



**Submission to the Government of Canada's Consultation on
Foreign Investment in the Telecommunications Industry**

July 30, 2010



SUMMARY

TELUS submits that fairness and competitive neutrality must prevail over any attempt to legislate short-term advantages for a select class of carrier shareholders, if Parliament is to achieve the greatest benefits for the greatest number of Canadians, by liberalizing its restrictions on foreign investment.

The government needs to address foreign ownership in a more holistic manner, rather than forcing artificial capital structures on the entire communications industry in an attempt to “fix” the short-term financing problems of some carriers brought on by high-risk business plans.

A law designed to favor foreign investment over Canadian could produce very negative and unintended consequences over time and would be of questionable legality.

To exclude carriers/distributors that are regulated pursuant to *Broadcasting Act* from the benefits of liberalization would effectively exclude virtually all Canadian telecommunications carriers from benefitting from reform.

Access to carriage or distribution platforms is a matter easily regulated by the CRTC regardless of the nationality of carriers or distributors.

Liberalization of FDI is about much more than lower cost of capital and includes the benefits of open markets, achieving increased scale, and innovation – all of which require that all market participants are treated equally.

The most appropriate safeguard would be structural separation of carriage/distribution from content, wherever the potential for the exercise of market power is most likely, regardless of the nationality of a carrier.

I. Fairness and competitive neutrality must prevail over any attempt to legislate short-term advantages for a select class of carrier shareholders, if Parliament is to achieve the greatest benefits for the greatest number of Canadians, by liberalizing its restrictions on foreign investment.

TELUS is pleased to contribute to the Government of Canada's consultation on removing restrictions on foreign direct investment in telecommunications. As noted in its Consultation:

"In the Speech from the Throne and Budget 2010: Leading the Way on Jobs and Growth, the Government of Canada committed to opening Canada's doors further to venture capital and to foreign investment in key sectors, including telecommunications, in order to attract new capital and to encourage innovation and competition."

TELUS supports the comments of Minister Clement in launching this consultation that the objective of this exercise must be to "encourage investment, innovation and competition in the telecommunications sector for the benefit of both businesses and consumers."

The consultation paper presents the following three options for consideration:

1. Increase the limit for direct foreign investment in broadcasting and telecommunications common carriers to 49 percent;
2. Lift restrictions on telecommunications common carriers with a 10 percent market share or less, by revenue; or
3. Remove telecommunications restrictions completely.

TELUS submits that all of the Government's proposals fail its stated objectives and, in particular, Options #2 and #3 would discriminate against companies and shareholders that have contributed the most to telecommunications investment and innovation in Canada.

TELUS submits that none of these options will deliver the intended benefits of encouraging scale, investment, innovation and competition.

The first proposal, to merely raise foreign ownership limits by a slight margin, effectively 3 percentage points, will not achieve much that is not already achieved indirectly.

The second proposal, which explicitly favors so-called new entrants, including companies that have dominant market share in wireless in their home provinces, raises significant concerns because it would discriminate against most Canadian-owned carriers in order to give a small number of carriers the opportunity to either effect a change of control to remedy their financial challenges, access to highly leveraged financing not available from Canadian banks and other Canadian investment vehicles or simply by promoting the entry of foreign carriers in a fashion that advantages them relative to Canadian enterprises and their investors. We worry that such an asymmetric law may remain in force for decades with deep and unintended consequences in terms of an erosion of the value of domestic carriers in Canadian communications. We submit that fairness and competitive neutrality must prevail over any attempt to legislate short-term advantages for a small class of carrier shareholders, if Parliament is to achieve the greatest benefits for the greatest number of Canadians by liberalizing its foreign ownership restrictions.

Both options #2 and #3 also ignore the widespread integration of broadcast distribution and telecommunications carriage over unified, integrated networks (a phenomenon generally referred to as “convergence”). Ignoring the technological and economic realities of convergence might serve short-term political considerations, but we would submit that the public interest is never well served over the long run by ignoring actual market realities.

We submit that the only course of action that meets the government’s stated objective “to rely more on market forces and less on regulation in the telecommunications industry” is a fourth option, namely:

- Remove the restrictions completely on all telecommunications carriers and broadcast distributors, while maintaining restrictions on the ownership of broadcast channels and specialty services and adopting safeguards with respect to vertical integration of broadcast carriers.

To enable this we propose that government endorse a clearer separation of carriage and content.

II. The government needs to address foreign ownership in a more holistic manner, rather than forcing artificial capital structures on the entire communications industry in an attempt to “fix” the short-term financing problems of some carriers brought on by high-risk business plans.

On several occasions over the past decade, governments have undertaken or commissioned studies to address the issues of improving productivity, enhancing access to capital, and increasing innovation, investment and competition within the

telecommunications industry. Inevitably, the findings of these studies underscore the benefits of facilities-based competition and increased foreign direct investment (FDI), the challenges of amending legislation in an integrated industry, and the policy choices of giving artificial advantages to new entrants versus encouraging investment by the industry as a whole.

The impetus for the most recent reviews has been the purported financing needs of some new wireless entrants which, having paid more for spectrum than anticipated, require ongoing risk capital or an exit strategy that is seemingly unavailable in Canada.

We note that there are basic flaws with this proposition. Contrary to populist sentiment, the issue around FDI is not that the cost of capital in Canada is higher. In fact over the past two years it has actually been lower. Rather, the issue is the appetite, or lack thereof, among Canadian and international investors to take on a minority position in certain very high risk businesses, given the small scale and existing competitiveness of the Canadian wireless market.

It is also a mistake to assume that somehow changes to FDI are required to access debt markets. The current problem of limited access to debt is not due to investment restrictions, since carriers are allowed to access high levels of foreign debt today under existing rules. Rather the reality is that international debt instruments for high risk ventures have dried up and equity is in short supply for high risk ventures absent a corresponding degree of control over that equity. For some carriers the only way to get a return on challenged investments is to be able to effect a change of control and that is most easily done if FDI restrictions are liberalized.

It is important for government to recognize that as the removal of FDI restrictions inevitably leads to change of control for some enterprises, many of the so-called new entrants are likely to be subsumed by larger carriers and that will change the competitive dynamic. TELUS is open to and supports a removal of FDI restrictions. And we are ready to compete in an open market because we have a solid business case. However it is unfair and unreasonable to provide advantages to larger foreign-owned carriers that are not equally available to domestic carriers. Government simply cannot promote open competition by applying asymmetric rules; particularly when the asymmetry disadvantages Canadian companies.

TELUS submits that regardless of what international benchmark studies such as those of the OECD might postulate about the competitiveness of the Canadian market, the signals that financial markets are sending about the risk associated with some wireless entrant business plans due to existing competition in Canada are a more accurate reflection of market reality. Any intervention based on a belief that government is better positioned than capital markets to assess and manage risk, is a risky proposition in itself, and may require ongoing, recurring intervention to sustain. Even-handed rules that apply to all competitors equally and do not distort financing markets should be preferred.

We do not dispute that some new entrants in the wireless industry are discovering that it is harder to compete than they may have presumed and that they are facing challenges in attracting investors. However, we submit that government needs to address foreign ownership in a more holistic manner, rather than forcing artificial capital structures on the entire communications industry in an attempt to “fix” the short-term financing problems of some carriers brought on by high-risk business plans. Changing a law that affects all communications companies in Canada to try to fix financing challenges for the shareholders of a very small number of wireless carriers is not an appropriate legislative response to a fundamental policy issue.

III. A law designed to favor foreign investment over Canadian could produce very negative and unintended consequences over time and would be of questionable legality.

The appropriate response to the challenges faced by some competitors in the wireless market is to change the foreign investment rules for the entire industry so that both new entrants and all other carriers compete in an open market under the same laws and rules. Long after these particular new entrants have either succeeded, sold out, or failed, the new law will remain on the books. A law designed intentionally to favor foreign carriers over Canadian could produce very negative and unintended consequences over time. For instance, such asymmetry could provide opportunities for large foreign carriers that already benefit from scale economies to leverage even greater North American-wide scale in a fashion denied to Canadian companies that have invested tens of billions of dollars in domestic infrastructure and employ tens of thousands of Canadians. That could erode the value of Canadian investments and the number of Canadian jobs the longer that asymmetry remains in force.

Any asymmetric changes to the law that would subvert and harm the interests of Canadian enterprises, and investors, would no doubt be vulnerable to challenge on legal and trade grounds. TELUS considers that such a law, if passed, could be subject to challenge under Canada’s international trade obligations as a member of the WTO, in that it would effectively discriminate against most shareholders of Canadian companies.

IV. To exclude carriers/distributors that are regulated pursuant to *Broadcasting Act* from the benefits of liberalization would effectively exclude virtually all Canadian telecommunications carriers from benefitting from reform.

TELUS has long supported removal of the foreign ownership restrictions on a fair and equitable basis for all telecommunications carriers regulated under the *Telecommunications Act* and for all broadcast distributors in their role of carriers of

video and data services pursuant to the *Broadcasting Act*. The need to remove restrictions on broadcast distributors simply reflects market realities, as most telecommunications carriers also hold broadcasting distribution licences. Further, all telecommunications carriers, even stand-alone wireless carriers and ISPs, now carry a mix of video, voice and data traffic on their networks, some of which may be considered broadcasting and therefore subject to the *Broadcasting Act*. It can be expected to become even less common to find a telecommunications carrier that is not involved in licensed broadcasting in one way or another in the future. A policy that effectively stipulates that only those carriers that are not affiliated in some way with licensed broadcasting can benefit from liberalized access to foreign investment would be contrived and artificial in the extreme, with no appreciable consumer benefits.

V. Access to carriage or distribution platforms is a matter easily regulated by the CRTC regardless of the nationality of carriers or distributors.

It is important to recognize that a licence to distribute (carriage) broadcasting is fundamentally different from a broadcasting licence where decisions are made as to which programs (content) are offered to the public. While the latter obviously goes to the core of the creation of Canadian content, the act of distributing/carrying traffic that includes broadcasting is not central to the achievement of cultural goals around content creation or access to the broadcasting system. Access to carriage or distribution platforms, after all is a matter easily regulated by the CRTC regardless of the nationality of a given carrier or distributor. To exclude carriers/distributors that are regulated to any degree pursuant to the *Broadcasting Act* from the benefits of liberalization would effectively exclude virtually all Canadian telecommunications carriers from benefitting from reform because the networks that these carriers currently operate support the carriage of telecom and broadcast traffic on a fully integrated basis. In effect, to ignore the integration of carriage and distribution under both acts would be to deny the benefits of reform to virtually all Canadians that currently subscribe to services provided by these integrated network providers.

TELUS recognizes that the Government may be reluctant to open up the *Broadcasting Act* because of the cultural debate that would ensue. However, there may be no need to actually change the Act itself. Unlike the *Telecommunications Act*, in which the specific Canadian ownership and control requirements are set out in the statute itself, the foreign ownership limits relating to broadcasting undertakings are not found in the *Broadcasting Act*. Rather, the *Broadcasting Act* merely declares that, among other things, it is the broadcasting policy for Canada that “the Canadian broadcasting system shall be effectively owned and controlled by Canadians”. The specific requirements to meet this test are set out in the *Direction to the CRTC (Ineligibility of Non-Canadians)*. This Direction could be amended by the Governor in Council to liberalize foreign ownership in broadcasting and yet grant the CRTC increased powers to maintain protections for programming-related decisions, such as Canadian content rules or the

implementation of rules relating to the structural separation of carriage and content businesses.

VI. Liberalization of FDI is about much more than lower cost of capital and includes the benefits of open markets, achieving increased scale, and innovation – all of which require that all market participants are treated equally.

TELUS believes that addressing integration in a realistic fashion is a critical part of the foreign investment liberalization process. While the politics of broad-based liberalization are more challenging, that does not justify imposing a competitively inequitable law on the Canadian communications industry. In particular, a law that would only benefit stand-alone carriers under the *Telecommunications Act* would amount to virtually no real change in practice.

The point of opening up foreign investment is not simply to obtain a lower cost of capital. The Canadian financial market can deliver that today. The challenges for some new entrants is not cost of capital but rather access to highly leveraged capital due to the level of risk inherent in their business plans. As we note, that type of capital is not readily available in either international or Canadian debt markets. That is why change of control may be, for some, the only financial recourse to fix a shaky business plan. Regardless of whether some carriers simply want to sell a licence to achieve a high return without achieving operational efficiencies or simply grow to scale, liberalization is, or should be, more about the benefits of open markets, achieving increased scale in order to lower cost, and increased innovation. To achieve all that requires that all market participants are treated equally in order that all consumers benefit. Minimizing access to FDI simply minimizes any benefits associated with liberalization.

VII. The most appropriate safeguard would be structural separation of carriage/distribution from content, wherever the potential for the exercise of market power is most likely, regardless of the nationality of a carrier.

Full liberalization for carriers and distributors (but not broadcasters), as TELUS proposes, would ensure that the benefits of scale accrue to the whole market, consistent with the Government's own objectives. Moreover, TELUS submits that full liberalization does not have to undermine cultural policy as long as the regulatory tools remain in place to ensure access and diversity on the content side. It's content that matters, not transmission, and we submit that safeguards, if imposed commensurate with reform, can more than adequately contribute to measures to promote our culture. We believe that the most appropriate safeguard would be structural separation of

carriage/distribution from content wherever the potential for the exercise of market power is most likely, regardless of the nationality of a carrier.

Separation of carriage/distribution and content is easily done and achievable, even if ownership restrictions on broadcast distribution were removed. First, it has been common practice for integrated companies to put all content properties like broadcast channels and specialty services in a structurally separate company or division. Such separation does not interfere with physical network operation. It would seem easy therefore to make clear in the rules that any sale of a telecommunications or cable company to a foreign entity can only be permitted where any common content assets (radio, TV and specialty channels) are first fully divested from the carriage and distribution assets. Under such a model it would be clear that broadcasting properties like radio, TV and specialty channels are not for sale to foreign entities, and if an integrated carrier wanted to avail itself of the benefits of foreign ownership, it must divest such assets prior to any sale taking effect.

The second piece of the puzzle is to ensure that the content distribution rules, particularly those against self-dealing and undue preference/disadvantage, are clear and clearly enforced. Since self-dealing is more likely to occur where companies actually are vertically integrated than in circumstances where content is divested, perhaps the time for concern about access is now, as effective control over key broadcast content is being taken over by cable companies. However, we would submit that as long as the CRTC is prepared to clearly and quickly address complaints about undue preference and enforce its rules, it is not material who owns the carriage platform. In fact, given the separation of carriage and content that would be required if a foreign carrier ever bought a cable company, the risks of self-dealing would be considerably less than the risk that would arise where Canadian cable and broadcasting is predominantly vertically integrated.

VIII. Conclusion

TELUS supports the removal of the foreign ownership restrictions, on a fair and equitable basis, for all telecommunications carriers regulated under the *Telecommunications Act* and for all broadcast distributors in their role of carriers of video and data services pursuant to the *Broadcasting Act*.

TELUS also supports maintaining foreign ownership restrictions on radio, television and specialty channels (programming undertakings) to ensure the achievement of Canadian cultural objectives under the *Broadcasting Act*.

TELUS considers that cultural objectives in the area of content distribution/carriage can continue to be achieved through regulation, as these have always been in the past, irrespective of who owns the platform.

Changing Canadian law with respect to foreign ownership should not be done simply to favor a certain class of wireless carrier shareholders that may be looking for highly leveraged financing to support a risky business case or to effect a change of control to achieve an immediate return on a licence.

The point of liberalization is to maximize the benefits of more open markets, increased scale and innovation, and investment for all Canadian consumers and all Canadian carriers, not simply the shareholders of a handful of new wireless entrants.

If government cannot reform its rules in a fashion that does not discriminate against most existing Canadian carriers and distributors (and their shareholders), it should postpone any change until it can effect equitable reform. That approach would avoid changing the law in a fashion that favors a select few, and perhaps in a legally impermissible fashion, with respect to trade treaty obligations.

However, TELUS believes that regulation and enforcement of broadcast carriage rules in a way that removes opportunities for self-dealing and requires clear divestiture of content properties prior to any change resulting in control by foreign-owned entities should provide sufficient comfort for government to fully liberalize the carriage/distribution market without delay.