

**University of Cape Town**  
School for Advanced Legal Studies

**The Foreign Direct Investments and their impact on Canadian and  
South African Telecommunications Industry**

By  
**Caroline Bergeron**  
**BRGCAR007**

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**Supervisor: Hudson Janisch**

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I hereby declare that I have read and understood the regulations governing the submission of Master of Laws dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

Cape Town, South Africa  
This 25 day of September, 2008.

Signed by candidate  
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## Introduction

Can you picture yourself living without any means of telecommunications? Can you imagine a life without the ease of accessing information from around the globe? Are you not always looking for more efficient and faster ways of communicating? If you answered yes to all of those questions, you are like many others addicted to information technologies and are always seeking new ways to acquire information.

In every country, the government is responsible to establish an adequate foundation for the telecommunications industry. Foundations are specific rules that enable different players to compete fairly. In some countries, governments decided to rely on market-forces to create a competitive platform. In others, governments are still enacting strict policies to insure fair-play. In both scenarios, the government's behaviour is always responsible for the telecommunications' market health.

One of the most important decisions that a government has to make with respect to telecommunications is whether foreign direct investments (FDI) will be partly limited, fully restrained or permitted. For the Organisation for Economic Co-operation and Development (OECD), FDI 'reflects the objective of obtaining a lasting interest by a resident entity in one economy ("direct investor") in an entity resident in an economy other than that of the investor ("direct investment enterprise")'<sup>1</sup>. Lasting interest in a country by an investor from another country can take many different forms. For example, it can consist of the acquisition or creation of a subsidiary company or an associate company, or even a branch in a foreign country.

In the telecommunications industry, FDI has been a controversial subject for many years<sup>2</sup>. In some third world countries, FDI is a miracle enabling the community to have access to decent means of telecommunications (ie: Pakistan). In the European

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<sup>1</sup> Organisation for Economic Co-operation and Development 'OECD benchmark definition of Foreign Direct Investment' (1999).

Organisation for Economic Co-operation and Development 'Measures of restrictions on inward foreign direct investment for OECD countries' (2003/1) 36 *OECD Economic Studies*.

Union, FDI is applauded because they ease the access to revolutionary technology for everyone; however, other countries fear the expansion of FDI. For those countries, FDI is a threat to state sovereignty and can threaten the security of the citizens. The solution to prevent the state sovereignty and security concerns is by strict regulation either partly or totally limiting FDI.

The scope of this paper is to demonstrate that countries should abolish the restrictions on FDI in order to create a successful telecommunications market. FDI can increase competition with amazing consequences for consumers. In Canada, FDI restrictions apply on basic suppliers and are a major burden for companies competing in this market. The illustration of this issue occurred with the take over of one of the incumbent companies, Bell Canada Enterprise (BCE). In South Africa, the telecommunications industry is stagnate and needs the influx of FDI to compete on an international level. FDI restrictions thwart the expansion of the South African telecommunications industry by turning down foreign capital. Countries around the world are benefiting from FDI and it is time for Canada and South Africa to liberalise their telecommunications market and step forward in this new trend.

## FIRST PART

### **1- Crucial importance of foreign direct investment**

Telecommunication has long been regarded as a very important economic sector not only for the size of the industry but also because of the multiple links with every other sector<sup>3</sup>. Communication and information are the central point of market competitiveness and socioeconomic development and a healthy telecommunication industry is crucial to a country's economic growth.

Since the two last decades, the liberalisation of telecommunications forced governments to step back from their previously important place in the industry. Governments used to own the monopoly, now they are asked to do as little as possible. Private parties are now fighting for this very lucrative business but to invest in this fast-moving industry with success, you need the right formula and there is no space for mistakes.

In 2008, the digital divide is still a main concern around the world. The digital divide is described as the gap in communication and information technology between countries<sup>4</sup>. While developed countries are establishing next generation networks, many developing countries are still facing difficulties to attain universal access. In some countries, local investors are hard to find and their budget is limited. In this perspective, foreign direct investment seems to be the only true means to bridge the gap. In countries where the telecommunications sector has been open to competition, the International Telecommunications Union (ITU) statistics show that the growth of the networks has been twice as rapid as in those countries where monopolies have prevailed. Furthermore, the

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<sup>3</sup> For further information on this subject see Georgette Wang 'Foreign investment policies, sovereignty and growth' (2003) 27 *Telecommunications Policy* 267-282.

<sup>4</sup> George Sciadras 'Unveiling the Digital Divide' (October 2002) *Science, Innovation and Electronic Information Division*, Connectedness series, Statistics Canada.

ITU study of 30 developing countries in Africa and Latin America show that privatization has a positive impact on network penetration<sup>5</sup>.

Foreign investors bring much more than only capital. Foreign investors specialising in the telecommunications industry can import massive amount financial resources and a very specific knowledge of the industry and skilled personnel to make sure foreign investment is in good hands.

Three key elements have to be recouped in an equity firm to make good foreign direct investors: capital, technology skills and management know-how. In Canada, it will be probably possible to find the required skilled-people to manage businesses and the appropriate technology but important capital might be lacking. In South Africa, the country is slowly recovering from the legacy of apartheid so that capital, avant-garde technology and managing experienced people will be difficult to find locally. It is then crucial for those two countries, like many others, to search for foreign direct investment to get them out of the impasse and help them improve their telecommunications industry.

### *1.1- The capital to develop the industry*

A massive amount of capital is required to create and maintain nation wide telecommunications network. In the beginning of telecommunications, governments owned a monopoly company providing basic services to the population. The liberalisation of the markets and the evolution of the technology are now pushing previously government-owned enterprises to search for investors to take the lead. However, very few equity firms are able to reach this spectacular amount of money to take over incumbent companies and restructured them. For some countries, to have the opportunity to benefit from overseas capital can be a turning point in their economy.

### *1.2- The transfer of technology to enable the competition*

In telecommunications, technology is moving at a very fast pace. Players in the industry have to always stay alert for new trends and innovation in order to keep up with the competitors. New entrants can be overwhelmed without the possibility to offer the latest

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<sup>5</sup>International Telecommunications Union 'ITU Special Sessions on Telecommunications' (25 June 1999) *Council for Trade in Services*, Geneva.

technology, often available only to bigger corporations. Foreign investors willing to pierce a new market will bring with them futuristic technology which will help the corporation compete at a high level.

### *1.3- The Management know-how to permit the growth*

With the capital and the latest technology, a company can expect to be equipped to compete. However, a key asset essential to the success of a company is the management know-how. It is primordial that the directors of the company know every detail of the market and have the ability to bring the company a step ahead of the competition. The management experience acquired overseas will be a must, especially when establishing a network from scratch.

## **2- Why do governments restrict foreign direct investments?**

Over the years, many arguments have criticised foreign direct investment in the telecommunications market. The most common arguments are obviously national sovereignty and security concerns.

### *2.1- National Sovereignty Concerns*

In the past years, the rise of globalisation has made the scholars think that state sovereignty is in decline. Information from around the world is available in many household by a simple search on the web. Governments from first to third world countries felt that keeping foreign direct investment restrictions was crucial to maintain the thin portion of sovereignty left. Telecommunications is the cornerstone of globalisation and facilitates the transmission of information around the world. Many governments thought that by limiting FDI in the telecommunications sector, national sovereignty and cultural autonomy will be safely guarded.

Steve Globerman in his analysis of non-economic factors in FDI recalled this significant quote by the Consultative Committee on the Implication of Telecommunications for Canadian Sovereignty:

‘Telecommunications, taken in the broadest sense, will form the infrastructure of the new industrial society that is now coming into being around the world. Canadian sovereignty in the next generation will depend heavily on telecommunications. If we wish to control our economy then we will require a sophisticated telecommunications sector developed and owned in Canada to meet specific Canadian requirements. To maintain our Canadian identity and independence we must ensure an adequate measure of control over data banks, trans-border data flow and the content of information services available in Canada. Telecommunications, as the foundation of the future society, cannot always be left to the rigors of the market’<sup>6</sup>.

Around the globe, it is unlikely that pressure for abolishing all trade barriers in telecommunications will end. Governments should act promptly to enact appropriate policies their public interest rather than enact restricted policies based on loss of sovereignty fears.

#### 2.1.1- Encouraging ‘National champions’

In this era of persistent competition between countries aspiring to top international position, countries can be tempted to favour home-based companies to have ‘national flag carrier’ shining at a high level. To support argumentation regarding mergers, parties are often claiming that consolidation will promote greater efficiency in an industry. The cornerstone of ‘national champions’ policies is whether the nationalities of the merging parties should matter.

As concluded by Hutton and Rushton in *National Champions- Canadian competition and Industrial Policy*, ‘national champions and firms looking to be national champions are not and have not been afforded special treatments under Canadian merger review’<sup>7</sup>. Rather, Canada’s protectionism over its ‘sensitive’ economic sectors has been by way of restrictions placed on foreign investments.

The population view on this subject can also undermine the government’s choice. Citizens without valuable information on the benefits of FDI can be angry at the government letting ‘national flag carriers’ slip into foreign hands. Education on the

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<sup>6</sup> Steve Globerman ‘Foreign ownership in telecommunications, a policy perspective’ (1995) 19 *Telecommunications Policy* at 21.

<sup>7</sup> Susan M. Hutton and Kevin Rushton ‘National Champions- Canadian Competition and Industrial Policy’ (12 February 2007). Paper prepared for the 2007 Competition Law and Policy Forum, Cambridge Canada.

overall benefits of the country is necessary to reduce restrictions on FDI and displace fears among the people.

### *2.2- Security Concerns*

Telecommunications industry is present in every sphere of the economy. Banks, large multi-nationals and governments are using networks and means of telecommunications to carry out their every-day work. As a result of the importance of telecommunications, some countries are frightened by the possibility of foreigners penetrating this critical sector. For example, the United States, ‘the most powerful advocate of the free trade principle and the world’s leading exporter of products and services in the field of communications never entirely let go of its control over the communications and information sector vis-a-vis foreign influences’<sup>8</sup>.

In Canada, attempt to empower the Governor in Council to review and disallow foreign investments in Canadian businesses that could affect the ‘national security’ was made in 2005<sup>9</sup>. The idea died on the Order Paper when a general federal election was called in late 2005. The subject recently resurfaced in front of the Parliament with substantially similar effect but with a slight terminology difference focusing on ‘national interest’ instead of ‘national security’<sup>10</sup>. This new legislative amendment would have to be referred to a committee for in-depth analysis and its prospects for enactment are uncertain<sup>11</sup>.

### **3- How do governments restrict foreign direct investment?**

Even with the international community agreeing on the benefits of removing FDI restrictions from the legislation, few countries still persist to complicate foreign investments.

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<sup>8</sup> Georgette Wang, note 3.

<sup>9</sup> Bill C-59, An Act to amend the Investment Canada Act, 38<sup>th</sup> Parl., 1<sup>st</sup> Sess.

<sup>10</sup> Bill C-386, An Act to amend the investment Canada Act (foreign investments), 39<sup>th</sup> Parl., 1<sup>st</sup> Sess.

<sup>11</sup> Susan Hutton and Kevin Rushton, note 7 at 11.

In a study by the Organisation for Economic Co-operation and Development (OECD) on foreign direct investment restrictions in member countries, the OECD concluded that overall FDI restrictions were low in the OECD area at present but important in a few countries<sup>12</sup>. Iceland, Canada and Turkey were the countries with the most restrictions while the United Kingdom and most of the European Union were at the opposite side of the scale. It was not until recently that the European Union took a favourable attitude regarding FDI and decided to open its doors. Since 1992, FDI flows intra-European Union is almost completely unrestricted. Other countries like the United States and Japan were precursors and both had relatively low statutory restriction since 1980.

In addition, some economic sectors are much more affected by FDI restrictions. This is the case for such sectors as electricity, telecommunications and transport which are the ones most frequently facing restrictions. These industries have usually been liberalised and privatised a few years ago and the government is still conscious of FDI. Concerns of national security are also important to protect those 'national flag carriers'. Other sectors like manufacturing, hotels, restaurants and construction are unlikely to have any statutory restrictions.

Different types of barriers for FDI have been used with more importance given to some of them. Formal restrictions include limits on foreign ownership, screening and approval procedures and constraints on foreign personnel and operational freedom. Informal barriers like opaque informal public or private measures can also be applied to restrict FDI.

### *3.1- Restrictions on ownership*

Restrictions on foreign ownership are the most obvious barriers to incoming FDI. A country can decide to limit foreign investors the access by a percent of the shares of a company. For instance, less than 50 per cent can be the maximum foreign investors can own to insure that the control will stay in national's hands. Limitations can also prohibit any foreign ownership in specific sectors.

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<sup>12</sup> Organisation for Economic Co-operation and Development 'VII- Foreign direct investments restrictions in OECD countries' (2003).

Sectors frequently affected by domestic ownership requirements include aviation, telecommunications, coastal and fresh water shipping and natural resources<sup>13</sup>. As it will be explained further, this kind of restriction has been used in Canada and in South Africa in the telecommunications industry.

The ownership barrier can have very harmful effects on a country. Policies restricting foreign investments send a signal to the international community that the country's frontiers are closed to foreign capital. Reciprocity concerns will push other countries to apply the same treatment which can be damaging to a country's economy. Conversely, policies that ensure that the ownership of foreign firms are enhanced will most likely be regarded as investor-friendly and consequently, encourage foreign firms to move production abroad.

### *3.2- Screening*

Mandatory screening and approval procedures can also be used to limit foreign direct investment. Screening includes all the reviewing process put in place by governments to assess the repercussion of the investment. Complicated review process can undermine transactions and repulse investors. Stipulations that foreign investors must show economic benefits for the country can also increase the price of implementing business and discourage investors<sup>14</sup>. However, important regulation without effective implementation will not be a constraint for some investors. Simple pre- or post-notification is unlikely to have much impact on foreign investors. Each country has to find the right balance between its national security concerns and the importance of the verification of new investors, and the undesirable loss of FDI.

For instance, the Investment Act in Canada obliges foreign investors to succeed to the 'net benefit for Canadian' test if they want to invest or take over a business within the country. Explained later in further detail, the Canadian government has a rigorous test but with the help of the Industry ministry, no one can fail.

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<sup>13</sup> OECD note 12 at 2.

<sup>14</sup> OECD note 12 at 3.

### 3.3- Foreign personnel and operational freedom

Policies can also restrict the movement of foreign personnel or assign high responsibility positions to nationals only. Foreign investors without the possibility to bring key personnel can feel a lack of control over their holdings and hence make them more hesitant to invest under such circumstances. In addition, the resources of skilled-people are very low in developed countries and a company might find that they can not make use of the necessary expertise to make their investment worthwhile.

For example, the Black Economic Empowerment Strategy (BEE Strategy) in South Africa requires that a number of previously disadvantaged people work in every South African company and this might have a negative effect on foreign investors<sup>15</sup>.

### 3.4- Informal barriers

Informal barriers can have disastrous effects on FDI. Even if they are not enacted in specific policies, opaque private or public measures are often used to limit the entry of foreign investors. For example, the 'United States trade representative has frequently stated that the system of corporate control in Japan has hampered investment by American companies and that the regulatory practices in telecommunications in the European Union work as *defacto* FDI restraining measures'<sup>16</sup>. Similar complaints were made against the United States in regards to the complex set of regulations in financial regulation.

## 4- Positive results of FDI

Foreign direct investment has already helped many third world countries to strengthen their telecommunications industry. The incredible advancement of Pakistan's telecommunications industry is an impressive illustration of FDI benefits<sup>17</sup>. In the beginning of 2000, the country signed WTO Basic Telecom Agreement and liberalised the telecommunications sector. In less than 5 years, FDI influx increased by more then 50 per

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<sup>15</sup> Further explanation in Part 3 of this Paper.

<sup>16</sup> OECD note 12 at 3.

<sup>17</sup> Zaineb Hussain Siddiqui 'Telecom sector liberalisation and deregulation in Pakistan: Economic and social benefits' (February 2008) *Ministry of Information technology, Government of Pakistan*.

cent on infrastructure and licence totalling a sum of over US\$8 billion. Consequently, combined teledensity (fixed-line and cellular phone) has already reached 53.41 per cent compared to only 4 per cent in 2003.

Impacts on the population took many different forms. First, consumers have benefited from a reduction in prices from both fixed and mobile lines. Secondly, the country predicts 1 366 698 direct and indirect jobs created in 2007 only from the expansion of telecommunication services. The health care, agriculture and education sectors are few of many that directly improved from the arrival of FDI in the country. The economic and social benefits have been significant and will continue to increase over the years in Pakistan.

The Republic of Mauritius (Mauritius) is another good example of how FDI can transform a country<sup>18</sup>. In this small island in the middle of the Indian Ocean, the government acknowledged that to improve its citizen's life a radical change in telecommunications policy was required. The country signed the WTO Basic Telecom Agreement and entered into a liberalisation process of the telecommunications legislation. Since 2005, it reached full compliance with the WTO requirements and completed the liberalisation and privatisation of the telecommunications sector. Today, foreign direct investments are financed by countries around the globe, with the United States providing the principal influx (44 per cent). After modifying the legislation, Mauritius became an attractive country for foreign investors which has contributed to the growth of their telecommunications industry.

Pakistan and Mauritius are examples of many countries that have made the jump to liberalisation and opened their doors to FDI. The population has greatly benefited from their government's decisions. Other countries should look at the success story of these two countries and enact legislation with fewer restrictions in FDI.

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<sup>18</sup> M. K. Oolun 'Outsourcing in Mauritius' (February 2008) *ICT Authority-Mauritius*.

## SECOND PART

### **1- Legislation review on foreign direct investments restrictions in Canada**

#### *1.1- Investment Canada Act*

In the early 1980's, Canada experienced a growing amount of foreign investors looking to penetrate its market and as a result, the government introduced the Investment Canada Act of 1985.

Among the plethora of regulations restraining foreign investment, the Act is the most significant restriction<sup>19</sup> for investors and falls under the supervision of Industry Canada. The aim of the Act is 'to encourage investment in Canada by Canadians and non-Canadians that contribute to economic growth and employment opportunities and provide for the review of significant investments in Canada by non-Canadians in order to ensure such benefit to Canada'<sup>20</sup>. Non-Canadians have to succeed at the rigorous test of 'net benefit' for Canada to invest in or takeover a Canadian business.

#### 1.1.1- 'Net benefit' for Canada

The notion of 'net benefit' is central to the Act's understanding. In order to determine what is considered as a net benefit for the country, six factors are taken into account: (1) the effect of the investment on the level and nature of economic activity in Canada, (2) the degree and significance of participation by Canadians in the business, (3) the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada, (4) the effect of the investment on competition within any industry or industries in Canada, (5) the compatibility of the investment with national industrial, economic and cultural policies, and (6) the contribution of the investment to Canada's ability to compete in worlds markets<sup>21</sup>. If the Minister is satisfied that the investments are likely to be of net benefit to Canada with regards to the above

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<sup>19</sup> Fraser Institute 'Increased foreign investment provides Canadian consumers with lower prices and higher wages' (8 November 2007) *Fraser Institute News Release*.

<sup>20</sup> Investment Canada Act (1985, c. 28 (1st Supp.)) s.2.

<sup>21</sup> Investment Canada Act, s.20.

mentioned factors, a notice will be sent to the applicant that his request is accepted under the Act<sup>22</sup>.

This elaborate review process is in fact not as restrictive as it seems to be. Industry Canada personnel's mandate is to ensure that foreign investor's requests meet the criteria and represent a net benefit to Canada<sup>23</sup>. The Act came into effect on 30 June 2007 and since then, 12,342 applications to acquire Canadian businesses and 3,652 applications to start new businesses in Canada have been sent to the Industry minister. 1,545 of the foreign acquisitions of Canadian companies were of sufficient size to trigger a review under the Act<sup>24</sup>. The help of the ministry to get around the obstacles and the possibility to amend their demands resulted in the approval of every request since the enactment of the Investment Canada Act.

The directive given by the government to the Industry minister is clearly not in favour of publicly rejecting any applications. A very strict approval system brings the risk of signalling that the country is not completely open to foreign capital<sup>25</sup>. Sending a message that a country has a strict system for approvals can seriously harm the enthusiasm of foreign investors.

In other countries, different formulas have been implemented to control foreign investments. For instance, Australia applies a 'negative test' which consists of an evaluation by the government of what is 'contrary to the national interest' in regard to the widely held community concerns of Australians<sup>26</sup>. Unlike Canada, the Australian government has used the 'national interest test' in the past to block major investments. The US, although considered to be a very welcoming state for foreign investors, has a mechanism that screens all foreign acquisitions on the basis of national security concerns.

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<sup>22</sup> Investment Canada Act, s.21.

<sup>23</sup> Strategic Policy Directorate 'Restrictions on Foreign Ownership in Canada' (August 2003) *Policy Research Branch* TP I4500E at 4.

<sup>24</sup> Michael Holden 'The Foreign Direct Investment Review Process in Canada and Other Countries' (19 September 2007) *Library of Parliament- Parliamentary Information and Research services* PRB 07-13E at 3.

<sup>25</sup> Michael Holden note 24 at 4.

<sup>26</sup> Michael Holden note 24 at 5.

However, the review is not automatic for most types of foreign direct investment and investors will normally apply for national security reviews on a voluntary basis<sup>27</sup>.

### 1.1.2- Distinction for WTO members

The Act draws a clear distinction between WTO members and non-members. The thresholds which will generate the review provisions of the Act will vary depending on whether the investors are part of the organisation or not. The threshold to review for a WTO member acquiring a Canadian business not engaged in a specified sensitive sector<sup>28</sup> is calculated yearly by the Minister of Industry. For 2007, the transaction threshold has been set at C\$281 million. The threshold is much lower when the acquisition is in a specified sensitive sector or for a non-member. In such cases, all direct acquisitions of Canadian businesses with assets of C\$5 million or more, all indirect acquisitions of Canadian businesses with assets of C\$50 million or more and all indirect acquisitions of Canadian businesses with assets of C\$5 million or more where the Canadian assets represent more than 50 per cent of the value of the total international transaction will be reviewed by the Industry ministry<sup>29</sup>.

One hundred fifty-two countries including major economies like China, India, Japan and the US are member of the WTO<sup>30</sup>. Around 30 countries are considered 'observer governments' and are currently negotiating their membership. However, regarding the definition of 'WTO member' included in the Act, the above 30 countries are not considered as members and will then be subjected to the more severe reviewing process<sup>31</sup>. So far, 14 states and 2 territories have no official interaction with the WTO.

## 1.2- The Telecommunications Act

### 1.2.1- Canada moves towards restrictions in FDI

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<sup>27</sup> Michael Holden note 24 at 9.

<sup>28</sup> The production of uranium and ownership of a uranium-producing property in Canada, financial services, transportation services and cultural activities are considered as «sensitive sector investments» Investment Canada Act s.14.1 (5).

<sup>29</sup> Investment Canada Act s.14.

<sup>30</sup> World Trade Organisation 'Members and Observers'. Available online at [www.wto.org](http://www.wto.org) (23 May 2008).

<sup>31</sup> Investment Canada Act s.14.1 (7).

The phenomenon of FDI restrictions in the telecommunications in Canada is quite recent. The first apparition of this trend occurred on telecommunications common carrier in 1984, on a selective basis, when Rogers Cantel inc. was granted the first national cellular radio licence<sup>32</sup>. The Department of Communications chose a limit of 20% available to foreign investors of the voting stock in the corporation. Furthermore, in 1987 and in 1991 the Teleglobe Canada Act<sup>33</sup> and the Telesat<sup>34</sup> Canada Act both placed FDI restrictions on the two telecommunications companies that bear the names Teleglobe and Telesat Canada.

In July 1987, a comprehensive policy document named *A Policy Framework for Telecommunications on Canada* (Policy Framework) was introduced by the Minister of Telecommunications. Many policy proposals on telecommunications issues were set in the Policy Framework, including foreign direct investment restrictions<sup>35</sup>. The Canadian government was proclaiming its will to apply foreign investment restrictions to all telecommunications carriers achieving its goal ‘to harmonize Canadian policy with that of other countries and ensure the national sovereignty, security and economic, social and cultural well being’.

The launch of the Policy Framework took place within the same period of the negotiations between the Canadian and American governments for the Canada-United States Free Trade Agreement<sup>36</sup>. At that time, US had strict restrictions on foreign ownership in telecommunications but removed every restriction with the Telecommunications Act of 1996<sup>37</sup>. Canada followed its neighbour in implementing FDI restrictions in 1987 but did not modify its Act when the US enacted the more permissive legislation. Today, the US is pressuring Canada to remove every restriction on FDI in telecommunications and are impatiently waiting for a change.

### 1.2.2- The Telecommunications Act of 1993

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<sup>32</sup> Strategic Policy Directorate note 23.

<sup>33</sup> Teleglobe Canada Reorganization and Divestiture Act (1987) c.12.

<sup>34</sup> Telesat Canada Remission Order (1991) c.24.

<sup>35</sup> Strategic Policy Directorate note 23.

<sup>36</sup> The Canada-United States Free Trade Agreement was superseded by NAFTA on January 1<sup>st</sup> 1994. Mexico joined Canada and the United States to create the largest free trade area in the world. For more information see [www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/us-eu.aspx?lang=en](http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/us-eu.aspx?lang=en) (available 7 July 2008).

<sup>37</sup> Telecommunications Act of 1996, Pub. L.A. No. 104-104, 110 Stat. 56 (1996)

Although the Policy Framework for telecommunications came into effect in 1987, Canadians had to wait until the passage of the Telecommunications Act<sup>38</sup> in 1993 for the specifics of its application to be implemented. Section 7 of the Act described the different objectives underlying the Act. It first stipulates the essential role of telecommunications in the maintenance of Canada's identity and sovereignty, has previously discussed<sup>39</sup>.

National objectives in the telecommunications industry are then described as followed:

- (a) to facilitate the orderly development throughout Canada of a telecommunications system that serves to safeguard, enrich and strengthen the social and economic fabric of Canada and its regions;
- (b) to render reliable and affordable telecommunications services of high quality accessible to Canadians in both urban and rural areas in all regions of Canada;
- (c) to enhance the efficiency and competitiveness, at the national and international levels of Canadian telecommunications;
- (d) to promote the ownership and control of Canadian carriers by Canadians;
- (e) to promote the use of Canadian transmission facilities for telecommunications within Canada and between Canada and points outside Canada;
- (f) to foster increased reliance on market forces for the provision of telecommunication services and to ensure that regulation, where required, is efficient and effective;
- (g) to stimulate research and development in Canada in the field of telecommunication and to encourage innovation in the provision of telecommunication services;
- (h) to respond to the economic and social requirements of users of telecommunication services; and
- (i) to contribute to the protection of the privacy of persons<sup>40</sup>.

Those different goals similarly aim towards implementing a greater telecommunications industry in Canada; however, conflicts can occur between legislative vehicles put in place to reach those goals. In the following part, I will analyse and compare three of the national objectives of the Telecommunications Act: the objective of

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<sup>38</sup> Telecommunications Act 1993 c.38. (hereinafter referred as Telecommunications Act)

<sup>39</sup> See section 2.1.

<sup>40</sup> Telecommunications Act s.7 (d).

reliable and affordable telecommunication services; the efficiency and competitiveness of Canadian telecommunications at national and international levels; and the promotion of ownership and control of Canadian carriers by Canadians.

#### 1.2.2.1- Reliable and affordable telecommunications

The objective proposed under section 7(d) of the Telecommunications Act is crucial for the development of the Canadian society. Reliable and affordable services of high quality in both urban and rural areas are essential for the growth of the country and the well-being of the population. Section 27 of the Act imposes Canadian carriers to provide services at just and reasonable rates and without unjust discrimination or undue or unreasonable preference. As stated in paragraph 5 of section 27, the Commission may adopt any method to determine whether a rate is just and reasonable. The notion of just and reasonable is very imprecise and no one can know to which extent the government will interfere in the market to reach its goal.

#### 1.2.2.2- Efficiency and competitiveness of Canadian telecommunications

Efficiency and competitiveness establish that for the country to keep its world leading position in telecommunications, the Canadian market has to be more efficient and competitive.

Many different powers have been given to the CRTC to assure an efficient and competitive market in Canadian telecommunications. For example, a Canadian carrier can be forced by the Commission to implement interconnection with another telecommunications carrier<sup>41</sup>. The Commission has also the opportunity to refrain, in whole or in part and conditionally or unconditionally, from the exercise of any powers given to it by the Act to increase the reliance on market forces<sup>42</sup>.

If the Commission does not establish an efficient and competitive market for telecommunications, the Act gives the authority to the Governor in Council to issue to the Commission directions of general application on broad policy matters in respect to the

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<sup>41</sup> Telecommunications Act s.40

<sup>42</sup> Telecommunications Act s.34 (1).

Canadian telecommunications policy objectives<sup>43</sup>. Policy directions are binding on the Commission.

Efficiency and competitiveness are the keys to Canada's telecommunications success. As it will be elaborated further, problems of efficiency and competitiveness are directly related to FDI restrictions.

#### 1.2.2.3- Ownership and control of Canadian carriers by Canadians

Part II of the Telecommunications Act defines the conditions to be eligible to operate a telecommunications common carrier. Under section 16, an entity will fulfill the requirements if it is a 'Canadian-owned and controlled corporation incorporated or continued under the law of Canada or a province'. A corporation is Canadian-owned 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 than 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.<sup>44</sup>

Similarly, non-Canadians can not own more than 33.3 per cent of the voting shares of a non-operating parent corporation of the operating carrier, nor can the parent be otherwise controlled in fact by non-Canadians. This was established by the Governor in council in the Canadian Telecommunications Common Carrier Ownership and Control Regulations in October 1994<sup>45</sup> on the recommendation of the Minister of Industry, Science and Technology, pursuant to section 22 of the Telecommunications Act.

Consequently, the maximum total that a non-Canadian can hold is 46.7 per cent which is calculated as holding directly 20 per cent of the voting shares of a telecommunications carrier and indirectly 33.3 per cent of the voting shares of a holding company that owns the telecommunications carrier. For instance, the voting shares of a

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<sup>43</sup> Telecommunications Act s.8.

<sup>44</sup> Telecommunications Act s.16 (c).

<sup>45</sup> Canadian Telecommunications Common Carrier Ownership and Control Regulations (SOR/94-667) (hereinafter Regulations SOR/94-667).

company X are divided in two parties: 20 per cent to a non-Canadian company and 80% to a non operating parent Canadian company Y. The non-Canadian company also possesses 33.3 per cent of the voting shares of the company Y. In total, the non-Canadian corporation owns 46.7 per cent of the company X (20 per cent plus 33.3 per cent multiplied by 80 per cent), which is the maximum legally allowed.

#### 1.2.2.3.1- Definition of ‘Canadians’

The Canadian Telecommunications Common Carrier Ownership and Control Regulations defines ‘Canadians’ as including:

- a Canadian citizen or permanent resident;
- a corporation without share capital where a majority of its directors or officers are appointed or designated by a federal or provincial government;
- a corporation in which Canadians beneficially own and control, in the aggregate and otherwise than by the way of security, not less than two-thirds of the issued and outstanding voting shares, and which is not otherwise controlled by non-Canadians;
- a trust in which Canadians have not less than two-thirds of the beneficial interest and of which a majority of the trustees are Canadian; and
- a partnership in which Canadian partners beneficially own and control not less than two-thirds of the beneficial interest and which is not otherwise controlled by non-Canadians<sup>46</sup>.

#### 1.2.2.3.2- Definition of ‘control’

The notion of control is described as the ‘control in any manner that results in control in fact, whether directly through the ownership of securities or indirectly through a trust, an agreement or arrangement, the ownership of any body corporate or otherwise’<sup>47</sup>. It is important to note that an agreement between the shareholders to give control to non-Canadians is not permissible under the Act. The goal of promoting the ownership of Canadian carriers by Canadians is accomplished by preventing foreign nationalities to

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<sup>46</sup> Regulations SOR/94-667 s.2 «Canadians».

<sup>47</sup> Telecommunications Act s.2(1) «control».

attain decisions-making positions. However, it is doubtful that this will be respected by the by foreign investors as was the case in the take over of Bell Canada Enterprises.

### 1.2.3 Tension between goals

If at first sight objectives of reliable and affordable telecommunications, efficiency and competitiveness of the market and the promotion of ownership of telecommunications companies by Canadian<sup>48</sup> seem to head in the same direction, conflicts between them happen too often. How can the government provide an efficient and competitive telecommunications platform without foreign investors increasing the competition? Consequently, how can reliable and affordable services be implemented if competition is reduced by limited numbers of competitors? National objectives should all have the same importance but it is obvious that in the present case, the objective of ownership of Canadian carriers by Canadians considerably outweigh the other objectives.

### *1.3- WTO Basic Telecommunications Agreement*

In the past decade, a wave of change in telecommunications industry brought a transformation from government ownership and strict regulation towards competition as the *modus operandi*<sup>49</sup>. The Fourth Protocol to the G.A.T.S. (commonly known as the WTO Basic Telecom Agreement) concretised this new direction and 69 countries with over 90 per cent of the international telecommunications traffic signed the Protocol. The Regulatory Framework Reference Paper was issued to lay down the basic pro-competitive regulatory commitments agreed on by the parties. Six matters were covered in the Reference Paper: competitive safeguards, interconnection, universal service, public availability of licensing criteria, independent regulator and allocation and use of scarce resources.

At the end of the negotiations, Canada resisted to the strong pressure of other members to remove the restrictions on foreign ownership. One of the country's reserves to the Reference paper mentions that it 'limits foreign equity in all facilities-based

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<sup>48</sup> See section 1.2.2.1 to 1.2.2.3.

<sup>49</sup> James R. Green and David J. 'Four approaches to telecommunications deregulation and competition: The U.S., U.K., Australia and New Zealand' Haas School of Business, University of California.

suppliers to 20 per cent direct and 46.7 per cent combined direct and indirect foreign ownership'.<sup>50</sup> The reserve complies with the Telecommunications Act which enacts the same restriction. However, there are no foreign restrictions for value-assed telecommunication services or for resale<sup>51</sup>. Having set this reserve, the government clearly expressed the peculiar dimension of basic telecommunications facilities seen as 'national flag carriers' unlike other telecommunications services.

Furthermore, the reserve stipulates that facilities-based telecommunication service suppliers should be controlled in fact by Canadians. The concept of control in fact means that agreement between Canadians shareholders and foreign nationals shareholders including a transfer of control is not permissible.

During the negotiations for the Reference Paper, many countries concluded that the benefits of increasing access to foreign capital outweigh the implicit cost of any associated loss in sovereignty. Canada decided to follow another path and 'almost all other OECD countries now have more liberal telecommunications foreign investment regimes than Canada'<sup>52</sup>. The Canadian government took a leading role in the WTO basic agreement on telecommunications and the reserve on FDI is in disparity with goals that had been fixed by the country. Canada should act to promote the principle of open markets, including open investment rules by abolishing the existing restrictions on FDI.

## **2- Recent developments**

### *2.1-The Telecommunications Policy Review Panel Report*

The Telecommunications Policy Review Panel (Panel) was created in March 2006 and the aim of the Panel was clear: to review the Canadian Telecommunication policy framework and to recommend new ideas to modernize it to ensure that Canada has a strong, internationally competitive telecommunications industry that delivers world-class services for the economic and social benefit of all Canadians<sup>53</sup>. Telecommunication is a very wide field and the panel focused on three crucial and problematic aspects. First, Canadian

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<sup>50</sup> CRTC 'Telecom Public Notice' Decision CRTC 94-37.

<sup>51</sup> Strategic Policy Directorate note 23 at chap.5

<sup>52</sup> Competition Bureau, Telecommunications policy review panel 'Final report, 2006' [2006] Public Works and Government Services Canada at 35(hereinafter cited as Telecom report).

<sup>53</sup> Telecom report note 50.

consumers and businesses were in a desperate need for a new regulatory framework that is more efficient, functional, forward looking and that can adapt to changing technological landscape. Secondly, the Panel had to recommend mechanisms to ensure that the appropriate level of access to modern telecommunications services is available to all Canadians. Finally, the promotion of development, adoption and expanded use of advanced telecommunication services was a fundamental goal and the means to fulfil such goals were required.

The important telecommunication specialists regrouped in the Panel brought answers and recommendations on many crucial questions in the telecommunications industry. However specific modifications on restrictions on FDI were totally forgotten. The change proposed for section 7 erasing the objective of promoting ownership of Canadian carriers by Canadians is a huge step forward for foreign investors<sup>54</sup>.

Instead of concrete suggestions, the report proposed a phased approach to liberalization of the telecommunications industry. The objective is ‘to achieve the benefits of liberalization of the rules while retaining the power to avoid the major potential negative consequences’<sup>55</sup>. Widely held concerns about the loss of high-paying management and high-tech jobs, the reduction of research and development in Canada and the protection of Canada’s public safety and nationality were acknowledge by the Panel. Furthermore, modifications should coincide in the Telecommunications Act and in the Broadcasting Act to reduce the possibility of competitiveness issues between cable companies and telecommunication companies.

The reform proposals are far from being perfect but it is a first step in the right direction. Without the national objective of ownership by Canadians, government goes from promoting the interest of a few citizens to endorse the interest of every Canadians. Foreign investors can be excited that the Canadian government is finally going in the direction chosen by almost every developed country.

## *2.2- Policy direction*

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<sup>54</sup> Telecom report note 50 at 12-3.

<sup>55</sup> Hank Invent ‘Telecommunications Policy Review Panel charts a new course for Canadian telecommunications’ (28 March 2006) *McCarthy Tétrault presentation details*.

For the first time since the adoption of the Telecommunications Act, the Minister of Industry, Mr. Maxime Bernier, on June 13<sup>th</sup> 2006, tabled in Parliament a proposed policy direction to the Canadian Radio-television and Telecommunications Commission (CRTC). The proposal follows the release of the Panel's final report. Section 8 of the Telecommunication Act provides to the Governor in Council with the authority to issue to the CRTC directions of general application on broad policy matters with respect to the Canadian telecommunications policy objectives<sup>56</sup>. Policy directions do not have legal enforcement but are often used as tools for the government to provide guidance to an organization like the CRTC. The Honorable Maxime Bernier during the press-conference following the announcement said: 'Tabling this document signals the government's intention to direct the CRTC to rely on market forces to the maximum extent feasible under the Telecommunications Act and regulate — where there is still a need to do so — in a manner that interferes with market forces to the minimum extent necessary.'<sup>57</sup> Before the announcement of a complete reform of the Telecommunication Act, the government had to give the above new directions to the CRTC. The document tabled would direct the CRTC to take a more market-based approach in implementing the Act<sup>58</sup>. Published on June 17<sup>th</sup> 2006, the order came into force on December 14<sup>th</sup> 2006<sup>59</sup>.

### *2.3- Competition Policy Review Panel*

Almost a year after its creation, the Competition Policy Review Panel proposed its final report to the government of Canada in June 2008. As mentioned by the chair of the Panel, L.R. Wilson, at the release of *Compete to Win- Final Report*<sup>60</sup> 'The Panel believes that Canada needs to be more open to competition, as competition spurs the productivity enhancements that underpin our economic performance and ultimately our quality of life'<sup>61</sup>. The title of the report was chosen to describe two fundamental beliefs of the Panel.

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<sup>56</sup> Telecommunication Act of 1993 (Canada), c.38.

<sup>57</sup> Isabelle Fontaine 'Canada's New Government Tables Proposed First-of-its-Kind Policy Direction on Telecommunications to CRTC Calling for Greater Reliance on Market Forces' (6 November 2007) Available at [www.ic.gc.ca](http://www.ic.gc.ca) [6 November 2007].

<sup>58</sup> Telecommunications Act of 1993 (Canada), c.38.

<sup>59</sup> Government of Canada 'Order Issuing a Direction to the CRTC on Implementing the Canadian Telecommunications Policy Objectives' (27 December 2006) 140 26 Canada Gazette.

<sup>60</sup> Competition Policy Review Panel 'Compete to win- Final report 2008' (June 2008).

<sup>61</sup> L.R. Wilson 'release of Compete to Win' (26 June 2008) Speech by L.R. Wilson, chair, Competition Policy Review Panel to the Economic Club of Toronto.

First, they believe that the country needs to be more competitive at home like abroad to reach a good position in the global market. Competitors getting stronger rapidly, ‘Canada must step up its game’<sup>62</sup>. Second, Canadians are very talented and determined to win and will do so.

During their research, the Panel asked important players in the industry to give their view on how the Canadian telecommunications industry should be shaped. For Bell Canada, as acknowledged within the Consultation Paper, ‘Canada has been experiencing a growing productivity gap with its largest trading partner (the U.S.), and a continual lack of improvement in its own productivity growth’<sup>63</sup>. The incumbent company suggested diverse solutions to strengthen Canada’s position relative to other destinations for FDI, including encouraging increased business investment in ICT, new tax policy and credit and an augmentation of the talent pool of IT-skilled workers.

The Panel proposed to the government two different approaches to succeed in the telecommunications market. First, Canada should promote talent, capital and innovation within the Canadian market and between Canada and the world. Secondly, the country should demonstrate a strong commitment to openness to talent, investment and ideas from around the world. For the Panel, this openness is crucial in the era of globalization with competitors getting stronger and coming from emerging economies.

The Panel had the mission to review two important pieces of legislation: the Investment Canada Act and the Competition Act. Brilliant recommendations were made on both Acts. In the view of the Panel, the 20 year old Investment Canada Act does not reflect the dynamics of today’s global commerce and importance of foreign investment to Canada’s economy<sup>64</sup>. The onus of the Act should be the reverse and impose on the Minister to articulate why a transaction is contrary to ‘national interest’ instead of foreign investors being required to demonstrate a ‘net benefit’ to Canada. Furthermore, the thresholds should be raised to diminish the number of review.

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<sup>62</sup> L.R. Wilson note 59.

<sup>63</sup> Bell Canada ‘Response of Bell Canada: Competition Policy Review Panel’s Sharpening Canada’s Competitive Edge’ (January 2008) at 2.

<sup>64</sup> L.R. Wilson note 59.

With the goal of creating more competition in the telecommunications field, the Panel made a few suggestions to 'tune-up' the Competition Act but also mentioned, the Act was well suited to today's climate. Finally, the Panel asked the federal, provincial, territorial and municipal governments to work together in the pursuit of a common goal, the best interests for Canada<sup>65</sup>.

### **3- Impact of FDI restrictions in Canada**

The restrictions on foreign direct investment in the telecommunications industry negatively affect the development of competition in Canada. Restrictions effectively limit investment in telecommunications, increase the cost of access and can delay the diffusion of new technology<sup>66</sup>. Canada is one of six OECD countries where restrictions on foreign investment are still applicable. This protectionism on telecommunications common carriers starkly contrasts with the openness of the telecommunications market of most other provisions around the same subject. As previously explained, national sovereignty concerns expressed by the Canadian government harm the competition in telecommunications by restraining access to new competitors by limiting access to capital.

In 2002, the OECD was concluding a review of the regulatory reform in Canada and found that the country was one of the leading OECD countries in terms of its performance in the telecommunications sector. However, the OECD opined that the most important weakness that characterises the Canadian market is the FDI restrictions<sup>67</sup>. Every participant in the telecommunications scene is affected by the FDI restrictions.

#### *3.1- Impact on incumbent companies*

Incumbent companies can appear to be benefit from the restrictions on FDI. While harming the capacity of new competitors to pierce the market, incumbent companies have a wide open field. In addition, one can assume that incumbents can rely on operation funds to survive and those affirmations are true to a certain extent. The takeover of Bell

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<sup>65</sup> L.R. Wilson note 59.

<sup>66</sup> Organisation for Economic Co-operation and Development 'OECD reviews of regulatory reform; Regulatory reform in Canada: from transition to new regulation challenges; Regulatory reform in the telecommunications industry' (2002) at 18.

<sup>67</sup> OECD note 64 at 48.

Canada Enterprises that took place in June 2008 clearly illustrates that even huge players have difficulties related to FDI restrictions.

### 3.1.1- Case study: Bell Canada Enterprises takeover

Bell Canada Enterprises (BCE) is the country's largest communications company and controls a number of telecommunication and broadcasting businesses<sup>68</sup>. The company describes itself as 'providing the most comprehensive and innovative suite of communication services to residential and business customers in Canada'<sup>69</sup>. For the past 127 years, BCE brought Canadians local and long distance phone service, wireless voice and data service, internet access, satellite television and other related services<sup>70</sup>.

Over the past few years, Canada has not kept up with the pace in the technology sector. In this field, the issue is not only how you revolutionize your approach but also how fast you do it. For many experts, even with the recent progress made by the country, "Canada has not remained at the leading edge of development and deployment in the two key growth areas of the telecommunications sector — broadband and wireless"<sup>71</sup>. BCE being a cornerstone of the Canadian telecommunications economy, many consumers were staring at the poor results of the company in innovation and development and were asking for improvement.

BCE, the parent company of Bell Canada, was a public company held by over 600 000 shareholders. On June 30<sup>th</sup> 2007, a consortium led by Ontario Teachers Pension Funds announced that it had struck a deal to acquire BCE<sup>72</sup>. Other partners in the buyout included U.S. equity firms Providence Equity Partners Inc., Madison Dearborn Partners and Merrill Lynch Global Private Equity.

Many issues harmed the takeover including the complicated foreign direct restrictions policies that BCE had to respect. As previously explained, Canadians have to own a minimum of 66.6 per cent of the shares of a telecommunications basic services

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<sup>68</sup> Lorne P. Salzman 'Canada : CRTC allows foreign investors to acquire large stakes in Canadian broadcasting companies – Despite Canadian ownership and control restrictions' (30 June 2008) *Mondaq*.

<sup>69</sup> Bell Canada Enterprise 'About BCE' available at [www.bce.ca/en/aboutbce/](http://www.bce.ca/en/aboutbce/) (17 July 2008).

<sup>70</sup> Bell Canada Enterprise note 67.

<sup>71</sup> Telecom report note 50 p.35

<sup>72</sup> Tom McFeat 'The BCE takeover' (4 July 2008) *CBC News*.

company. In the present case, Morcague Holdings Corp., a Canadian-controlled company will hold 66.7 per cent of the Class A shares of BCE Holdco, with the balance of 33.3 per cent held by non-Canadians, namely Providence, Madison and Merrill Lynch. A voting agreement between Morcague and Teachers' Private Capital, a division of Teachers', will be formed with respect to the Class A shares.

In addition, the majority of Class B shares and all of the Class C shares of BCE Holdco will be held by Canadians as mandated by the Telecommunications Act. Teachers' will be holding the largest equity stake in the company at 51.6 per cent. Non-Canadians would hold approximately 42 per cent of the equity of BCE Holdco while respecting the limit of 46.7 per cent. Providence, Madison and Merrill Lynch would be the largest non-Canadian shareholders with respectively 17.3 per cent, 9.0 per cent and 6.1 per cent<sup>73</sup>.

The criterion of control-in-fact in the Telecommunications Act was also carefully examined by the CRTC before approving the take-over. Teachers' does not have any particular expertise in the communications field while Providence specializes in investments in communications companies<sup>74</sup>. The CRTC was concerned about a few matters related to the control in fact: the composition and mandate of the Board of Directors of BCE Holdco (Board) and the boards of its subsidiaries, the quorum provisions for the Board, the composition of the Executive Committee, the transactions requiring investor approval, the composition of the Independent Programming Committee and the advisory services<sup>75</sup>. To be certain that the control in fact will remain in Canadian's hands, the Commission imposed a few changes which were accepted by Teachers'. Among many other requirements<sup>76</sup>, Teachers' will have to name two of the five members of the executive committee, and that they, along with the CEO must be Canadian<sup>77</sup>. The CRTC approved the transfer of effective control of BCE, subject to the conditions mentioned

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<sup>73</sup> Lorne P. Salzman note 66.

<sup>74</sup> Lorne P. Salzman note 66.

<sup>75</sup> CRTC 'Transfer of effective control of BCE Inc. to a corporation to be incorporated and a consequential change in ownership of CTVglobemedia Inc.' Decision CRTC 2008-69 at 30.

<sup>76</sup> CRTC note 73 at 77.

<sup>77</sup> Sean Silcoff 'CRTC approves \$52 billion takeover of BCE, with conditions' (7 March 2007) *Canwest News Services*.

above<sup>78</sup>. The decision went all the way up to the Supreme Court where a unanimous judgment in favour of the buyout was held in June 2008<sup>79</sup>.

In fact, Providence does not intend to have a passive investors' role in the company. With their strong knowledge of the telecommunications industry, they planned on acting behind the scenes but would be selecting and monitoring closely the plans of operators<sup>80</sup>. Time will tell if the CRTC will criticize the huge American influence on the new BCE.

At this point, it is important to recap that two other private equity group participated in the awkward auction for the buyout of BCE. One of them is composed of The Canada Pension Plan Investment Board (CPP), the Caisse de dépôt et placement du Québec (Caisse), Onex investments and Kohlberg Kravis and Roberts (KKR) and was created after an active role by Micheal Sabia, CEO of BCE, tried to increase the competition of potential buyers. The second one was composed of the Hospital of Ontario Pension Plan, Richard Li, CanWest Communications and Cerberus. Both consortiums faced trouble complying with the requirements of Canadian ownership. The first group mentioned lost at the very last minute because there Canadian partner, Caisse and Onex, was forced to abandon the process<sup>81</sup>. As for the second group, Richard Li of Hong Kong who had never resided in Canada after obtaining his citizenship<sup>82</sup> couldn't meet the 'Canadian' definition in the Telecommunications Act and with only CanWest as Canadian component, the consortium didn't fulfil the requirements. Conclusions can be drawn that the FDI restrictions literally blocked two possible bidders and harmed the possibility of a more competitive process bringing the best value for the shareholders.

After a last-minute reduction, the per-share price was established at 42.75 and still stands as a major achievement. The pursuit of BCE's directors for a 'maximum value for BCE's shareholders, against adverse legal and financial forces, ranks as one of the

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<sup>78</sup> CRTC note 73 at 148.

<sup>79</sup> Sean Silcoff 'Top court rules in favour of BCE' (20 June 2008) *National Post*.

<sup>80</sup> Sean Silcoff 'Stealth Mogul' key to Bell b2id' (9 July 2007) *National Post*.

<sup>81</sup> Sean Silcoff, 'KKR bif for Bell unravels' (6 June 2007) *National Post*.

<sup>82</sup> Sean Silcoff 'Cerberus woos Manulife in bid for BCE: sources' (16 June 2007) *National Post*.

greatest achievements in the annals of Canadian law and Canadian corporate history'<sup>83</sup>. The question that the shareholders can ask themselves is 'how much they could have cashed in without the burden of the FDI restrictions?'

The winning consortium now has a \$42 billion debt over its head. BCE will have to reduce or eliminate inefficiencies rapidly and the new private company will have to be very imaginative to get back on top of the game. Now in private hands lifting all foreign investment restrictions would be a unexpected gift for the consortium. The buyout was a success even with the limited foreign capital but the future will tell if it is viable in the long run.

If in due course everything appears to work out, the takeover would surely have been much easier without the foreign direct investment restrictions. Teachers' had to concoct an elaborate share structure and organization charts to bring in foreign partners<sup>84</sup>. Incapable of assuming the takeover by itself and without any concrete knowledge in telecommunications, Teachers' finally managed to attract partners with complementary resources. This was a huge achievement in light of the small counter-balance proposed to investors due to restrictive regulation. Foreign investors are usually reluctant to invest when the power of the company is out of reach. Nevertheless, the consortium is now controlling a other competitors by those same rules.

### *3.2- Impact on new entrants*

Incumbent companies, like BCE, are suffering from the restrictions on FDI but the impact is even worst on smaller competitors. Restraining access to capital to new entrants lessens all their chances to compete fairly with bigger companies. FDI is a major source of capital for those trying to penetrate the Canadian market. New entrants usually start from scratch with no funds from operations and they are totally reliant on external sources from debt and equity. The Competition Panel's assessment of telecom investment rules is worth repeating.

'Foreign investment restrictions reduce competitive intensity in a number of ways that are well known. In relation to telecommunications markets, they include placing

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<sup>83</sup> Terence Corcoran ' BCE is still BCE, a giant trapped in Canadian law regulation (4 July 2008) *Financial Post*.

<sup>84</sup> Terence Corcoran note 81.

potential new entrants (to the extent they can enter markets in the first place) at a cost disadvantage relative to incumbents, limiting the sources of finance available to existing incumbents, distorting optimal financing structures, preventing the transfer of the latest technology into the marketplace and, perhaps most fundamentally, removing pressure on existing firms to reduce or eliminate inefficiencies in their business practices and activities and to be world-class (rather than best-in-country-class) competitors.<sup>85</sup>

In opposition, incumbents being well established and having many diverse financial resources can succeed without FDI. For example, day-to-day operations can be funded from internally generated cash flows and do not need 'risk' capital<sup>86</sup>. On the other hand, this 'risk' capital is often the only resource available to new entrants and the possibilities are severely limited if only Canadian sources are available. Furthermore, strategic foreign investors not only bring with them financing but also the skills and know-how<sup>87</sup> and in return, they obviously expect a certain control over the enterprise's operations. FDI restrictions push away such strategic investors. The current result is a very high percentage of debts for those little fishes making the jump into a pool of big sharks. The restrictions promote passive investment and have done little to encourage development in the Canadian telecommunications industry.

Some experts' opinions go even further and provide that 'restrictions on foreign investment serve to shut out a major potential source of financing for telecom competitors in Canada'<sup>88</sup>. By doing so, incumbents are guaranteed to keep the monopoly in their respective regions without being disturbed.

### *3.3- Impact on population*

The government's mandate in reforming the telecommunications industry is the increase in the efficiency in the provision of services and the beneficial effects it is expected to deliver to users and consumers<sup>89</sup>. The Canadian government has to put in place a healthy market foundation where competition will put pressure on players to boost innovation and

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<sup>85</sup> Competition Policy Review Panel 'Compete to win- Final report 2008' (June 2008).

<sup>86</sup> Lemay-Yates Associates Inc. 'Access to capital- Impact of foreign investment restrictions on telecom competitors' (February 2003) Report presented to the House of Commons Standing Committee on Industry, Science and Technology.

<sup>87</sup> Strategic Policy Directorate note 23.

<sup>88</sup> Lemay-Yates Associates note 84.

<sup>89</sup> OECD note 64 at 38.

development and make prices drop. In the existing scenario, barriers created by FDI restrictions are so high that new entrants can barely penetrate the market place. If they do, the future of those companies is in peril because of the strong difficulties to access capital. The consequences are that competition is lessened and consumers can not benefit from its positive effects.

### *3.4- Where do we stand now?*

Even with the progress made recently, 'Canada has not remained at the leading edge of development and deployment in the two key growth areas of the telecommunications sector — broadband and wireless'<sup>90</sup>. In June 2003, an OECD report indicated that Canada was 2<sup>nd</sup> in broadband penetration per 100 inhabitants<sup>91</sup>. Two years later, Canada was ranked sixth and slowly falling in the ranks. New advanced technologies at very affordable rates help a country like South Korea ranked 1<sup>st</sup> ahead of the competitors. In the near future, wireline and wireless will need to be accessible "anytime, anywhere and by anyone" and countries like Japan, United States and South Korea are spending money and time to achieve this goal<sup>92</sup>. In the OECD countries, Canada was classified second to last for mobile wireless subscribers, with only 47.2 per cent<sup>93</sup>. Canada's most important comparator is the United States because of the similar geography, demographics and telecommunications markets and since the United States is its principal trade partner and competitor. In regards to a study conducted by Merrill Lynch, Canadians are using approximately 52 per cent of the average U.S. usage measured in minutes of use per month<sup>94</sup>. With the important value of wireless networks, Canada needs to evolve to diminish the gap between itself and its main business partner and develop a more efficient and vibrant wireless industry.

Canada has also been dawdling in establishing new regulation for the telecommunications markets. While many countries are already getting used to their new

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<sup>90</sup> Telecom report note 50 at 35.

<sup>91</sup> Organisation Economic for Co-operation and development 'OECD Broadband Statistics' (June 2005).

<sup>92</sup> Telecom report note 50 at 36.

<sup>93</sup> International Telecommunication Union 'Market information and statistics'.

<sup>94</sup> Merrill Lynch 'Global Wireless Matrix 2005' (December 2005).

telecommunications framework, Canada is at the beginning of its examination and will still need to contemplate new possibilities.

Furthermore, the pressure on the Canadian government increased with this year's rapid improvement of the Canadian Dollar's value. The currency held the same value as the American Dollar for a few months in 2008. The rise of the Canadian dollar, or the decline of the American dollar, forced Canada to adapt to a changing economy. 'This year's rapid ascent of the Canadian dollar is putting new pressure on Canadian businesses to become more competitive' said Anoop Singh, the International Monetary Fund's (IMF) western hemisphere director<sup>95</sup>.

Economists at the IMF and the OECD stated similar conclusions in separate reports on how to face this new challenge. Both reports concluded that excessive regulation restricting foreign direct investments is holding Canada back<sup>96</sup>. In its report, the IMF urged the Canadian government to remove any remaining impediments to investment, including foreign direct investment in telecommunications. Singh also mentioned that 'restrictions on inward foreign direct investment in network industries weigh on productivity growth, given the benefits of foreign ownership to productivity'<sup>97</sup>. The report also explained that Canada failed to benefit from the wave of technology that was driving productivity growth up in the US and other high-growth OECD countries.

The time is short for a massive revolution and regulators, businesses and public representatives have to come to a consensus immediately. The telecommunications industry needs a major tuned up and the population's wait has already been long enough.

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<sup>95</sup> Barrie McKenna 'IMF, OECD urge Canada to drop foreign ownership caps' (19 December 2007) *G8 News and Analysis*.

<sup>96</sup> Barrie McKenna note 92.

<sup>97</sup> Barrie McKenna note 92.

## PART 3- Foreign Direct Investments restrictions in South Africa

### 1-Legislation review of foreign direct investments restrictions in South Africa

#### 1.1- WTO Basic Telecom Agreement

On 15 April 1994, South Africa signed the General Agreement on Trade and Services (GATS)<sup>98</sup> and committed to achieve specific goals in its Schedule of Specific Commitments when it entered into force on 5 February 1998<sup>99</sup>. It is important to notice that South Africa's latter undertakings were entirely fashioned on the Telecommunications Act of 1996 recently enacted in the country. Many countries similarly renewed obligations made nationally which brought about scepticism in the real value of the Regulatory Reference Paper (RP). As explain by Tracy Cohen: 'its real strength lies in the fact that it ensures that this implementation occurs within a set time frame'<sup>100</sup>.

Those commitments at the international level for South Africa and other members were creating the new design of the acceptable regulatory framework. The RP was conceived as a facilitation tool for the development of the telecommunications regulatory system adaptable for different countries. The RP provides the minimum grounds for a member state and those states have the possibility to enact stronger rules. However, many observers found that the commitments were for the most part vague and incomplete and consequently, less useful then expected.

One has to remember that the Reference Paper is a specific annex to the GATS. The canon of non-discrimination through the principles of 'most-favoured nations' and 'national treatment' is the central point of this commercial alliance. This translates into an obligation by every member-country to treat equally every different partner; and furthermore, to conduct business with them no less favourably then with its own nationals. This proposition brought many conflicts during the negotiations with many countries not

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<sup>98</sup> 'General Agreement on Trade and Services' contained as Annex 1b) of 'General Agreement on Tariffs and Trade- Multilateral Trade negotiations' (Uruguay Round) [15 December 1994] 33 ILM 1167, 1195.

<sup>99</sup> World Trade Organisation 'WTO Schedule of Specific Commitments' (15 April 1998) South Africa GATS/SC/78, (94-1075). SA's final offer was submitted on 13 February 1997(S/GBT/W/1/Add9/Rev2 (97-0563)).

<sup>100</sup> Tracy Cohen 'Domestic policy and South Africa's commitments under the WTO's Basic Telecommunications agreement: explaining the apparent inertia' (2001) *Journal of international Economic Law* 725-754.

inclined to such openness. Following this, reserves can be made by countries limiting foreign entry in their market.

South Africa, like did Canada, decided to add reserves to the agreement and committed to different obligations. The country's first obligation was to end the monopoly supply and introduce a second supplier by the end of 2003 in public-switches facilities based services. It also offered to liberalize resale services and committed to duopoly supply of mobile cellular telephony. South Africa also committed to add at least one more cellular network within two years; however, foreign investment in telecom suppliers was limited to 30%. In addition, foreign direct investment requires the movement of people to establish and operate a branch. When the Reference Paper was signed, much discretion lied with the Department of Home Affairs who was considered obstructionist<sup>101</sup>. South Africa also reserved the right to prevent companies with foreign ownership of over 25 per cent to raise capital locally.

The WTO Reference Paper brought the country a step closer to liberalization in telecommunications by setting up deadlines. Multiple delays in the implementation affected the credibility of the government's undertakings. Furthermore, the restrictions in foreign direct investments handicapped the benefits of the process. Full liberalization could not be reached without removing this restriction.

### *1.2-Telecommunications Act<sup>102</sup>*

The Telecommunications Act was of monumental importance at the beginning of the new democratic government's mandate. The Act was crystallizing the major objectives set up to improve the telecommunications industry in South Africa with public interest as the cornerstone. Unfortunately, the government even though acting in good faith made stringent errors that harmed the development of the industry. The attainment of social objectives played an important role while drawing up the new Act. The South African approach severely limited the extent of competition in the market which had grave repercussions on the population.

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<sup>101</sup> James Hodge 'Liberalising communication services in South Africa' (September 2000) 17 3 Development Southern Africa 373-387.

<sup>102</sup> Telecommunications Act (103 of 1996)

Before the enactment of the Telecommunications Act in 1996, South Africa went through a new democratic way of legislating. A Green and White Paper process was convened to draw up the government's policy on telecommunications. Many interested parties participated in the Green Paper and raised important issues. Historically disadvantaged groups were included in the negotiations to reach a consensus representing all South Africans. Even with the international pressure pro-competition, the Green Paper conclusion was to try and find the proper balance between competition and the monopoly.

The White Paper followed with a much smaller consultation process. The frenzy of democracy was slowing down and only those with the resources and expertise participated. A White Paper is considered as a final statement from the government; however, major changes were made before enacting the Telecommunications Act. One of the changes included the suppression of a timetable to liberalization which was considered too restraining and/or impossible to apply. The Telecommunications Act was supposed to help South Africa narrow the gap between itself and the developing world. Inadequate choices were made and the South African telecommunications industry and the population were about to pay the price.

First of all, Telkom, the incumbent telecommunications supplier was granted an exclusivity period of not less than five years on national long-distance, international and local-access telecommunication services, public payphone services, telecommunication facilities for the provision of VANS and PTNs, and telecommunication facilities comprising fixed lines for the mobile cellular telephone operators, with a possibility of one more year if certain conditions were respected<sup>103</sup>. The reasoning behind this awkward decision in an era of liberalisation was:

- 'new entrants would target the more lucrative and easily established business and long distance markets first and not seek to rollout in these under-serviced areas;
  - Competition in these markets would squeeze the profitability of Telkom and so limit its own ability to rollout in these unprofitable areas; and
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- The option of contributions to a universal service fund was not desirable until basic exchange infrastructure was in place in some areas to which low income households could be more cheaply connected<sup>104</sup>.

In exchange for this incredible favour, Telkom had strict licence obligations including rolling out 2.81 million new lines over the exclusivity period and particularly in the under-served areas. Stringent financial penalties were introduced to increase pressure on Telkom to reach its target. Another crucial aspect was the requirement that Telkom contribute R10 million a year to a Universal Service Fund. As it will be explained further, Telkom did not achieve the goals fixed in the Telecommunications Act.

Secondly, the government set objectives to attain with the new legislation. These objectives include: promoting the universal and affordable provision of telecommunication services, promoting the provision of a wide range of telecommunication services in the interest of the economic growth and development of the Republic and encouraging investment and innovation in the telecommunications industry<sup>105</sup>. It is widely known that liberalising the market to benefit from the pro-competitive effects will enable a country to accomplish these types of objectives. South Africa stepped in the opposite direction by giving exclusivity to Telkom and affectively reduced the possibility of competition. The country was not in position to benefit from lowering price-cost margins and greater productivity growth, two important effects of pro-competitive legislation.

The Telecommunications Act did not reach its objectives. The government was hoping to protect its assets in the incumbent company and chose privatisation over liberalisation and competition. Two mandates were given to Telkom with its exclusivity period: «to expand telecommunications service to the previously disadvantaged and to develop advanced services for South African businesses» and «Telkom was also charged

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<sup>104</sup> James Hodge note 98

<sup>105</sup> Telecommunications Act s. 2 a), b) and d).

with protecting its own value and preparing itself for eventual competition»<sup>106</sup>.

Unfortunately for the population, the company invested most of its efforts in the second goal, with very poor results in expending services to South African people.

### *1.3- Growth, Employment and Redistribution Strategy*

With the ending of the tragedies from the apartheid, South Africa was very optimistic to move toward the next century as a proudly unified and strong country. The government implemented the Growth, Employment and Redistribution Strategy<sup>107</sup> (GEAR Strategy) with a long-run vision for a better South Africa for all. Re-establishing the equality between all South Africans was one of the main concerns for the new government and was strongly apparent in the GEAR Strategy. GEAR Strategy was trying to balance domestic social justice with international competitiveness and macroeconomic stability<sup>108</sup> and was also based on the desire to create favourable market-led economic growth. Four major objectives were set out in the document:

- 1-a competitive fast-growing economy which creates sufficient jobs for all work seekers;
- 2-a redistribution of income and opportunities in favour of the poor;
- 3-a society in which sound health, education and other services are available to all; and
- 4-an environment in which homes are secure and places of work are productive.

To achieve this growth strategy, it was acknowledged that it was essential to maintain a favourable investment climate to attract foreign investment. As stated in the report, foreign direct investments flow has been very low in South Africa since 1994. The committee located fundamental determinants of international investment decisions which

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<sup>106</sup> Robert B. Horwitz and Willie Currie 'Another instance where privatization trumped liberalization: The politics of telecommunications reform in South Africa- A ten-year retrospective' (Sept-Oct 2007) 31 8-9 *Telecommunications policy* at 445-462.

<sup>107</sup> Department of Finance 'Growth, Employment and Redistribution; a macroeconomic strategic' Department of Finance, Republic of South Africa [1996] (hereinafter GEAR Strategy).

<sup>108</sup> Ruth Teer-Tomaselli 'Transforming state owned enterprises in the global age : lessons from broadcasting and telecommunications in South Africa'(2004) 18 1 *Communicatio* at 26.

may be relevant to South Africa including the political and economic stability, the sustained high rates of economic growth, the investment incentives and the labour market stability and flexibility. They also pointed at the international evidence that growth itself is a powerful stimulus for foreign investment. To attract more foreign direct investment in the country, the committee suggested among other ideas to implement a tax regime favourable to foreign investment and to restructure state assets so as to create opportunities for equity investment in public corporations by foreign partners.

The recognition by this powerful team of scholars and influential South Africans of the importance of FDI and the necessity to sell state assets to foreign equity partner discord from the direction taken by the government with regards to the telecommunications industry. As previously explained, the Telecommunications Act granted Telkom five years exclusivity period thus restraining access to local and foreign competitors. GEAR Strategy aimed to secure the confidence of international businesses as a key to economic growth and employment creation<sup>109</sup>. The GEAR Strategy failed because of the government's presence where market power should have dictated the game.

#### *1.4- Immigration Amendment Act*

The Immigration Amendment Act (19 of 2004) came into force July 1<sup>st</sup> 2005 and proclaimed the openness of the South African government regarding foreign investment. Following the Minister of Home Affairs comments at the press conference, the new immigration legislation 'will contribute towards boosting direct foreign investment, attraction of skills required by the economy, support the growth of tourism and support the emphasis and realisation of the goals of our foreign policies'<sup>110</sup>. Creating an suitable environment for attracting more foreign direct investment in South Africa was one of the main goals of the government in promoting the economic growth.

Prior to the Amendment Act, investors and entrepreneurs were applying for a «business permit» issued for a maximum of 24 months at a time. This duration

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<sup>109</sup> Alison Gillwald 'Experimenting with institutional arrangements for communications policy and regulation: the case of telecommunications and broadcasting in South Africa' (2002) 21 *The Southern African Journal of Information and Communications*.

<sup>110</sup> 'Immigration Amendment Act come into release' Media release, South African Department of Home Affairs (30 June 2005).

requirement has been eliminated and the duration of the permit will now be determined case-by-case. Furthermore, the permit can be extended more than once.

The requirements for the business permit were considerably changed. Where a Chartered Accountant was previously required to confirm two out of seven possible categories, the new regulations only require proof of the available funds to be invested<sup>111</sup>. The amount has to be invested within 24 months of the submission.

Other notable ameliorations have also been made in the Amendment Act and will considerably help South Africa in attracting foreign investors. The government of South Africa equipped the country with better assets to help it receive its part of the foreign direct investment capitals.

## **2-Impact of FDI restrictions in South Africa**

### *2.1- Issues to find investors: Case study, the Second Network Operator*

‘The rain becomes the river, the river becomes the sea, we become each other’. This message was displayed at the launch of the long awaited Second Network Operator Neotel (SNO), referring to the ‘gift of communication’ that this new entity will bring to South Africa<sup>112</sup>. Theoretically, Neotel was supposed to compete against Telkom and bring about competition in the fixed-line market. In practice, almost everyone was doubtful of this miracle promised by Neotel and the South African government. The way to Neotel’s creation was full of pitfalls and its debut was delayed. Expectations might have been too high and as of now, many are reluctant with the poor results brought by the SNO. The long walk of the SNO will be analysed as well as the pitiful improvement that it brought to South Africa’s network.

#### **2.1.1- Penetrating Telkom’s kingdom**

The new SNO was planning to revolutionise South African telecommunications. Competition was the key word in this market that spent too many years in stagnation because of Telkom’s monopoly and the SNO was to be the instrument of change. Ajay

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<sup>111</sup> IBN Consulting and Immigration ‘The South African Immigration Law 2005’ (2005).

<sup>112</sup> Hila Bouzagloul and I-Net Bridge ‘Say hello to Neotel, SA’s second network operator’ (August 31<sup>st</sup> 2006) *Mail and Guardian*.

Pandey, Neotel's management director stated 'In its very form, our new identity demonstrates our commitment to change your experience of telecommunications, to respond to your needs with efficient simplicity, and to become your preferred telecommunications partner'<sup>113</sup>. The Communications Minister Ivy Matsepe-Casaburri was also very optimistic saying that Neotel 'will help us (South African government) respond to the competitiveness of our economy, to sustainable development and to meeting our goals'<sup>114</sup>.

However, during its 5 years exclusivity Telkom had two specific mandates: first, to expand telecommunications service to the previously disadvantaged and develop advanced services for South African business and secondly, to protect its own value and prepare itself for eventual competition. If the first goal results were very disappointing, Telkom worked diligently on the second goal and achieved its objective by policing and even augmenting its exclusivity over the fixed-line network<sup>115</sup>.

Telkom and its monopoly prices have angered South Africans for years and there were high expectations that Neotel would finally bring down telecom prices, especially in broadband internet access<sup>116</sup>. Nevertheless, many were in disbelief that the SNO would fulfill the mandate. Richard Frank, an IT journalist who led the campaign for Telecoms Action Group<sup>117</sup> said 'The SNO is not a magic pill for the South African ICT industry'<sup>118</sup>. Following his opinion, "anti-competitive practice is the norm in South Africa, even in the absence of a monopoly"<sup>119</sup>. Reducing the cost of telecommunications correlate with a cheaper way to operate business and the Government and businesses were hoping that Neotel would help attract foreign investors to set up call centres and other outsourced services<sup>120</sup>.

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<sup>113</sup> Hila Bouzaglou note 109.

<sup>114</sup> SouthAfrica.info reporters 'Neotel : SA's 2<sup>nd</sup> network online' (1 September 2006) *South Africa.info*.

<sup>115</sup> Robert B. Horwitz note 103 chap 4.

<sup>116</sup> [www.hellkom.co.za](http://www.hellkom.co.za) (4 May 2007).

<sup>117</sup> The Telecoms Action Group was calling on South African businesses and private individuals to donate money to take out a full-page advertisement in a national newspaper protesting against the lack of alternatives in the country's telecommunications. Riaan Wolmarans 'Bad telecoms service? Tell the world'(30 August 2006) *Mail and Guardian*.

<sup>118</sup> Riaan Wolmarans note 114.

<sup>119</sup> Riaan Wolmarans note 114.

<sup>120</sup> [www.hellkom.co.za](http://www.hellkom.co.za) (May 4<sup>th</sup> 2008).

The company's planned roll-out of telecommunication services was straight forward: providing South Africans with leading-edge technologies and introducing initial services for consumers<sup>121</sup>. With Eskom Enterprises and Transnet being part of the SNO consortium, Neotel will have access to their infrastructure including almost 10 000km of optical-fibre backbone in metropolitan areas and across the country<sup>122</sup>. With the circuit for optical-fibre already available, the technical difficulties vanished and the benefits like the enormous potential bandwidth will be a good springboard for Neotel.

Neotel, like Telkom, was required to provide universal service and community service but the licence postponed those obligations to give the company a chance to integrate the market without too heavy of a burden<sup>123</sup>.

Neotel had high hopes to gain a substantial percentage of market shares but like Pandey said: 'the company is up to the challenge but concedes it will have to be smart in winning over consumers and building a profitable alternative to Telkom'<sup>124</sup>.

#### 2.1.2- The quest for a good foreign direct investment partner

The plan for a SNO was on the table but investors were still missing. The dilemma of who would be granted the licence was particularly important for the government and for Telkom. Governments are often reluctant to give the control of basic telecommunications networks to foreigners and furthermore, when it is planned to compete against their own assets<sup>125</sup>.

The quest for foreign direct investment goes far beyond finding a good candidate ready to invest capital in your country. As we have seen, the investment can be in many different forms: capital, technology transfer and management know-how. For new entrants, technology transfer and management know-how were essential to compete

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<sup>121</sup> Hila Bouzaglou note 109.

<sup>122</sup> Hila Bouzaglou note 109.

<sup>123</sup> Government Gazettes 28482 no.197 (February 8<sup>th</sup> 2006)] chap. 6 (hereinafter referred as SNO licence).

<sup>124</sup> [www.hellkom.co.za](http://www.hellkom.co.za) (May 4<sup>th</sup> 2008).

<sup>125</sup> Georgette Wang note 3.

against Telkom. Telkom had been in place for many years and will hardly be ousted by a new entrant providing the same kind of service at the same quality and in the same way. New technologies and a more efficient management strategy were required to enable the SNO to compete fairly.

### 2.1.3- Mix-jurisdiction; power struggle between Icasa and the Ministry

The Telecommunication Act of 1996 created the SATRA, the South African Telecommunications Regulatory Authority, now renamed as ICASA (Independent Communications Authority of South Africa)<sup>126</sup>. The WTO Basic Telecom Agreement also required its members to include in their legislative framework an independent body overlooking the telecommunications sphere. If the government was ready to approve this new watchdog, it wasn't ready to lose the entire control of the telecommunications sector. A kind of joint jurisdiction on key licensing and regulatory issues was born and that was the beginning of many clashes between the Department of Communications (DoC) and the ICASA.

The Ministry was placed in a very difficult position: on one side, pressure from the government to protect such an important asset like Telkom was pushing it to make decisions that would not harm the company. The government owns 38.85 per cent of Telkom shares and doesn't want to risk its own investment<sup>127</sup>. On the other hand, it had to assume its position involving devotion to the sector and always acting for the benefit of it, mainly towards competition and service innovation<sup>128</sup>.

The Ministry was granted the power to approve ICASA regulations and major licences which created serious regulatory bottlenecks with critical sector development regulations being delayed in the Ministry for months and even years<sup>129</sup>. In addition, ICASA and the Ministry fought over procedural requirements concerning the invitation of

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<sup>126</sup> In May 2000, the Independent Communications Authority of South Africa Act (Act 13 of 2000) was passed and SATRA and IBA (Independent Broadcasting Authority) merged and transferred their powers to ICASA.

<sup>127</sup> Telkom 'Telkom South Africa annual report 2007' (2007).

<sup>128</sup> Allison Gillward 'Good intentions, poor incomes; Telecommunications reform in South Africa' [August 2005] 29 7 *Telecommunications Policy* at 469 -491.

<sup>129</sup> Allison Gillward note 125 at 480.

investors for the SNO. ICASA's regulating procedure was also controlled by the Ministry and the political establishment with more tortuous means through the ICASA Council appointment process and budget<sup>130</sup>.

Furthermore, ICASA and Telkom have met in court on a number of occasions where the incumbent was directly challenging the regulator and the latter has had its decisions overruled<sup>131</sup>. The minimal budget of ICASA compared to the immense wealth of Telkom is probably a factor for such one sided victories.

The Basic Telecom Agreement requires that each member state that the decisions and procedures used by the regulator shall be impartial with respect to all market participants. By repeatedly undermining the ICASA's recommendations, the Ministry has unapologetically used its authority to the benefit of Telkom and the disadvantage of South African citizens at large<sup>132</sup>. In those circumstances, it is hardly possible to refer to ICASA as an Independent regulator as defined in the Basic Telecom Agreement.

The recent judgment by High Court of South Africa, Re Altech Autopage Cellular v. ICASA et al<sup>133</sup>, shows how ministerial policies can bring impediments to ICASA. The conflict emerged when the Telecommunications Act was repealed on 19 July 2006 to give way to the Electronic Communications Act<sup>134</sup>. In the latter act, holders of VANS licences had to apply for 'conversion' of their licences to new ones pursuant to the new Act. Ministerial policy directions were issued and instructed ICASA on how to conduct the conversion process. As explain by Judge Davis AJ 'when the directions in fact entail, it is clear that the directions overstep the line of pure policy or directions of general nature'<sup>135</sup>. Even if the Ministry behaviour was ultra vires of its capacities, the regulator incomprehensibly obeyed. In this particular case, the intrusion of the Ministry in

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<sup>130</sup> Robert B. Horwitz note 103 at chap.4 "Although statutorily the appointment to Council was made by the President on the recommendation of the Parliamentary Portfolio Committee on Communications, in reality it was primarily the Ministry and Department of Communication that put forward nominees."

<sup>131</sup> Fuaad Ali 'The South African telecommunications environment: a brief assessment of regulatory change' (2003) 29 1-2 *Communicatio* 114-128.

<sup>132</sup> Debbie Love 'An Overview of the South African Telecommunications Industry: From Pre-1994 Policy-making to Gloomy 2005 Realities' (2005) *Honours Research Report*, submitted to the University of the Witwatersrand.

<sup>133</sup> *Altech Autopage Cellular v. ICASA and al.*, 2008 (20002) SA

<sup>134</sup> Electronic Communications Act 36 of 2005.

<sup>135</sup> *Altech Autopage Cellular* at 5.9.

the regulator's task was obvious and clearly illustrates the lack of independence by the regulator.

In reality, a totally independent regulator is impossible not only because the regulator is technically an organ of state but also because the regulator's has been appointed to implement government policy. Nevertheless, some boundaries can be applied to protect the essential role of the independent regulator without forgetting that the government has been democratically elected by the people and is entitled to keep an eye on state bodies.

The negative consequences of joint jurisdiction created a burden even beyond the frontier of South Africa. While looking for investors to take part in the Second Network Operator, many investors declined the invitation because of the country's 'protectionist and non-independent regulatory structure'<sup>136</sup>. A reputation of efficiency and clean leadership enhances the prospects for foreign investment while the opposite creates a climate of uncertainty and risk that scares away investors<sup>137</sup>.

#### 2.1.4- Telecommunications Amendment Bill; the Alternative Licensing Method

The passing of the Telecommunications Amendment Act introduced the 'managed liberalisation', a policy of slow liberalisation in South Africa's telecommunications. It created the Alternative Licensing Method as a new way for the Minister to provide licences, including for PSTS. The new section 35A stated that '... the Minister may in specific instances determine the manner in which applications may be made, such by way of auction or tender, or both, and the licensing process and the licensing conditions that will apply...' <sup>138</sup>. In other words, the Minister was then able to proceed without ICASA's participation in awarding the most important licence. Withdrawing this power from ICASA dramatically showed the government's impact on the telecommunications industry and presented an unconstructive image of the lack of independence to ICASA. According

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<sup>136</sup> Robert B. Horwitz note 103 chap 4.

<sup>137</sup> Zein Kebonang 'The New Partnership for Africa's Development; Promoting Foreign Direct Investment through Moral Political Leadership' (April 2005) 35 *Africa Insight* at 9.

<sup>138</sup> Telecom Act s 35A added by section 10 of Act 64 of 2001

to Goldstein, the changes resulting from the Amendment Act were ‘criticised not only by the private sector but also by the Department of Trade and Industry which argued that it was not supportive of the development of logistics and other knowledge-driven activities’<sup>139</sup>.

#### 2.1.5 - BEE’s restrictions

The Strategy for Broad-Based Black Economic Empowerment (the BEE Strategy) was issued by the Minister of Trade and Services following the Broad-Based Black Economic Empowerment Act of 2003<sup>140</sup>. The BEE Strategy was appointed to adjust the divergence between ethnical groups resulting from the legacy of apartheid<sup>141</sup>. One of the key policies of the BEE Strategy was to substantially increase the number of black people who have ownership and control of existing and new enterprises<sup>142</sup>. In May 2002, the invitation to apply for the provision of the PSTS was issued by the Minister of Communications, in terms of section 35A of the Telecom Act, informing that 19 per cent of the SNO will be reserved for a Black Economic Empowerment applicant<sup>143</sup>. This percentage of equity stake set by the Minister aims to further the empowerment of historically disadvantaged persons through a set-aside mechanism<sup>144</sup>.

If the abolition of the apartheid legacies through new policies is essential for South Africa, it can be really harmful for foreign investors not prepared to adhere to BEE’s criteria. Investors might lose their interest if they have to conform to the strict regulations specific to South Africa. Furthermore, one has to remember the implication of South Africa’s commitment to the Basic Telecom Agreement which includes obligations of national treatment. This principle demands that a Member treat foreign services and suppliers no less favourably than it treats its own<sup>145</sup>. One can argue that requesting foreign

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<sup>139</sup> Andrea Goldstein and José Claudio Linhares Pires ‘The design and performance of regulatory agencies: What can South Africa learn from the Brazilian experience?’ (September 2001) *Trade and Industrial Policy Secretariat (TIPS) Annual Forum*. Available at: <http://www.tips.org.za/f2001/goldstein1.pdf>

<sup>140</sup> Broad-Based Black Economic Empowerment Act (No 53 of 2003) s 11.

<sup>141</sup> ‘South Africa’s Economic Transformation : A Strategy for Broad-Based Black Economic Empowerment’ Department of Trade and Industry.

<sup>142</sup> Broad-Based Black Economic Empowerment note 137.

<sup>143</sup> Government Gazettes 23469, Notice 786 of 2002 s 7.4

<sup>144</sup> Government Gazette 23010, Notice 27 of 2002.

<sup>145</sup> Tracy Cohen ‘Advisory 6: South Africa’s commitments under the WTO’s Basic Telecommunications Agreement’ (15 February 2001) *Internet service Providers Association*.

investors to respect the BEE requirements will put a much heavier burden on them compared to South African companies.

#### 2.1.6 - The impact of South Africa's government behaviour

During the Apartheid regime, many countries banned South Africa from trading agreements and refused to invest in their country. The 'Mandela effect' led to the removal of many politically motivated constraints on South Africa's full participation in the world economy and renewed investor's confidence in South Africa<sup>146</sup>. Political image is a very important concern for foreign investors: 'they will only expend their resources if they are assured that the host government will not act in a manner that compromises their return on investment'<sup>147</sup>. The legislation in the telecommunication area demonstrates that the ANC government wants to maintain power over the sector<sup>148</sup>. This protectionism was almost fatal for the SNO and delayed its launch because of the complicated process to distribute the shares. In a domain like telecommunications, every year, even every month, is crucial for the development of the technology and the innovative service to the community.

Furthermore, in committing to the Regulatory framework of the Basic Telecom Agreement, South Africa bound itself to the international community to end a monopoly and introduce a second supplier by the end of 2003 in public-switched, facilities-based services<sup>149</sup>. South Africa failed to respect its obligation by deliberately delaying the process.

#### 2.1.7- The final results of the SNO

The licence for the SNO was issued in Johannesburg on December 9<sup>th</sup>, 2005. The final consortium is an amalgam of three key groups: the Black Economic Enterprise Nexus (19 per cent), the state-owned enterprise Soecoe (30 per cent) and Sepco, the strategic equity

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<sup>146</sup> Zein Kebonang note 134 at 3.

<sup>147</sup> Zein Kebonang note 134 at 10.

<sup>148</sup> Robert B. Horwitz note 103 'That environment, in which a duly constituted democratic body was largely foiled in its efforts to do its job, dovetailed with the larger political environment of ANC actions to consolidate political power in 1996, a relative lack of transparency in decision-making, and the discouragement of public criticism generally speaking—the latter the legacy of the ANC's exile culture of democratic centralism.'

<sup>149</sup> WTO Basic Telecom Agreement note 96.

partner (51 per cent). The state owned enterprise company shares are divided equally between Eskom Enterprises and Transnet. The strategic equity partner is the result of a failed bid to attract a major international operator and consists of four different entities: Tata Africa (1 per cent), Videsh Sanchar Nigam Limited (25 per cent), Communitel (12.5 per cent) and two telecommunications consortium (12.5 per cent).

Following the modifications to the Telecommunications Act of 1996 by the Telecommunications Amendment Bill of 2001, the SNO was 'granted a public switched telecommunication service (PSTS) licence on no less favourable terms and conditions than those of the licence held by Telkom'<sup>150</sup>. The licensee was then entitled to construct, maintain and use the public switched telecommunications network (PSTN) and to provide PSTS in terms of the Act<sup>151</sup>. In order to compete with Telkom, the SNO was permitted to use the incumbent telecommunication facilities on a resale basis for a period of two years<sup>152</sup>.

#### 2.1.8- Difficulties and challenges facing the SNO

Very troubling information is provided on [www.hellkom.co.za](http://www.hellkom.co.za), a parody website about Telkom<sup>153</sup>. Statistics show that 90 per cent of businesses have been locked into 3 to 5 year contracts to stifle the SNO from acquiring customers at start-up<sup>154</sup>. With the SNO delayed for almost three years, Telkom has had plenty of time to bind its customers with long-terms contracts. The principle starting point of the SNO was to provide telecommunication networks to businesses, but it appears that Telkom had prepared its position before the entry of its competitor.

On April 29<sup>th</sup> 2008, Neotel gave the details of its first consumer offering, NeoConnect Prime. The product offered is designed to solve the consumers' painful experiences which were observed in the research process and included issues relating to 'the perceived speed and capacities for internet access, lack of voice quality and reliability, the complexity associated with obtaining and setting-up services and a lack of

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<sup>150</sup> Telecom Act s 32B(a).

<sup>151</sup> SBO licence note 120.

<sup>152</sup> Telecom Act s 32A(2) (a).

<sup>153</sup> [www.hellkom.co.za](http://www.hellkom.co.za) (4 May 2008).

<sup>154</sup> 'Facts about Telkom' available at [www.hellkom.co.za](http://www.hellkom.co.za) (30 April 2008)

true value for the customer'<sup>155</sup>. The offer will be first available to consumers who have already approached Neotel and registered for the services during the pilot phase. A formal public announcement will follow in May 2008. The future will tell us if customers are ready for a change and tired of Telkom in order to make the jump towards new providers.

## *2.2- Impact on population*

At the beginning of its mandate in 1994, the ANC was facing major problems including the legacies of apartheid, widespread poverty and unemployment. The government also inherited the highest average telephone teledensity in Africa. In mid-1990s, 10.05 per cent or roughly 3 million South African households had a telephone<sup>156</sup>. However, the repartition of this amount was very racially skewed. Eighty-nine per cent of white households, 77 per cent of Asian households, 43 per cent of Coloured households and only 11 per cent of Black households possessed a telephone.

The Telecommunication Act focusing on public interest aimed on dramatically reducing this 'phone gap'. Consequently, Telkom received its exclusivity period combined with the obligations of improving the network especially for previously disadvantaged people. The government was convinced that private companies would not succeed in this task because companies would concentrate on their own acquisition of wealth. As explained by Gillwald: 'In the mid-1990s, South African telecommunications policy was hailed as drawing on international best practice while at the same time seeking to deal with the country's particular historical legacies'<sup>157</sup>. Those two conflicting issues resulting from the unordinary history of the country were difficult to simultaneously solve.

As mentioned earlier in this paper, the Telecommunications Act aimed to promote the universal and affordable provision of telecommunications services. Telkom failed drastically in its mission to help the government with reaching this objective. Research demonstrates that Telkom's prices increased instead of being more affordable

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<sup>155</sup> 'Neotel Neoconnect details' (29 April 2008) available at [www.mybroadband.co.za/news/Broadband/3646.html](http://www.mybroadband.co.za/news/Broadband/3646.html).

<sup>156</sup> Alison Gillwald 'Experimenting with institutional arrangements for communications policy and regulation: the case of telecommunications and broadcasting in South Africa' (2002) 21 *The Southern African Journal of Information and Communications*.

<sup>157</sup> Allison Gillwald note 125.

and that the incumbent did not raise the number of residential subscriber fixed line customers as imposed in its licence agreement. For example, from 1997 to 2002, the cost of a local 3 minute call increased by 26 per cent while the residential monthly telephone subscription increased by 6.4 per cent<sup>158</sup>. Furthermore, it may well be that the number of residential subscribers has declined from 1997 to 2002. Telkom did install lines in rural areas but nothing was made to enable new subscribers to afford monthly payments and understand the modalities around it. High prices and complicated method of payments were the cause of many households abandoning the lines.

As of now, Telkom holds a monopoly over essential public and consumer services without much competition from the SNO. With this powerful advantage, Telkom can easily force consumers to pay unreasonable high prices<sup>159</sup>. Furthermore, without competition there is no urge for Telkom to improve the network and provide consumers with better quality services. Consequently, South Africa is one of the very few countries where decline in network development has been observed. Year after year, the country's international ranking with respect to network penetration and consumer prices continues to decline.

Telkom's monopoly was supposed to improve the universal access in the country; however, like many other African countries, it is private companies that have contributed the most to achieving universal access. Cellular phone companies revolutionized the way of communicating in Africa and with new method of payments, low cost and user friendly apparels, almost anyone will have the ability to connect to the world.

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<sup>158</sup> William H. Melody 'Assessing Telkom's 2003 Price Increase Proposal: price cap regulation as a test of progress in South African Telecom reform, and e-economy development' (November 2002) LINK Center Policy Research Paper, Graduate School of Public and Development Management, University of Witswatersrand,

<sup>159</sup> William H. Melody note 155.

## **Conclusion**

FDI growth is a direct cause of globalisation. Year after year, the world becomes smaller and investors are looking for new doors to increase their returns on investment. Benefits from around the globe on the impact of FDI have been observed by economists. Nevertheless, some countries like Canada and South Africa are still not convinced and FDI restrictions remain in place.

In Canada, the Investment Canada Act and the Telecommunications Act contain rules creating road blocks for foreign investors. Canada did not modify its legislation and the maximum FDI in basic telecom is 46.7 per cent. Recent development shows that the telecommunications industry, as well as many other sectors directly or indirectly touched by these restrictions, urges the government to remove every impediment to FDI.

Canada faced the consequences of its legislation with the take over of BCE. The incumbent company struggled to find foreign investors to be part of the consortium that was looking to buy the telecommunications giant. Investors were reluctant to participate in these transactions because they were not given much control on the company.

The Canadian position on FDI clashes with almost every other first world country. Around the world, developed countries reap the benefits of FDI and opened their markets. Today, Canada has an important decision to make for the advantages of the country's economy, the citizens and their progeny.

South Africa, like Canada, decided to keep FDI restrictions expecting that it would help the country solve its social problems. The South African government was facing important issues left from the legacy of apartheid. Universal access was a main concern and the government was convinced that foreigners would be more motivated by their own enrichment than by the social goals of the country.

Repercussions of restricting FDI appeared when the country was trying to extend the market to the SNO. Capital was lacking and foreign investors were hard to find. FDI restrictions, the Immigration Act obligations and the BEE's strategy frightened possible investors and slowed down the process. The future will tell us if the SNO will be

successful in bringing more competition to the South African telecommunications market and enrich the communications in the country.

Canada and South Africa are similar in the way they restrict FDI but the resulting impact on the population differs. For Canada, a first world country, the impact is visible in the quality of network and means of communications available to the population. In addition, Canada has lost its international lead in the industry and FDI will be essential to regain a place on the technology train. In South Africa, the issues are different and much more related to the basic needs of the population. Universal access is still incomplete and a better telecommunications industry will enable every sector of the economy to grow faster.

Finally, Canada and South Africa should both even though for different reasons remove from legislation every obstacle to FDI. From around the world, the consensus was made that FDI has a very positive effect on many economic sectors and both countries have to make a quick decision in order to avoid awful repercussions.

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