

Submission to Industry Canada's Consultation on Foreign Investment in Telecommunications

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A. Why Foreign Investment Restrictions?

1. Introduction

Industry Canada's consultation paper on this topic, which presents options for reform and seeks public comment, offers no policy rationale for the existence of Canadian ownership requirements that currently apply to facilities-based common carriers in Canada (carriers that own or operate telecommunications network infrastructure). These requirements – foreign investment restrictions by another name – limit the extent to which foreign investors can hold equity in, or otherwise control, a Canadian carrier.

The consultation paper indicates that generally applicable Canadian ownership rules were introduced at the time of Canada's free trade agreement with the United States. At the time, the US also had foreign investment restrictions, as did a number of Canada's other major trading partners. Since then, the paper explains, the US, our other major trading partners, and most member states of the Organization for Economic Cooperation and Development (OECD) have removed such restrictions. Canada therefore stands almost alone within the OECD in retaining its restrictions on foreign investment in this capital-intensive industry. So if parity with other countries was once a plausible rationale for these restrictions, it is no longer sustained by the facts as presented in the paper.

However, concern about Canadian ownership of telecommunications carriers in Canada has a longer history. The *Bell Canada Act* required regulatory approval of the sale of certain assets, which impeded foreign acquisition of that company; telephone companies in Atlantic and Western Canada were provincially-owned and therefore Canadian; Teleglobe and Telesat were structured to be Canadian-

owned; and, as the paper notes, Canada's first cellular carriers were required to be Canadian. Indeed, for many years, BCTel and QuebecTel (both now integrated into Telus) were exceptions to the norm because they were owned by an American telephone company known at the time as GTE. Their foreign ownership was "grandfathered" when Canadian ownership rules came into force under the 1993 *Telecommunications Act*. So Canadian history has both a general rule of Canadian ownership *and* long-standing exceptions.

2. Possible Rationales

Other than the no-longer-valid concern about parity with other countries, the public record reveals little substantive policy rationale for Canadian ownership requirements. In 1987, the year in which the Canada-US Free Trade Agreement was negotiated, the then Minister of Communications issued a document entitled *A Policy Framework for Telecommunications in Canada* which stated that "domestic ownership of Canada's telecommunications infrastructure is essential to national sovereignty and security." This assertion was restated in the 1993 *Telecommunications Act*, which declares that telecommunications "performs an essential role in the maintenance of Canada's identity and sovereignty". These references appear to be the only public justifications. Yet these assertions would be as true for other countries as for Canada and most others do not require domestic ownership and control of carriers as a consequence.

The familiar arguments that economic nationalists use to defend domestic ownership rules are well-known, and have been debunked by careful analysis:

- The idea that foreign-owned firms divert profits to foreign shareholders rather than reinvest locally may have validity in colonial and developing markets but is demonstrably weak in advanced economies: If they did this to the detriment of the business, the firm would become uncompetitive and lose market share. So most firms must, and do, reinvest in their foreign subsidiaries. As for return on shareholder investment: whether Canadian or foreign, boards of directors and company management have a fiduciary responsibility in this regard. Canadian shareholders are free to invest their profits wherever they wish – many invest abroad, just as many foreigners invest in Canada. Cross-border investment is a beneficial two-way street from which Canada and Canadians have benefitted greatly.
- The so-called "hollowing-out" of corporate Canada has been shown to be a myth by publicly available data and research: Canadian firms are highly active players in global markets and Canadian subsidiaries of foreign firms are often active participants in global value-chains.
- The idea that the loss of "head office" jobs will have negative impact is similarly unsubstantiated.
- The argument that big Canadian firms are more likely to invest in research in Canada has been debunked by data that show the contrary: a good number of foreign multinationals invest more in R&D in Canada than do

Canadian firms. With the dismantling of Nortel, this is certainly the case in telecommunications today. (In any event, Nortel's status as "Canadian owned" has been uncertain since it was sold by BCE.)

- The notion that only Canadian-owned companies will support local charities and public initiatives has been given the lie by the active participation of Canadian subsidiaries of multinationals in such activities.

Beyond these considerations, telecommunications infrastructure is made up of hard assets – wires, cables, fibre optic lines, buried conduit, poles, radio towers, transmitters, satellites – that are expensive to build, deploy and maintain. They require ongoing updates and investment to meet demand and stay competitive. They would be costly to dismantle and remove. They occupy public rights of way. They can be accessed, under warrant, by law enforcement agencies. So what is the concern about Canadian ownership? Given the references to national sovereignty, security and identity, two other possibilities are worth considering.

First is the notion that Canadian-owned companies are more likely than foreign-owned companies to be responsive to regulatory and policy concerns in a field like telecommunications, which has an impact on Canadian society, the economy and competitiveness. Examples might include timely deployment of new technologies, extending service to remote areas, or even privacy and security concerns. The problem with this argument is that its merit depends on at least one of the following assumptions being valid:

- Foreign-owned firms are more inclined than Canadian-owned firms not to respect Canadian laws and regulations, *and* are actually able to do so (inclination alone is not enough); and/or
- Canadian-owned companies are more likely than foreign-owned firms to value public policy objectives, beyond legal or regulatory obligations, over the interests of shareholders.

Let's consider these assumptions. If it were true that foreign-owned firms are more inclined not to respect Canadian laws and regulations, *and* are actually able to do so, then Canada has a problem that far exceeds the scope of this consultation. For this would be true in all sectors of the economy, most of which have no Canadian ownership rules. Think only of foods and pharmaceuticals that touch directly every Canadian. Is there a valid concern that foreign firms operating in Canada are not respecting Canadian laws and regulations? Or is this concern only valid with respect to telecommunications? If the latter, how so? Some have argued that privacy protection or national security concerns are served by Canadian ownership, but both areas are subject to law and regulation. Are foreign owners somehow able to evade such legal requirements or do the laws themselves need to be strengthened to address whatever concerns exist?

With respect to balancing the objectives of government and shareholders, as noted previously, in Canada company directors and management have a fiduciary responsibility to pursue shareholder interest. The notion that Canadian-

owned firms will pursue this duty with any less vigour than foreign-owned counterparts suggests that Canadian directors and managers are either less competent or are prepared to value and pursue altruistic nationalism over fiduciary duty. This argument is simply unsubstantiated (the observations below suggest otherwise). If true, it would not bode well for Canada's competitiveness. More likely, this is an anachronistic idea held over from the days when telecom carriers were monopolies with rates of return fixed by regulation and therefore whose directors and managers might deviate from normal pursuit of shareholder interest in the hope of influencing the regulator or government. This notion is simply out of touch with today's competitive telecommunications markets.

Today, most telecom market segments are deregulated; exceptions are markets that remain monopolistic and transactions between former monopoly carriers and their competitors. Market forces determine infrastructure investment, deployment and prices *unless* the regulator imposes requirements (such as extension of networks in rural areas) or government provides incentives (like funding for rural broadband). Any "social" contributions by carriers are either undertaken as a competitive advantage to serve a niche market, as part of sponsorship or community service budgets that serve corporate interests, or are imposed by regulation (such as the fund to subsidize service to high cost areas, the "Do Not Call List" and the Commissioner for Complaints for Telecommunications Services). As in other sectors of the economy, behaviour is determined by market forces, laws and regulation.

Second is the idea that Canadian government regulators, officials and politicians may have greater influence vis-à-vis Canadian-owned firms than foreign-owned firms. The idea here is that strong words, admonishments, cajolment or threats of intervention will have more sway with the former than with the latter. Whatever merit this concept might have, it is more characteristic of colonial government – like the so-called "family compact" that ruled Upper Canada in the 1800's – than of the modern, democratic, efficient, open and transparent government that Canadians, and our international treaties, expect. In a competitive market, such tactics are doubtful of success since their outcomes are neither accountable nor verifiable, and, if pursued with vigour, they invite challenge on grounds of abuse of process. Like the previous argument, this too recalls the former status of carriers as regulated monopolies dependent on the regulator and government for guaranteed rates of return. It is an anachronism.

3. Observations

Underlying all of the potential rationales for foreign investment restrictions is a concern about the behaviour of foreign-owned firms as compared to Canadian-owned firms. *Yet, where is the hard evidence to support the notion that controlling the citizenship of capital is an effective means to ensure corporate behaviour in support of public policy?* Market forces, laws and regulation are demonstrably effective determinants of corporate behaviour. In either

telecommunications or broadcasting, where Canadian ownership rules also apply, it would be very difficult to find an instance in which Canadian ownership caused some behaviour in support of public policy objectives that was not otherwise dictated by regulation or initiated for good business reasons. The fact that good business reasons include a sense of “corporate responsibility”, for many foreign as well as domestic firms, would make it even more difficult to isolate Canadian ownership as the causal factor.

Conversely, one can readily identify instances in which the behaviour of Canadian owned companies in both these fields was driven purely by corporate interest, despite public policy concerns, and sometimes even to the point of open defiance of regulation. For example, having long highlighted R&D powerhouse, Nortel, as an important benefit of Canadian ownership of telecom carriers, BCE promptly sold Nortel when it was clearly in the interests of its shareholders to do so, leaving Canada’s leading private sector R&D performer open to foreign acquisition. (Within BCE, Nortel had been kept separate from Bell Canada, the regulated carrier, so that Nortel was not subject to Canadian ownership rules; but stimulating R&D in Canada is also an objective of the *Telecommunications Act*.) An example of defiance was Shaw Communications withholding its regulated contributions to the Canadian Television Fund until CRTC action forced it to pay. These business decisions are cited not to criticize these two firms, but rather as widely publicized examples of how citizenship of capital does not ensure corporate behaviour in support of public policy. Other examples can be found in the records of CRTC proceedings such as: tariff filings that exceeded allowed increases; commercial contracts that contravened regulated pricing rules; service to competitors below regulated quality of service standards.

The long-standing presence in Canada of foreign-owned carriers lends further weight to this analysis. For decades, BCTel and QuebecTel were the regulated monopolies serving British Columbia and parts of Quebec. Is there evidence that foreign ownership of these companies made their behaviour different in any significant way from the Canadian-owned monopolies serving other regions of Canada? On the contrary: all the former monopolies were part of the “Stentor Alliance”, behaving in many respects as a single entity.

Today, “resellers” that lease capacity, facilities and services from carriers that own and operate telecom network infrastructure (like small ISPs or some long-distance providers) are not required to be Canadian owned and are not even subject to direct regulation by the CRTC. Nevertheless, they render the same services to Canadian consumers and businesses as the facilities-based carriers that are subject to the Act and some have made significant investments in Canada. Although not directly regulated, they too respect a variety of CRTC rules which are implemented indirectly through provisions imposed by the regulator on their contracts with underlying facilities-based carriers. Some resellers have even argued that the CRTC should have direct authority to regulate them under the

Telecommunications Act (except for Canadian ownership rules) rather than be captured through contracts with regulated carriers with which they compete. Whatever validity these possible rationales may have had in the age of regulated monopolies they are, like the parity rationale, long since overtaken by events.

B. Impact of Foreign Investment Restrictions

If the rationale for foreign investment restrictions in telecommunications has been unclear, their impact has been both clear and substantial. While the CRTC had allowed some resale competition in the late 1980's, fully-fledged facilities-based competition was introduced into Canadian telecom markets with the passage of the 1993 *Telecommunications Act*. The same Act implemented foreign investment restrictions. In hindsight, the result was predictable.

The CRTC struggled mightily to develop frameworks to enable cost-based interconnection among competitors and access by new entrants to essential and other facilities of the former monopoly carriers. Yet foreign investment restrictions forced new entrants to make hard choices. They could:

- find Canadian investors willing to be majority shareholders in risky new start-up companies that faced huge up-front capital investments before seeing any revenues and competition against established former monopolies that held 100 percent market share (there were few takers);
- remain “resellers”, always dependent on regulated access to facilities of their former-monopoly competitors, and the margin between wholesale and retail prices, while seeing that margin squeezed in response to competitive pressures;
- try to establish a loyal clientele as a reseller while searching for a majority Canadian shareholder – in effect hoping to reach the scale at which a carrier can attract committed investors before going broke;
- watch the cable-TV companies wait on the sidelines until their network technology enabled the offer of reliable local residential telephone service to existing subscribers, and see that market collapse for other competitors.

Many new entrants pursued these strategies; and many have come and gone.

Almost two decades later, Canada's telecommunications markets are regional oligopolies dominated by two or three service providers. Former-monopoly telecom carriers and cable-TV companies dominate in both wireline and wireless network infrastructure and services including voice, data and Internet access, as well as in broadcasting distribution. A few resellers service niche markets. New entrants from the Advanced Wireless Services spectrum auction are changing the wireless market segment, but foreign investment limits remain a significant challenge for them. Of course, the incumbent telecom carriers and cable-TV operators have naturally occurring market advantages: monopoly-financed infrastructure that reach well over 90 percent of Canadians; long-standing clientele; reliable revenue streams; and established access to capital to finance

new lines of business. But foreign investment restrictions reinforce these advantages by impeding dynamic market entry.

For example: Unlike other OECD countries, Canada has seen no sustained facilities-based entry by a major global carrier to offer robust competition to domestic former monopolies. To enter this market, such a carrier would have to relinquish control of a massive up-front investment and forego the potential synergies of an integrated subsidiary, while competing with former monopolies that have the means to protect their markets. The histories of AT&T Canada and Sprint Canada illustrate this challenge. The wireless market provides another example: although building competitive wireless networks is more economically feasible than overbuilding existing wireline networks, the ownership rules undermined previous new entrants Clearnet and Microcell; this helped the incumbents retain their dominance in this market segment, eventually buying out the failed entrants (the ownership rules limited the pool of potential buyers).

Dynamic market entry, or even the threat of entry, is *the* market force that disciplines companies to be responsive to consumers. It is therefore the principal means by which consumers benefit from a policy of reliance on market forces. In this sense, these restrictions are both a fundamental flaw in telecommunications policy and anti-consumer.

The restrictions were, from the outset, at odds with a policy to foster competition in a telecoms market the size of Canada's. In a bigger market, like the US, the impact would be similar, but capital would be more accessible and less risk-averse and competition would always be more vigorous. But if foreign investment restrictions were at odds with the goal of the 1993 Act to foster competition, they are even more at odds with the current government's stated policy to rely on market forces "to the maximum extent feasible". This policy, enshrined in a formal Policy Direction to the CRTC in 2006, was adopted from the report of the Telecommunications Policy Review Panel, but implemented independently from the Panel's other recommendations. The result, like the 1993 Act itself, is a policy framework fraught with internal inconsistency.

On the heels of its 2006 Policy Direction to the CRTC, the government, in 2007, rewrote a CRTC decision so as to accelerate the deregulation of local telephone service even in markets where competition was still nascent. Accelerated deregulation was based largely on the entry of regional cable-TV companies into local telephone service markets. Deregulation allowed the former monopoly telephone companies to compete more vigorously. The outcome effectively sidelined all competitors other than the local cable-TV operator; this helped entrench an oligopoly market structure that was already buttressed by foreign investment restrictions – an unintended, but natural consequence.

A further impact relates to Canada's competitiveness. OECD research has demonstrated that multinational firms – those that operate in more than one

country – outperform purely domestic firms across a wide range of measures and industries. Multinationals tend to invest more in equipment and staff training; and they are much more likely to invest in research, and to use advanced technology and processes. Foreign investment restrictions have impeded foreign telecom multinationals from operating in Canada. Has this made Canadian carriers less competitive? One hopes not. But almost two decades after competition was introduced, Canada’s telecommunications services industry remains primarily domestic in scope: none of the major Canadian telecom carriers has any significant investments outside Canada. Accordingly, in telecommunications infrastructure, unlike most other industries, the Canadian market does not benefit from the enhanced performance of either foreign or domestic multinationals. Yet this is the infrastructure of the digital economy.

C. The Link to Broadcasting

1. Convergence

In the debate about foreign investment restrictions, much has been said about “convergence”, in particular the convergence of local telephone and cable-TV network technologies and architectures. Convergence has enabled both of these former monopoly industries to enter each others’ lines of business and the newer field of Internet access and services. Both businesses are subject to substantially similar Canadian ownership rules. A converged network operator is subject to both sets of rules: under the *Telecommunications Act* for its telecom services (telephone, data and Internet) and under the *Broadcasting Act* for broadcasting distribution and programming. So “convergence” begs the question as to whether the telecoms rules can be changed independently of those for broadcasting.

In most markets across Canada, telecom carriers complement their telephone offerings with Internet access and broadcasting distribution (the latter either on their own network or via satellite). For their part, cable-TV firms deliver telephone service along with television and Internet access. All the local telecom carriers and Rogers Communications offer wireless service too. Shaw, Videotron and EastLink recently acquired radio spectrum for this purpose. Some of these companies extend their converged operations into content. Rogers owns a string of television channels and radio stations as well as magazines. The Shaw family that owns Shaw Communications also owns Corus Entertainment, which operates a string of television specialty channels. Videotron’s owners also own television stations.

The combination of converging digital network technologies and foreign investment restrictions has led to a significant level of vertical and horizontal integration in Canadian telecommunications and broadcasting today. Whether this is a good thing is a matter for the CRTC and the Competition Bureau to consider. Ideally they would do so jointly, but this is not currently possible under

Canadian law. Perhaps, as the Telecommunications Policy Review Panel has recommended, it should be. But this is a digression...

2. Converged Networks and Canadian Ownership Rules

The former monopoly telecom carriers and cable-TV operators have argued that local network convergence *requires* that any liberalization of investment rules for telecommunications be accompanied by liberalization for broadcasting, at least with respect to broadcasting distribution services. It is, of course, in the corporate interests of these companies to make this argument from several perspectives; but there are counter-arguments too.

In today's converged network operations, it is certainly correct that voice, Internet and broadcasting services are delivered in an integrated manner such that it would be difficult to structurally separate these lines of business to accommodate different ownership rules. This reflects the technological history of the underlying networks which were designed for, and integrated with, specific services (telecom networks for voice and data; cable-TV networks for one-way video).

But the idea of integrated services and infrastructure is a technological anachronism: on the Internet, voice, video, text and image-based services can all be delivered independently of each other and of the underlying infrastructure. The evolution toward fully digital, Internet protocol-based network infrastructure is enabling the complete disaggregation of on-line services from infrastructure. This is what drives the incredible explosion of services on the Internet. (Think of independent ISPs, newspapers on-line with sound and video, Skype, Canoe, Yahoo, Netflix, YouTube, Hulu.) Fiber-to-the-home networks deployed in the US and other markets already deliver broadcast quality Internet protocol TV. Networks in Canada are moving in this direction. The concept of integrated services delivery has no basis in Internet technology. Rather, it is a business imperative for network operators who want to "own" subscribers with bundled services. As operators deploy IP technology further into their networks to save costs and free-up capacity in response to demand for Internet services, the "converged network" argument is becoming obsolete. But we're not there yet.

Structural separation of broadcasting distribution services may be difficult for today's converged network operators; but difficult does not mean impossible. In fact, direct-to-home (DTH) satellite broadcasting distribution is a real-life example of how this kind of service is operated entirely separately from its distribution infrastructure. Both of Canada's DTH satellite services lease satellite distribution infrastructure under contract from Telesat. Shaw Communications owns one DTH service; Bell owns the other (more horizontal integration...) and each holds a broadcasting licence. Telesat, the underlying carrier, is not considered a broadcaster and holds no broadcasting licence. Another example of structural separation and convergence is how the Shaw family owns Corus Entertainment separately from Shaw Communications, with different minority investors.

So, setting aside costs and complexities (which are not trivial), a converged telecom carrier or cable-TV operator *could* set-up its broadcasting distribution service as a separate company with a broadcasting licence. That separate company could lease distribution capacity from the converged network operator or, as technology evolves, migrate to Internet-based delivery. In this scenario, the converged network operator is solely a carrier, so the *Broadcasting Act* would no longer apply to it. If telecom rules were liberalized independently of broadcasting rules, this strategy would allow a converged operator to obtain greater foreign investment in its network infrastructure while retaining Canadian ownership of its affiliated broadcasting distribution service.

Moreover, a change in the telecom rules would not *require* any change in corporate structure. Rather, structural separation would be precipitated *only if and when* the converged network operator wanted to take advantage of liberalized telecom rules. This would provide significant leverage in determining the best approach and corporate fit with respect to increased foreign investment *and* preventing a hostile takeover.

There is also a possible strategic value for the converged network argument put forward by the former monopolies. Canadian ownership is a highly sensitive topic for broadcasting and for cultural policy more generally. The demand that ownership rules for broadcasting distributors be liberalized in tandem with any liberalization of the telecom rules enlists the entire cultural community in opposition, creating an obstacle to change. Foreign investment restrictions help to maintain the status quo telecoms/broadcasting distribution oligopoly. So the position can be demonstrated to be valid based on local network convergence, while at the same time protecting its proponents' interest in the status quo.

Network operators face uncertain futures. As their networks evolve toward fully Internet protocol based infrastructure, they enable more competition to the services they themselves provide. Video over the Internet already makes it possible for Canadians to access foreign and domestic TV programming from sources other than a licensed over-the-air broadcaster or broadcasting distributor. On-line services like YouTube, Surf The Channel and Hulu do not depend on affiliation with a converged network operator. Canadian broadcasters are already among the many providers of on-line video. Netflix has announced plans for a service to Canadians next year. Not surprisingly, cable-TV operators are moving in this direction too. It is still unclear how Canadian broadcasting policy will adapt to this new distribution environment. What is clear, though, is that the new environment means more competition. In broadcasting, as in telecommunications, highly competitive markets further undermine whatever validity there may once have been to the notion that Canadian ownership is an effective means to ensure corporate behaviour in support of public policy.

While not addressed in this consultation, this discussion highlights the need for a thorough review of broadcasting policy. The current *Broadcasting Act*, policy and

regulation were based on the 1986 Report of the Caplan-Sauvageau Task Force. That report was issued more than a generation ago in years and considerably more than a generation ago in the evolution of communications technologies. Several CRTC reports and other studies have demonstrated how the Internet has radically changed the technological premises upon which the 1991 *Broadcasting Act* is based. The policy objectives set out in the Act reflect concerns arising from a market and technologies of a vastly different era when audio and video content were accessible only from over-the-air TV and radio, cable-TV and big old-fashioned satellite dishes. Times have changed.

3. How Important is Canadian Ownership of Broadcasting Distributors?

Broadcasting distribution services, like cable-TV and DTH satellite, receive and then retransmit, in various packages, a range of local, distant and specialty TV channels, movie rental services, some radio stations and shopping services. The first such operations in Canada were unregulated and some were foreign owned. The 1967 *Broadcasting Act* swept them under CRTC regulation and Canadian ownership rules, which led to divestitures. These services are the tamed “Trojan horse” of Canadian broadcasting policy. Initiated as a means to deliver popular American television channels to Canadians living too far from the US border for over-the-air reception, they were transformed by CRTC regulation into a vehicle for advancing the distribution of an increasing range of Canadian programming services along with the US channels.

In their core function as packagers and retransmitters of services programmed by others, broadcasting distributors have little if any impact on programming per se. The packaging of Canadian services with foreign services is subject to CRTC regulation, as is the negotiation of agreements for carriage between distributors and programming services. As well, broadcasting distributors are required to make a financial contribution to the Canadian Television Fund (CTF) to support Canadian program production, based on a percentage of revenues. Given the extent to which these operations are regulated, it is hard to see how Canadian ownership has any material impact on Canadian content objectives. Recall Shaw Communications’ public defiance of its obligation to contribute to the CTF.

Some broadcasting distributors also operate a local community channel and movie services, which involve programming. These services may be authorized by the CRTC either separately or as part of the distribution licence. However, as a general rule, other programming services owned by a broadcasting distributor are operated under a separate subsidiary and separate licences, or even held in a separate company like Corus. “Converged network” arguments simply do not apply with respect to programming services; these could easily be spun out into a separate company. This should reduce even more any concerns about foreign ownership of distribution service network operators.

So liberalization of the rules for broadcasting distribution in step with liberalization for telecom carriers is unlikely to have any material impact for broadcasting policy. Any concerns could be addressed by the regulator by other means.

The current consultation is not the first time that the government has faced pressure to liberalize the ownership rules for broadcasting distribution. In its 1996 Convergence Policy (<http://www.ic.gc.ca/eic/site/smt-gst.nsf/eng/sf05265.html>), as if in anticipation of today's debate, the government of the day stated: "Most rules governing foreign investment in telecommunications and broadcasting have been harmonized. However, *it is not government policy to ensure ongoing harmonization of ownership rules for broadcasters and Canadian carriers in the future.*" (Emphasis added.) This gave the impression that Canadian ownership in broadcasting was sacred. Yet, in implementing the Convergence Policy, the government made an exception for broadcasting distribution.

The Convergence Policy was a formal expression of the government's desire to enable competition between the monopoly telecom carriers and cable-TV firms. At the time, BCTel and QuebecTel were foreign-owned. Although grandfathered under the telecommunications rules, they would still be ineligible to hold a licence for broadcasting distribution. In response to heavy lobbying, the government passed an Order in Council under the *Broadcasting Act* in 1997 that allowed these companies to hold a broadcasting distribution licence provided that the service was run by a separate subsidiary with a Canadian CEO and Canadians in charge of decisions that affect programming. Although this exception was opposed by the cultural community at the time, the opposition was primarily based on "slippery slope" worries. Nonetheless, this provides another alternative should the government not be prepared to move on broadcasting ownership.

4. Summary of Options to Address Converged Operations

- a) Liberalize ownership restrictions for telecommunications carriers independently of any change to broadcasting rules. Converged operators could either retain broadcasting distribution as an integrated service and remain Canadian owned, or structurally separate it so that they could take advantage of increased access to foreign capital for their network infrastructure.
- b) Liberalize ownership restrictions for broadcasting distribution services in tandem with liberalization for telecommunications carriers. Let the CRTC decide how best to deal with their licences for programming services; or issue a policy direction requiring structural separation of programming from distribution.
- c) Liberalize ownership restrictions for broadcasting distribution services in tandem with liberalization for telecommunications carriers but subject to the broadcasting distribution service being a separate subsidiary with a Canadian CEO and Canadians making decisions that affect programming. Address licences for programming services owned by distributors as in option b.

D. The Way Forward: Recommendations

With this consultation, the government has an opportunity to rebalance telecommunications policy to make it more consistent with its stated objective of reliance on market forces “to the maximum extent feasible”. To do so, it should apply to itself the framework for considering regulatory measures set out in its 2006 Policy Direction to the CRTC.

The Policy Direction to the CRTC contains the following:

1. In exercising its powers and performing its duties under the *Telecommunications Act*, the Canadian Radio-television and Telecommunications Commission (the "Commission") shall implement the Canadian telecommunications policy objectives set out in section 7 of that Act, in accordance with the following:
 - (a) the Commission should
 - (i) rely on market forces to the maximum extent feasible as the means of achieving the telecommunications policy objectives, and
 - (ii) when relying on regulation, use measures that are efficient and proportionate to their purpose and that interfere with the operation of competitive market forces to the minimum extent necessary to meet the policy objectives;
 - (b) the Commission, when relying on regulation, should use measures that satisfy the following criteria, namely, those that
 - (i) specify the telecommunications policy objective that is advanced by those measures and demonstrate their compliance with this Order,
 - (ii) if they are of an economic nature, neither deter economically efficient competitive entry into the market nor promote economically inefficient entry,

This Policy Direction was brought into force by the current government after a full public consultation. It is recent and it is the first and only such Policy Direction ever issued to the CRTC under the *Telecommunications Act*. Accordingly, it can only be understood to be an unequivocal expression of this government's beliefs with respect to telecom policy. In the circumstances, the government should be consistent and apply to itself the principles of this Direction in its analysis and consideration of telecommunications policy measures under its control.

It is clear that the legislative and regulatory measures that implement Canadian ownership create, by design, significant barriers to market entry, and therefore on their face run counter to a policy to rely on market forces "to the maximum extent feasible".

Recommendation 1: *Consistent with its own Policy Direction, the government should consider whether the Canadian ownership requirements that apply to facilities-based telecommunications carriers in Canada:*

"are efficient and proportionate to their purpose and interfere with the operation of competitive market forces to the minimum extent necessary to meet the policy objectives"; and

"neither deter economically efficient competitive entry into the market nor promote economically inefficient entry."

This submission suggests that the Canadian ownership requirements would not meet either of these criteria. They are neither efficient nor proportionate to their purpose (which is unclear) and they interfere significantly with the operation of market forces. Moreover, they deter economically efficient entry by facilities-based carriers and promote economically less efficient entry by resellers. Full liberalization by repealing the Canadian ownership requirements would be most consistent with the government's stated policy. The alternative of allowing foreign ownership for carriers below a certain revenue or market-share threshold would be less inconsistent with stated policy than the current regulations as this approach would be more proportionate, would interfere less with markets and would remove a significant barrier to economically efficient market entry.

Recommendation 2: Consistent with the principles of its Policy Direction, the government should proceed with liberalization of foreign investment and the repeal of Canadian ownership requirements.

Recommendation 3: The government should also consider whether amendments to the Telecommunications Act, the Investment Canada Act or other legislation would be appropriate to address any outstanding concerns thought to be addressed in some indirect way by Canadian ownership.

The location of data banks containing information about Canadian clients is one issue which may need to be addressed. Since data held in the US may be subject to access by US authorities under the Patriot Act, Canadian privacy laws may be violated where carriers (Canadian- or foreign-owned) hold data off-shore. This may already be the case for some carriers. Another issue may be national security concerns. If ensuring compliance with applicable laws is an issue, then compliance measures should be reinforced, since this is no less a concern with respect to Canadian-owned than it maybe for foreign-owned firms.

Recommendation 4: If the government decides to retain investment restrictions in whole or in part then, then in keeping with its Policy Direction, it should explain:

- a) the objectives that these measures are intended to achieve; and*
- b) how these measures are in keeping with the Policy Direction.*

In responding to point b), the government should set out the reasons why less intrusive measures, such as those available under the *Telecommunications Act* to the CRTC and those available to government under the *Investment Canada Act*, would be inadequate to achieve the desired objectives – even if amended to address outstanding concerns and/or strengthen compliance measures.

Whatever their merit, Canadian ownership restrictions are founded on a belief that controlling the source of capital is an effective means to ensure corporate behaviour in support of public policy. The government should explain how foreign-owned firms are less likely than Canadian-owned firms to be compliant with Canadian law and regulations that govern telecommunications in Canada.

Recommendation 5: The government should liberalize Canadian ownership rules for broadcasting distribution services in tandem with liberalization for telecommunications carriers. In consequence, the government should either let the CRTC decide how best to deal with distributors' programming services or direct the CRTC in this regard; the government could also require that broadcasting distribution services be separate subsidiaries with a Canadian CEO and Canadians making decisions that affect programming.

Recommendation 6: If liberalization of Canadian ownership rules for broadcasting distribution is considered beyond the scope of this consultation, then the government should proceed with liberalization for telecommunications and let converged network operators determine how best to adapt their corporate structure to the liberalized environment for telecommunications.

Recommendation 7: The government should undertake a comprehensive review of broadcasting law, policy and regulation in the context of the interactive, global Internet. The review should consider whether existing measures are still useful and effective in pursuing policy objectives for Canadian content and, if not, what other measures would be more effective while interfering minimally with open access to the Internet.