

DBRS Canada Newsletter

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Peter Bethlenfalvy
Co-President, Canada
+1 416 597 7361
pbethlenfalvy@dbrs.com

Steven Bavaria
Managing Director,
Leveraged Finance
+1 212 806 3285
sbavaria@dbrs.com

Eric Beauchemin, CFA
Managing Director,
Public Finance
+1 416 597 3619
ebeauchemin@dbrs.com

Michael Caranci
Managing Director,
Energy
+1 416 597 7304
mcaranci@dbrs.com

Paul Holman, CMA
Managing Director,
Communications, Media,
Retailing, Consumer
Products and Real Estate
+1 416 597 3617
pholman@dbrs.com

Kam Hon
Managing Director,
Natural Resources,
Industrials and Auto
+1 416 597 7543
khon@dbrs.com

Brenda Lum
Managing Director,
Canadian Financial
Institutions
+1 416 597 7569
blum@dbrs.com

Larry J. White
Managing Director,
Business Development
and Originations
+1 416 597 7457
lwhite@dbrs.com

Toronto
DBRS Tower
181 University Avenue
Suite 700
Toronto, ON M5H 3M7
+1 416 593 5577

Caroline Creighton
Coordinator,
Senior Vice President,
Communications and
Media
+1 416 597 7317
ccreighton@dbrs.com

GOVERNMENT DIALS UP POTENTIAL CHANGES TO THE TELECOM AND MEDIA INDUSTRIES

In last week's Speech from the Throne, the Governor General indicated that the Government of Canada has plans that could ultimately impact the country's telecom and media industries. While the federal budget (released the day after the Throne Speech) referred more specifically to liberalizing foreign ownership restrictions of "Canadian satellites" (DBRS presumes this refers to satellite operators such as Telesat Holdings Inc. as opposed to satellite distributors), DBRS believes the broader issue relating to telecom and media will likely be further explored as part of the Government's agenda. However, it remains too early to determine the precise impacts on these industries and specific companies. As such, there is no immediate impact on DBRS's credit ratings of the companies it rates in the telecom and media industries.

DBRS notes that the Government's plans, as outlined in the Throne Speech, touch on three areas and include: (1) "launching a digital economy strategy to drive the adoption of new technology across the country;" (2) looking to "strengthen laws governing intellectual property and copyright;" and (3) a strategy to "open Canada's doors further to venture capital and to foreign investment in key sectors, including the satellite and telecommunications industries, giving Canadian firms access to the funds and expertise they need."

These first two areas appear to be straightforward with a goal of shrinking the digital divide by ensuring that more Canadians have access to broadband services and the Internet, as well as ensuring that the rights of creative content originators are protected. The first initiative could lead to government supported programs for broadband deployment in areas where no such service is available today. This would likely benefit the telcos the most by supporting rural network investment programs. These investments could be in the form of wireline, wireless or satellite-based networks to accomplish this goal.

While the foreign ownership issue may appear to have been triggered by the recent review of a new wireless entrant, Globalive Wireless Management Corp., DBRS believes that foreign ownership liberalization was already being considered by the Government. As such, the Globalive decision did not define the Government's plans, it merely was being consistent with previous determinations by Industry Canada that permitted Globalive to bid on spectrum. Notably, the Government believes that Canadians should be able to benefit from foreign capital in areas such as satellite and telecommunications to enhance the technology available and to encourage competition to make these services more affordable.

Currently, DBRS notes that foreign ownership restrictions pertaining to the telecom and media industries restrict voting control by a foreigner to 46.7% (among other factors). Specifically, this includes: (1) limiting the voting shares held by a foreigner to 20% of an operating company; (2) limiting the voting shares held by a foreigner to 33.3% of a holding company; (3) requiring that a board of directors is at least 80% Canadian; and (4) requiring that the Canadian Radio Television and Telecommunications Commission (CRTC) ensures that a foreigner cannot exercise "control in fact."

DBRS notes that the federal budget focused specifically on the liberalization of foreign ownership restrictions of Canadian satellite operators. This would remove an inherent inequality for operators like Telesat, whereby foreigners are permitted to operate satellite services in Canada while Canadian satellite operators remain subject to foreign ownership restrictions. Size and scale benefits can be critical in the recently consolidated satellite operators market. Secondly, such liberalization regarding satellite operators could serve as a trial for possible broader liberalization in telecom and media in the future.

DBRS notes that the relaxation of foreign ownership rules as noted in the Throne Speech appears to target the telecom and satellite sectors but makes no mention of the cable sector. It remains unclear whether the same initiatives being considered will be applied to the cable operators that today, like the telcos, have licences under the *Telecommunications Act* to operate telecom services in addition to their licences under the *Broadcasting Act* that allow them to distribute their incumbent video services. Furthermore, satellite distributors (such as Bell TV and Shaw Direct) that compete with the cable and telecom sectors are also licensed to distribute video services under the *Broadcast Act*.

DBRS believes that any decision on the telecom, wireless and satellite sectors should be applied equally to the cable sector as the telecom and cable operators have become each other's largest competitors as the traditional lines between the two sectors have blurred. This would be more consistent with the second phase of the Competition Policy Review Panel's two-phased 2008 recommendations regarding liberalizing foreign ownership restrictions. These recommendations included: (a) a first phase (for a period of five years) allowing foreign companies to establish new telecommunications companies or acquire existing companies with less than 10% market share; and (b) a second phase (following the five years of the first phase) that would broadly liberalize foreign ownership for telecom, wireless, cable and satellite companies. Meanwhile, any necessary foreign ownership restrictions on media companies would be maintained. DBRS notes that while the Government might be heading in the direction of these recommendations as per the Throne Speech, it was not specific given the high level nature of the Government's plans.

Foreign ownership liberalization could lead to a number of outcomes including foreign companies taking significant stakes in new and/or existing telecom, wireless, cable and satellite companies that are today domestically owned and controlled. While it is possible that this could lead to increased level of competition, larger scale benefits and an acceleration of innovation in the telecom, wireless, cable and satellite sectors in Canada, there is no assurance that this desired result would occur.

DBRS believes that while the benefits of encouraging new entrants (such as new wireless carriers) appear to be clear in terms of innovation and the competitive landscape, it remains more difficult to see how foreign ownership of the incumbent telecom and cable operators would encourage these innovation and competition goals. While this could bring marginal benefits in terms of innovation, existing shareholders could become the largest beneficiaries with no discernable impact on the existing competitive landscape. This situation has occurred in other industries in Canada during the previous decade. DBRS believes that the Government should take great care to avoid this outcome as it considers its foreign ownership liberalization initiatives. Alternatively, should new entrants gain a footing, the existing telecom and cable operators may look to merge in order to gain additional size and scale. Should the new entrants have an impact on competition, incumbent telecom and cable operators may seek synergies by merging to create a national telecom or cable champion.

DBRS notes that should any foreign change of control event occur, such a transaction would then be reviewed under the *Investment Canada Act* to ensure national security is protected and that there is a net benefit in Canada in terms of investment, economic growth and employment. This would give the Government some discretion which has been recently used a number of times in the telecom and media industries. Any domestic acquisitions or mergers would most likely be reviewed by the Competition Bureau to determine the competitive impact on that specific sector and would also be subject to approval by the CRTC.

DBRS will assess the impact of the Government's initiatives on the telecom and media industries once additional clarity is achieved; however it could be months before new legislation is enacted and codified into law. Ultimately, any foreign ownership liberalization initiatives in Canada could result in more event-driven credit actions that occur in the near- to medium-term, while any competitive changes are only likely to impact a sector over the medium- to longer-term.

For further information, please contact Chris Diceman, CFA cdiceman@dbrs.com; Paul Holman, pholman@dbrs.com; Reza Khanahmadi, rkhanahmadi@dbrs.com; Kam Hon, khon@dbrs.com.

Related Research

[DBRS Notes That Globalive Can Enter the Wireless Market in Canada as the CRTC is Overturned Once Again](#)

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