



Position on the issues raised in the Consultation Paper titled “Opening Canada’s Doors to Foreign Investment in Telecommunications: Options for Reform”

[July 30th, 2010]

INTRODUCTION

In June 2010, the Federal Minister of Industry released a Consultation Paper titled “Opening Canada’s Doors to Foreign Investment in Telecommunications: Options for Reform”.

The paper describes past proposals and recommendations for change. Further, the paper articulates three specific options for consultation for moving forward on the commitment made by the Federal Government in the March 2010 Speech from the Throne. Interested parties were asked to submit comments on the paper and the three options by no later than July 30, 2010.

The options articulated in the paper can be summarized as follows:

- **Option 1:** Increase direct limit for broadcasting and telecommunications to 49 percent

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 to 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. The *Broadcasting Act* would not have to be amended to implement this option.

This option is based on the proposal of the Chairman of the Canadian Radio-television and Telecommunications Commission (“CRTC”) during his testimony before the Standing Committee on Industry, Science and Technology (the “Committee”) in April 2010.

- **Option 2:** The Telecommunications Policy Review Panel / Competition Policy Review Panel approach

Under this option, investments by foreign entities in start-up telecommunications companies, as well as in existing small industry players, would be exempted from the existing restrictions on foreign investment in telecommunications.

Specifically, the *Telecommunications Act* would be amended so that telecommunications common carriers with telecommunications revenues of less than 10 percent of total telecommunications market revenues would be relieved from the current provisions of section 16 of the *Telecommunications Act*. In order to encourage long-term investments in Canada's telecommunications industry, 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*.

This option defines the 10-percent criterion to be less than 10 percent of total telecommunication market revenues.

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

In recognition of regulatory symmetry between small and large telecommunications common carriers, this option would remove the telecommunications foreign investment restrictions applicable to telecommunications common carriers. Specifically, section 16 of the *Telecommunications Act* would be repealed. This option is based, in part, on the 2003 House of Commons Standing Committee on Industry, Science and Technology review, which recommended full removal of the restrictions to foreign investment in telecommunications.

Public Mobile has taken a consistent and pragmatic approach to the matter of foreign ownership and control of telecommunications carriers in Canada. In the past, Public Mobile's views have been articulated and presented to the Minister, to Members of Parliament (including those who sit on the Standing Committee of Industry, Science and Technology), to the CRTC, and to members of Canada's Public Service. Public Mobile's position generally can be summarized as follows:

- Public Mobile supports the elimination of any restrictions on foreign ownership for telecommunications carriers in Canada.
- The restrictions on foreign investment in telecommunications – embodied in Sec. 16 of the *Telecommunications Act* and the Canadian ownership and control regulations – limit access to foreign capital, particularly for smaller players and new entrants that are bringing additional competition and innovation to the industry and do not advance any currently-desirable public policy purposes.
- Increased access to foreign investment strengthens new entrants and better ensures the sustainability of new competition in markets like wireless services.
- New entrants bring benefits to Canadian consumers through increased innovation and better prices. Competition and innovation make the telecommunications industry stronger by growing the range of services delivered to Canadians, resulting in more jobs and opportunity in the industry. The growth and strength of the telecommunications industry – as a key facilitator of other industries – increases productivity for the Canadian economy as a whole. This “spillover” effect produces better, higher paying jobs across the entire economy.

- While Canada has operated for more than 20 years with the current foreign ownership regime, the situation at this time is particularly acute. First, the government's policy to encourage the development and growth of wireless new entrants is being hampered by the restrictions on investment capital imposed. Second, making an exception for a single new entrant (viz., Globalive Wireless) has created an unlevel playing field; perpetuating the current level of uncertainty will only serve to discourage new investment in Canada's wireless industry.

BACKGROUND

- The current policy governing foreign ownership of telecommunications carriers in Canada dates back to *A Policy Framework for Telecommunications in Canada* issued by the Minister of Communications in 1987, which as then enshrined in legislation in the Telecommunications Act in 1993¹. At that time, almost all aspects of the industry were based on regulated monopolies divided into specific silos based on the specific services being offered to consumers. The wireless industry was in the earliest stages of adoption and growth, and there was essentially no Internet or broadband business.
- It isn't clear that these restrictions on foreign investment were ever necessary, but they seem even less applicable today.
- The past 23 years have seen massive change. Competition has been introduced to almost all aspects of the industry and there has been a steady deregulation of businesses. Cross-pillar competition has grown between the incumbent telephone and cable companies. Growth in wireless, broadband and the Internet have enabled both new services and new competitors. All of this has been wrapped in the revolution in information technology that both enables these changes and makes the health and vitality of the telecommunications business critical to the growth of productivity and innovation in the Canadian economy.
- In 2010, the greater challenge facing the telecommunications industry, and Canada as a whole, is creating an environment where competition and innovation can thrive. Removing barriers to new entrants in all aspects of the industry is a key component of making the industry more competitive. More competition benefits consumers by providing more choices and better prices. More competition benefits the industry by forcing greater innovation and improved productivity. More competition benefits Canada because the benefits of a leading-edge telecommunications industry flow through to other aspects of the economy – enabling innovation and productivity growth in all the other industries for which telecommunications is a key input. All of this ultimately leads to better, higher paying jobs for Canadians.
- While the telecommunications industry in Canada has evolved a long way from 1987, these developments have not produced the level of competition desired to maximize the potential benefits for consumer and for innovation in the Canadian economy.

¹ This policy was enshrined in legislation through Section 16 of the *Telecommunications Act* in 1993. Identical provisions were applied to the holders of wireless spectrum licences through the *Radiocommunications Act* in 1996. Almost identical provisions are applied to Broadcast Distribution Undertakings through the *Broadcasting Act*.

- It is in this new environment that the Government of Canada adopted a policy in 2007 designed to encourage the introduction of wireless new entrants. Towards this end, the government adopted three key policies:
 1. Spectrum set-aside – ensured that there was a subset of the spectrum licences made available purely for new entrants.
 2. Mandatory roaming – provides a mechanism for new entrants to manage one of the key hurdles to competing in the wireless market.
 3. Mandatory tower sharing – both simplifies the infrastructure challenges for new entrants and increases the efficiency of the infrastructure for the industry as a whole.
- The most significant remaining hurdle for new entrants is access to risk capital – the funding necessary to both build out new networks and to fund losses during the initial start-up and growth phases of these businesses. This hurdle is exacerbated greatly by the restrictions on foreign ownership and participation.

WHY DOES THIS MATTER?

- Increased competition generates multiple benefits for Canadians and the Canadian economy. Competition from new entrants leads to lower prices and new alternatives for consumers. Competition encourages innovation as companies seek to introduce new technologies and develop new business models to do so. Competition also drives investment as companies build new infrastructure to bring new technologies and services to market.
- All of this benefits the Canadian economy by increasing investment and jobs that enable Canadians to get better, more diverse services at better prices.
- In the case of telecommunications, there is an additional benefit from the role this technology plays in the overall economy. As with other areas of information and communication technologies (ICT), growth and investment in telecommunications creates a “multiplier” effect, enabling businesses to improve productivity, develop new services and to interact with consumers in new ways.
- The government's policy objective of encouraging new entrants and additional competition in the Canadian wireless industry is the correct one.

REMOVING BARRIERS TO CAPITAL INVESTMENT

- While Public Mobile supports the liberalization of foreign ownership restrictions for all telecommunications companies, the impacts of the restrictions, in particular the barriers to capital investment, are felt most acutely by new entrants who need substantial capital to launch and grow their businesses to the point of sustainability.
- All new entrants require significant investment to acquire spectrum, build their network, develop operating infrastructure and fund operations until profitable. Public Mobile will spend hundreds of millions of dollars to launch service to provide Canadians with a superior choice of wireless services.

- In contrast, the incumbent telephone and cable companies do not have a similar need to access capital. Despite making significant investments in infrastructure in recent years, they are all returning excess capital to their shareholders through dividend payments and share buyback programs. Appearing before the House of Commons Standing Committee on Industry, Science and Technology, they all indicated they are not currently limited in either their access to capital or their ability to take on additional foreign ownership.
- There is a risk capital shortage in Canada with disproportionately low levels of venture investing accessible to new entrants. Historically, Canada's large, institutional investors have limited their investments in early stage ventures. This has made it very difficult for Canadian new entrants to partner with financial backers of sufficient heft to be able to compete successfully, over a sustained period with the well-capitalized incumbents.
- Public Mobile has first-hand knowledge of the challenges involved in raising substantial equity from Canada's large institutional investors. Our largest shareholder, OMERS Private Equity, stands out as the only large Canadian institutional investor to support a wireless new entrant.
- In 2003, the Committee studied this issue – in response to several independent studies recommending a change in policy and in response to a request from the Minister of Industry – and concluded:

In summary, foreign ownership restrictions compromise, among other important economic contributions, the diffusion of new communications technologies and Canadians' access to modern telecommunications services. For all these reasons, the Committee recommends the complete removal of Canada's foreign ownership restrictions applicable to telecommunications common carriers.

- In 2006, the Telecom Policy Review Panel Report demonstrated how Canadian firms are impacted to the detriment of their capital structure:

“The Panel has also considered evidence that Canada's foreign investment rules impact negatively on the financing structures of Canadian telecommunications common carriers. In limiting a company's ability to raise equity outside of Canada, the foreign investment rules provide an incentive for greater reliance on debt than equity capital and for raising a larger share of equity capital in Canada than firms otherwise might do.”

- The Competition Policy Review Panel reached the same conclusion two years later and repeated the Telecom Policy Review Panel's recommendation of removing the foreign ownership restrictions through a two step process.

THE PROBLEM WITH THE STATUS QUO

- Until 2009, while the Canadian ownership and control requirements acted as a barrier to foreign direct investment in Canadian telecommunications companies, there was at least a clear, stable and recognized set of rules. With more than two decades of experience, there was considerable precedent to guide investors seeking to invest in the Canadian industry.

- During the spectrum auction, these rules were made clear to all potential bidders and they were all required to acknowledge that both the spectrum licence and their ability to operate as a wireless carrier required compliance with the existing regulations.
- At Public Mobile, we recognized these requirements and the importance of having substantial Canadian investors that reflected the required Canadian ownership and control. Those requirements, by their nature, limited the opportunities to attract additional capital from foreign investors and made securing significant Canadian investment mandatory.
- With the inclusion of OMERS Private Equity, Peter Thomson, Peter Munk and other prominent Canadians as shareholders of Public Mobile, we have satisfied these requirements. At this point, Public Mobile is the only new entrant to secure an equity investment from a new Canadian investor since the close of the spectrum auction in July 2008.
- All of Public Mobile's investors – both Canadian and non-Canadian – made their commitments recognizing the constraints of the Canadian ownership and control requirements and with the belief that the same rules would be applied equally to all.
- However, the Federal Government decided to authorize a single player – Globalive – under a different set of rules. Globalive is the only player in the Canadian telecommunications industry in which there is not a single Canadian investor with any capital at risk in the business. Virtually all of the funding for the wireless business has come through from Orascom Telecom of Egypt.
- Worse, this case was subject to three contradictory decision by three different decision makers:
 1. Industry Canada – the Minister of Industry granted Globalive Wireless its spectrum licences in March 2009 based on an ownership and control structure that seemed inconsistent with the requirements of the Canadian ownership and control legislation and regulations.
 2. CRTC – the CRTC conducted an extensive review of the ownership and control of Globalive based on the structure that was approved by Industry Canada. Despite numerous changes – removing some of the most direct and obvious levers of control for Orascom – the Commission concluded in October that the revised structure was still not compliant.
 3. Governor in Council – issued an Order in Council in December 2009 that reversed the CRTC decision. In doing so, it emphasized that the decision was intended to be a special case that only applied to Globalive.
- While nominally intended to encourage competition, this Order in Council has created the worst possible situation for Canadian telecommunications carriers and for the Canadian industry:
 1. It rewards a single foreign investor by providing a competitive advantage to a single player by applying different rules, while every other player – both existing companies and new entrants – complied with the Canadian ownership and control requirements, leaving Globalive Wireless free access to capital from Orascom Telecom with effectively no constraints. (Since the decision, Orascom has taken full advantage of this flexibility by

- investing an additional \$200 million in Globalive Wireless, further increasing its dominance and control.)
2. It creates uncertainty about when and where the existing rules will actually be enforced. There is no worse environment for investment than one in which the rules are applied haphazardly or capriciously. Until this situation is clarified, no investor – Canadian or non-Canadian – can invest in the Canadian telecommunications industry with any certainty regarding the rules.

WHAT NEEDS TO BE DONE

- To ensure an open and level playing field, the rules governing all new entrants need to be brought into alignment. The most effective solution would be to immediately lift the foreign ownership restrictions on all new entrants in the telecommunications market.
- The best means to promote competition, to attract investment, to encourage innovation and to generate productivity growth and better jobs in Canada is to eliminate the restrictions on foreign investment in the Canadian telecommunications industry.
- The foreign ownership restrictions in Canada have not protected Canadian jobs, but have helped to protect the legacy monopoly carriers. The foreign ownership restrictions on “carriers” do nothing to promote or protect the generation and distribution of Canadian content.
- This conclusion is not new and has been the conclusion of every independent study to look at this issue in the past decade – including the Committee’s 2003 study of the issue.
- Resolving the immediate problem should not be hung up by attempts by the incumbents to stall the process, even though Public Mobile recognizes that the regulation of content producers and distributors is more complex and may not be in the public interest.
- Previous policy reviews have recommended a two step process – removing the limits on new entrants first, followed by incumbents at a later date – because the policy change has no immediate impact on the business of the incumbents. Access to risk capital for new entrants is critical now and in the near future.

PUBLIC MOBILE’S VIEW OF THE THREE OPTIONS

- The Telecommunications Act obviously has a two-prong test for eligibility to operate set out in section 16; a Canadian carrier must be both Canadian owned and controlled. The consultation paper makes many explicit references to the first prong (i.e., foreign investment thresholds), but there is no explicit reference to the second prong (i.e., foreign influence or control).
- The paper sets out 3 “options”:
 1. Increasing direct foreign ownership of voting shares for broadcasting and telecommunications to 49%.

2. Exempting foreign investment in start-ups and small (<10% market share) telecoms.
 3. Removing foreign investment (and control) restrictions for all telecoms.
- **Option 1** in reality, is a meaningless “non-option”. Public Mobile is of the view that it will be unfortunate if the recommendation coming out of this process were to be to increase permitted foreign ownership of voting shares to 49% without any change to the control in fact test, because doing so would have no impact whatsoever on Canadian telecoms’ access to foreign capital.
 - There are plenty of precedents for ownership structures of Canadian telecom carriers that maintain compliance with the existing legislative (*de jure*) restrictions on voting shares while allowing greater flexibility for equity investments (through holding company/ operating company structures and with the issuance of non-voting shares). These arrangements have allowed foreign investors to maintain some influence to help protect their investment without Canadians ceding control. Adopting a 49% limit would marginally simplify this process, but do nothing to attract additional investment capital.
 - To meaningfully increase the level of foreign investment in Canadian wireless providers will require allowing the foreign investors to have control of the business commensurate with the level of its investment.
 - Increasing the direct foreign ownership of voting shares to 49% without allowing foreign control will not change anything, and will not attract one additional dollar of foreign investment to Canada’s telecommunications sector.
 - **Options 2 and 3** contemplate removing both foreign (voting) ownership and control restrictions, in different scenarios. In Public Mobile’s submission, either of these options, if adopted, could result in meaningful and positive changes for the telecommunications industry in Canada.
 - For the reasons articulated above, Public Mobile submits that the Government should adopt a staged approach to change. This could employ both Options 2 and 3. Initially, Option 2 should be employed whereby the foreign investment levels in start-up and small telecommunications carriers (<10% market share) would be eliminated. Then, at a pre-determined point (which is either set simply by the passage of time or after an assessment and determination of adequate competition in the marketplace), the mechanics of Option 3 would be deployed, eliminating foreign investment levels for all telecommunications carriers in Canada.