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Opening Canada's Doors to Foreign Investment in Telecommunications:

Options for Reform

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OPENING CANADA'S DOORS TO FOREIGN INVESTMENT IN TELECOMMUNICATIONS: OPTIONS FOR REFORM

1. INTRODUCTION

With over \$40 billion in revenues, representing 3.3 percent of Canadian gross domestic product, the telecommunications industry is critical to the modern digital economy. Given this importance, the Government of Canada has made it a priority to encourage investment, innovation and competition in the sector and has taken consistent policy actions to ensure that Canadian consumers and businesses reap the benefits.

In the Speech from the Throne on March 3, 2010, the government announced its intention to "...open Canada's doors further to...foreign investment in key sectors, including the satellite and telecommunications industries, giving Canadian firms access to the funds and expertise they need." This commitment was further highlighted in Budget 2010, which stated that "increasing foreign investment is an important way of strengthening market competition and attracting new capital and innovative ideas from abroad."

Recently, the Government of Canada released a consultation paper on a digital economy strategy for Canada entitled *Improving Canada's Digital Advantage*, which highlights Canada's need for a strong, globally competitive information and communication technologies sector. The telecommunications industry is a key to enabling businesses and consumers alike to participate in the modern digital economy, and an essential factor in Canada's digital economy strategy is a supportive policy framework that encourages investment, competition and innovation.

Over the past few years, there have been a number of studies and reports on Canada's foreign investment restrictions in the telecommunications sector. For example, in 2007, the government established the Competition Policy Review Panel to review Canada's competition and foreign investment policies. The Panel's report, *Compete to Win*, was released in June 2008 and made comprehensive recommendations focused on one central premise: raising Canada's overall economic performance through greater competition to provide Canadians with a higher standard of living. This report echoed a number of others in recommending that Canada relax its restrictions on foreign investment in the telecommunications sector to achieve the following:

- To ensure that Canadian companies have access to capital and expertise;
- To promote competition in the sector; and
- To improve services for consumers.

The government is now inviting views on foreign investment in telecommunications to better inform its approach to moving forward on the commitment made in the March 2010 Speech from the Throne. This consultation paper outlines the current restrictions as well as how they compare with other member countries of the Organisation for Economic Co-operation and Development (OECD) and identifies a number of options for moving forward. In addition, through this paper, Industry Canada is soliciting comments on the options and key issues to be considered moving forward.

2. CANADA'S TELECOMMUNICATIONS FOREIGN INVESTMENT RESTRICTIONS

The decision to introduce foreign investment restrictions for telecommunications was made in 1987, in the context of the Canada–U.S. Free Trade negotiations. In *A Policy Framework for Telecommunications in Canada*, it was announced that foreign investment restrictions would be placed on all telecommunications common carriers, thereby ensuring that these would be protected in that trade agreement. There had been earlier instances of foreign investment restrictions for particular classes of carriers, such as in the licensing of cellular communications carriers in 1984, but these restrictions did not apply to all telecommunications common carriers.

In 1993, the foreign investment restrictions set out in the 1987 policy framework were enshrined in the *Telecommunications Act*. Section 16 of the *Telecommunications Act* requires that, in order to be eligible to operate in Canada, a telecommunications common carrier must be a “Canadian-owned and controlled corporation,” incorporated or continued under the laws of Canada. Subsection 16(3) of the *Telecommunications Act* stipulates that a corporation is Canadian-owned and controlled if:

- (a) not less than eighty per cent of the members of the board of directors of the corporation are individual Canadians;
- (b) Canadians beneficially own, directly or indirectly, in the aggregate and otherwise by way of security only, not less than eighty per cent of the corporation's voting shares issued and outstanding; and
- (c) the corporation is not otherwise controlled by persons that are not Canadians.

By virtue of the definition of a telecommunications common carrier, section 16 of the *Telecommunications Act* applies to all facilities-based telecommunications service providers. Non-facilities-based telecommunications service providers, such as resellers, are not subject to Canadian ownership and control requirements. Section 16 explicitly exempts established carriers that were foreign owned and controlled on July 22, 1987, from these restrictions. This provision allowed both BCTel and QuebecTel, at that time owned by the U.S. company GTE Corporation, to continue to operate.

In 1994, the *Canadian Telecommunications Common Carrier Ownership and Control Regulations* came into force. These regulations set the minimum Canadian ownership level for holding company ownership at 66 and two-thirds percent of voting shares.

In 1996, section 10 of the *Radiocommunication Regulations*, made pursuant to the *Radiocommunication Act*, established the requirement that a radiocommunications common carrier (a telecommunications common carrier using a wireless rather than a wireline telephone network) must meet Canadian ownership and control requirements that are virtually identical to those of the *Telecommunications Act* and associated regulations to be eligible to receive a radio licence in Canada.

In 1997, in the context of the General Agreement on Trade in Services (GATS) Agreement on Basic Telecommunications Services, many countries made commitments to reduce barriers to entry into their telecommunications markets, including allowing the entry of foreign-owned service providers. Canada agreed, as part of its commitments, to lift the foreign investment restrictions from international submarine cables and to allow foreign-owned satellites to offer service in Canada. Consequently, the *Telecommunications Act* was amended in 1998 to exempt international submarine cables and satellite earth stations from the foreign investment restrictions.

Consistent with announcements in the March 2010 Speech from the Throne and Budget 2010, the *Budget Implementation Act*, currently before Parliament, proposes to further amend the *Telecommunications Act* to remove the foreign investment restrictions applicable to providers offering satellite telecommunications services. This will allow Canadian companies to gain access to both international capital and advanced technologies. It will enable them to form global partnerships and achieve greater economies of scale to expand business internationally.

3. RESTRICTIONS IN OTHER OECD COUNTRIES

In 1993 when the *Telecommunications Act* was promulgated, most telecommunications service markets in OECD countries were closed to foreign investment. In the ensuing years, and especially after the signing of the GATS Agreement on Basic Telecommunications Services, many OECD countries opened their markets to foreign participation.

The OECD monitors and publishes reports on those countries that maintain foreign investment restrictions as well as on those countries that have partial or majority government ownership of telecommunications operators. For example, France and Germany currently have partial ownership stakes in France Télécom and Deutsche Telekom, respectively, and Australia and Japan maintain restrictions on their traditional, incumbent operators. Further, the U.S. *Communications Act* allows the Federal Communications Commission (FCC) to deny certain radio licences to parent corporations with greater than 25 percent foreign investment. However, in light of the U.S.'s commitments in the GATS Agreement on Basic Telecommunications Services, the FCC announced in 1997 that it would follow an open entry policy for carriers from members of the World Trade Organization.

The OECD has noted that "There are 30 OECD member countries, and only three countries have investment and ownership restrictions that apply to all public telecommunication operators. These countries are Canada, Mexico, and Korea. Of the three countries, Canada has the most severe restrictions."

4. PAST PROPOSALS FOR CHANGE

Changes to Canada's restrictions to foreign investment in telecommunications have been proposed by the House of Commons Standing Committee on Industry, Science and Technology in 2003, by the Telecommunications Policy Review Panel in 2006 and by the Competition Policy Review Panel in 2008. In 2010, the Standing Committee on Industry, Science and Technology once again studied the issue of Canada's restrictions to foreign investment in telecommunications. Highlights of these reports are outlined below.

2003: House of Commons Standing Committee on Industry, Science and Technology

The House of Commons Standing Committee on Industry, Science and Technology undertook a study of Canada's restrictions to foreign investment in telecommunications in response to a request for a review of these restrictions by the Minister of Industry in 2002. The mandate of the Committee's review was to examine the effect of Canada's restrictions to foreign investment in telecommunications on the industry and to determine if changes could be made to the restrictions without compromising Canada's national interests. In its final report in 2003, the Committee recommended that Canada's restrictions on foreign investment in telecommunications be removed entirely. The Committee also recommended that any changes made to the foreign investment restrictions applicable to telecommunications common carriers also be made to the foreign investment restrictions applicable to broadcasting distribution undertakings.

2006: Telecommunications Policy Review Panel

The Telecommunications Policy Review Panel (TPRP) was appointed in 2005 to conduct a review of Canada's telecommunications policy and regulatory framework. The TPRP was asked to make recommendations on how to move Canada toward a modern telecommunications framework in a manner that benefits Canadian industry and consumers. In the afterword of its 2006 report, the TPRP commented on Canada's restrictions to foreign investment in telecommunications. The TPRP proposed what it described as a "phased and flexible approach" for changing Canada's telecommunications foreign investment restrictions.

In the first phase, the *Telecommunications Act* would be amended to give Cabinet the authority to waive the foreign investment restrictions applicable to a Canadian telecommunications common carrier based on a foreign investment or class of investments being deemed by the Cabinet to be in the public interest. The TPRP proposed that, during the first phase, a presumption should be made that investments in any new start-up telecommunications investment or in any existing telecommunications common carrier with less than 10 percent of the revenue in any telecommunications service market would be in the public interest. This presumption could be rebutted by evidence related to a particular investor or investment.

Prior to the second phase, the TPRP recommended completion of a review of broadcasting policy to resolve issues related to the separation of Canadian policy on broadcasting content from policies for the carriage of telecommunications. It recommended that there should then be a broader liberalization of foreign

investment rules in a manner that “treats all telecommunications common carriers including the cable telecommunications industry in a fair and competitively neutral manner.” This liberalization would apply to the carriage business of broadcasting distribution undertakings, while new broadcasting policies would focus any necessary ownership restrictions on content businesses. The Cabinet would retain authority to screen significant investments to ensure they are in the public interest.

2008: Competition Policy Review Panel

The Competition Policy Review Panel (CPRP) was announced by the ministers of Industry and Finance in 2007 and was mandated to review Canada's competition and foreign investment policies. The CPRP was asked to make recommendations to the Minister of Industry, on behalf of the Government of Canada, for making Canada more competitive in an increasingly global marketplace. As part of its study, the CPRP reviewed Canada's sectoral restrictions on foreign investment, with one of these sectors being the telecommunications and broadcasting sector.

Recommendations made by the CPRP concerning Canada's telecommunications foreign investment restrictions were consistent with the approach proposed by the TPRP. Specifically, the CPRP advocated a two-phased approach to reducing Canada's foreign investment restrictions. In the first phase, lasting five years, the CPRP advocated that the *Telecommunications Act* be amended to permit foreign companies to establish a new telecommunications business in Canada or to acquire a telecommunications business with a market share of 10 percent or less. In the second phase, following a review of broadcasting and cultural policies, the CPRP recommended that restrictions to foreign investment in telecommunications and broadcasting be liberalized in a manner that would be competitively neutral for telecommunications and broadcasting companies.

2010: House of Commons Standing Committee on Industry, Science and Technology

In 2010, the House of Commons Standing Committee on Industry, Science and Technology once again undertook a study of Canada's restrictions on foreign investment in telecommunications. The Committee heard a comprehensive and broad range of testimony from academics, incumbent and new entrant telecommunications companies, cable companies, content producers, cultural groups and others. This testimony conveyed the full range and complexity of the issues at hand, including rapidly changing business models and technologies, integrated networks and product offerings, carriage, broadcasting, content and culture. The Committee is expected to release its report shortly.

5. OPTIONS FOR REFORM

Taking into account past proposals for change, the following options for consultation have been developed for moving forward on the commitment made in the March 2010 Speech from the Throne.

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 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. According to the CRTC's Communications Monitoring Report of 2009, total telecommunication revenues in 2008, based on CRTC data collection, amounted to \$40.3 billion. A 10-percent threshold in 2008 would therefore have been \$4.03 billion.

Option 3: Remove telecommunications restrictions completely

In recognition of the benefits 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.

6. TELECOMMUNICATIONS AND BROADCASTING

Telecommunications and broadcasting are subject to different legislative authorities and objectives. Telecommunications is subject to the *Telecommunications Act*, the objectives which are primarily economic in nature, such as enhancing the competitiveness and efficiency of Canadian telecommunications, fostering increased reliance on market forces and ensuring that regulation, when required, is efficient and effective. In 2006, the Government of Canada reinforced this market-driven approach by issuing a policy direction to the CRTC to rely on market forces to the maximum extent feasible.

The objectives of the *Broadcasting Act*, however, are more cultural and social in nature, for example encouraging the production and availability of Canadian content and reflecting Canadian values. While it is recognized that telecommunications and broadcasting are increasingly converging, the policy objectives and legislative authorities under the *Telecommunications Act* and the *Broadcasting Act* are distinct, and the government is not considering changes to the *Broadcasting Act*. With respect to broadcasting content and culture, the government will not consider any action that could impair its ability to pursue Canadian culture and content policy objectives.

7. ISSUES FOR CONSIDERATION

As noted in the March 2010 Speech from the Throne and Budget 2010, increasing foreign investment is an important way of strengthening market competition and attracting new capital and innovative ideas from abroad. The Government of Canada is committed to ensuring that Canadian consumers and businesses can benefit from any potential reform of foreign investment in the telecommunications sector. In assessing 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.

Further areas of interest

In addition to comments on the specific options, to further inform potential policy actions on this issue, the government is interested in views on the following questions:

- 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 foreign direct investment in the Canadian telecommunications sector? What are the potential benefits and risks of having more global players in the market?

8. SUBMITTING COMMENTS

Interested parties should submit their comments no later than July 30, 2010. Soon after this date, all submissions received will be posted on Industry Canada's website at www.ic.gc.ca/telecominvestment. Respondents are requested to provide their comments in electronic format (WordPerfect, Microsoft Word or Adobe PDF) to the following email address: telecominvestment@ic.gc.ca.

Written submissions should be addressed to the Director General, Telecommunications Policy Branch, Industry Canada, 16th Floor, 300 Slater Street, Ottawa, Ontario, K1A 0C8.

