

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

This submission is made by Globalive Wireless Management Corp., operating under the brand name WIND Mobile (“**WIND**”), Canada’s first new entrant wireless company to provide services after completion of the Advanced Wireless Services auction, and Yak Communications (Canada) Corp. (“**Yak**”), a consumer-focused CLEC and long distance services provider operating across Canada. WIND and Yak are collectively referred to as “**Globalive**” in this submission.

WIND has been offering wireless telecommunications services to customers since December, 2009. It has licensed spectrum covering approximately 26 million Canadians and currently offers service on its own newly constructed 3G, GSM-based HSPA network in five markets - Toronto, Ottawa, Calgary, Edmonton and Vancouver. It plans to expand its coverage in those areas and to expand its business into other markets throughout 2010 and beyond.

Yak is a national long distance service provider and a CLEC operating in seven Canadian exchanges with plans to expand into hundreds more exchanges. Through a combination of its own facilities and resale, Yak provides primary exchange phone and ADSL services as well as long distance and dial-around long distance services to over 1 million Canadians each year.

Both WIND and Yak are owned directly and indirectly by Globalive Investment Holdings Corp., and are both proudly Canadian companies that comply fully with all current Canadian ownership and control requirements.

Background

In this consultation, the Government is considering three options with respect to changing or eliminating foreign investment restriction in the Canadian telecommunications sector as follows:

1. Increase direct limit of voting shares which can be held by non-Canadians for broadcasting and telecommunications to 49%. All other current provisions, including those related to control in fact, would remain unchanged. The *Broadcasting Act* would not have to be amended to implement this option.
2. Adopt the Telecommunications Policy Review Panel/Competition Policy Review Panel approach. Under this option, investments by foreign entities in start-up telecommunications companies, as well as in existing small industry players, would be exempted from the existing restrictions on foreign investment in telecommunications. Specifically, the *Telecommunications Act* would be amended so that telecommunications common carriers with telecommunications revenues of less than 10 % of total telecommunications market revenues would be relieved from the current provisions of section 16 of the *Telecommunications Act*.
3. Remove telecommunications restrictions completely. This option would remove the foreign investment restrictions applicable to all telecommunications common carriers.

Option 2: The Best Way Forward

Globalive recommends Option 2 above.

Over the past few years, there have been a number of studies and reports on Canada's foreign investment restrictions in the telecommunications sector. For example, in 2007, the Government established the Competition Policy Review Panel (CPRP) to review Canada's competition and foreign investment policies. The CPRP's report, *Compete to Win*, was released in June 2008 and made comprehensive recommendations focused on one central premise: raising Canada's overall economic performance through greater competition to provide Canadians with a higher standard of living. This report echoed a number of others in recommending that Canada relax its restrictions on foreign investment in the telecommunications sector to achieve the following:

- To ensure that Canadian companies have access to capital and expertise;
- To promote competition in the sector; and
- To improve services for consumers.

The CPRP recommended a two-phased approach to reducing Canada's foreign investment restrictions. In the first phase, lasting five years, the CPRP recommended that the *Telecommunications Act* be amended to permit foreign companies to establish a new telecommunications business in Canada or to acquire a telecommunications business with a market share of 10 % or less. In the second phase, following a review of broadcasting and cultural policies, the CPRP recommended that restrictions to foreign investment in telecommunications and broadcasting be liberalized in a manner that would be competitively neutral for telecommunications and broadcasting companies.

The CPRP policy review has provided a good road map to ensuring that Canada develops a strong and competitive telecom industry.

In our view, the key issue to increasing competition in telecom is facilitating access to foreign capital on reasonable terms. The telecom business is extremely capital intensive. The existing restrictions on foreign control were never intended to discourage foreign capital investment in Canada's telecommunications industry, but this has unquestionably been the effect. Even having been successful in securing foreign investment, we know how hard it is to raise capital for a start-up telecommunications business on reasonable terms. The very expensive terms upon which our capital was secured demonstrates the difficulty. Under the existing regime and without dramatic improvement in the capital markets, we expect it will be very challenging to replace this expensive capital with capital on better terms.

Our experience is not unique. Many Canadian telecom carriers started up their businesses as foreign-controlled companies using foreign capital, including Bell and TELUS. It's ironic to hear those same companies complaining now that someone else might be looking to a major foreign investor to do exactly what was done to build this country's legacy telecom networks at an earlier stage in our history. The competitive imbalance in Canadian wireless was the impetus for the advanced wireless spectrum set-aside, but the set-aside itself is not enough. Telecom start-ups need lots of capital. WIND alone

expects that its peak funding will be well in excess of \$1B. This is simply not available in the Canadian markets on reasonable terms given its high risk start-up profile. Thus the new entrant carriers are at a substantial disadvantage to the established incumbent carriers. Moreover, Canadian capital markets are relatively small, and in our experience the larger sources of Canadian investment capital are quite reluctant to jeopardize relationships or potential relationships with the incumbents who are extremely powerful not just within the sector but within the Canadian economy as a whole.

As we have seen in the early days of wireless competition, absent quick robust growth, new entrants sometimes just hang around, make a little competitive noise, and wait to be bought out when circumstances permit. Competition is good for Canadians seeking telecommunications services, but capital is critical for companies like Globalive that are seeking to compete long-term.

The existing telecommunications foreign control restrictions are, in our view, an overly broad and inefficient regulatory tool. In today's global environment, Canada needs a more nuanced and effective tool as soon as possible. The CPRP report shows the way.

Option 1

CRTC chairman Konrad von Finckenstein has argued that Canada will attract enough foreign capital to create a competitive telecom environment if the percentage of voting shares in a Canadian telecom company that can be owned by a foreign entity is increased to 49% directly and indirectly. We disagree. Simply increasing the amount of permissible foreign voting equity to levels that still do not confer voting control will not make investment in Canadian telecom companies substantially more attractive than under current rules.

Worse still, Chairman von Finckenstein has recommended maintaining the highly subjective “control-in-fact” test. If our experience has taught us anything, it is that such a highly subjective test and the regulatory uncertainty that it creates is a disincentive to foreign investment. To grow our business to its fullest potential within the existing regime, we will need to access third-party capital, and securing that capital exclusively, or even primarily, in Canada will be a challenge.

Option 3

Option 3 would accomplish the same, or arguably even greater, benefits to the Canadian economy as Option 2. However, we recognize that given the substantial broadcast holdings of Canada's largest telecom providers, removing foreign ownership restrictions for these larger providers raises significant cultural issues that do not arise with Option 2. We believe it is important to consider how to address these issues and to ensure that there are effective measures to promote the creation and distribution of Canadian content. A future broadcast policy review can resolve issues related to the separation of broadcast and content policy from telecommunications carriage. In the meantime, recommendations for a phased liberalization of foreign investment restrictions in telecom should not be delayed or forced to await a review of broadcast policy. Consumers need help now. Thus the phased approach embodied in Option 2 would avoid the possibility of weakening current protections for the Canadian broadcast system pending further review.

In addition to comments on the specific options discussed above, in assessing options, the Government has indicated that it will give particular consideration to their potential effect on:

- Availability and choice of telecommunications services for consumers and businesses;
- Competition, innovation and investment in the telecommunications industry;
- The level of foreign investment in the telecommunications industry and distribution of capital in the telecommunications industry (e.g., whether those sectors of the telecommunications industry that are most in need of capital would benefit);
- The adoption and use of digital technologies in Canada's economy and, more generally, the objectives set out in the digital economy strategy; and
- The competitiveness and productivity of the Canadian economy.

Foreign Direct Investment (“**FDI**”) restrictions directly impact the availability and choice of telecommunications services for consumers and businesses. According to recent report of the Senate Committee on Transportation and Communications, “Plan for a Digital Canada.ca”, the incumbents “may provide more benefits for their shareholders than for the average Canadian consumer...”.¹

Canada’s wireless sector has been underserved by the three dominant wireless providers and is sorely in need of greater competition. Canada has less than 70% penetration in wireless, which according to the OECD puts it 30th of 30 OECD countries. At a minimum, the OECD’s statistics are directionally correct and suggest a significant structural problem. The low penetration of wireless in Canada results from unnecessarily high prices, a function of the virtual oligopoly of the large incumbent carriers that has created opportunities for companies like WIND and Yak.

Further evidence of a virtual oligopoly in Canada where competition is limited and consumers are harmed can be found in a recent “Global Wireless Matrix 2Q10” report issued Glen Campbell at Merrill Lynch Bank of America dated 09 July 2010. In that report, Canada was listed as having the highest Average Revenue per User (ARPU) of the 50 countries covered in the report. Canada also had the highest percentage Year over Year EBITA growth and the lowest percent of population subscriber penetration.

The entrenched, hugely capitalized incumbent telecommunications service providers enjoy some of the highest profit margins in the business world, earned through practices that limit competition and harm consumers, including long-term contracts with unreasonably high rates; punitive early termination fees; and fees for fictitious network services, such as system access fees and Rogers' regulatory recovery fee.

¹ Senate Committee on Transport and Communications, “Plan for a Digital Canada.ca”, June, 2010, Executive Summary, page 3

Obviously the lack of real competition has a significant impact on costs for consumers and businesses and deeply important follow-on consequences for innovation and productivity in the Canadian economy. Clearly, competition is needed.

FDI restrictions also negatively impact on the competitiveness and productivity of the Canadian economy.

There is substantial evidence documenting the merits of FDI into the Canadian economy as demonstrated in the attached report prepared by Dr. Walid Hejazi, Rotman School of Management, University of Toronto. His report demonstrates that inward FDI results in positive outcomes for the Canadian economy. Furthermore, his report indicates that the results for Canada are in no way an anomaly: these results hold across countries, and underlie the policy position of most of the world's national governments which welcome FDI.

The benefits of increased FDI to the Canadian economy described by Dr. Hejazi include:

- **Increases in R&D intensity:** Inward FDI is an important source of R&D diffusion. In other words, Dr. Hajazi's report suggests that policies that permit greater FDI could help to offset lagging Canadian R&D expenditures relative to other OECD countries. When Canada imports goods and services, it imports the embedded technology. Similarly, when a foreign multinational invests in Canada, it brings with it foreign technology, which is then deployed in the Canadian economy, not just by the foreign firm, but also by Canadian firms as they absorb that foreign technology to improve their own productivity. The impact of technology that comes to Canada through FDI, according to the report, is up to three times more effective than technology gained through imports;
- **Increases in Canadian productivity:** Foreign firms are more productive than domestic firms. In order to be globally competitive, foreign firms must have some competitive advantage, typically derived from R&D efforts and innovation. When the foreign firms enter another country, the enhanced competition forces domestic firms to improve their productivity substantially – and the evidence finds this to be the case. Since foreign firms are international and hence have met the global competitiveness bar, and are also more trade intensive (they import and export more than domestic firms), their presence in a local economy generates significant productivity improvements. The domestic industry is forced to compete, and the enhanced global trade deepens the industry's penetration into global supply chains; and
- **Increases domestic capital formation:** When foreign firms come into the Canadian market, they bring with them access to foreign capital and as such are able to undertake investments that otherwise would not have occurred within the Canadian market. As such, industries which are more open to FDI have higher levels of investment and capital formation.

In short, inward FDI has been shown to be important in many dimensions of the Canadian economy. The substantial benefits that come with inward FDI underlies the move globally by governments to

attract multinationals. Sectors that are more open to inward FDI and international trade are more competitive relative to those that are less open.

The report of Dr. Hejazi also demonstrates that restrictions on FDI result in reductions in competition in the domestic market, lower levels of R&D, innovation and hence productivity. These negative impacts of foreign investment restrictions have worked to reduce the competitiveness of Canadian business, and hence the prosperity of Canadians.

Dr. Hejazi 's evidence also shows that Canada's shares of inward FDI have been falling – that is, Canada is becoming less attractive to foreign investors, *relative to global trends*, and hence its FDI position is slipping. This trend has contributed to Canada's reductions in productivity, and hence to the increased prosperity gap with other countries, including the United States. The OECD has also ranked Canada as one of the more restrictive countries among all developed countries, in large part because of the heavy restrictions on foreign investment into three critical infrastructure sectors, which includes telecom.

Competition, innovation and investment in the telecommunications industry also directly benefit the Canadian economy as a whole.

The telecommunications sector is special because all other sectors of the economy depend on the services provided by the telecommunications sector. How efficiently it operate impacts the entire economy. Small business, which is the source of significant job growth, is particularly negatively impacted by poor performance in the telecommunications sector. As such restrictions on foreign investment into the telecommunications sector has hurt the productivity and competitiveness of that sector, and this has impacted the entire economy. As a result of these restrictions, the efficiency and global competitiveness of Canadian firms has been negatively impacted, and the prosperity of Canadians has suffered. Allowing more foreign participation in Canada's telecommunications sector will deliver many benefits to the Canadian economy, including increased competition and investment in ICT, reduced service costs and improved service for users, thus enhancing Canadian productivity, incomes and prosperity.

Increased competition that results from foreign participation will enhance the quality and reliability of services provided, and this will drive down the costs faced by consumers and businesses using telecommunications services. Furthermore, the enhanced innovativeness in this sector and the improvements in its productivity and competitiveness will generate benefits across the economy – that is, the gains are not confined to the telecommunications sector. All sectors in the economy that interact with the telecom sector will benefit.

Assuming the Government were to adopt Option 2 as recommended by Globalive, it is important to consider how the changes to foreign investment restrictions in telecommunications sector will affect incumbents and new entrants.

First, the removal of FDI restrictions will increase the ability of the telecommunications sector to attract foreign capital. As noted by Dr. Hejazi's report, the restrictions on foreign entry in the Canadian telecommunications sector have restricted the amount of capital available to the Canadian

telecommunications sector, thus raising the cost of capital. There is significant evidence demonstrating that the amount of credit intermediation (i.e., available credit) in Canada has lagged that in other G7 countries. Much domestic credit is sourced locally, but much of it comes from international sources, and comes in the form of FDI or mergers and acquisitions. Lifting restrictions on foreign investment would therefore result in enhanced capital flowing into the sector. As has been discussed above, there is a need for significant foreign capital to allow the telecommunications sector to enhance its investments in ICT and perform to a much higher standard than is currently the case, as noted in various international rankings.

Second, as noted by Dr. Hejazi 's evidence, new entrants have a particularly more difficult time accessing capital, especially foreign, because they are unable to demonstrate existing established businesses. Existing companies in the telecommunications sector can go to, for example, the Canadian and US debt markets and raise capital on a relatively cost effective basis or tap into low cost equity. In sharp contrast, it would be far more difficult for a start-up such as Globalive to do so. It is only once firms have established track records and predictable revenues that the premium associated with start-up businesses goes away.

The corollary to this of course is that current incumbents have an enormous advantage in terms of acquiring both domestic and foreign capital. Stated differently, if new entrants were to gain access to start-up capital from foreign sources, incumbents will not unfairly suffer. In fact, allowing start up to access foreign capital would move the industry slightly in the direction of a more level playing field, but in no way fully. Even with access to foreign capital, the incumbents still hold an enormous advantage.