments would be allowed to proceed only if FIRA and the government determined they would benefit Canada.

In book publishing, special regulations were announced in 1974: new foreign-controlled start-ups and direct foreign takeovers of Canadian firms were prohibited. In the case of indirect foreign investments – where a foreign investor takes over an existing foreign-controlled subsidiary, typically as part of a larger international acquisition – FIRA would permit the transaction only if it provided "net benefit to Canada" in cultural and economic terms.

The government's rhetoric promised robust enforcement of the new policy. Secretary of State Hugh Faulkner stated: "The Canadian government believes strongly that the major segment of the book publishing industry in Canada should be owned by Canadians. Canadian books and magazines are too important to the cultural and intellectual life of this country to be allowed to come completely under foreign control, however sympathetic and benign."

FIRA's implementation of the policy produced substantial gains for Canadian ownership in two instances. In 1976 Gulf + Western bought Simon & Schuster in the U.S., including its mass-market paperback imprint Pocket Books. Canadian-owned General Publishing handled distribution for both S&S and Pocket Books in Canada, but the new owners informed FIRA that they planned to dissolve that arrangement and take over distribution themselves. Since the move would have resulted in major losses of jobs and revenue at General, FIRA held up the transaction until net benefit to Canada could be negotiated. As a result General retained distribution rights to the Simon & Schuster list by acquiring Pocket Books of Canada. The Canadian publisher grew its assets and market share, gaining greater clout in the mass market for its own line of Canadian-authored paperbacks. This was the first tangible example of how foreign-investment policy, creatively applied, could obtain net benefit for the Canadian-owned industry.

A year later in 1977 Bantam Books changed hands in the U.S., triggering FIRA's review of the change in ownership of Bantam Books of Canada. As a condition of allowing the acquisition to proceed, FIRA negotiated a significant commitment from Bantam's new owners: they entered a joint venture with McClelland & Stewart to create a new imprint, Seal Books, which would publish Canadian-authored mass-market paperbacks. M&S owner Jack McClelland held 51 per cent of the new company, Bantam 49 per cent. Since access to the mass market was extremely difficult for Canadian publishers, Bantam's well-established distribution operation was of great value to Seal and its Canadian list. Although Seal would later encounter financial obstacles in the form of substantial service fees charged by Bantam, the deal represented a serious attempt to use the policy as a tool to achieve net benefit for Canada.

1.3 *Investment Canada Act*: Baie Comeau Policy, 1985-92

Elected in 1984, the Progressive Conservative government of Prime Minister Brian Mulroney took a very different approach to foreign investment, embracing free trade, deregulation and privatization, and famously telling the world that Canada was open for business. Paradoxically, the Conservative government also introduced an even more interventionist foreign investment policy for book publishing than practised by the Trudeau government.

The Baie Comeau Policy was the brainchild of Minister of Communications (later Canadian Heritage) Marcel Masse. Like French culture ministers André Malraux and Jack Lang, Masse believed in using state powers to promote national cultural interests. He was able to persuade his cabinet colleagues, at least for a time, that measures to strengthen Canadian ownership in publishing and other cultural industries would allay public concerns that the government agenda of free trade with the U.S. would diminish Canadian sovereignty.

The Baie Comeau Policy was administered by a new agency, Investment Canada, whose basic objective was to encourage foreign investment, not restrict it. And yet the policy maintained the prohibitions on foreign publisher start-ups in Canada, as well as foreign takeovers of Canadian firms. In the case of indirect takeovers of existing foreign-controlled subsidiaries, the policy boldly extended the review process. Henceforth, foreign investors acquiring a Canadian subsidiary in book publishing, distribution or retailing would be required to sell a majority interest in the subsidiary to Canadians at fair market value within two years.

The policy's strategic objective was not only patriating ownership of the book industry over time, but enhancing the financial viability of the chronically unprofitable Canadian-owned sector. It would do so by redirecting revenue flows from the most profitable areas of the business – import distribution and educational publishing, two areas where multinational subsidiaries were dominant – into Canadian hands. Potentially the policy's long-term implementation could have achieved Hugh Faulkner's ambitious goal a decade earlier of bringing "the major segment of the book publishing industry in Canada" under Canadian control.

But despite numerous opportunities presented by international mergers and acquisitions over the next several years, that objective was never even remotely realized. Right from the policy's announcement in July 1985, the Mulroney government showed little appetite for enforcing it. The first indirect takeovers to occur – of Prentice-Hall Canada by Gulf + Western (which threatened it would respond with a "scorched-earth policy" if forced to divest), and Pitman / Copp Clark by British-owned Pearson – were grandfathered under the policy.

In the single instance where the government enforced the policy, the effort was half-hearted. Late in 1985 Gulf + Western bought two educational publishers with Canadian subsidiaries, Ginn and General Learning Corporation (GLC). After merging the two, Paramount Communications, as the corporation was known by then, went through the motions of offering 51 per cent of Ginn /

GLC Canada to Canadian investors. Although several Canadian publishers expressed interest, the terms of the offer were so unattractive that, in the ACP's words, it was "designed to fail."

By the time the government took action in the case of Ginn / GLC, it was 1990 and the Canada-U.S. Free Trade Agreement was in force. Under clause 1607 of the FTA, the government of Canada was obliged to compensate American investors "at fair open market value" for any assets divested under Canadian law, whenever no acceptable offer was received from the private sector. Subsequently the government agreed to purchase 51 per cent of Ginn / GLC for $10.3 million. Yet the government left Paramount in operational control of the company and even gave Paramount a veto over any resale of the government's interest to Canadian investors.

The government that had negotiated the FTA, claiming it had "kept culture off the table," was temperamentally unwilling to implement the Baie Comeau Policy. Doing so meant interfering in the affairs of multinational corporations and incurring financial obligations in the process. The Finance Department was nervous about a consultant's estimate that enforcing the policy could cost the government up to $40 million a year over the next 10 years. Departmental officials assured ACP representatives at the time that this prospect was unacceptable.

Other indirect transactions, such as Pearson-owned Penguin's 1988 takeover of New American Library, were simply approved by Investment Canada. No divestiture was required, nor was any discernible form of net benefit to Canada. For all practical purposes, the Baie Comeau Policy was dead. Its fate illustrates the folly of a government adopting a policy that it lacks the political will to enforce. The Mulroney government's contradictory behaviour had merely sown confusion about its intentions in the publishing industry at home and abroad.

In 1992 Baie Comeau was formally replaced by the policy still in force today, 25 years and three governments later. At first it was assumed that, after so many political gyrations, the new policy must be one the government could live with – and would surely implement when the time came.

2. Purpose and Scope of the Revised Foreign Investment Policy in Book Publishing and Distribution (1992)

2.1 Debut of the *Revised Foreign Investment Policy in Book Publishing and Distribution*

The *Revised Foreign Investment Policy in Book Publishing and Distribution* received a well-publicized announcement in January 1992, part of a package of measures for the book industry introduced by Minister of Canadian Heritage Perrin Beatty. The Mulroney government was ridding itself of Baie Comeau and the troublesome financial exposure it entailed, yet it wasn't abandoning either the domestic book industry or the principle of regulating foreign investment.

Beatty announced a tripling of funding for Canadian-owned publishers through the Book Publishing Industry Development Program (BPIDP), as his department's program was now known, to $25 million a year over five years. A new (and soon short-lived) Publications Distribution Assistance Program, also budgeted at $25 million, would replace the longstanding Book Rate postal subsidy by targeting assistance to publishers and booksellers for their distribution costs. And the *Copyright Act* would be amended to include book importation regulations, requiring retailers to purchase imported titles from authorized Canadian distributors – a long-sought measure to end publishers' loss of revenue from the practice of "buying around" the Canadian supplier.

Though the Baie Comeau divestiture requirement was cancelled, other components of the policy remained: the prohibitions on new foreign-controlled ventures and on foreign takeovers of Canadian-owned firms. Significantly, however, an unexpected exception was made to the latter provision: "under extraordinary circumstances," foreign investors could now purchase a Canadian-controlled business on certain conditions, to be described in the next section. Just how significant this exception was would emerge in the years ahead.

In the case of indirect foreign investments, the government returned to the "net benefit" test, its parameters flexible and open to interpretation. But here ACP advocacy had won a victory: net benefit was defined as being not only "to Canada" but also "to the Canadian-controlled sector." This appeared to set the stage for productive rulings in future.

2.2 The Policy Clause by Clause

The text of the policy is part of the *Investment Canada Act* as amended in 1992.

Objectives: The preamble states that the policy is being revised in 1992 as one of several measures "to strengthen the book publishing and distribution sector." Hence new foreign investments must be 1) "compatible with national cultural policies" and 2) "of net benefit to Canada and to the Canadian-controlled sector."

Methodology: To give effect to the policy, the government of Canada amended the *Investment Canada Act*, "empowering the Minister responsible for the Act to determine whether a business in the cultural sector which meets, prima facie, the definition of Canadian control under the Act is indeed Canadian-controlled." That is, de facto Canadian control is a central issue for the policy, and legislated ministerial power is the means necessary to determine Canadian control of specific businesses to which the policy applies.

The minister in question, ordinarily the Minister of Industry, became in 1999 the Minister of Canadian Heritage for purposes of reviewing foreign investments in the cultural industries.

Guidelines: i) Establishment of new foreign-controlled businesses in the sector is prohibited. New foreign investment is restricted "to Canadian-controlled joint ventures."

ii) Foreign acquisitions of existing Canadian-controlled businesses are also prohibited. Exceptions are allowed "under extraordinary circumstances," provided the government receives "credible evidence from the vendor" that the Canadian business "is in clear financial distress," and "Canadians have had full and fair opportunity to purchase."

iii) If a foreign owner wishes to sell an existing Canadian business separately from any other transaction (e.g. an international one), credible evidence is required that Canadians have had full and fair opportunity to purchase.

iv) Indirect foreign acquisitions resulting from larger international transactions must be reviewed to determine "whether they are likely to be of net benefit to Canada and to the Canadian-controlled sector." They will be "assessed on their merits by reference to the factors set out in Section 20" of the *Investment Canada Act*. These include such considerations as:

- Effect on the Canadian economy, e.g. on employment, services produced in Canada, etc.;
- Degree and significance of participation in the business by Canadians;
- Effect on productivity, technological development, product innovation, product variety;
- Effect on competition within the industry;
- Compatibility with national industrial, economic and cultural policies, including provincial cultural policy objectives; and
- Contribution to Canada's ability to compete in world markets.

Moreover, in reviewing indirect foreign acquisitions for net benefit, the government will "typically seek from the foreign investor one or more commitments, such as":

- A commitment to developing Canadian authors, such as joint ventures with Canadian-controlled publishers to introduce the partner's authors to new markets;
- A commitment to support the infrastructure of the book distribution system, e.g.:
  a) Distributing imported titles via a Canadian-controlled publisher-agent;
  b) Maintaining a fully integrated warehousing and order-fulfilment operation in Canada;
  c) Active participation in cooperative ordering / distribution / marketing endeavours;
- Accessibility of the company's Canadian marketing and distribution infrastructure or international network to Canadian-controlled publishers;
- A commitment to education and research through financial and professional assistance to programs in publishing studies.

The text of the policy concludes with an admonitory statement: “These guidelines will be strictly enforced and any undertakings negotiated under the net benefit test will be closely monitored.” An examination of a representative group of transactions reviewed under the policy will show just how “strictly enforced” its guidelines have been.

3. Implementation of the Policy

3.1 HarperCollins, 1992

The first ruling under the revised policy came soon after its adoption. Rupert Murdoch’s News International had merged British-owned William Collins with Harper & Row to create HarperCollins three years earlier, in 1989, so legally the transaction should have been reviewed under the Baie Comeau Policy. But by then the Mulroney government had determined to ditch the policy, and so delayed its ruling until the new policy was in force. In the meantime HarperCollins Canada started up in its downtown Toronto offices. By the time the ruling came down, the company had been fully operational for three years.

The company developed an important Canadian publishing program, as the William Collins subsidiary had done previously, and filled Canadian orders from a full-service warehouse in Toronto, thus providing two valuable forms of net benefit to Canada. Far from benefiting the Canadian-controlled sector, however, HarperCollins’ arrival seriously harmed two Canadian publishers, Fitzhenry & Whiteside and Gage (the latter having become Canadian-owned once again). Both firms lost important agency business to HarperCollins – the Harper & Row agency in the case of F&W, Scott Foresman in the case of Gage – and were deprived of substantial revenues. Nonetheless HarperCollins received retroactive approval under the new policy in 1992.

3.2 Indigo / Borders, 1996

Chapters opened its first book superstore in 1995, and entrepreneur Heather Reisman started a competing big-box chain, launched as Indigo Books & Music in 1996. But Reisman’s initial business plan included gaining a competitive advantage over Chapters by forming a partnership with Borders, one of the biggest bookselling chains in the U.S. The American retailer would be a minority partner, as required by the foreign investment policy, and would provide Indigo with management expertise and digital ordering and other systems from its American operations.

Critics of the proposed partnership, including the ACP, contended that Reisman, an experienced businessperson but a neophyte in book retailing, would rely so heavily on Borders to build and manage the company that the minority partner would exercise de facto control. Buying strategies and ordering systems imported from the U.S. would disadvantage Canadian books, authors, publishers and distributors, making Indigo a Trojan horse for the entry of American booksellers into the Canadian market. The ACP sought an expert legal opinion from McCarthy Tetrault to determine where effective control would lie under Indigo's business plan, and the finding was that it would reside with Borders. Presented to Investment Canada, that opinion won the day, and the partnership was disallowed.

The ruling represented the most forceful and decisive use of foreign-investment policy in nearly two decades – and remains so to this day. It simply enforced Canadian law, which gives the Minister responsible for the *Investment Canada Act* the power to determine whether a business in the cultural sector is Canadian-controlled in fact. Yet the ruling did not prevent Ms. Reisman from revising her business plan and starting up Indigo as a fully Canadian-controlled enterprise. Five years later Indigo made a successful takeover bid for rival Chapters, creating a retail giant that has dominated domestic English-language bookselling for the past 16 years.

3.3 Random House / Doubleday, 1999

In 1998 the German media conglomerate Bertelsmann A.G. bought American-owned Random House and merged it with an earlier acquisition in the U.S., Doubleday. Since both publishers operated large subsidiaries in Canada, the Canadian portion of the transaction had important implications for this country. It would create, according to the ACP, an entity larger in terms of revenue than the five biggest Canadian-owned publishers combined (which at that time included Stoddart / General Publishing, McClelland & Stewart, and Ron Besse's Canada Publishing Corp., including Gage and Macmillan). The merged business, to be called Random House of Canada, would control an unprecedented 25 per cent of the English-language trade market, according to an informed estimate by *Quill & Quire*.

The ACP lobbied Investment Canada about the merger's negative effects on competition in English-Canadian publishing (competition being one of the foreign investment policy's prime concerns, specified in Section 20 of the *Investment Canada Act*). But Investment Canada approved the transaction in 1999 with little serious attempt to extract net benefit to Canada, much less to the Canadian-controlled sector.

A year earlier there had been five multinational subsidiaries with substantial programs of Canadian-authored trade books. Following the Random House / Doubleday merger and the 1998 shuttering of Little, Brown Canada by its American parent, Time Warner, only three were left – the other two being Penguin and HarperCollins.

3.4 Prentice-Hall / Addison-Wesley, 1999

Later in 1999 the Chrétien government transferred authority for regulating foreign investment in the cultural industries from the Department of Industry to the Department of Canadian Heritage. This development was applauded by the ACP. Canadian Heritage had been administering policies and programs for the book industry for years, giving it far greater knowledge of publishing. And the Department's first ruling suggested that the policy would be applied henceforth with greater rigour to achieve its objectives.

The British conglomerate Pearson was merging two large educational publishers with subsidiaries in Canada, Prentice-Hall and Addison Wesley. The decision by Canadian Heritage allowed the transaction to proceed, but on condition that Pearson divest itself of some of the merged company's educational publishing programs to Canadian-owned firms. This intervention was both creative and pragmatic. It required professional understanding of the nature of the businesses involved, combined with a serious approach to fulfilling the intent of the foreign investment policy. The ruling created tangible and meaningful net benefit for the Canadian-controlled sector. As such it could have stood as a model for future decisions.

3.5 Random House / McClelland & Stewart, 2000, 2011

The most-discussed foreign takeover in Canadian publishing is the gradual absorption of our best-known English-language publisher, McClelland & Stewart, into the largest multinational publisher in the English-speaking world. Random House's acquisition of 100 per cent of M&S and its subsidiary, Tundra Books, occurred in two stages 11 years apart. It's impossible to say with certainty that this outcome was planned from the moment in July 2000 when M&S owner Avie Bennett donated a 75 per cent share of M&S to the University of Toronto and sold the remaining 25 per cent to Random House of Canada. Bennett himself disavowed any such thing; he always insisted that his intention had been to keep M&S Canadian-owned by entrusting it to the university, while obtaining a minority partner with the marketing and distribution clout, and the financial, managerial and digital expertise, to help M&S survive in the difficult new publishing environment – a business climate shaped by a single dominant bookstore chain, a single giant online retailer, and a digital revolution, collectively resulting in reduced sales and reduced margins.

From the start of the arrangement in 2000, critics, many of them in the ACP, argued that M&S was no longer effectively Canadian-controlled. But M&S maintained that, in addition to being owned 75 per cent by the University, which held a majority on the board of directors, it remained independent editorially, proven by the fact that it competed with Random House for authors. Government officials and funding bodies accepted the company's argument, and M&S remained eligible for support from federal and provincial funding programs.

For 11 years Random House managed the company's sales, marketing, distribution and finances, charging M&S "market value" for these services. M&S's large and exceptionally strong Canadian trade program continued year after year, retaining its internationally renowned authors and originating work by many new writers. Yet throughout that period, M&S became increasingly integrated with Random House operations and personnel. Random took over the company's design and production functions, and, as credibly argued in Elaine Dewar's recent book *The Handover*, began exerting control over its editorial direction beginning around 2004-05. Dewar also estimated, very conservatively, that between 2001 and 2011 M&S received about $7 million in federal and provincial funding, not counting Ontario tax credits.

By 2011 M&S and Tundra employed only about 15 dedicated staff, and M&S had acquired an enormous debt, much of it attributable to the service fees charged by Random (c.f. Seal Books' financial obligations to its minority partner, Bantam, referenced earlier). At year's end, Random House announced it was taking over 100 per cent of M&S – a takeover blessed by the federal government on the grounds that M&S now qualified under the foreign investment policy as a Canadian business "in clear financial distress."

The transaction did not, however, meet the policy's corollary requirement that "Canadians have had full and fair opportunity to purchase." *Quill & Quire* reported at the time that Random House considered this requirement moot, because its original deal with Bennett gave it a veto over any new partner coming into the business. Elaine Dewar revealed in *The Handover* that in 2000 the deal's principals had also obtained a letter from the Minister of Canadian Heritage, Sheila Copps, confirming that the government regarded M&S as still Canadian-controlled, thereby qualifying it to continue receiving government grants and tax credits. Most notably, the Minister's letter pre-empted her and her successors' legislated power to determine "whether a business in the cultural sector which meets, prima facie, the definition of Canadian control under the Act is indeed Canadian-controlled."

In the five years since the takeover, M&S as an imprint of Penguin Random House has seen its original Canadian publishing program shrink to a shadow of its former self. Meanwhile the firm's illustrious backlist continues to generate revenue for its multinational owner. Given the government's highly malleable approach to enforcing both the letter and the spirit of the policy in M&S's case, it's hardly surprising that later rulings also took a hands-off approach.

3.6 John Coutts Library Service, 2000, 2006, 2014

As the ACP argued in a representation to the Department of Canadian Heritage, the case of John Coutts Library Service, once an important Canadian-owned book wholesaler serving libraries, illustrates – like the more famous case of M&S – the problematic consequences of allowing exceptions to the policy. A limited exception may seem justifiable in the first instance. But in a significant number of cases it has led, like the analogy of the camel in the tent, to justifying further exceptions, until ultimately all restrictions are removed, "the incursion of the foreign interest is complete, and the Canadian industry is further undermined."

In 2000 the British-owned wholesaler BMBC Books was allowed to purchase the John Coutts operation in Niagara Falls, ON, thanks to the loophole in the policy permitting foreign takeovers of Canadian-owned firms "under extraordinary circumstances." BMBC made a commitment to maintain the business in Canada. But in 2006 the giant American wholesaler Ingram bought Coutts from BMBC, and in 2014 Ingram closed the Canadian facility and moved its operations to the U.S. Ninety Canadian jobs disappeared – the very kind of economic impact that Section 20 of the *Investment Canada Act* is concerned with.

Further, as the ACP observed, with Ingram's closure of Coutts a valuable body of expertise in Canadian books and the Canadian library market was lost, increasing the likelihood that Canadian libraries would be supplied with U.S. editions of Canadian authors. This development constituted a detriment to Canadian literature, since it contributed to "the weakening of a well-integrated supply chain, one of the most important elements in supporting a Canadian [publishing] industry which is itself a key element in supporting Canadian writing."

3.7 Amazon.ca, 2002, 2010

Approvals of Amazon's expansion into the Canadian market, in two stages eight years apart, also follow the camel-in-the-tent pattern. In 2002 the huge Seattle-based online retailer already enjoyed many Canadian customers attracted by its huge inventory of international titles, efficient customer service and lower prices. But Amazon wanted even greater penetration of the Canadian market. It sought approval for obtaining a Canadian domain name and for shipping books within Canada using Canadian intermediaries, such as Canada Post. Therefore it required an exception to the investment policy's prohibition on foreign-controlled start-ups.

Amazon's move into Canada had huge potential to reduce the market share of Canadian retailers and was adamantly opposed by both Chapters Indigo and the Canadian Booksellers Association. Yet the exception was granted – in part, no doubt, because no government (in this case the Chrétien government) wishes to be seen interfering with Canadians' access to an extremely popular brand, and in part because regulating the Internet is a difficult and unpopular idea. In any case, the justification went, the Amazon decision didn't abrogate the policy since the company wouldn't have a physical corporate presence in Canada, such as a warehouse.

Not surprisingly, in 2010 Amazon applied to establish its own distribution centre in Ontario, for which it needed another exception to the policy. Despite opposition once again from the ACP and Canadian booksellers, the Conservative government of Prime Minister Stephen Harper obliged, showing that being Amazon-friendly isn't unique to one political party. Minister of Canadian Heritage James Moore issued a news release stating that "Amazon has shown its willingness to promote Canadian cultural products" and listing commitments on which the decision was based. These included an unspecified number of new jobs, improved service for consumers, increased visibility for Canadian books on the Amazon website and Kindle e-reader, including French-language products, financial contributions to undefined "cultural events," and "dedicated staff to assist Canadian publishers."

In a 2014 brief to the Department of Canadian Heritage titled "The Ownership Policy for Canadian Book Enterprises and the Concept of Net Benefit to Canada," the ACP spelled out "three examples of net benefit to Canada gone wrong," but did make an exception for the exceptions granted to Amazon. Despite its earlier reservations, the ACP acknowledged that since establishing its fulfilment centre, Amazon had come closer than other foreign investors to achieving net benefit to Canada.

The reasons cited were Amazon's improved service to Canadian consumers, its lead sponsorship of the 49th Shelf, the industry's Internet platform for Canadian books, and its commitment to better communication and working relationships with Canadian publishers. The brief noted that the retailer had not yet hired dedicated Canadian buying staff and had insufficient involvement with BookNet Canada. Still, it concluded about Amazon: "More Canadian books, by more Canadian authors, for more Canadian readers: that is surely what net benefit to Canada looks like. No other exception [to the policy] made in the past ten years has approached that standard."

3.8 Simon & Schuster, 2002, 2004, 2013

Previously without a subsidiary in Canada, Simon & Schuster began its staged expansion into this country by obtaining an exception to the foreign investment policy. In 2002 S&S applied to take over its Canadian-owned distributor, Distican, formerly part of General Publishing, giving it direct and more profitable control over distribution of its American books. This was in simple contravention of the policy: Distican was not in clear financial distress, and Canadians were given no opportunity to bid. But S&S wanted control, and Distican's owner was willing to sell. If it didn't get its way, S&S's corporate owner Viacom said, it would pull out of Canada and go home. Unwilling to call Viacom's bluff, the Chrétien government granted yet another exception, all in the name of saving 80 jobs.

Just two years later in 2004 S&S announced it would close its Canadian warehouse and fill orders from facilities in the U.S. So much for Canadian jobs. But S&S retained its Canadian subsidiary, which was eager to do more than market the parent company's product. S&S Canada wanted to publish Canadian authors too, something it had agreed not to do as a condition of the Distican takeover. After circumventing that condition by contracting with Canadian authors through its New York head office, the company received the coveted exception in 2013, shortly after publishing a work of hockey history by Prime Minister Harper.

There are conflicting views on whether this exception has produced significant net benefit for Canada. The ACP has stated that "no new authors will get published as a result of this exception; the few books that Simon & Schuster Canada publish would all have found other homes or have been signed by the New York office of Simon & Schuster itself." Authors and their agents, on the other hand, view S&S in a different light – as one of only three remaining multinational subsidiaries in Canada, after the 2013 Penguin-Random House merger, interested in publishing Canadian trade books. All three have the resources to bid up author royalty advances and invest in costly marketing campaigns considered necessary for a book's success.

3.9 Rakuten / Kobo, 2012, 2015

Indigo Books & Music launched the Kobo e-reader in 2010 as majority shareholder, with minority investments from several international partners. Kobo was marketed internationally and by 2012 had captured nearly half the Canadian market for e-readers. It enhanced Canada's international reputation as an innovator in new technology, allowing readers to access e-books that were not tied to a single type of device.

In 2012 another exception was made to the foreign-investment policy, allowing Indigo and its partners to sell Kobo to the Japanese e-commerce conglomerate Rakuten. The office and staff were retained in Canada, but the chairman of the company's board is a Japanese executive from Rakuten. Since the entire review process lacked transparency, it remains difficult to know what, if any, net benefit was derived from the transaction. In 2015 Kobo was allowed to establish its own publishing program despite being foreign-owned.

3.10 Cengage / Nelson Canada, 2012

Cengage is a U.S.-based, globally active educational content, technology and services company, created in 2007 out of the restructuring of International Thomson Publishing. In 2012 Cengage received approval from the Department of Canadian Heritage to acquire Canadian-owned educational publisher Nelson Canada. After a number of restructuring proposals and a period of bankruptcy protection, the transaction was completed in 2015. Because of its previous status as a

Canadian-owned firm, Nelson Canada had been able to purchase the assets of numerous smaller Canadian educational publishers, including Irwin, Gage, Reidmore, Arnold, Modulo and Duval. With the approval of Nelson's sale, all these formerly Canadian assets, built up with public funding, came under foreign control – the exact opposite of the policy's intent.

3.11 Random House / Penguin, 2013

The merger between two global publishing giants, Bertelsmann-owned Random House and Pearson-owned Penguin, created a colossus dwarfing even their multinational rivals. With 10,000 employees worldwide and 15,000 new titles annually, published under some 250 imprints, the new company was owned 53 per cent by Random House, a figure that rose to 75 per cent earlier this year. The Canadian subsidiary, Penguin Random House Canada, holds by its own estimate about one-third of the Canadian trade book market in English.

Despite this unprecedented market dominance, it was highly unlikely that the Canadian government, based on its track record, would hold up the domestic portion of an immense international transaction merely to extract net benefit to Canada, much less to the Canadian-owned sector of the industry. Unlike its announcement of the Amazon distribution centre decision in 2010, the Department of Canadian Heritage issued no ministerial news release about the Penguin Random House ruling. Consequently we don't know of any commitments or undertakings made by the principals as a result of the ministerial review.

3.12 News Corp. / Harlequin, 2014

The Harper government's lack of transparency around foreign investment rulings means there is also no public information about any undertakings made by Australian-owned News Corp. in receiving approval to acquire Harlequin Books, the world's leading publisher of romance novels and for many years the largest Canadian-owned publisher by far. In 2014 Harlequin was sold by Torstar Corporation, publisher of *The Toronto Star* and majority owner of Harlequin since 1975, for $455 million CAD – an astronomical sum for a Canadian book publisher.

Of course Harlequin was never a typical Canadian publisher. It specializes in the immensely popular mass-market genre of paperback romance novels, which it translates into many languages and sells globally through offices in nearly 20 countries, including China. The majority of its authors and settings are American. Yet Harlequin was a long-time Canadian-owned business, founded in Winnipeg in 1949 and headquartered in Toronto.

It's believed that when Harlequin was delivered into the hands of HarperCollins by its parent, News Corp., the latter did commit to keeping Harlequin's head office and CEO in Toronto, thus preserving Canadian jobs – at least for a limited time. We're indebted for this information to

Elaine Dewar, who recounts in *The Handover* an extensive interview she conducted with Torstar chair John Honderich. According to Honderich, there was no pretence about Harlequin's suffering financial distress, nor any requirement that it first had to offer the company to Canadian investors. Instead, it seems, Harlequin told the government that it represented a special case, for which a new kind of exception should be made. As a global business that doesn't specialize in Canadian books, Harlequin was not the sort of publisher for which the foreign investment policy was intended. It didn't contribute to Canadian culture (a specious argument) and just happened to be owned and headquartered in Canada.

The Consrvative government apparently accepted that argument. In 2009, according to the Dewar-Honderich interview, Torstar had secured a ministerial letter stating that the foreign investment policy didn't apply to Harlequin, and the government would accept its sale to a foreign owner as long as the offer was made independently by a third party, i.e., that Torstar had not solicited the offer. The letter was supposed to bind any future government, as did (according to Dewar) Minister Copps's letter defining M&S as Canadian-owned in 2000. All of which shows that federal decision-makers can be creative when it suits them.

3.13 Nelson / McGraw-Hill Ryerson, 2017

The most recent transaction to fall under the policy was announced in May 2017 and is the first to be considered by the Liberal government of Prime Minister Justin Trudeau. Ironically, it involves the Canadian subsidiary of one of the American publishers, McGraw-Hill, that triggered the birth of Canadian publishing policy 47 years ago.

Nelson Education, formerly Canadian but now U.S.-owned (see 3.10 above), has reached a deal to acquire the kindergarten-to-grade-12 publishing division of one of its chief rivals in Canada, McGraw-Hill Ryerson. If approved by the government, the transaction will consolidate most of Canadian K-to-12 educational publishing in a single foreign-controlled company – a situation that should immediately raise serious concerns about corporate concentration and lack of competition in a major, highly sensitive area of publishing. The transaction is currently under study by Cultural Sector Investment Review at the Department of Canadian Heritage.

This case offers ample scope and justification for following the precedent set by Canadian Heritage in its 1999 ruling on Pearson Education's merger of Prentice-Hall and Addison-Wesley (3.4 above): that is, making approval of the transaction contingent upon Nelson's divesting itself of some of the merged company's publishing programs to Canadian-controlled educational publishers. Following the Department's own model in that earlier case would generate substantial net benefit for the Canadian-controlled sector, thereby setting a new course for meaningful implementation of the policy. If the Department is unwilling to follow its own precedent, or to adopt some other creative approach producing significant net benefit, the policy will have ceased to be a usable tool of government.

4. The Policy's Effectiveness in Achieving its Objectives

A page on the Government of Canada website headed "Policy on Foreign Investment in the Book Industry" (https://www.canada.ca/en/canadian-heritage/services/foreign-investment-books.html) tells the world in no uncertain terms about the policy's fundamental raison d'être:

"The Policy states the Government's longstanding position of favouring Canadian control of businesses in all three sectors of the book industry: publishing, distribution, and retail. *Canadian control is a key and longstanding tenet of the Government's intervention in the book industry*, given the demonstrated commitment of Canadian-owned firms to the identification, development, and support of a wide range of Canadian authors" [italics added].

The succession of government rulings summarized in section 3 above demonstrates that the "key and longstanding tenet" of Canadian control has been honoured more in the breach than the observance. In only two rulings, the Indigo / Borders decision (3.2, 1996) and the Prentice-Hall / Addison Wesley decision (3.4, 1999), has the federal government put teeth into the policy by requiring meaningful net benefit for Canada and the Canadian-owned sector. As acknowledged by the ACP, a partial case could also be made that some of the commitments undertaken by Amazon.ca (3.7) serve the Canadian public interest.

But in 10 of the 13 cases described above, the rulings strengthened primarily or exclusively the interests of the foreign investors involved. These rulings represent a persistent, ongoing pattern of circumventing the policy's core purpose, declared so simply and vividly on the government's own website.

Increasingly the policy has become virtually invisible. Replacing it over the years has been a sort of shadow policy, the apparent objective of which, or at least its cumulative effect for all practical purposes, has been the opposite of the official one: providing little or no direct benefit, in either cultural or economic terms, to Canada, and none whatever to the Canadian-owned sector of the industry. In some cases, demonstrable harm has been done to the sector.

To draw this conclusion, one need only refer to the policy's various elements described in 2.2 above, "The Policy Clause by Clause."

The preamble states that the policy's core purpose is "to strengthen the book publishing and distribution sector." As corollaries to this purpose, new foreign investments must be 1) "compatible with national cultural policies" and 2) "of net benefit to Canada and to the Canadian-controlled sector."

As we've seen, rulings under the policy have served these objectives only rarely, especially in recent years. The economic and cultural well-being of the Canadian-controlled sector is served far more unequivocally by publisher support programs at the Department of Canadian Heritage and the Canada Council for the Arts, to cite two manifestations of "national cultural policies" with which the foreign investment policy is meant to be compatible.

To give effect to the policy, the government of Canada amended the *Investment Canada Act* to empower "the Minister responsible for the Act to determine whether a business in the cultural sector which meets, prima facie, the definition of Canadian control under the Act is indeed Canadian-controlled." De facto Canadian control is central to the policy, and this ministerial power is the modus operandi for assessing it. As stated in the policy guidelines, de facto Canadian control is required in cases involving direct foreign investment in new start-ups (e.g. Indigo, Simon & Schuster, Kobo). In indirect foreign acquisitions, evidence of net benefit is required for both Canada and the Canadian-controlled sector.

But the great majority of government rulings have been silent on, and apparently indifferent to, the question of Canadian control, whether in direct or indirect investments. They have generally ignored and sidelined this issue, as well as the types of investor commitments stated in the policy guidelines as examples of "net benefit." Again the exceptions are the Indigo / Borders decision, a proposed start-up where de facto Canadian control was considered crucial and found wanting, and the Prentice-Hall / Addison Wesley decision, an indirect transaction where tangible benefits to Canadian-controlled firms were explicitly mandated.

In two highly significant cases where Canadian control should have been the pre-eminent consideration – Random House / McClelland & Stewart (3.5) and News Corp. / Harlequin (3.12) – the Ministers of the day voluntarily pre-empted their legislative power by providing foreign investors with letters that bound their own hands. In both cases, foreign owners were allowed to take over Canadian-owned publishers without meeting the policy's requirements, i.e., proving a) that the publisher was "in clear financial distress," and b) that Canadian investors were given "full and fair opportunity to purchase." In these two cases the policy was effectively neutered.

The policy concludes with the statement: "These guidelines will be strictly enforced and any undertakings negotiated under the net benefit test will be closely monitored."

But increasingly the Department of Canadian Heritage has invoked the need for secrecy surrounding any transaction reviewed under the *Investment Canada Act*. Since the 2010 Amazon decision, Ministers have stopped releasing details of any undertakings entered into by foreign investors to provide net benefit. Unless the investors themselves publicize their commitments, which happens rarely, the government keeps the book industry and the public in the dark about what undertakings, if any, were negotiated. Nor does the government make available for public scrutiny any efforts to monitor undertakings after the fact, to ensure that they have been fulfilled. This lack of transparency hardly inspires confidence in the policy's administration.

Rather than strengthening the book industry, then, the cumulative effect of exceptions granted under the policy has been to deliver Canadian publishing assets, some foreign-owned but others indubitably Canadian-owned, into the hands of an ever-diminishing number of foreign owners.

There is irony in this situation. One element of the policy that has been generally, though not uniformly, enforced since 1974 is the prohibition on starting up new foreign-controlled ventures. The absence of new foreign entrants in book retailing and distribution, as well as publishing, has benefited the Canadian-controlled publishing sector in a variety of ways. The sector has been able to grow, innovate and become creatively vibrant in the more open cultural and economic space that has resulted, strengthened by financial support from federal and provincial programs. Some large and important English-language, Canadian-owned publishers have not survived in the difficult business environment of the new millennium; but the remaining diverse community of publishers, as represented by the ACP's membership of 115 firms spread across the country, is battle-tested and resilient.

Meanwhile the multinational subsidiary publishers grandfathered under the policy because of their presence in Canada before 1974 have been aggressively pursuing merger and acquisition strategies. Consequently the foreign-controlled sector – especially in Canada's English-language market – has become intensely concentrated, consolidating ownership of publishing capacity and market share in a very few companies. Both the anglophone trade and educational publishing sectors are now dominated by foreign-owned oligopolies.

Three huge multinationals dominate the trade market. The biggest, Penguin Random House, holds by its own estimate a one-third market share. The other two, HarperCollins and Simon & Schuster, are many times larger than any Canadian-controlled publisher, yet considerably smaller than their juggernaut rival, which comprises several large, important and previously separate companies – Random House, Doubleday, Penguin and their numerous imprints, plus the venerable, formerly Canadian-controlled McClelland & Stewart.

In English-language educational publishing, the dozen multinationals that once competed in the Kindergarten to Grade 12 market have been consolidated into two multinational giants, Nelson Education and Pearson Canada.

In both sectors, the effect on competition and product diversity – prime characteristics of a free market, which the foreign investment policy is explicitly meant to encourage (see 2.2 above) – has been highly negative. Jobs have disappeared in book publishing, distribution and retail; editorial capacity has been lost; Canadian authors' incomes and access to publishing outlets have shrunk; and Canadian-controlled publishers, still the source of over 80 per cent of the books this country produces, are less able to compete for top authors, market share and retail display space against their multinational rivals.

Canada's foreign investment policy isn't entirely responsible for creating this situation, which is international in origin. But the frequent, harmful and unnecessary exceptions that previous governments have made to the policy have greatly exacerbated the problem.

5. Conclusion

Broader political and economic factors have made it difficult for previous governments to implement the foreign investment policy, leading to its current state of decline. In some ways the policy is the product of another era: an era before the dominance of big-box retail chains, the pervasive presence of the Internet, the popularity of online retailing, the massive mergers among the world's largest multinational publishers. These globalizing factors and, above all, Western governments' wholesale embrace of free trade, have created a very different economic and political climate from the world in which the policy was created.

Previous Canadian governments, both Liberal and Conservative, have been concerned enough about cultural sovereignty that they continued to maintain national cultural policies and programs. But when the foreign investment policy called upon them to intervene in the business dealings of large multinational corporations, their political commitments to free trade and foreign investment made them highly reluctant, rendering the policy almost unenforceable in certain cases. And yet successive governments have left the policy on the books, as the Harper government did, even after conducting its policy review in 2010.

From the standpoint of Canadian book publishing and the ACP, this is a fortunate circumstance. In spite of its past political difficulties, the policy as it stands remains based on valid principles and objectives of cultural sovereignty that Canadians still care deeply about. In its methodology and guidelines, the policy is flexible enough to be adapted to contemporary realities and used in effective ways to benefit Canada and the Canadian-controlled sector of the industry. Indeed, it contains sound and practical options for strengthening Canadian-owned publishing that have seldom if ever been tried.

With a still relatively young government currently in power, a government committed to positive social and cultural change, the ACP has an opportunity to influence policymakers to set a new course: implementing the foreign investment policy in ways that achieve its original objective for the benefit of Canadian authors, books and readers. As the government re-evaluates its policies for the creative industries, the ACP is uniquely knowledgeable about the policy's history, uses and abuses, and uniquely positioned to advocate a bolder, more productive approach.

This government has made it clear that it wants to distinguish itself in certain areas from the values and actions of its predecessor. One such area is arts and culture, as indicated by the government's commitment to double the Canada Council's budget. In his mandate letter to Minister of Canadian Heritage Mélanie Joly, the Prime Minister spoke about his government's “overarching goal” of strengthening Canada’s cultural and creative industries, stating that he expects Minister Joly’s department to work toward that goal. Mr. Trudeau spoke also about the importance of setting “a higher bar for openness and transparency in government.” (The letter is available for viewing on the government website.)

For her part, Minister Joly’s landmark “Creative Canada” speech in September 2017 reaffirmed her government’s continuing support for the Canada Book Fund under Creative Canada’s first pillar: “Investing in Canadian creators, cultural entrepreneurs and their stories.” And she committed to launching a parliamentary review of the *Copyright Act* and vowed the review would defend the interests of creators – a clear break with the previous government’s approach. These announcements represent a promising start in the relationship between the government and Canadian book publishers.

ACP advocacy efforts can and must link these government goals with its own objectives, fostering a new approach toward implementing and enforcing the foreign investment policy.

As the recognized national voice of English-language, Canadian-owned publishing, the ACP can vigorously and credibly urge the government to use the ample powers provided in the policy’s text so that Canada finally has a workable, respected regime for foreign investment in the book industry, instead of a hollow sham that does a disservice to the industry, the government and the nation itself.