

GOVERNMENT OF CANADA  
Foreign Investment Consultation

***Opening Canada's Doors to Foreign  
Investment in Telecommunications***

**SUBMISSION OF**

***MTS***  ***allstream***

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**SUBMISSION OF MTS ALLSTREAM INC.**  
**To**  
**THE GOVERNMENT OF CANADA**  
**Opening Canada's Doors to Foreign Investment**  
**in Telecommunications: Options for Reform Consultation**

**Introduction**

"Open global markets have been responsible for the growing worldwide prosperity of the past generation. If we lose our commitment to open markets, no matter how understandable the short-term political reasons may be, then we will lose that prosperity." – Prime Minister Harper at the G-20 Sherpas meeting in Ottawa on 18 March 2010

"Our goal is to encourage investment, innovation and competition in the telecommunications sector for the benefit of both businesses and consumers" – Minister Clement, News Release, 11 June 2010, *Government of Canada Consults with Canadians on Foreign Investment in the Telecommunications Industry*

1. Canada's restrictions on foreign investment in telecommunications (the "investment restrictions") present a serious barrier to competitive entry and, consequently, an ongoing impediment to competition. The consequences of reduced competition are clear: lagging innovation, productivity and adoption of information technology by Canadian businesses and a lack of choice for Canadian consumers and businesses alike. The continued presence of these restrictions, particularly after repeated study and expert commentary from panels appointed by the Canadian government, respected international organizations and our trading allies and partners, has branded Canada globally as having a closed market in telecommunications – an industry pivotal to our global competitiveness and success.
2. MTS Allstream fully endorses the government's initiative to show the world that we are open for business and that we intend to be a leader in the digital global economy. The Industry Minister's expressed goal in initiating this consultation illustrates the government's understanding of the fundamental link between telecommunications competition and infrastructure investment and innovation, as well as the fact that competition has been impeded by the current restrictions on foreign investment.
3. In establishing the rules for the Advanced Wireless Spectrum (AWS) auction this government demonstrated that it has the courage to take bold action to position Canada favourably in order to compete in the global economy. Canadians have reaped immediate benefits of this initiative. Indeed, the government's approach created the conditions for increased competitive entry and produced benefits for Canadian consumers even prior to actual competitive entry. The three large national players swiftly responded to the prospect of new entry by offering better handsets, packages and pricing to consumers and, in the case of Bell and TELUS, hastened capital investment in and deployment of a state of the art wireless broadband network. The removal of the investment restrictions, particularly for new entrants, will ensure that this competitive momentum continues beyond this first wave.
4. The AWS auction and the post-auction regulatory battles also highlighted just how difficult it is to enter the Canadian market, as well as the negative asymmetrical impact of the current foreign investment restrictions on new entrants. Last year's public review by the Canadian Radio-television and Telecommunications Commission (the "CRTC") of the Globalive investment and ownership structure placed a glaring spotlight on the burden that a heavy reliance on debt financing – a direct outcome of the restrictions – places on entrants. This burden increases the cost of building network infrastructure and acquiring customers relative to the large incumbents. It is also cumulative to the delay in service launch created by regulatory review of entrants'

corporate and capital structures in light of the restrictions, including most particularly the broad test for “control in fact”.

5. The negative impact of the investment restrictions is also evident from the competitor experience in the business market, particularly the small and medium-sized business (“SME”) segment. To-date this crucial market segment has really not reaped the expected benefits of the full opening of the Canadian telecommunications markets to competition that took place over the 1990s. Irrespective of the service – traditional wireline, mobile wireless, or broadband – the degree of competition and hence deployment of innovative, cost-effective services to SMEs has been lacking. Indeed, while initial entry looked promising, the regulatory framework coupled with the investment restrictions conspired to eliminate at least 14 entrants, most of which were positioned to serve precisely this market segment – a market segment that is critical to Canada’s productivity and international competitiveness. This competitive paradigm must change if Canada is to be a leading global economy. Removal of the investment restrictions is a crucial ingredient to changing this competitive paradigm. It is clear that these restrictions serve no one’s interests except perhaps those of large national incumbents, by cushioning them from further competition in traditional wireline, wireless and IP-based services.
6. Key factors to the success of any reform of the foreign investment restrictions will be the option selected and the pace at which change is implemented. Accordingly, each of the three options put forward by the government must be assessed in terms of its respective ability to stimulate competition sufficient to create real change for the benefit of Canadian businesses and consumers.
7. Option 1 will not accomplish the government’s goals. This option – of only altering the percentage of voting shares that can be held by non-Canadians from the existing 46 2/3% to 49% and retaining the control in fact test – will not increase access to much-needed risk capital in a meaningful way, if at all. At best, this option will result in inconsequential change at the margin – a poor pay-back for what will still require significant legislative effort. It is no surprise that this option has not been recommended by any of the bodies that have studied the impact of the investment restrictions over the past 10 years in Canada.
8. By contrast, Option 2, that is, removing all foreign investment restrictions for new entrants and existing carriers with less than a 10% share of the national telecommunications market, has a strong evidentiary basis, including the recommendations of both the Telecommunications Policy Review Panel (the “TPRP”) and the Competition Policy Review Panel (the “CPRP”). Indeed, in the context of strengthening Canada’s position as a global competitor, the CPRP, in its report *Compete to Win*, concluded that foreign investment restrictions for the telecommunications sector should be removed on a staged basis. The initial phase of this staged approach is mirrored by the Consultation Paper’s Option 2, that is, removing all foreign investment restrictions for new entrants and existing carriers with less than \$4 Billion in annual revenues.
9. The CPRP was very clear that the rationale behind its recommendation is the same as the government’s goal – to effect meaningful change in the competitive landscape:

“[T]he number of entrants in the marketplace has a bearing on increasing competitive intensity and achieving better results for consumers. The Canadian telecommunications market is characterized by the presence of a limited number of integrated wire line and wireless carriers. If foreign investment liberalization results only in a shift in control of these existing Canadian firms to foreign owners with no increase in competitive pressure, then no significant change to current competitive circumstances will necessarily ensure. The Panel believes that *measures to liberalize foreign investment should provide an opportunity to promote the growth and development of new entrants rather than merely provide*

*an opportunity for a shifting of corporate control between existing market participants.” (emphasis added)<sup>1</sup>*

10. MTS Allstream, too, advocates adoption of Option 2 as the option that will best meet the government’s goals. As described in the attached report from SECOR, *Perspectives on Scenarios for Foreign Direct Investment in the Canadian Telecommunications Industry* (the “SECOR Report”) this option is the most likely to achieve the government’s stated policy objectives for a vibrant, sustainable market. As well, SECOR evaluates the likeliness of no new investment being attracted as “low” under this Option.
11. Although MTS Allstream believes the Government’s goal can best be met by the staged reform of Option 2, Option 3 – the immediate and complete removal of the foreign investment restrictions for all Canadian carriers, regardless of their size – would also create meaningful change by removing an uncharacteristically protectionist and counter-productive measure from Canadian regulation. SECOR rates this Option as “moderately likely” to achieve the government’s policy objectives.
12. MTS Allstream applauds the Government’s resolve to reform the investment restrictions – a long-overdue policy initiative. A staged removal of the restrictions will best ensure that foreign direct investment (FDI) will be focused on entrants and smaller competitors, where it is most needed and will have the greatest impact on the competitive dynamic in the industry. This will produce the greatest benefits for Canada and our international competitiveness by providing these undertakings with efficient access to capital that can be used to challenge the established players, and their complacency, for the benefit of all Canadians.

#### **About MTS Allstream**

13. MTS Allstream is one of Canada’s leading telecommunications providers, with 6,000 employees across Canada, \$1.9 billion in revenues, and nearly two million customer connections. We serve residential customers in Manitoba and business customers across Canada with a national broadband and fibre optic network that spans almost 30,000 kilometers. As AT&T Canada, we were the first competitor to successfully build a national IP-enabled network, at a cost of approximately \$4 billion – a cost which, because of the high payments required on the foreign debt required to fund our capital build – in the nature of \$400 million annually – together with the disproportionately high cost of wholesale access, resulted in our undergoing the second largest CCAA proceeding in Canadian history at the time. Accordingly, we have both a track record as a successful and proven competitor, and a unique perspective on the importance of removing the investment restrictions to better enable Canada’s economic prosperity.

#### **Issues for Consideration and Organization of Comments**

14. The Consultation Paper indicates that in assessing the three options, the government 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.

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<sup>1</sup> *Compete to Win*, page 48.

15. MTS Allstream shares the government's view that the foregoing considerations must be paramount in determining which option to pursue. Accordingly, these comments first discuss these considerations (albeit re-ordered), following which MTS Allstream assesses the specific options against these considerations. In the course of this discussion, MTS Allstream will also address, where appropriate, the additional questions in which the government expressed interest, namely:
- What conditions are necessary to maximize any potential benefits of reform for consumers?
  - Are there currently barriers to investment that constrain access to capital in the telecommunications industry, affecting innovation and competition?
  - How will changes to foreign investment restrictions in telecommunications affect incumbents and new entrants?
  - Are there potential unintended effects of increased FDI in the Canadian telecommunications sector? What are the potential benefits and risks of having more global players in the market?

### **Competition, innovation and investment in the telecommunications industry**

16. Greater foreign investment in telecommunications has clear benefits. It will lead to a more competitive market within the sector, with a greater variety of innovative providers and services, lower prices and greater efficiency. Canada's past history as a leader in communications should give us confidence in our ability to benefit from new ideas and competencies that non-Canadians can bring to ensure ours is a leading-edge communications infrastructure.
17. Competition, innovation and investment are symbiotically linked. No one can deny that in business markets, inciting greater investment, competition and innovation is of particular urgency. Canadian enterprise and SMEs lag their international competitors in terms of productivity and ICT adoption rates. And there can be no debate that availability of well-priced, innovative and varied telecommunications service – although not the entire answer – is of fundamental importance to the competitiveness of the Canadian economy.
18. Infrastructure investment and the consumer market recently received a boon from the government's approach to the AWS auction and post-auction market structure and operation. The government took the steps necessary to ensure that there would be an opportunity for new entrants in the wireless market by establishing spectrum auction and license rules that have facilitated the launch of several new wireless service providers in the Canadian market. The benefits of this were apparent even prior to any new entrant actually commencing service.
19. Immediately post-auction, the prospect of increased competition spurred the incumbents to take a less complacent approach to consumers by offering better pricing, terms and handsets to consumers. It also sparked significant new investment by the incumbents – for example, Bell and TELUS partnering to invest in and build an HSPA network throughout Canada. Rogers and MTS Allstream have also partnered to a more limited extent, to deploy an HSPA network throughout Manitoba and entering into an MVNO arrangement to enable MTS Allstream to offer wireless services to its business customers nationally. None of this would have occurred at the pace and intensity that it did if the Government had not set the stage through the policy and rules it adopted for the AWS auction. Moreover, in addition to generating \$4B in AWS auction revenues, the spectrum acquired through the new entrant set-aside has resulted in the imminent entry of two major cable companies (Vidéotron and Shaw) and the entry of three unaffiliated new wireless entrants (WIND, Public Mobile and Mobilicity).
20. Most critically, competition drives investment. Telecommunications providers are driven to invest in their networks where they face intense competition. Since the middle of the last

decade, competition has begun to take root in the residential market where there are two networks, each built under monopoly conditions for different purposes, which are now converging. MTS Allstream competes with a vigorous cable competitor in Manitoba – ShawCommunications. The larger established incumbent telephone companies, such as Bell and TELUS, make it clear that they, too, have strong incentives to invest in infrastructure where they compete with cable companies.

21. This specific competitive dynamic, however, is absent from the business market. Unlike the residential market, where their networks are virtually ubiquitous, the evidence is clear that the cable companies are unable to serve at least 90% of the buildings in which business customers are located. Moreover, in this market, the cable companies' service offerings are relatively basic – their broadband offerings, for example, generally consist of Internet access services only – and are therefore of limited use in addressing the needs of business customers. Other potential sources for intermodal competition in the residential market – primarily wireless broadband – clearly are not substitutes for wireline broadband services in the business market due to speed and capacity limitations, as well as the lack of security and other features necessary for “mission critical” business broadband services.
22. Where no ubiquitous second network was constructed under a cable television monopoly, the government and the CRTC have recognized that no one has, or will, replicate the telephone incumbent networks on an end-to-end basis under competitive market conditions. In these business markets, therefore, competition must come from facilities-based competitors like MTS Allstream, which both own and lease facilities. Facilities-based new entrants, including MTS Allstream, have invested billions of dollars to bring competition to the national business market.
23. Just as competition and investment enjoy a symbiotic relationship, so too, do competition and innovation. Entrants and smaller competitors must innovate in order to differentiate their services from those of the larger established incumbents – telephone and cable alike. MTS Allstream has done this repeatedly in the business market, where it holds many “firsts” in rolling out IP-based networks and services. It is equally true, however, that an incumbent has no incentive to innovate in the absence of competition. Competitors innovate to serve customers' demands. Incumbents then are forced to innovate in turn, both to respond to competition and to meet customers' new expectations. This is particularly true of the SME market, where in the absence of competition incumbents have little incentive to innovate or customize their services for the needs of Canadian businesses. Meanwhile, competitors entering the market must cater to these customers to serve their own need to win business from the incumbent.
24. In addition to a robust wholesale framework, under which facilities-based competitors have mandated access to inputs, at cost-based rates, which they can combine with their own facilities in order to provide competitive alternatives to customers, new entrants and smaller competitors must have efficient access to capital.
25. It is axiomatic that the telecommunications industry is highly capital-intensive. In order to fund the investments and innovations that will promote competition, and with it, a vibrant industry, entrants and smaller competitors must have efficient access to capital. And make no mistake – the only type of capital that may be available to fund a venture to compete with the larger established players is risk capital. This risk capital, however, is in short supply in Canada. That is why entrants and smaller competitors, and with them, competition in markets such as the business market, are asymmetrically and adversely affected by the current restrictions. It follows, therefore, that removing the restrictions in their entirety for these industry players must be a key feature of any option chosen by the government.

## **Availability and Choice of Telecommunications Services for Consumers and Businesses**

26. As outlined above, in the consumer markets, the result of intermodal competition between the telephone and cable incumbents has been increased investment in broadband networks to serve this segment of the market. This investment has resulted in decent – though no longer world-leading – broadband penetration, and less competitive pricing and speeds.
27. In the wireless market, actions taken by the government through the AWS auction policy and post-auction industry structure, in response to Canada’s historically low wireless penetration rates, has dramatically increased network investment by both new entrants and established incumbent players, and has significantly increased choice for consumers.
28. In the business market – in particular, the SME segment – there is far greater cause for concern. Currently there is very little choice in telecommunications services for Canadian SMEs, and the situation is worsening. While initial competitive entry looked promising for this sector, the regulatory framework and investment market dynamics conspired to eliminate at least 14 entrants, most of which were positioned to serve precisely this market segment.
29. The decrease in competitive options in Canada, in particular in the critical market for broadband services, has been commented on internationally. In February of this year, the Berkman Center for Internet & Society at Harvard University released its final report entitled, *Next Generation Connectivity: A review of broadband Internet transitions and policy from around the world* (the “Harvard Report”), in which the slide in the fortunes of entrants in the Canadian market is chronicled. It notes:
- “[The] consolidation in the residential market has its parallel in the business market, as incumbent TSPs who had ventured out of their traditional areas seem to be retrenching in their own historical territories, while other entrants have lost market share, largely to cable companies.”<sup>2</sup>
30. Canada’s international standing in the race to achieve ubiquitous, seamless, high-capacity connectivity has suffered significantly as a result of this reduction in competition. The Harvard Report identifies the fact that Canada sank from 2<sup>nd</sup> in broadband penetration per 100 in December 2003, to 10<sup>th</sup> by September 2008. By other criteria, Canada fared even worse:
- “Its numbers on speed and price are worse. In terms of top speeds available, Canada ranked 19<sup>th</sup> in the OECD. In terms of prices, Canada ranks 21<sup>st</sup> for the lowest speeds and 23<sup>rd</sup> for middling speeds. It ranks next to last in prices of high speeds (only the Slovak Republic has higher prices in that tier of service)...On our composite measure, Canada occupies the 19<sup>th</sup> spot. *Early aggressive facilities-based competition certainly made Canada an early starter, but it does not seem to have enabled it to maintain its standing.*”<sup>3</sup> (emphasis added)
31. The Harvard Report concludes: “Canada continues to see itself as a high performer in broadband, as it was early in the decade, but current benchmarks suggest that this is no longer a realistic picture of its comparative performance on several relevant measures.”<sup>4</sup>
32. The lack of competitive alternatives for business customers, and SMEs specifically, is reflected in the CRTC’s own Communications Monitoring Report 2010 (the “2010 Monitoring Report”), which provides a compelling picture of both the decline of alternative providers’ market share in the business market, as well as the disproportionately high market share still held by incumbent telephone providers in services to small and medium-sized businesses:

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<sup>2</sup> Harvard Report, page 250.

<sup>3</sup> Harvard Report, page 168.

<sup>4</sup> Harvard Report, page 257.

- In 2009, incumbent TSPs (excluding out-of-territory) held 70% or more of the total business market wireline revenues in every market segment. This translated to roughly 90% in the small business market and more than 80% of the medium business market, contrasting with about 70% for large businesses and roughly 75% for very large businesses.<sup>5</sup>
  - The contrast between the two SME segments and the residential wireline market was even greater. Incumbent TSPs held a 49% share of total residential wireline revenues, compared to 42% held by cable carriers<sup>6</sup> – a competitive dynamic that was not observed in the business market.
  - Incumbent TSPs' (excluding out-of-territory) share of local and access revenues in the residential market dropped from 90% in 2006 to 74% in 2009, mainly as a result of gains by cable carriers. On the other hand, the incumbent TSPs' (excluding out-of-territory) share of local and access revenues in the business market, stayed constant at about 86% over the same period.
  - The lack of competition in the local and access market over the 2006-2009 timeframe was further demonstrated by the fact that the incumbents' average local and access retail monthly revenue per line increased by nearly 2% per year, from \$47.86 in 2006 to \$50.60 in 2009.<sup>7</sup>
33. International comparisons have also demonstrated that the Canadian business market – in particular, SMEs – have less availability and choice than in other markets.

**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)**

34. To be effective in meeting the Government's goal, the option selected must address the more urgent need of new entrants and smaller competitors for increased access to risk capital. Indeed, the investment restrictions are not tenable, not only because they prevent Canada from reaching its larger goals, but also because of their asymmetric impacts on new entrants and smaller competitors to the largest, established incumbent telephone and cable companies, who are also the Big 3 Wireless carriers. These large incumbents – whose networks were funded in large part by foreign capital prior to the imposition of the restrictions – can leverage their economies of scale and their free cash flow to significantly invest in their existing networks. Conversely, competitor investment – which is crucial to greater competition, lower prices, and greater choice, particularly in the business market – is entirely risk-based. The stakes are higher, the risks are greater, and capital far less available from Canadian sources for these industry players.
35. One need look no further than the recent entry of Globalive into the Canadian market for an abject lesson in the challenges facing competitors with respect to accessing risk capital. Throughout the proceeding before the CRTC to consider its eligibility to operate, Globalive's representatives repeatedly made it clear that they were doing everything in their power to attract more investment or debt from Canadian sources. Canadian doors, which are relatively few to begin with, were shut.
36. At the same time, Canada's largest players are not similarly capital constrained. As a witness representing Canada's largest cable company – Rogers – stated during the hearings of the Standing Committee on Industry, Science and Technology (the "Committee")<sup>8</sup>:

<sup>5</sup> 2010 Monitoring Report, Table 5.1.6, page 118.

<sup>6</sup> Calculated using data from the 2010 Monitoring Report, Tables 5.2.7, 5.2.11 and 5.3.1, pages 129, 132 and 138, respectively.

<sup>7</sup> 2010 Monitoring Report, Table 5.2.7, page 128.

<sup>8</sup> *Study on Canada's Foreign Ownership Rules and Regulations in the Telecommunications Sector.*

“During [Mr. Rogers’] career, I’m sure he could have benefited from foreign ownership liberalization. However, at this point, Rogers is not capital constrained. We really don’t have any difficulty after Mr. Rogers’ successful 40-year journey in raising capital. That’s why we don’t need to have foreign ownership of our floating equity.”

37. The history of competitive entry into the Canadian telecommunications market is littered with the entry, and subsequent exit, of foreign providers and their capital. The restrictions force Canadian companies to rely more heavily on foreign debt, which often is unattractive to both issuers and to investors, due to onerous annual interest charges. This was the experience of Allstream, which, in 2000, while operating as AT&T Canada, had to resort to debt financing to fund an innovative (but costly) rollout of a national IP network, leading later to a historically large restructuring in the face of onerous interest charges. Furthermore, debt is often unattractive to foreign investors who prefer to control their investments. Simply put, it is unreasonable to expect a non-Canadian investor to commit significant risk capital if they have to hand control of their investment over to a third party, or cannot consolidate their investment on their books.
38. The investment restrictions do not hamper the large national incumbents’ ability to attract capital, and to attract it at favourable rates, in the same way they block access to risk capital for entry and expansion of competitive alternatives. In fact, as has been repeatedly recognized, the restrictions represent a competitive *advantage* on which these large providers can rely in order to thwart competitive entry. In Canada, new entrants faced a sort of “double-jeopardy” under which the government’s and the regulator’s policies in favour of “facilities-based competition” require new entrants to make greater investments in facilities while at the same time restricting and making more expensive these entrants’ access to capital through the imposition of restrictions on foreign investment.
39. The stakes are higher, the risks are greater, and capital far less available from Canadian sources for entrants and smaller competitors. This point was made eloquently by the witness from the OECD who testified before the Committee. Mr. Ypsilanti said:

“What about the costs of foreign investment restrictions on the telecommunications sector and I believe these costs are quite high? First, there’s a higher cost of capital and the potential difficulty by new entrants to get access to equity capital. Canada, relatively speaking, has a fairly small capital market and it is important in a capital intensive sector like the telecommunications one for companies, even if they’re Canadian-based companies, to go outside to obtain equity capital.”
40. The playing field has been tilted in favour of the large, established carriers for a very long time – in excess of 100 years in the case of Bell Canada. Virtually all of the largest incumbents’ ubiquitous networks were constructed at a time when there were no restrictions on foreign investment in place whatsoever. Indeed, when the current restrictions were first enacted, GTE’s investment in BC TEL and Québec Téléphone (now TELUS and TELUS Québec) was grandfathered to permit it to continue to benefit from foreign capital in building out its network and even its subsequent entry into the broadcasting distribution market.
41. To maximize the potential for meaningful change in the competitive landscape by ensuring that new entrants and smaller competitors are able to compete effectively with the existing large national incumbents, reform of the investment restrictions should seek to ameliorate the current asymmetric impacts.

**The adoption and use of digital technologies in Canada’s economy and, more generally, the objectives set out in the digital economy strategy**

42. As recognized by the government, a strong, competitive digital economy is key to Canadian prosperity in the 21st Century. Technology, particularly a leading-edge communications

infrastructure, is an enabler of ideas, opportunities and knowledge: it creates a platform for innovation on the part of Canadian companies of all sizes and across all industries, which leads to yet better technology. Better technology, in turn, drives productivity, and productivity creates jobs and raises living standards.

43. There is no debate: SMEs are the main driver of economic growth in Canada. The government has explicitly recognized this:
- SMEs are critical to the Canadian economy: The success of SMEs affects the well-being of the Canadian economy and society as engines of job creation, economic growth and innovation. SMEs account for 45% of GDP, much of the economy's growth, 60% of all jobs in the economy, and 75% of net employment growth. SMEs are an integral part of our country's economic fabric [...]<sup>9</sup>
44. The key to harnessing Canada's digital leadership potential lies with SMEs. Accordingly, a successful digital strategy must reflect the needs of SMEs as users of digital technology, and unleash SMEs' unique incentives to innovate. The challenge, however, is that SMEs are falling behind in terms of ICT adoption and innovation. Our analysis indicates that Canadian businesses lag in email use, website use and e-commerce, and are about four years behind the United States in selling on-line. While SMEs have long been recognized as Canada's economic engine, this segment of the economy is bereft of vibrant telecommunications competition, with regional markets across Canada characteristically dominated by a large incumbent service provider originating from a former state-granted monopoly.
45. The digital delay costs more than money, however: for example, Canada occupies last place in adoption of ICT in health care among the major industrialized countries. Why are Canadian SMEs falling behind? In part, because the telecommunications sector does not provide them with the cutting-edge solutions international competitiveness demands. There is no question that Canada can, and must, do better.
46. The current restrictions on foreign investment serve to limit the ability of competitors to raise the risk capital needed to augment existing investments and to further invest in network expansion. Thus, the regulatory framework cripples competition and stifles investment by both competitors and the incumbent service providers. Without sufficient competition the pressure for the incumbents to make the investment necessary to deliver economically efficient and innovative telecommunications solutions to the SME sector, in particular, is lacking.
47. This is at a significant cost to Canadians, Canadian business and Canada's international standing in the global digital market.
48. *Improving Canada's Digital Advantage*, the government's Consultation Paper on a Digital Economy Strategy for Canada, identifies the scale, scope and consequences of Canada's digital delay, and the opportunities to be realized in getting up to speed with other leading countries. In MTS Allstream's view the restrictions on foreign investment is one of the two major, but moveable, obstacles restraining Canada's digital progress.<sup>10</sup> The investment restrictions shield Canadian incumbents from competitive pressures to innovate, and limit entrants' and smaller competitors' access to capital. As a result, Canadian telecommunications companies are slower to invest in and deploy leading-edge technologies, and competitors or

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<sup>9</sup> Public Works and Government Services Canada, "Importance of SMEs", online: <<http://www.tpsgc-pwgsc.gc.ca/app-acq/pme-sme/importance-eng.html>>.

<sup>10</sup> The other major obstacle is the regulatory framework which needs to take into account the importance of telecommunications competition in the business market. Although competition for consumer markets continues to grow due to intermodal competition between the telephone companies and cable companies, the lack of equitable wholesale access to essential network infrastructure acts as a drag on competition, investment and innovation in the SME market. As a result, Canadian businesses are less able to deliver world class digital solutions to Canadians than their international counterparts.

new entrants, which are poised to deliver such innovative technologies, are restrained by the investment restrictions which limit the scale and scope of necessary capital investment.

49. To put Canada back on the path to digital leadership the Digital Economy Strategy must catalyze innovation, investment, infrastructure and growth, and it can only do so by fuelling the economic engine that drives Canada. Removing the foreign investment restrictions, particularly as they apply to entrants and smaller competitors, is an important step toward this goal.

### **The competitiveness and productivity of the Canadian economy**

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50. The benefits of FDI are widely recognised and undisputed. Permitting increased foreign investment in entrants and smaller players in the telecommunications industry will create the competition that, as noted above, is required to spur further investment and innovation. Foreign investment encourages the growth of efficient Canadian companies that can better compete at home and abroad. It increases productivity, attracts knowledge and best practices from outside our borders, and helps create a culture of innovation. Canada has experienced this firsthand – the biggest telecommunications companies were built in large part with foreign investment before current restrictions, and in the oil and gas industry foreign investment has enhanced Canadian competitiveness.
51. In the 1970s, the Canadian oil and gas industry was highly regulated and subject to the oversight of the Foreign Investment Review Agency ("FIRA"). After FIRA was dissolved, domestic ownership went up. Today, almost 50% of the industry is owned by Canadian-based companies that can freely access global capital.<sup>11</sup> Moreover, Calgary today is Canada's "head office capital", measured on a per capita basis.<sup>12</sup> A wide range of small, medium and large Canadian businesses are active in the sector, many of whom have become global leaders.<sup>13</sup>
52. Our analysis clearly shows that Canadians want the Government to encourage foreign investment, especially in the case of telecommunications, because Canadians recognize that allowing foreign investors more opportunity to invest in, build, and own telecommunications companies that operate in Canada, will result in more jobs, more consumer choice, and new ways to promote Canadian culture. The strong public opinion about Globalive's challenging path to market is a recent, obvious example. Although the auction process itself, as described above, resulted in near immediate investment and innovation by incumbent wireless providers, foreign ownership restrictions nearly frustrated Globalive's ability to launch WIND Mobile and yet further spur incumbents to innovate to retain customers.
53. In MTS Allstream's submission to the Committee, we noted that over the last decade, removing restrictions on foreign investment in the telecommunications sector has been repeatedly recommended in order to increase Canadian productivity, innovation and prosperity. Moreover, four separate reports<sup>14</sup> commissioned by Canadian federal governments in the last decade have recommended reviewing and/or removing the restrictions. Each of these reports reached the same conclusion: FDI is crucial to Canada's economic success. As the TPRP wrote in its final report, "the economic case for liberalization of FDI is so well established in Canada and

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<sup>11</sup> Source: Canadian Association of Petroleum Producers.

<sup>12</sup> Between 2002-2006, it experienced a 60.3% growth in major head offices. Head office employment increased by 24.8% during the same time period. 109 Calgary-based companies are on the FP500 database, 9 of which are among the top 50 in Canada. Source: Calgary Economic Development, <http://www.calgaryeconomicdevelopment.com/>.

<sup>13</sup> Indeed, the sheer number of companies from Canada and abroad which have chosen to locate in Canada's "oil patch" has made it a hotbed of development in technologies used by the oil and gas sector. That research and development (R&D) has paid off, giving Canadian companies exportable advantages in the global marketplace.

<sup>14</sup> See: (i) Report of the National Broadband Task Force, *The New National Dream: Networking the Nation for Broadband Access*, Industry Canada, (June 2001); (ii) Report of the Standing Committee on Industry, Science and Technology, *Opening Canadian Communications to the World*, (April 2003), page 55; (iii) Telecommunications Policy Review Panel, (2006); (iv) *Compete to Win: Final Report of the Competition Policy Review Panel*, pages 46-49, (June 2008).

other OECD countries that the main area of economic debate is not whether it boosts domestic competitiveness and productivity but by how much."<sup>15</sup>

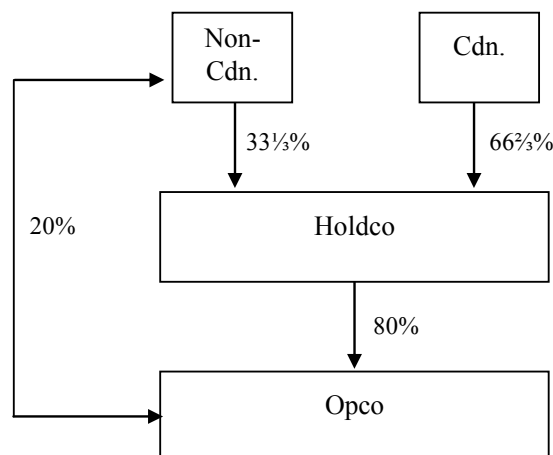
**Option 1: Increasing the Direct Limit for Voting Shares to 49 percent Will Not Bring About Change**

- 54. Under this option, the requirement imposed by paragraph 16(3)(b) of the *Telecommunications Act* that not less than 80 percent of voting shares of a telecommunications common carrier be held by Canadians would be reduced to 51 percent. In addition, paragraph (b) of the definition of “qualified corporation” set out in the *Direction to the CRTC (Ineligibility of Non-Canadians)* would be amended to reduce the minimum percentage of voting shares and votes that must be owned and controlled by Canadians to 51 percent from 80 percent. All other current provisions, including those related to control in fact, would remain unchanged.
- 55. It is important to understand that this option would accomplish nothing. The choice of this option would frustrate the government’s stated goals in the March 2010 Speech from the Throne and Budget 2010, of “strengthening market competition and attracting new capital and innovative ideas”.<sup>16</sup>
- 56. Currently, non-Canadians are permitted to own 46 2/3 % of the voting shares in an undertaking, rather than the 49% now being proposed.<sup>17</sup> In all cases where non-Canadians have sought to make economic investments in excess of the threshold for voting shares, they have simply made the additional investment in the form of non-voting shares: Persona, CanWest, Globalive – the examples are too numerous to mention. Indeed, notwithstanding that it rejected Globalive’s eligibility, the CRTC explicitly acknowledged that it has permitted non-Canadians to take an economic interest (made up of both voting and non-voting shares) of 65%. This underscores the degree of subjectivity employed in the control in fact test as well as the difficulties for investors as they are not given an adequate means of exercising control over their investment.
- 57. The requirement that Canadians have both legal control and control in fact would be maintained pursuant to this option. Simply put, it is unreasonable to expect a non-Canadian to commit significant risk capital if they have to hand control of their investment over to a third party, or cannot consolidate their investment on their books. Both of these limitations relate directly to the control in fact test.

<sup>15</sup> TPRP Final Report, March 2006, page 11-16.

<sup>16</sup> Consultation Paper, page 11.

<sup>17</sup> This can be effected by the non-Canadian taking a 20% voting interest in the undertaking directly, and a 33 1/3% voting interest in a parent company that holds the remaining 80% voting interest. The resulting structure looks like this:



58. Again, Globalive is a case in point. Although Orascom, the Egyptian investor, put up the significant risk capital necessary to get a national new entrant off the ground, both Bell and the CRTC – the same parties who are now advocating maintaining the control in fact test – used this precise test to argue that Globalive did not meet the requirements of the Restrictions.<sup>18</sup>
59. Control is key to sourcing equity and debt alike. As Rogers' witness before the Committee observed, "Canada does need some work on start-ups, and start-ups are funded by venture capital and venture capitalists want to have a path to control of that company they are funding." On the debt side, the normal result of debt instruments is that a creditor acquires control if the borrower doesn't pay it back. The investment restrictions prevent this remedy from being available to non-Canadian creditors.
60. The SECOR Report concludes "Option 1 is unlikely to achieve the government's stated policy objectives for a vibrant, sustainable market".<sup>19</sup> It finds that of various scenarios flowing from this option, "no investment" is the most likely one, and has no impact compared to the base case studied. It concludes that for consumers and business, choice of providers would remain the same, new competitors are unlikely to be created and this option would be unlikely to attract foreign investment in Canada without a path to control.
61. This option should therefore be seen for what it is – a proposal to maintain the status quo.

**Option 2: The Telecommunications Policy Review Panel/Competition Policy Review Panel Approach Will Best Meet the Government's Goals**

62. Option 2 – a staged removal of the restrictions – best meets the government's goals, of strengthening market competition and attracting new capital and innovative ideas from abroad. Moreover, Option 2 will best ensure that Canadian consumers and businesses can benefit from the reform of foreign investment in the telecommunications sector.
63. Option 2 has been recommended by no less than two independent panels of "wise persons" appointed by the government and its predecessor, and for good reason. It permits the immediate infusion of much-needed capital where it is needed most, while permitting the government further study respecting the implications of removing the restrictions on the entire industry, including the largest, most established incumbents – Bell, TELUS and Rogers.
64. The CPRP was very clear regarding the rationale behind its recommendation of this option:  
*"[T]he number of entrants in the marketplace has a bearing on increasing competitive intensity and achieving better results for consumers. The Canadian telecommunications market is characterized by the presence of a limited number of integrated wire line and wireless carriers. If foreign investment liberalization results only in a shift in control of these existing Canadian firms to foreign owners with no increase in competitive pressure, then no significant change to current competitive circumstances will necessarily ensure. The Panel believes that measures to liberalize foreign investment should provide an opportunity to promote the growth and development of new entrants rather than merely provide an opportunity for a shifting of corporate control between existing market participants."* (emphasis added)<sup>20</sup>
65. The SECOR Report reinforces the CPRP's rationale and the selection of Option 2. It concludes that Option 2 is "more likely" to meet the government's stated policy objectives for a vibrant, sustainable market. It observes:

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<sup>18</sup> In the typical CRTC decision barely one paragraph is devoted to the applicant being able to meet the voting share threshold while pages and pages of analysis are devoted to the control in fact test. Although the test itself is well established in the jurisprudence, its application remains complex and highly subjective.

<sup>19</sup> SECOR Report, page 31.

<sup>20</sup> *Compete to Win*, page 48.

“For both consumers and business, the choice of providers would likely increase with stronger, more competitive small telecom players. Broadband penetration would be expected to increase as competitors expand into new markets. As seen in both the U.S. and Japan, new and vibrant competition spurs new product introduction, increased service availability and price competition. For consumers, foreign investment in the new wireless players would likely improve services and price competitiveness. For businesses, foreign investment in new or existing wireline competitors would likely increase infrastructure, choice of service providers and access to business services.”<sup>21</sup>

66. This option can be easily accomplished, by relieving new entrants and telecommunications common carriers with telecommunications revenues of less than 10 percent of total telecommunications market revenues from the current provisions of section 16 of the *Telecommunications Act*. For this purpose, data from the CRTC’s annual *Communications Monitoring Report* can be used both to establish the total market revenues as well as the revenues of any telecommunications carrier and its affiliates. The 2010 Monitoring Report measures total telecommunications revenues in 2009 to be \$41 billion. A 10-percent threshold in 2009 would therefore have been \$4.1 billion. This 10 percent threshold would align with the Canadian wireless industry, where the Big 3 – Bell, TELUS and Rogers – would be the only providers exceeding that threshold.<sup>22</sup>
67. Finally, MTS Allstream agrees with the Consultation Paper’s suggestion that foreign investors who are successful in growing their market shares in excess of 10 percent of total telecommunications market revenues would continue to be relieved from compliance with the provisions of section 16 of the *Telecommunications Act*. Leaving aside the extreme unlikelihood that any new entrant would achieve a 10 percent share of the total telecommunications market revenues within the 5-year phase-in period being contemplated, it would be impractical and counter-productive to seek to put the “genie back in the bottle” or to otherwise apply restrictions mid-course to successful new entrants.

### **Option 3: Remove telecommunications restrictions completely**

68. Under this option, the foreign investment restrictions would be removed for all telecommunications common carriers.
69. Although MTS Allstream believes the Government’s goal can best be met by the staged reform contemplated in Option 2, the immediate and complete removal of the foreign investment restrictions for all Canadian carriers, regardless of their size, would be preferable to the status quo, as represented by Option 1. Option 3 would remove an uncharacteristically protectionist and counter-productive measure from Canadian regulation.
70. As described in the attached report from SECOR, this option is “moderately likely” to achieve the government’s stated objectives for a vibrant, sustainable market.
71. The Consultation Paper states that this option would remove the restrictions for all telecommunications common carriers “[I]n recognition of the benefits of regulatory symmetry between small and large telecommunications carriers.” As described above, however, the playing field has been tilted in favour of the large, established carriers for a very long time – in excess of 100 years in the case of Bell Canada. Virtually all of the largest incumbents’

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<sup>21</sup> SECOR Report, page 40.

<sup>22</sup> Given that the CPRP recommended that “Greenfield” or new entrants also be relieved of the restrictions, there would need to be a cut-off for establishing which entities would be considered to be “new entrants”. MTS Allstream recommends that this cut-off should be aligned with the same time period used to measure revenues for the 10 percent threshold. In other words, if the 10 percent threshold were established by reference to 2009 revenues, then a telecommunications carrier that did not carry on business prior to the commencement of that period should be automatically relieved of the restrictions.

ubiquitous networks were constructed at a time when there were no restrictions on foreign investment in place whatsoever. Indeed, when the current restrictions were first enacted, GTE's investment in BC TEL and Québec Téléphone (now TELUS and TELUS Québec) was grandfathered to permit it to continue to benefit from foreign capital in building out its network and even its subsequent entry into the broadcasting distribution market. Accordingly, while MTS Allstream supports the ultimate removal of the restrictions for all carriers regardless of size, this particular consideration, in MTS Allstream's view, should not be determinative.

## **Conclusion**

72. MTS Allstream fully endorses the government's stated goal to encourage investment, innovation and competition in the Canadian telecommunications industry for the benefit of both businesses and consumers by opening the market to more foreign investment. Option 1, which does not represent any meaningful change from the status quo, will not achieve this goal. Both Options 2 and 3 present the possibility of meeting the government's goal. While such an outcome is more likely with the approach of staged reform represented by Option 2, an option that has been recommended by several of the bodies that have studied the impact of the investment restrictions in Canada over the past 10 years, most recently by the CPRP in its report *Compete to Win*.
73. Under Option 2, foreign investment opportunities will be focused initially on entrants and smaller competitors, thus broadening the scope of the competitive market. This is also a potential outcome under Option 3, although there is potential that foreign capital will be used to only invest in the larger incumbents. Rather than broadening the scope of competition, and along with it investment in infrastructure and service innovation, the latter outcome could lead to reconsolidation of the industry over time.
74. While the government has made it clear in the Consultation Paper that it is only giving consideration to opening up the telecommunications market to additional FDI, this does not preclude foreign investment in companies that currently have both telecommunications and broadcasting distribution assets. Just as BCE Inc. was able to reorganize the assets held by Bell Canada in 1999, in order to make it more appealing for the strategic partnership that saw Ameritech Corporation acquire a 20% stake in Bell Canada, others could implement something similar to deal with the broadcasting portions of their business.
75. It is clear that all players in the industry will be able to respond in a way that will allow them to take advantage of the increased opportunity to procure cost effective capital offered by Option 3. In the case of Option 2, as recommended in the CPRP report, it would be the first step and not the last word in opening up Canada to global investment. This is a staged approach, one that will provide a catalyst to further change in the market structure and dynamic and with it further changes to the investment restrictions. Introducing no change or meaningless change (Option 1) will result in further erosion of Canada's global position in the digital economy, a diminishing level of competition and would close the doors to global investment in Canadian ICT. Instead of driving Canadian competitiveness and productivity growth the outcome will be the reverse – continuing decline in Canada's standing within the international ICT sector and with it a decline in the Canada's economic growth and prosperity.

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