

CANADIAN COMPETITION RECORD

FOREIGN INVESTMENT**FACTS, FEARS AND FOREIGN INVESTMENT: THE STATE-OWNED ENTERPRISES GUIDELINES, THE COMPETITION POLICY REVIEW PANEL'S CONSULTATION PAPER AND STATISTICS CANADA'S RESEARCH**

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Foreign investment – the nature of it, its benefits and risks, and how to balance these tradeoffs with other objectives and regulate it successfully – is a popular topic. Beyond the media reports on the “hollowing out of corporate Canada”, foreign states investing in Canada, and the spectre of national security, there are now two formal, concurrent (and complementary) policy reviews being conducted on how we regulate this issue. The first review, by the Competition Policy Review Panel (the “Panel”), considers Canadian policies regarding competition policy, foreign investment in Canada, and Canadian investment abroad. The second review, by the federal government, focuses on the issues of foreign investment by state-owned enterprises (“SOEs”) and national security.

As we undertake these reviews, it is helpful to stay focused on the facts regarding foreign investment and the Canadian national interest as it relates to foreign investment. The Panel summarized the issue in the following terms: “[i]f Canada is to continue to be successful and if Canadians are to continue to enjoy the prosperity to which we have become accustomed, choices will have to be made, and decisions taken.”² Before starting the decision-making process, it is important to understand what we know about foreign investment and, to date, there have been few comprehensive summaries of what we know about foreign investment and its influence on Canada’s economy. In order to provide some economic and statistical background to the discussions about foreign investment, Statistics Canada recently produced a summary of its research on foreign multinational companies in Canada and Canadian multinationals abroad.³ The Panel has also published its consultation paper (the “Paper”) which, in the context of describing the Panel’s mandate, has also attempted to frame at least part of the policy debate. Finally, the Minister of Industry recently released the first results of the government’s review: new guidelines under the *Investment Canada Act* for reviews concerning SOEs (“SOE Guidelines”).⁴ This article will examine the Paper, the SOE Guidelines, and some considerations in regulating foreign investment on the basis of national security concerns primarily through the lens of Statistics Canada’s findings regarding foreign investment in (and from) Canada. At the risk of oversimplifying, the messages from the research seem to be that continuing to attract and retain multinational companies will be important to Canada’s prosperity, and that our foreign investment regulations will impact whether these firms come and grow in Canada. Accordingly, we believe that the outcomes of both reviews have the potential to enhance Canada’s prosperity and place in the business world if they can modernize and refine our policies while maintaining Canada’s openness to foreign

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investment. The following sections summarize Statistics Canada's research, consider the Paper, and discuss the SOE Guidelines and some potential pitfalls in regulating foreign investment on the basis of security concerns.

Statistics Canada's Research on Foreign Multinational Companies in Canada

In November 2007, Statistics Canada published a timely synopsis evaluating its research and findings on: (1) the importance of foreign multinational companies to Canada's economy; (2) how foreign multinationals' strategies and activities compare to those of Canadian companies; and (3) the foreign activities of Canadian multinational companies. The key messages from Statistics Canada are: (1) Canada's economy is becoming more engaged with the global economy, but its future position is not certain; (2) the presence of multinational companies in Canada and the foreign direct investment ("FDI") they attract has benefited the Canadian economy; and (3) foreign investment regulations have historically had an impact on the volume of foreign investment in Canada. Within these broad statements, there is much that we do not know, and even more that we would like to know in order to formulate effective and efficient policies about foreign investment.

Canada is engaged with a globalized world, but its future place is not certain

Statistics Canada has analyzed data on the volumes, countries, industries, and forms of investment that Canadian companies are making abroad, and that foreign firms are making in Canada. While both FDI and Canadian investment abroad have been increasing over the last 20 years as trade agreements have been negotiated and regulatory barriers have generally declined, Canadian investment abroad exceeds inward FDI.⁵ Canadian investment abroad has also become more varied geographically, although the plurality of Canadian FDI is in the United States (as the plurality of FDI into Canada is from the United States),⁶ while it is low in large emerging nations such as Brazil, China, and India.⁷ Canadian investment abroad remains concentrated in the finance and insurance industries⁸ as well as in energy, metals and minerals, services and retailing.⁹

Canadian investment abroad is weighted towards investment flows other than mergers and acquisitions activities.¹⁰ However, M&A represents the largest part of FDI into Canada, and was higher as a fraction in the last two years.¹¹ While the number of foreign firms acquired by Canadians was greater than the number of Canadian firms acquired by foreigners, in terms of value of transactions, the opposite was true.¹² The emerging picture is that Canada is becoming increasingly linked to foreign markets and investments, while in the past it was primarily linked to the United States. Total global FDI flows totalled approximately US\$2.5 trillion in 2006,¹³ and as the Panel writes, "[i]nternational investment flows are typical of the global economy, and Canadian firms will need to continue to participate in global transactions in order to prosper."¹⁴

Multinational companies are good for the Canadian economy

The bulk of the Statistics Canada survey examines the similarities and differences between foreign-owned Canadian businesses and Canadian-owned businesses in Canada. The focus is comparing foreign multinationals with Canadian firms which only operate within Canada.¹⁵ In general, foreign multinationals in Canada benefit from the liberalized trade Canada has with other nations by having higher import and export propensities than domestic firms.¹⁶ On the basis of this comparison, foreign multinationals are usually larger, more productive, pay

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more per worker, and have a higher fraction of white-collar workers.¹⁷ They are also more likely to diversify across multiple industries, react to different economic trends than domestic firms, and maintain more stable employment with respect to output changes than domestic firms.¹⁸ They appear to be engaged in “integrated production” across borders and have “re-engineered their production systems in response to trade liberalization.”¹⁹

Perhaps surprisingly, and contrary to the “hollowing out” arguments, foreign multinationals are reported to be more likely to have a Canadian head office than domestic firms.²⁰ Statistics Canada writes: “[a]s a result of foreign takeovers, more new head offices were created than lost in the post-1999 period, and employment in head offices was as high after the takeovers as it was before.”²¹ As reflected in the general investment trends, foreign firms rely relatively more than domestic firms on merger and acquisition to enter into markets.²²

In addition, foreign firms “innovate in all sectors more frequently than do Canadian-owned companies in almost all size categories and are more likely to have a research and development (R&D) division. They are also more likely to introduce breakthrough rather than more imitative innovations. They are more likely to use advanced technologies.”²³ Foreign firms do not simply rely on the foreign technology of their parent companies, but typically are heavily engaged in research in Canada, including collaborative research with universities and other firms.²⁴ However, these differences in innovation levels disappear when the differences in size and R&D activity between foreign multinationals and Canadian firms are controlled for.²⁵

Foreign multinational firms also increase Canadian productivity by having higher growth in their plants, spurring productivity spillovers to domestic producers, and by merging with other firms and increasing their productivity – a trend that is persistent and has increased over time.²⁶ The entry of foreign multinationals into manufacturing industries in Canada has had a spillover effect by fostering competition and increasing productivity across the Canadian economy, as new plants, often owned by foreign multinationals, tend to be both larger and more productive than the domestic plants they replace.²⁷

The key drivers to these enhanced results appear to be the business benefits of operating across multiple countries rather than the fact that the companies are not Canadian. The Canadian operations of Canadian multinationals “resemble their foreign-owned competitors in many important respects.”²⁸ In fact, when controlled for size, age, and industry, Canadian-owned multinationals do slightly better than foreign multinationals with respect to R&D and innovation.²⁹ We suggest that to grow Canadian multinationals, we need access to global capital. Canada has the potential to continue being a larger economic player than its size suggests, but it is likely not big enough to finance its ambitions and fulfill its global potential alone.

Canadian foreign investment regulations impact foreign investment in Canada

In addition to reviewing the benefits of FDI, Statistics Canada has also considered the link between FDI levels at any particular time and the prevailing Canadian FDI regulatory landscape. An important finding of Statistics Canada’s analysis of data from the last 40 years indicates that “changes in foreign multinational activity coincided with important transitions in the regulatory regime governing foreign direct investment.”³⁰ While the amount of foreign control in Canada in 2005 was approximately the same as it was in the mid-1960s, there was a decline

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in the share of non-financial corporate assets under foreign control during the *Foreign Investment Review Act* era of the mid-late 1970s and early 1980s.³¹ An earlier Statistics Canada study³² was summarized as concluding that “the impact of regulation is apparent, even after accounting for a host of macroeconomic factors that are posited to determine the attractiveness of the Canadian economy to foreign investment.”³³ This research confirms that Canadian regulation matters to foreign investment and, consequently, the Panel’s and the government’s reviews may have immediate and substantive impacts on the amount of foreign investment Canada receives in the future.

The Competition Policy Review Panel’s Discussion Paper

In the Paper, the Panel describes its “fundamental task” as providing “recommendations to the government on how to enhance Canadian productivity and competitiveness. . .”³⁴ or more specifically, “to make recommendations to the government on ways to establish the domestic conditions that both encourage Canadian firms to be active and aggressive investors at home and abroad, and maximize Canada’s attractiveness as a destination for new investment and talent.”³⁵

The Panel’s mandate is not protectionist, and the Paper recognizes the past benefits that “the ability of Canadian firms to access foreign markets, and . . . openness to foreign investment and immigration” have provided.³⁶ The Panel’s focus is fourfold: (1) investment policies (including industry specific foreign ownership restrictions); (2) competition policies; (3) foreign investment by Canadians abroad; and (4) Canada as a destination for investment.

The Panel observes that “the goal for Canada should be to make this country the location of choice for the higher-value elements of these global value chains – whether led by Canadian firms or as part of others’ supply chains.”³⁷ A new focus for Canada could be attracting divisional head offices, or research and development facilities, rather than head offices themselves.³⁸ These intermediate offices may offer many, and perhaps all, of the benefits that head offices bring to local economies, including providing opportunities for future head office candidates to work in Canada and abroad. Canada’s particular strengths in education, health, and open immigration policies may further promote the development of these divisional head offices in Canadian cities, which presumably do not need the same proximity to large capital markets that head offices may require.³⁹

Investment Policies

Statistics Canada’s work has demonstrated that Canada’s investment policies have an impact on the level of foreign investment in Canada. The centrepiece of Canadian foreign investment legislation is the *Investment Canada Act*, which along with its regulations and guidelines, has largely remained unchanged for the last 20 years. The general concerns about the *Investment Canada Act* are rooted in ideas of efficacy and fairness. The empirical question is whether it works to best accomplish its objectives. The fairness concerns focus on the lack of transparency in the process, along with “increasing public discussion of reciprocity in connection with acquisitions of Canadian enterprises by acquirers which are based in jurisdictions in which a Canadian enterprise would not be able to make a corresponding acquisition because of formal or informal barriers in place in such jurisdictions.”⁴⁰

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The Panel is correct in identifying these issues as challenges facing businesses which are required to comply with the *Investment Canada Act*. Some of the specific challenges posed by the lack of transparency in the process include the lack of predictability in the process, which is exacerbated by the lack of precise definitions (e.g., what exactly is a “transportation business” or a “book”?) and the fact that, with the exception of the SOE Guidelines, no recent guidelines, precedents, or opinions have been issued. The results from the process may not be consistent due to this lack of transparency and the subjective nature of “net benefit” determination.

There is further uncertainty given the application of the *Investment Canada Act* to *de minimis* sensitive sector activity. If only a minor segment of the transaction is involved with transportation or another protected sector, the entire transaction may be reviewable. Furthermore, unlike the WTO threshold for review, which is regularly increased, the thresholds for triggering sensitive sector review have remained static and are now out of date. The *Investment Canada Act*, its regulations, and practices enforcing it, need to be reviewed and amended to address these concerns.

Beyond the *Investment Canada Act*, the Paper summarizes Canada’s sectoral specific legislation which restricts foreign ownership in the telecommunications, broadcasting, cultural industries, transportation, and uranium sectors, as well as the generally applicable restrictions on concentrated ownership in the financial services sector which may have a similar effect. The Panel will explore “whether there are alternative, and equally effective, mechanisms that have less impact on Canada’s competitiveness but nevertheless meet the objectives of the various sectoral investment regimes currently in place.”⁴¹ To the extent that the Panel is attempting to refine Canadian foreign investment policy, it must also offer some specific observations on legislation outside the *Investment Canada Act* that creates foreign ownership restrictions.

Competition Act

The Panel’s focus is appropriately weighted towards foreign investment review rather than a general review of the *Competition Act*. The few topics noted are conspiracies, efficiencies, market studies, and evolving the Competition Bureau’s mandate to respond to globalization. Despite the brevity of this section, one of the Panel’s questions is “Does Canada’s approach to mergers strike the right balance between consumers’ interest in vigorous competition and the creation of an environment from which Canadian firms can grow to become global competitors?”⁴² It is not clear whether this is intended to explore whether Canadian competition policy should promote national champions over competition in the domestic market. This has not traditionally been a predominant objective of Canadian competition policy.

It seems that as the Panel’s focus is foreign investment, it may focus on considering the parts of the *Competition Act* which most directly impact it – namely, merger review. The theme of the review should be convergence – convergence of the requirements within the *Competition Act*, convergence with merger reviews conducted under other Canadian statutes, and convergence of Canadian merger review policies with those of our trading partners and international best practices. Furthering convergence may be part of the Panel’s discussion of evolving the Competition Bureau’s mandate, as a “crucial issue for competition agencies is how to evolve their mandates, activities and operations to reflect a new and changing global commercial environment.”⁴³ Since Statistics

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Canada's research on foreign investment indicates that there is a correlation between Canada's regulatory climate and investment from abroad, we could infer that a rationalized competition policy that directly relates to the ease of foreign investment may have a positive impact on foreign investment in Canada.

Canada's two-part merger review regime involving statutory waiting periods of up to 42 days set under Part IX of the *Competition Act* and substantive review periods under Part VIII of up to five months established by the Competition Bureau's Fee and Service Standards Handbook creates uncertainty (as evidenced by the Labatt Lakeport litigation) and the Panel could explore how it could be integrated into a single regime with a single timeline. The information requested under each Part could also be consolidated into one flexible submission or information request.

Foreign firms seeking to acquire Canadian businesses in several sectors may face multiple and, in some cases, seemingly duplicative, reviews. The Panel has a clear opportunity to analyze and recommend ways to lessen this burden. For example, foreign firms seeking to acquire a Canadian business involved in the transportation industry may face reviews by the Competition Bureau, Investment Canada, and the Minister of Transport, all of whose reviews contain a competition consideration.

Finally, the International Competition Network has promoted best practices with respect to merger review which could align Canada with the processes of other nations, including some key trading partners. In the multi-jurisdictional transactions that multinational firms are likely to be involved in, a greater overlap between the information required by various governmental agencies would substantially lessen the time and cost required to complete the transaction.

Canadian Direct Investment Abroad

The Panel's discussion of this topic focuses on the nature of Canadian investment abroad. Despite its importance, Canadian investment abroad is relatively restricted in its geographic breadth: the Panel notes that "Canadians invest more than four times as much in Barbados (7.3 percent) as they do in Brazil (1.6 percent). Indeed, Canadian investment in the relatively small Caribbean economies of Barbados, Bermuda and the Cayman Islands represents 12 percent of total CDIA [Canadian direct investment abroad], while CDIA in large, emerging economies like China, India and Brazil accounts for less than 5 percent."⁴⁴ Reflecting this limited geography, the focus of Canadian investment abroad has been in financial services, energy, minerals, and services.⁴⁵ Canadian firms have also been relatively less active than foreign firms in making acquisitions abroad.⁴⁶

The Paper refers to the barriers that Canadian firms face, how the Canadian government could promote Canadian direct investment abroad, and asks whether special policies for small and medium enterprises are necessary. The Panel also queries the impact of a strong Canadian dollar. Among these issues, the Panel could focus on how Canadian trade and investment negotiations could facilitate increased investments and open markets for Canadian firms abroad.

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Canada as an Investment Destination

The Panel's focus remains on enhancing Canada's place in global value chains. The Paper refers to the examples of Ireland and Australia as countries which have focused on improving their attractiveness to international investment.⁴⁷ The Panel writes that "[s]ince the implementation of free trade agreements almost two decades ago, Canada has not been the location of choice within North America."⁴⁸ However, the Panel questions whether Canada should remain as focused on investment from other North American countries as it has in the past. An investment made in Canada in order to export to the United States "requires a compelling case of economic advantage to offset potential border risk."⁴⁹ Furthermore, the Panel implicitly contrasts Canada's situation with "the signing by both the U.S. and Mexico of bilateral trade and investment agreements with many countries, both within the hemisphere and outside it. As a result, both the U.S. and Mexico have the advantage of being investment hubs with radiating spokes to numerous free trade markets."⁵⁰ In addition to considering the value of diversifying foreign investment into Canada, the Panel may also wish to consider the ways in which the government can assist in building Canada's business profile abroad.

Federal Government's Review Regarding National Security and State-Owned Enterprises

At the same time that the Panel is conducting its review, the federal government is engaged in an expedited review concerning how to treat foreign investment with respect to national security and SOEs. On December 7, 2007, the SOE Guidelines were released. The same day, the Minister of Industry affirmed that the government "will be carefully considering the creation of a national security test".⁵¹ The SOE Guidelines do not create a new review process and leave the door open to continuity with past treatment of investments by SOEs. It is an open question as to whether any national security provisions will more closely resemble the SOE Guidelines or the national security amendments to the *Investment Canada Act* that were proposed by Bill C-59, which died on the order paper in 2005.

Guidelines on State-Owned Enterprises

The SOE Guidelines merely enumerate some additional factors for the Minister to consider in his or her net benefit to Canada determination. They focus on:

- **Foreign state control:** These guidelines apply to "an enterprise that is owned or controlled directly or indirectly by a foreign government", however, SOE is not further defined. The review will also consider "the extent to which the non-Canadian is owned or controlled by a state".
- **Corporate governance:** The "governance and commercial orientation of SOEs are considered in determining whether reviewable acquisitions of control in Canada by the SOE are of net benefit to Canada."⁵² The criteria to be assessed include the SOE's corporate governance (including "whether the non-Canadian adheres to Canadian standards of corporate governance"),⁵³ reporting structure, and compliance with "Canadian laws and practices".

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- Continued operations: The review will consider “whether a Canadian business to be acquired by a non-Canadian that is an SOE will continue to have the ability to operate on a commercial basis”.⁵⁴

These factors may have already been used implicitly by the Minister to evaluate investments by SOEs, and the new guidelines provide greater transparency without a greater regulatory burden on investors.

National Security

Should the national security review result in a new review hurdle for foreign investment, there is a possibility that foreign investment into Canada, and all of the benefits that it brings, will be reduced. There are several key risks with guidelines concerning national security which were potentially present in Bill C-59: namely, they can easily be too wide-ranging, contain an inherently conservative and protectionist bias, create a procedurally uncertain process, and open the investment review process up to unnecessary politicization and, ultimately, protectionism.

Going forward, policy on national security reviews must be as clear as possible on what the concept of “national security” would include. Furthermore, it should be clear which investments in Canada could engage “national security” issues. The risk is that, without clarifying the definition, almost anything could be caught in a “national security” net, and there would be few, if any, bright lines exempting any investment, of any amount, by any person, in any industry, from scrutiny. As we have seen in other contexts, when issues of national security are left unspecified, there is a natural tendency to become overly conservative in defining it. This increases the probability of foreign investment being unnecessarily stifled. The potential breadth in coverage makes it particularly important to clearly describe any new review process to be applied – without clarity, regulatory risk may needlessly chill foreign investment. There is also the very real potential for a national security review process to become needlessly highly politicized. The potential for inordinate politicization dovetails with another potential concern: protectionism, which is contrary to the thrust of the government’s statements, the Panel’s purpose, and Statistics Canada’s research. The government’s review must carefully balance the legitimate interests in protecting Canada’s national security with fostering its prosperity as a part of an integrated world economy.

Conclusion

Statistics Canada has confirmed the value that foreign investment has for Canada, and the continued importance of engaging with the world by being the location of choice for multinational firms, regardless of their nationality. The ongoing reviews of Canadian policies concerning foreign investment appear largely to have accepted Statistics Canada’s messages and, in particular, the correlation between Canadian investment policies and the amount of foreign investment in Canada. We hope that the Panel can focus its efforts on recommending reforms to the most critical regulatory levers impacting foreign investment in Canada – the *Investment Canada Act* and foreign ownership rules, and also improve the functioning of the *Competition Act*’s merger review provisions. While the federal government has adopted guidelines on SOEs which appear to strike a reasonable balance regarding foreign investment in Canada from SOEs and the potential questions they may raise, the trickier issue of amendments concerning national security has yet to be determined. We hope that these initiatives continue

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to remain focussed on the facts and the national interest in remaining open to foreign investment and strike a balance that best promotes prosperity and openness over protectionism and fear.

Notes

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² Competition Policy Review Panel, "Sharpening Canada's Competitive Edge" (October 30, 2007) [Paper] available online at: [http://www.ic.gc.ca/epic/site/cprp-gepmc.nsf/vwapj/sharpening_e.pdf](http://www.ic.gc.ca/epic/site/cprp-gepmc.nsf/vwapj/sharpening_e.pdf/$FILE/sharpening_e.pdf) \$FILE/sharpening_e.pdf at 3.

³ John R. Baldwin & Guy Gellatly, "Global Links: Multinationals in Canada: An Overview of Research at Statistics Canada" Statistics Canada Catalogue no. 11-622-MIE, No. 014 (November 13, 2007) [Baldwin] available online at: <http://www.statcan.ca/english/research/11-622-MIE/11-622-MIE2007014.pdf>.

⁴ Industry Canada, Investment Canada Act Guidelines – Investment by state-owned enterprises – Net benefit assessment available online at: <http://www.ic.gc.ca/epic/site/ica-lic.nsf/en/1k00064e.html>.

⁵ Baldwin at 37.

⁶ *Ibid.* at 15 and 38.

⁷ Paper at 26.

⁸ Baldwin at 38.

⁹ Paper at 27.

¹⁰ *Ibid.* at 12, citing data from Statistics Canada.

¹¹ Paper at 13.

¹² Baldwin at 39.

¹³ Paper at 11.

¹⁴ *Ibid.* at 15.

¹⁵ Baldwin at 7. The authors note that there are structural differences between foreign multinationals and firms which only operate within Canada.

¹⁶ *Ibid.* at 18.

¹⁷ *Ibid.* at 7.

¹⁸ *Ibid.* at 7-8.

¹⁹ *Ibid.* at 19.

²⁰ *Ibid.* at 8.

²¹ *Ibid.*

²² *Ibid.*

²³ *Ibid.*

²⁴ *Ibid.* at 27.

²⁵ *Ibid.* at 28.

²⁶ *Ibid.* at 8-9 and 29.

²⁷ *Ibid.* at 30-31.

²⁸ *Ibid.* at 9.

²⁹ *Ibid.*

³⁰ *Ibid.* at 7.

³¹ *Ibid.*

³² John R. Baldwin & Guy Gellatly, "Global Links: Long-term Trends in Foreign Investment and Foreign Control in Canada, 1960-2000" The Canadian Economy in Transition Series, Catalogue no. 11-622-MIE2005008, Ottawa: Statistics Canada (2005).

³³ Baldwin at 17.

³⁴ Paper at 1.

³⁵ *Ibid.* at 2.

³⁶ *Ibid.*

³⁷ *Ibid.* at 6.

³⁸ *Ibid.* at 14.

³⁹ *Ibid.* at 8.

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⁴⁰ *Ibid.* at 19.

⁴¹ *Ibid.* at 20.

⁴² *Ibid.* at 25.

⁴³ *Ibid.*

⁴⁴ *Ibid.* at 26.

⁴⁵ *Ibid.* at 27.

⁴⁶ *Ibid.*

⁴⁷ *Ibid.* at 31.

⁴⁸ *Ibid.*

⁴⁹ *Ibid.* at 32.

⁵⁰ *Ibid.*

⁵¹ Speaking Points of The Honourable Jim Prentice, PC, QC, MP, Minister of Industry (Calgary Chamber of Commerce, Calgary, Alberta, December 7, 2007) available online at: <http://www.ic.gc.ca/cmb/welcomeic.nsf/503cec39324f7372852564820068b211/85256a5d006b9720852573aa0063ab5d!OpenDocument>.

⁵² SOE Guidelines.

⁵³ *Ibid.*

⁵⁴ *Ibid.*
