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CRTC Issues Important Decision On Canadian Ownership And Control

On October 29, 2009, the Canadian Radio-television and Telecommunications Commission (CRTC) issued its decision respecting the eligibility of Globalive Wireless Management Corp. (Globalive) to operate as a telecommunications common carrier in Canada. Globalive was a successful bidder in Industry Canada's 2008 Advanced Wireless Spectrum (AWS) auction, and had announced plans to launch its wireless service in the next quarter.

In a landmark ruling (*Telecom Decision CRTC 2009-678*, *Review of Globalive Wireless Management Corp. under the Canadian Ownership and Control Regime)*, the CRTC has determined that Globalive's ownership structure is not compliant with the Canadian ownership and control provisions of the *Telecommunications Act* and related *Canadian Telecommunications Common Carriers Regulations*. This means that unless and until Globalive significantly restructures its financial, corporate governance and other arrangements with its principal foreign investor, it will not be eligible to operate as a public mobile wireless carrier in Canada, as the latest competitor to Bell, Rogers and Telus.

This decision is an important one for a number of reasons.

First, this marks the first time since the CRTC's review in 1996 of Unitel Communications that the CRTC has released a written decision with respect to the ownership and control of a Canadian carrier. It is also the first time that the Commission has conducted a public review of a telecommunications carrier's ownership structure. Although public reviews are conducted under the *Broadcasting Act* with respect to the ownership and control of broadcasting undertakings, the practice under the *Telecommunications Act* has been for these reviews to be done behind closed doors. Following submissions from a number of carriers earlier this year, which called for a detailed review of Globalive's compliance with the statutory requirements, the CRTC reviewed its prior practice and announced a new Canadian ownership and control review process in *Telecom Regulatory Policy CRTC 2009-428*.

This new policy identified four types of ownership application that would be subject to varying forms of review depending on their complexity, the perceived benefit of public comment and whether the facts were considered to give rise to the possibility of a new precedent. The corresponding review process would in turn range from a confidential CRTC review to a public hearing process with participation by interveners.

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Immediately following the release of this new policy, the CRTC announced that Globalive's application satisfied the criteria for a public hearing to be convened. This hearing took place in September, 2009 and the process concluded on October 7, 2009 with the filing of final reply argument by Globalive.

A second reason why this proceeding has attracted so much attention is that it highlights in a very real way the double jeopardy that facilities-based wireless carriers face under the *Radiocommunication Act* and the *Telecommunications Act*. Although the tests for Canadian ownership and control are the same under both statutes, they are administered by separate bodies. A government department, Industry Canada, reviews compliance under the *Radiocommunication Act* in connection with the issuance of radio spectrum licences required to compete in the public mobile wireless market, whereas the CRTC reviews compliance under the *Telecommunications Act* by Canadian telecommunications common carriers, which include public mobile carriers. In this case, Industry Canada conducted a confidential review of Globalive's ownership structure earlier this year and found it to be compliant with the requirements of the *Radiocommunication Act*. In its public hearing process, that followed several months later, the CRTC was reviewing under the *Telecommunications Act* a structure that had already been approved by Industry Canada.

While this type of double jeopardy is not unknown in other regulatory contexts, such as the review of mergers in the broadcasting sector by the Commissioner of Competition and the CRTC and the review of ownership of broadcasting undertakings by the CRTC under the *Broadcasting Act* that are associated with radiocommunication undertakings whose ownership has previously been reviewed by Industry Canada under the *Radiocommunication Act*, this marks the first time it has occurred in a public context in a purely telecommunications ownership review. This raises serious questions as to the efficacy of having two separate reviews conducted by two different governmental bodies – whether both are private or whether one is private and one is public.

A third reason for the high level of interest in this particular ownership review stems from the circumstances surrounding Globalive's entry into the public mobile market. Globalive participated in Industry Canada's 2008 AWS auction as a "new entrant" entitled to bid on spectrum that had been set aside to encourage additional competition in the Canadian wireless market. Like all spectrum auctions conducted by Industry Canada, the rules required a successful bidder to pay for the AWS spectrum it successfully bid on in advance of Industry Canada's review of its ownership structure. This meant that Globalive had to pay approximately $450 million to secure the spectrum in advance of knowing whether its ownership and control structure was compliant. The regulatory risk that this situation generated for Globalive's investors served to heighten interest in this case, as well as bringing into question the timing of the ownership review process.

Finally, the substantive arrangements between the Canadian and foreign investors in Globalive, which were the focus of the review process, were in many ways unique. They commanded the interest of the telecommunications and broadcasting industries in Canada as having the potential to stretch the boundaries of what had previously been considered possible under the ownership and control regulations. The original Globalive arrangements, if approved by the CRTC, created a new ownership blueprint for others to follow.

This process also generated considerable interest in the press, with Globalive depicting itself in a David and Goliath struggle pitted against the incumbent wireless carriers.

The Ownership Rules

The Canadian ownership and control tests for telecommunications or radiocommunication common carriers are on their face quite simple. In a nutshell, the carrier must be incorporated in Canada, 80% of its board of directors must be Canadian, 80% of its voting shares must be owned by Canadians, and it must not be otherwise controlled by foreign interests. Corporations investing in the operating carrier (holding companies) are considered to be Canadian if 66⅔% of voting shares of that corporation are held by Canadians and it is not otherwise controlled by foreign interests. "Control" in this context is defined as control in any manner that results in control in fact.

These tests have led to the use of a number of mechanisms over the years to increase the economic participation of foreign investors in Canadian carriers, as well as their influence over key corporate decisions. These mechanisms have included two-tiered investments by non-Canadians at the holding company (33⅓%) and operating company (20%) levels, the issuance of non-voting shares to non-Canadians to raise their level of economic participation, the use of independent Canadian directors as an alternative to board control by Canadian shareholders that are required to hold the majority of voting shares, and the use of veto rights and negative covenants in shareholder and loan agreements.

The use of these mechanisms, which are not specifically addressed in the regulations, focus regulatory attention on the "control in fact" part of the ownership and control tests. This involves an analysis of all of the arrangements between the parties, including shareholder agreements, board participation, loan arrangements, technology and intellectual property agreements, the relative industry know-how and experience of the Canadian and foreign investors and their relative financial strength.

The Investors

There are two principal investors in Globalive – AAL and Orascom.

AAL is a Canadian company controlled by a Canadian, Anthony Lacavera. Its principal businesses are in the operator services and long distance service markets. It has revenue of approximately $120 million. AAL's capital contribution to the Globalive venture appears to have been in the form of its existing wireline business and a $400,000 loan. It has no prior experience operating a wireless company.

Orascom is an Egyptian-based wireless communications company with revenues of $5.3 billion and assets of $9.9 billion (2008). It has wireless networks in 14 countries and has 130 million subscribers.

The relative size and related experience of the two principal investors became an important issue in the proceeding in the application of the control in fact test.

The Proposed Structure

Globalive's ownership structure involved many of the usual mechanisms that are used to enhance the influence of foreign investors in Canadian communications companies, as well as a number of less common ones. The structure that was initially presented to the CRTC for consideration had the following features:

- a two-tiered holding company structure with Orascom holding approximately one-third of the voting shares in both holding companies, which were stacked one on top of the other;
- 65% of equity of Globalive held by Orascom;
- 99% of debt (approximately $508 million in short-term loans at 18%) held by Orascom;

- equal participation on the board of directors by Orascom and AAL with the balance of power held by independent Canadian directors selected by a committee with equal representation by the two investors and the swing vote held by a former employee of an Orascom affiliate;

- the right of AAL to exit the wireless business and retract its former wireline business in year one at a fixed price;

- the right of AAL to "put" its shares to Orascom at a fixed floor price in the first five years;

- the right of Orascom to sell the business and "drag along" AAL thereby forcing AAL to sell;

- a technology agreement with Orascom that included a $100 million fee regardless of whether the technology services were used;

- an intellectual property agreement for the "WIND" trademark which is owned and used by Orascom in other countries; and

- veto powers for Orascom on a number of key business decisions, including the business plan, at relatively low monetary thresholds.

During the course of the CRTC's public hearing, in response to the submissions of interveners, and in particular in response to concerns expressed by the CRTC Chair and other Commissioners during their questioning of the Globalive panel, Globalive made a number of concessions and changes to the structure that had been originally presented for approval. These changes included: making Anthony Lacavera the chairman of the companies constituting the Globalive business; removal of one of the two holding companies; cancelling Orascom's "call" and "drag along" rights; eliminating AAL's retraction rights in the first year; reducing AAL's put options in the first five years to a single right in year three; eliminating the negative covenants in Orascom's loan agreement and making the loan renewable for up to five years at Globalive's option; increasing the monetary thresholds with respect to certain of Orascom's veto powers; changing the manner in which independent directors are selected; and changing the termination arrangements under the Technology Services Agreement. A number of other changes were also offered up. It is interesting to observe that these changes were made to a corporate and governance structure that had already been approved by Industry Canada.

Notwithstanding the many changes made to the structure on a voluntary basis, the three appearing interveners, Bell, Rogers and Telus, (all of whom are incumbent wireless carriers) continued to press for further changes to be made including:

- fundamental restructuring of Globalive's capital so that Orascom is no longer a major lender to the company, in addition to being the largest equity holder;

- elimination of AAL's put and guaranteed floor price which was argued to be inconsistent with a Canadian controlling interest in the company;

- permitting AAL to elect a majority of directors to the board at both the operating company and holding company levels, commensurate with it holding two-thirds of the voting shares;

- further changes to the arrangements between Orascom and Globalive under the Technology Services Agreement;

- further changes to the manner in which independent directors are selected;

- elimination of Orascom's right to veto the business plan and its replacement with a consultation right; and

- modifying the monetary thresholds attached to Orascom's other veto powers to ensure compliance with the formula identified by the CRTC in other cases.

In the past, both the CRTC and the National Transportation Agency (that looks at control in fact issues in the context of the aviation industry) have expressed concerns about combining major debt and equity interests in the hands of non-Canadians. The fear that has been expressed is that this combination may place too much economic power in the hands of non-Canadians and give rise to undue influence over the affairs of the corporation. While Globalive sought to address these concerns by stripping the negative covenants out of the loan agreements and by extending their term, the interveners argued that the $508 million loan by Orascom at 18%, coupled with AAL's right to "put" its shares to Orascom at a guaranteed floor price, placed both the economic risk and reward of the wireless venture on Orascom and made AAL more of an "accommodation party" that could exit the venture at a guaranteed price.

For its part, Globalive argued that its capital structure was interim in nature – being assembled in the depths of the recession when alternative sources of capital had dried up. The CEO of Orascom stated that he was not in the banking business and was providing bridge financing until market conditions improved.

The interveners responded that without any real equity in the company, new debt financing would not be likely to materialize.

The Decision

In *Telecom Decision CRTC 2009-678*, the CRTC made rulings on many of the issues identified above. While in some cases, the CRTC identified specific changes that could be made to alleviate its concerns, its findings with respect to the company's debt financing will likely prove to be much more difficult for the shareholders to address. Highlights of the CRTC's specific rulings follow.

Composition of the Boards of Directors

The CRTC determined that the revised board structure does not ensure that the nominees of the Canadian shareholder are sufficient in number to offset the influence of Orascom. In order to address this point, the CRTC said that Globalive would have to amend its Shareholders' Agreement and corporate documents so that on each of the two boards (holding and operating company level), AAL nominates five directors, Orascom nominates four directors, and AAL and Orascom each nominate one Independent Director. This would give AAL the right to elect a clear majority of the board.

Liquidity Rights

With respect to AAL's "put", the CRTC ruled that even in its revised form, the put provides an indication of Orascom's influence over the venture. It went on to state that the specification of a floor price and the imposition of a cap on the proceeds generated in the event that AAL sells its shares are inconsistent with the relative voting interests of the shareholders.

The CRTC also considered that Globalive should broaden the scope of parties to whom AAL would be eligible to sell its shares since the proposed arrangements prevented a sale to "strategic investors" that compete in the market. The CRTC ruled that the definition of strategic competitor should be amended to include only entities which, taken together with their affiliates, hold more than a 10 percent share of the Canadian wireless market on a per-subscriber basis.

Veto Rights

The CRTC considered that the value of the spectrum held by Globalive is not an appropriate foundation

on which to base the revised 5% monetary threshold for the various veto powers accorded to Orascom. Consistent with earlier rulings, the CRTC considers that Globalive's enterprise value is a more appropriate measure.

Accordingly, the monetary threshold for vetoes should be set at five percent of Globalive's enterprise value as determined by its board every two years, based on a third-party valuation.

Technical Services Agreement (TSA)

The CRTC noted that the TSA provides Globalive with benefits that operate as key determinants of its success. It went on to state that it is this reliance by Globalive on Orascom which defines their relationship and allows Orascom the opportunity to influence a wide range of operating and strategic decisions. Given the significant benefits Globalive derives from the TSA, the CRTC was of the view that Globalive will maintain the TSA for the foreseeable future. Consequently, the CRTC considered that Orascom will continue to have influence over operating and strategic decisions related to Globalive's network.

Trademark Agreement

Based on information that Globalive filed in confidence with the CRTC and discussions held during the *in camera* oral phase of the public hearing, the term of the trademark agreement and the termination rights were not of concern to the CRTC. However, the CRTC found that Globalive's adoption and use of a trademark belonging to an Orascom affiliate do provide Orascom (or its controlling shareholder) with influence over Globalive because Orascom has the power to limit how the brand can be used.

Economic Participation of Globalive and Non-Canadians

The CRTC ruled that while the 65.1 % equity interest held by Orascom provides an avenue for influence in this case, consistent with previous CRTC decisions, it is not sufficient on its own to convert that influence into control.

Financing Arrangements

The CRTC noted that debt levels and debt financing arrangements can be important indicia of where influence lies. It repeated its observation in the CanWest decision that the concentration of debt and equity in the hands of a single foreign entity can create an opportunity for undue influence over the venture by that non-Canadian entity.

In the present case, the CRTC noted that Orascom has provided approximately 99 percent of Globalive's current debt, excluding some third-party vendor financing, which represents the vast majority of Globalive's total financing. The magnitude of the debt provided by Orascom, the relative debt to equity financing, and the fact that the debt is concentrated in the hands of a single entity caused the CRTC concern with the loans as a source of Orascom influence. The modifications to the covenants and terms of the loans did little to reduce this concern. Furthermore, the CRTC noted that covenants similar to those deleted from the Orascom loan agreements were still contained in Schedule A to the Shareholders' Agreement.

In addition to the above-noted concerns, the CRTC considered that a company's inability to obtain financing from third-party sources may also be relevant to the issue of control in fact. As noted in the Unitel decision, "In certain circumstances it may be possible to conclude that a non-Canadian shareholder or lender may have a considerable amount of leverage, and even control, over a cash-strapped telecommunications common carrier."

It is the CRTC's view that such a significant concentration of debt in the hands of Orascom, representing the vast majority of Globalive's enterprise value, serves to provide Orascom with leverage over Globalive. The CRTC concluded on this issue by stating that, given Orascom's equity interest in Globalive, "…such a high level of debt in the hands of a non-Canadian is unacceptable".

Conclusion

It is clear from the decision that it was the debt structure that ultimately led the Commission to conclude that Globalive is controlled in fact by Orascom. In its concluding remarks the Commission stated that given the changes that were made during the public hearing, and presuming that the additional changes identified in the decision were made, the equity position of Orascom, its position as the principal source of technical expertise, and its control of the WIND trademark would not cause the CRTC to conclude that Orascom is in a position of influence that is both "dominant and determining".

"However, when these levers are considered in concert with Orascom's provision of the vast majority of Globalive's debt financing, the Commission finds that it cannot conclude that Globalive is not controlled in fact by a non-Canadian, to wit Orascom. In other words, the Commission finds that Orascom has the ongoing ability to determine Globalive's strategic decision-making activities."

In light of the foregoing, the CRTC determined that Globalive is controlled in fact by Orascom, a non-Canadian. Therefore, Globalive does not meet the ownership and control requirements in the *Telecommunications Act* and is not currently eligible to operate as a telecommunications common carrier in Canada.

While this ruling by the CRTC does not mean that Globalive cannot come back with a new structure that satisfies the stated concerns, it is clear from the CRTC's concluding remarks that the debt structure will have to be addressed before this can happen. Given Globalive's statements during the public hearing regarding the difficulty of attracting debt financing for a "green field" operation at this point in time, this decision could seriously jeopardize the timing of the company's service launch.

For further information about this decision and its implications for your communications business or your communications investment, please contact the undersigned or one of the other members of our communications practice group.

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