

CLEARING THE WALKWAY

Comments of the Directors Guild of Canada
to Industry Canada on

*Opening Canada's Doors to
Foreign Investment in Telecommunications:
Options For Reform*

30 July 2010



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A. OVERVIEW

1. Who We Are

Soon to celebrate its fiftieth anniversary, the Directors Guild of Canada (DGC) is a national labour organization created in 1962 to represent the interests of directors working in what was then a nascent film and television industry.

Since that time, the Guild has grown to represent over 3800 Canadians who work in 47 occupational categories in the areas of directing, producing, designing and editing. They are key creative and logistical personnel in the film, television and digital media industry. The DGC negotiates and administers their collective agreements; manages their health, welfare and retirement plans; and works to protect and promote their interests.

As part of these responsibilities, the Guild strives to encourage a public policy and program environment conducive to a vibrant screen-based industry.

2. What We Believe

We have recently set out our views, to the Digital Economy Consultation and in our pre-Budget brief to the House of Commons Standing Committee on Finance, that the government has an important role to play in stimulating much-needed private investment in the audiovisual sector.

We view innovation and investment in Canada's telecommunications industry as closely linked to the continued success of our audiovisual industries. The future of advanced digital services, including audiovisual media services, is being written now, and at a global scale. Telecommunications infrastructure is the means by which Canadians are participating in this vast collective enterprise.

We were therefore encouraged by the March 3, 2010 announcement in the Speech from the Throne stating the government's commitment to

open Canada's doors further to ... foreign investment in key sectors, including the satellite and telecommunications industries, giving Canadian firms access to the funds and expertise they need.¹

The Consultation Paper proposed three options for meeting this commitment.

- Option 1 would increase to 49 percent the proportion of voting shares which non-Canadians may hold in Canadian firms that are telecommunications carriers or broadcast licensees.

¹ Cited on page 3 of *Opening Doors to Foreign Investment in Telecommunications: Options for Reform* ("Consultation Paper"). Emphasis added.

- Options 2 and 3 would, either gradually or immediately, allow non-Canadians to own and control Canadian firms that are telecommunications carriers.

It is our view, for the reasons set out below, that Option 1 will help to meet the commitment set out in the Speech from the Throne, and that Options 2 and 3 will not help to meet that commitment. The Throne Speech sought to give Canadian firms access to funds and expertise. Options 2 and 3 incent Canadian firms to cease to be Canadian.

However, it is our submission that the most significant strides towards meeting the Throne Speech commitment lie outside any of the three options. Put simply, Canada's doors to foreign investment in telecommunications are already open. Foreign investors can today hold huge portions (if not all) of the non-voting share equity, and also finance large amounts of, if not all of the debt, of Canadian telecommunications carriers. In some cases, they already have.

But while the doors are open, the pathway has not been cleared. Percentages are an obvious quantitative target. But tinkering with them misses the real barriers to foreign investment in Canadian telecom carriers: a pile of administrative red tape, investor-unfriendly review procedures and poorly-understood rules.

The track record bears this out. All of the non-incumbent Canadian carriers that are new entrants in Canada's Advanced Wireless Services (AWS) segment, inaugurated after a well-publicized auction, rely heavily on foreign investment. Yet with rare exceptions such as Primus Canada, foreign investors have not taken advantage of their opportunity to act as full-service telecommunications service providers in Canada by procuring bare telecommunications facilities from a third party.

We have therefore recommended that, of the options proposed, the federal government select Option 1, which will open the door still wider—but that, in inviting investors in, the government focus its greatest efforts on clearing the walkway to get there.

B. THE 49 PERCENT SOLUTION

Option 1 would modify the 80 percent limits on voting shares in a telecommunications common carrier or broadcast licensee, set out respectively at paragraph 16(3)(b) of the *Telecommunications Act* and at paragraph (b) of the definition of "qualified corporation" set out in the *Direction to the CRTC (Ineligibility of Non-Canadians)*, to 51 percent.

1. Convergence

This Option was proposed by the Chairman of the Canadian Radio-television and Telecommunications Commission (CRTC), who has consistently maintained that Canadian firms

should be free to experiment with vertically-integrated models that combine carriage with content.²

Cable companies and direct-to-home (DTH) satellites, known as Broadcasting Distribution Undertakings (BDUs), are the best example of such vertical integration. Their businesses consist of bundling the carriage of audio and audiovisual content with the selection, packaging, placement and promotion of this content. We note and underline the important recognition throughout the work of the Standing Committee on Industry, Science, and Technology in 2010, echoed in section 6 of the Consultation Paper, that

the policy objectives and legislative authorities under the *Telecommunications Act* and the *Broadcasting Act* are distinct, and the government is not considering changes [other than those set out in Option 1] to the *Broadcasting Act*. With respect to broadcasting content and culture, the government will not consider any action that could impair its ability to pursue Canadian culture and content policy objectives.

BDUs exercise discretion over broadcasting content and culture in significant ways. One of these is, of course, their operation of video-on-demand and pay-per-view services and community channels. However, these are not fundamental to the operation of a BDU. The following functions are:

- BDUs choose which television channels, or “programming services”, are to be distributed.
- They negotiate the wholesale rates to be paid to the programming services, and in turn determine what rates consumers will pay for them.
- They perform simultaneous substitution, and insert promotional material in place of the “local availabilities” of non-Canadian programming services made available in Canada.
- Most importantly, they make the marketing, placement and packaging decisions which are at the heart of a programming service’s success or failure.

² However, we are aware that this approach has also been proposed in non-vertically-paired sectors. For instance, we note the 22 October 1999 letter from Konrad von Finckenstein, then Director of Competition, to the Hon. David Collenette, then Minister of Transport:

The airline industry is capital-intensive. One of the major reasons for failure in the airline industry is undercapitalization. New entrants have a critical need for capital from both domestic and foreign sources. Under the existing ownership rules, foreigners are restricted to a maximum of 25 percent of the voting shares of a Canadian carrier, and control-in-fact must rest with Canadians. The current framework allows the Governor-in-Council to increase the level of foreign ownership by regulation, as long as Canadian control is maintained. Raising the limit on foreign ownership of voting shares to 49 percent would increase access to foreign capital for carriers competing with the dominant carrier.

Because Option 1 ensures ongoing control by Canadian firms of both telecom common carriers and broadcasting licensees, its adoption would permit Canadian firms operating BDUs to seek increased foreign investment in respect of telecommunications facilities while retaining control of the BDU operations that make use of these facilities. That is not the case for Options 2 and 3 which would permit, for instance, Rogers or Bell Aliant to sell control of their operations to Comcast or Verizon, provided the Canadian incumbents first sold off their broadcasting operations.

We recommend that, of the options proposed in the Consultation Paper, and subject to the three technical revisions set out below, Option 1 is the preferred option. It is a simple, easy-to-understand, elegant approach to adjusting the percentage of voting equity which non-Canadians are to be permitted to hold in Canadian carriers and broadcast licensees.

2. Technical Revisions

First, we note that were Option 1 adopted as proposed in the Consultation paper, the foreign voting equity limit on Canadian telecommunications common carriers and broadcasting licensees would rise to 49 percent, but the foreign voting equity limit on their parent corporations would remain 33 1/3 percent. This disparity may not be consistent with the Chairman von Finckenstein's proposal, and in any case would lead to a strange result and reduce simplicity.

We therefore recommend that Option 1 be revised to provide for the deletion of paragraph (c) of the definition of "qualified corporation" set out in the *Direction to the CRTC (Ineligibility of Non-Canadians)*, and for any changes necessary to achieve a similar result to be made to the treatment of "carrier holding corporations" and "holdco excess voting shares" in the *Canadian Telecommunications Common Carrier Ownership and Control Regulations*.

Second, we note that the 80 percent limit on foreign voting equity is set out not only in the *Broadcasting Act* and *Telecommunications Act*, but also at paragraph (b) of the definition of "Canadian-owned and controlled" set out in subsection 10(1) of the *Radiocommunications Act*. Failure to harmonize the Canadian ownership and control requirements of the three communications statutes would significantly restrict the effectiveness of Option 1 and, more importantly, maintain the type of complexity that we have submitted is a barrier to foreign investment.

We therefore recommend that Option 1 be revised to provide for the amendment of paragraph (b) of the definition of "Canadian-owned and controlled" set out in subsection 10(1) of the *Radiocommunications Act*, in a manner consistent with Option 1's amendment to paragraph 16(3)(b) of the *Telecommunications Act*.

Third, we note that while the foreign voting equity limit established by Option 1 is very similar to that set out in the *Investment Canada Act*, including with respect to cultural businesses, it is not identical. Option 1 adopts a 49 percent cap. The *Investment Canada Act* refers to "a majority of the voting interests" that are to be owned by Canadians. The distance between these is not very great. Harmonizing this aspect of the respective tests would be straightforward and remove

what, particularly in a converged environment in which cultural businesses port content from platform to platform, is a possible irritant to foreign investment.

We therefore recommend that, rather than amending “not less than 80 percent” in the various provisions cited in the Consultation Paper and in these proposed technical revisions to read “not less than 51 percent”, this phrase be amended to “not less than a majority”. To be clear, we do not recommend the adoption of any other aspect of the *Investment Canada Act* control test.

C. THE DOOR IS ALREADY OPEN

The purpose of Options 2 and 3 is to allow non-Canadians to control Canadian firms that operate as telecommunications common carriers.

Option 3 would exempt all Canadian telecom carriers from the requirement that they be owned and controlled by Canadians.

Option 2 would exempt from ownership and control restrictions those investments resulting in foreign control of Canadian telecom carriers, including new carriers established by non-Canadians, whose revenues were less than 10 percent of market revenues for all Canadian telecommunications services at the time foreign control was established.

Option 2 is based generally on the recommendations of the Telecommunications Policy Review Panel (TPRP) and Competition Policy Review Panel (CPRP). They envisioned a second phase in which restrictions on foreign control of Canadian carriers would be lifted for Canadian-controlled firms with more than 10 percent of Canadian telecom market revenues. It is reasonable to assume that, were Option 2 adopted, then a framework similar to Option 3 would follow after some period of time.

DGC does not support the adoption of Options 2 or 3. We submit that, for the reasons set out below, the risk posed by unintended effects arising from Options 2 and 3 outweighs the likely benefits, which have not been demonstrated or supported, of adopting them.

1. Unsupported Assumptions

The Consultation Paper identifies as the government’s goal its commitment to opening Canada’s doors further to foreign investment in the telecommunications industry in order to give Canadian firms access to funds and expertise. However, there are no limits in the Canadian telecommunications industry on foreign investment *per se*—only on foreign control of telecommunications common carriers which own or operate certain types of network facilities. Indeed:

- foreign-controlled firms may own and operate telecommunications service providers that control virtually every aspect of their operations, provided they make use of underlying physical facilities leased from a third party, such as third-party fibre;

- lifting some restrictions on the activity of foreign-controlled firms would appear to lie within the discretion of the CRTC, such as the ability of a foreign-controlled firm to act as a Competitive Local Exchange Carrier or Interexchange Carrier by leasing underlying fibre in the manner described above;³
- similarly, a CRTC decision as to whether non-Canadian telecommunications service providers are permitted to light leased dark fibre, or whether they are on the contrary “operating” a “transmission facility” by doing so, is expected within the month following the filing of these comments.⁴

With rare exceptions, such as Primus Canada, few firms that are not Canadian have taken advantage of the flexibility available to them to substantially control Canadian non-carrier operations in order to launch national triple-play telecom service providers. On the other hand, several new Advanced Wireless Services (AWS) spectrum new entrants that are Canadian-controlled were able to raise debt and non-voting equity from foreign investors in order to undertake significant capital expenditures during a period which coincided with one of the least favourable economic climates in many years. It is simply not clear what evidence exists on which to base the assumption that non-Canadian investors’ inability to control Canadian carriers is the key brake to foreign investment in Canadian telecom services.

Even were there a basis on which to accept the assumption that what keeps foreign investors away from Canadian telecom services is the inability to control physical network facilities such as dark fibre, it is not clear that the intended result—more firms competing, or consolidated control of existing Canadian firms from foreign head offices—would achieve the goals set out in the Consultation Paper:

- On one hand, and particularly following the AWS set-aside for new entrants, Canada does not suffer from an insufficient number of facilities-based market participants.
- On the other hand, the consolidated control of large domestic firms by much larger foreign firms cannot be counted on to lead inexorably to consumer benefits, either. On the technical side, the telecom services markets largely run on standardized equipment sold and installed by a very small number of global manufacturers. On the marketing side, evidence does not point to innovation resulting from more customers being handled by a larger centralized call centre.

This is particularly the case when we consider whether foreign entry, whether it resulted in more firms competing or in foreign takeovers of existing firms, would assist those industry sectors that most need capital benefits. It would appear unlikely that foreign investors are biding their time

³ See, for instance, *ACC TelEnterprises Ltd. - Application dated 26 September 1997 to Review and Vary Local Competition*, Telecom Decision CRTC 97-8, 1 May 1997, Telecom Decision CRTC 98-12, 7 August 1998.

⁴ *Classification of service providers that light leased dark fibre for subsequent sale*, Telecom Notice of Consultation CRTC 2010-165, 19 March 2010, paragraphs 19-20.

to invest in rural and remote Canadian regions until they have the right to own their own dark fibre there rather than partner with or lease it from players such as utilities.

Indeed, satellites are the principal technology for which clear economies of scale exist for service to rural areas—and foreign investment in Canadian satellites has already been provided for, possibly in recognition of the fact that non-Canadian satellites were in any case already permitted to compete in Canada.

2. Unintended Consequences

Like other parties, DGC has reservations as to the unintended consequences which may arise from amending telecom ownership and control rules for the purpose of permitting foreign control over all Canadian carriers.

First, we are concerned with the government's ability to maintain the separate regulatory regimes that it proposes to maintain between foreign-controlled telecommunications and broadcasting, which is to remain Canadian owned and controlled. Large non-Canadian communications firms, which have pursued vertical integration between telecommunications and broadcasting activities, have every incentive to mount well-financed government relations campaigns in order to be permitted to pursue the same strategy in Canada, and have considerable means to explore all legal, regulatory and other avenues in doing so.

Second, we note that with respect to Option 2, the TPRP report called for facilitating foreign control of service providers with "less than 10 percent of the revenues *in any telecommunications market*", whereas the CPRP report referred to a market share of "up to 10 percent of *the telecommunications market in Canada*".⁵ Option 2 is premised on the latter version, but foreign control of a Canadian firm that controlled even 5 percent of a single telecommunications product market measured nationally could result in foreign control of monopoly facilities such as local central offices and wireline services in a number of geographic markets. These services are basic services. Is this a result that the government has considered?

Other unintended consequences are more traditional, and include fundamental issues of national sovereignty and security. It is difficult to see how it could be acceptable for the transmission of audiovisual or critical government communications to be under the control of a non-Canadian entity, or the privacy rights of Canadians subject to the reservations of foreign government carve-outs.

Similarly, the importance of specialized clusters to economic development is well-known, and Canada has a strong telecommunications sector with significant operations across the country, employing and educating tens of thousands of people with expertise and experience as good as that of any other workforce in the world. The service providers that operate in this sector are headquartered in Canada. They have made significant capital investments and provided opportunities for our brightest young people. They have been a launch-pad for Canadians to

⁵ Pages 11-26 (TPRP) and 49 (CPRP); emphasis added.

build on their experience by venturing abroad to bring Canada's brand to employers overseas, and they have been a magnet for attracting entrepreneurial Canadians back home. They have had a major ripple effect through the economy, providing leading-edge services and products which assist individuals, businesses and other organizations to achieve their goals—including all of the people and organizations building Canada's audiovisual industries. In the Canadian audiovisual sector, consolidation has invariably resulted in regional operations being phased out and centralized operations being expanded, but with a net shrinkage in employment. What reason is there to think that the same thing would not happen in the telecommunications sector at an international scale? And what evidence is there to support the proposition that Canadian firms absorbed by their counterparts in the much larger U.S. sector would be replaced by head offices of Canadian-based global telecom service providers?

D. CLEARING THE WALKWAY

Over Options 2 and 3 we have, in these comments, supported Option 1. With three minor technical changes, Option 1 would provide for symmetrical ownership and control requirements in broadcasting and telecommunications, and marked compatibilities with the requirements for other cultural businesses. Option 1 would do these things without taking the unnecessary risks associated with permitting foreign control over Canadian telecommunications common carriers, a change whose benefits are at best unclear.

However, we have also insisted that the primary means to meeting the Throne Speech's goal of attracting foreign investment, in a manner that gives Canadian firms involved in telecommunications access to the funds and expertise they need, does not lie in tinkering with the percentage at which non-Canadian voting equity in Canadian telecommunications carriers is capped.

In the Guild's submission to the Digital Economy Strategy consultation, we called for the CRTC to streamline and substantially improve corporate accreditation for broadcast investors. The same is necessary in respect of telecommunications, particularly under the new procedures adopted by the CRTC on 20 July 2009.⁶ For privately-held investors, involvement in a Canadian telecommunications services venture now runs a real risk that information about the privately-held investor which would not otherwise become public is made public. Does the public benefit from publishing these internal corporate documents outweigh deterring possible investors as a result of it? Could most of the benefits that flow from such publication not be captured by the CRTC through some form of documentation instead? We therefore propose, in the interest of attracting and retaining investors to the sector, a simple rule: disclose no more than would otherwise be disclosed by Securities Commissions and similar bodies.

We note a recent trend in the Canadian market away from long-term locked-in contracts, propelled both by new wireless entrants taking cues from other markets, and by new consumer legislation in Quebec. We would submit that waiting for the market to resolve consumer issues does not always work. The CRTC is empowered to enforce certain consumer protections, but its

⁶ *Canadian ownership and control review policy*, Telecom Regulatory Policy CRTC 2009-428, 20 July 2009.

status as a consumer policy enforcement agency has not always been clear. In our submission to the Digital Economy Strategy consultation we called for the CRTC to take up its role as a federal, sector-specific consumer protection agency similar to the role played by provincial consumer protection agencies for most areas of the economy, particularly otherwise-unregulated sectors. We renew that call here, as we believe that greater attendance to consumer issues will increase consumer confidence, take-up and, therefore, competition.

We have submitted that clearing the walkway down which foreign investors must proceed in order to get their foot in the Canadian telecom investment door should be the priority issue in connecting Canadian firms with the foreign funding and investment they need. The ideas set out above are only a small part of a conversation in which we would look forward to participating. In the meantime, we would look forward to the adoption of Option 1 over Options 2 and 3, in order to begin the work of clearing those obstacles.