Response To:

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

Industry Canada Consultation Paper

June 2010

Section 1. EXECUTIVE SUMMARY

Mobilicity is pleased to be given an opportunity to respond to the recently published Industry Canada Consultation Paper on foreign investment in Telecommunications. We have reviewed the various foreign investment options suggested in the publication, and would like to specifically support Option 2 – The Telecommunications Policy Review Plan / Competition Policy Review Panel approach – specifically allowing smaller telecom players to be exempt from current restrictions related to foreign investment in telecommunications.

In summary, we believe Option 2 will help facilitate fair competition among telecom companies and deliver the most consumer benefits of all the options under consideration. As will be discussed, telecommunications companies, in particular wireless operators, are capital intensive due to the large network and employee base required to offer service. Moreover, for new entrants and smaller operators, there is significant risk in their business plans because much of the capital outlay is required in advance of attracting subscribers, their large fixed cost base means that it is often many years before they can generate positive cash flow, and in the interim the incumbent competition can take predatory actions to impact smaller companies' viability. The result, therefore, is that while all telecommunications carriers need regular access to capital, new entrants in particular need access to "risk capital", which is funding for earlier stage companies, many of which are not developed enough to be traded publicly. In Canada, there is ample domestic capital available for mature, relatively safe businesses such as telecommunication incumbents, but the amount of risk capital available is small relative to the requirements of new entrants and smaller operators. Thus, the foreign ownership restrictions currently in place have had the practical impact of materially limiting access to capital for new entrants while leaving incumbents, who already have unfettered access to low-cost debt and equity capital today, unaffected. Option 2 would enable new entrants and smaller operators to access vital sources of risk capital outside of Canada, thereby correcting this disproportion that unjustly penalizes new entrants. This would facilitate competition which in turn would benefit consumers with more choices, lower prices, better services and more innovation.

Section 3 will show how Option 2 will have the greatest positive global impact for Canada. Through access to larger pools of capital, new entrants will have more resources to assure a better telecommunication industry as compared with other developed countries. In addition, Options 1 and 2 will have the least negative impact on Canadian employment among the three Options.

Section 2. **CONSUMER BENEFITS**

The addition of new entrants into the wireless industry already has proven to be of great benefit to Canadian consumers, who now have more choices and more competitive pricing. Relaxing restrictions on foreign investments will help ensure that these and additional benefits continue for the long-run by fostering competition between carriers and enabling new entrant participation in future spectrum auctions. Competition stimulates companies to provide higher quality services and encourages new innovation. In addition, competition promotes further investments by carriers into the industry as they compete for market share and open new markets.

Through the AWS spectrum auction, the government has effectively initiated competition and given the new entrants some ability to compete with the incumbents. Some of the consumer benefits from the AWS spectrum auction are already evidenced at the time of writing, merely half a year from the official launch of the first new entrant (WIND Mobile), and roughly two months from the official launch of the second and third new entrant (Mobilicity and Public Mobile). However, not all of the competition-assisting elements of the AWS spectrum auction have materialized as planned, particularly with respect to tower sharing, which has been difficult at best to implement, and roaming, for which the only available incumbent partner was able to set demanding terms for all new entrants. Further, Rogers has already announced the introduction of a new no contract, unlimited brand (Chat-r) and Bell has announced that it will modify its Solo brand to join the 'discount war'[1]. Analysts expect Telus to react as well[2]. The launch of these offerings will undoubtedly increase the challenges of new entrants, especially considering that incumbents may be cross subsidizing such "fighting brands". Although the additional incumbent brands may produce short term consumer benefits, we would suggest that long term consumer benefits can only be secured in an environment where new entrants are financially sound enough to maintain their operations in a competitive fashion. As was witnessed when Fido was acquired by Rogers and Clearnet was acquired by Telus, the elimination of carriers can lead to higher pricing and less choice for consumers. It is for these reasons that sustaining competition is equally important as introducing competition. To ensure the new entrants can survive, they need access to broader pools of capital in order to fund their continued network build-out, the hiring of hundreds of local employees, and support of operations.

Option 1 – Consumer Benefits

Generally speaking, Option 1 is a relatively modest change to the current environment that we believe would have little to no impact on access to capital and thus the competitive dynamics in the industry. As such, reducing the minimum required voting shares to be held by a Canadian to 51% in a direct-ownership scenario would not create significant benefits for Canadian consumers, or at the very least not nearly as significant as Option 2. The primary reasons for this statement are twofold: a) the changes are modest and thus wouldn't induce a large scale increase in interest from foreign investors (considering on an indirect basis, most foreign investors are able to control up to 33% of voting shares already at present), and b) the requirements of *Telecommuncations Act* and how they have been interpreted by the regulator to

[1] Financial Post, Jamie Sturgeon, July 14, 2010, http://www.nationalpost.com/news/Chatter+grows+that+Bell+will+join+discount/3278575/story.html

[2] Ibid.

go beyond mere voting shares and go to a variety of other indicia of control that stymie foreign investment.

Option 2 – Consumer Benefits

As is readily apparent due to the characteristics of the telecommunications industry, many hundreds of millions of dollars are required to operate as a common carrier, and the capital requirements last for many years. Given a lack of profits and track record, it is inevitable that capital for new entrants will come at a higher cost and is harder to find than capital for a mature, publicly-traded company like the incumbents. By lifting foreign investment restrictions for new entrants, new entrants would have more options and a greater variety of capital pools from which to seek out funding. Not only will it facilitate the basic need of raising additional risk capital but it also should lower the cost by increasing the potential investor base.. As stated by the Standing Committee on Industry, Science and Technology in their June 2010 report, foreign ownership restrictions disproportionally penalize new entrants and smaller players through their effect on the cost of capital.[3] Option 2 will help cure such inequality.

As has been evidenced by consumers in the period of time since the new entrants have launched, clearly new competition, and only new competition, can generate real savings and real value for Canadians on a continuous basis. This is evidenced most clearly by the incumbents latest strategy of introducing new “fighting brands”, or repricing existing ones, to the benefit of consumers.. Because such consumer-friendly reactions will be maintained only by the consistent presence of new carriers, and because additional risk capital is a requirement for new carriers’ long-term survival and competitiveness, Option 2 is required to maximize consumer benefit.

Option 3 – Consumer Benefits

With respect to new entrants and smaller operators, Option 3 would benefit consumers in much the same fashion as Option 2 in that the carriers will have access to the vital pools of

[3] Ibid

foreign risk capital that currently are not available in adequate scope. As discussed previously, the benefits of facilitating the survival and expansion of the new entrants is clearly in the best interests of consumers and thus we would submit that Option 3 is preferred relative to Option 1. Option 3, however, also opens the possibility that the incumbents would be consolidated into foreign firms with no corresponding potential benefit to the country or consumers. In sharp contrast to the new entrants, the incumbents currently have unencumbered access to low cost debt and equity in addition to their own free cash flow. Note specifically the chart below which indicates that the "big 3" incumbents, Bell, Rogers and Telus have collectively raised more than $23.5 billion of various forms debt capital in the last 28 months, all at an average cost of less than 6%.[4]

Issuer	Type	Announce Date	Amount ($mm)	Coupon	Maturity
Telus Corp					
Telus Corp	Medium Term Notes	20-Jul-10	$1,000	5.05%	23-Jul-20
Telus Corp	Medium Term Notes	01-Dec-09	$1,000	5.05%	04-Dec-19
Telus Corp	Medium Term Notes	14-May-09	$700	4.95%	15-May-14
Telus Corp	Medium Term Notes	04-Apr-08	$500	5.95%	15-Apr-15
Total MTNs			**$3,200**	**5.17%**	
Telus Corp	Commercial Paper	2010	$875	N/A	Within One Year
Telus Corp	Commercial Paper	2009	$5,387	N/A	Within One Year
Telus Corp	Commercial Paper	2008	$7,831	N/A	Within One Year
Total Commercial Paper Volume			**$14,093**		
Note: Telus has a $1.2 billion commercial paper program					
BCE					
Bell Canada	Debentures	23-Jun-09	$1,000	4.85%	30-Jun-14
Bell Aliant	Medium Term Notes	12-May-09	$350	6.29%	17-Feb-15
Bell Canada	New Unsecured Credit Facility	May-09	$1,200	Floating	May-12
Total			**$2,550**		
Rogers Communications					
Rogers Communications	Senior Notes	28-Oct-09	$500	6.68%	04-Nov-39
Rogers Communications	Senior Notes	28-Oct-09	$500	5.38%	04-Nov-19
Rogers Communications	Senior Notes	21-May-09	$1,000	5.80%	26-May-16
Rogers Communications	Senior Notes	06-Aug-08	US$1,400	6.80%	15-Aug-18
Rogers Communications	Senior Notes	06-Aug-08	US$350	7.50%	15-Aug-38
Total Senior Notes			**$3,750**	**6.39%**	

[4] Source: Company filings

Further note that in 2009, the three companies collectively generated more than $11.3 billion in cash earnings[5] that they could reinvest as they wished. In addition, they are all publicly-traded companies with a strong, international shareholder base as many of their largest shareholders are already non-Canadians; therefore additional equity financing is readily accessible as well. As such, the incumbents' access to foreign capital is already so straightforward that creating further ease will have no impact on their operational decisions or flexibility except in the scenario where a foreign firm takes over an incumbent, in which case it is possible Canadian jobs could be eliminated.

Section 3. GLOBAL BENEFITS

The following are affected to varying degrees through implementation of either of the options proposed by the Department:

(i) The competitiveness of the Canadian economy; and

(ii) Canadian employment.

Competitiveness of the Canadian economy

The profit levels of the incumbents are still the highest in the developed world, according to a report from the Bank of America Merrill Lynch. The incumbents control approximately 95% of the wireless telecommunications market, had earnings of 46.7% in the first quarter, topping the margin of 21 developed countries tracked by the bank. Canadian carriers enjoyed approximately 42.2% average margin, compared to the UK average of 22.6% and the developed world's average of 38.3%. Canadian carriers also led all 50 nations with the highest average revenue per user per month with $54.73, compared to the developed world's average of $42.90 and United

[5] Company filings; cash earnings defined as net income before dividends, plus depreciation, amortization and non-cash items.

States' $49.54. With approximately 69%, Canada was ranked among last in penetration among developed countries.[6]

The above numbers, while good news for incumbent shareholders, are clearly bad news for Canadian consumers. Improvements in the above market penetration, market share, and average revenue per user figures will not only help Canada improve its competitiveness in the telecommunication industry, but also Canada's overall economic competitiveness among other developed countries.

Competition offered by the new entrants increases consumer choices and makes it more affordable for more Canadians to enjoy wireless telecommunication services, thereby helping penetration. As provided in Section 2, Option 2 best helps promote and maintain competition. It follows therefore that Option 2 also best improve competitiveness of the Canadian economy.

Canadian Employment

It is not clear as to what effect, if any, would the Options have on Canadian employment. One can argue that once a carrier becomes fully owned and controlled by a foreigner, certain departments (for example research and development) may be moved abroad. On the other hand, the nature of the telecommunication industry dictates that certain departments can never be transferred abroad (for example marketing, sales and other areas that require local knowledge). Given these presumptions, Option 2 will likely have the most positive impact on Canadian employment, as an expansion of capital will likely lead to greater network builds and more intensive sales and marketing initiative, all things that would require local employment. Option 3 has the greatest chance for negative effects on Canadian employment, as a purchaser of an incumbent would seek to reduce costs and may move certain management elsewhere, given the maturity of their businesses. While there is considerable overlap between the positive implications of both options 2 and 3, they are differentiated in that option 3 has a greater

[6] CBC News, Peter Nowak, July 19, 2010, Canadian wireless firms still tops in profit: report, http://www.cbc.ca/technology/story/2010/07/19/canada-wireless-profit.html

likelihood of negative consequences, and thus we would suggest that option 2 is a more appealing alternative.

In summary, Mobilicity once again thanks the Department for the opportunity to comment on this important policy discussion. For the reasons provided in this paper, Mobilicity wishes Industry Canada to consider the selection of Option 2.