

Update

Communications

October 30, 2009

The CRTC Turns Down a New Wireless Entrant

Introduction

The CRTC yesterday determined that Globalive Wireless Management (“Globalive”) does not meet the Canadian ownership requirements set out in the *Telecommunications Act*. The public review of Globalive’s ownership structure, as well as the Commission’s outright denial of its eligibility, are novel aspects of this case, as is the inconsistency between the CRTC’s and Industry Canada’s determinations reached under identical rules. This has led to much intrigue in the press over whether the federal Cabinet, including the Minister of Industry, will exercise its legal right to intervene. In this Client Update, however, we avoid any prognostication in favour of a summary of the Commission’s ruling.

The Commission found that Orascom Telecom Holdings (“Orascom”), an Egyptian owner of mobile ventures in several countries, has the ongoing ability to determine Globalive’s strategic decision-making activities and that Globalive is therefore controlled in fact by Orascom. Accordingly, the Commission found that Globalive is not currently eligible to operate as a telecommunications common carrier.

Under the *Telecommunications Act*, in order for a telecommunications common carrier to be eligible to operate in Canada (as a “Canadian carrier”) it must be a Canadian owned and controlled corpo-

ration. The criteria include both “black-letter” restrictions, addressing ownership of voting shares and board composition, as well as a more subjective test that the undertaking and other Canadian entities in the structure not be controlled by non-Canadians. Precedents indicate that control, which is defined broadly and includes the concept of “control in fact” or “effective control”, is only established where influence is dominant or determining. In particular, the issue is whether non-Canadians have an ongoing power or ability, whether exercised or not, to dominate or determine the strategic decision-making activities of a corporation or to manage and run its day-to-day operations.

Globalive made significant changes to the legal arrangements among its shareholders in order to address concerns expressed by the CRTC and incumbent wireless operators. Ultimately, however, it was other factors, largely relating to the identity of Orascom as an operator and Globalive’s capital structure, that, taken together, led the Commission to conclude that Globalive does not meet the test.

The Commission determined that significant concerns remain with respect to the control in fact of Globalive by Orascom, given that Orascom:

- holds 65.1% of Globalive’s equity;
- is the principal source of technical expertise and has entered into a strategic technical arrangement with Globalive;
- provides Globalive with access to an established wireless trademark, the “Wind” brand, under which Globalive will operate; and
- holds the overwhelming majority (99%) of the outstanding debt.

The CRTC noted that it considers that each of the factors addressed in its decision provides Orascom with an avenue for influence over

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Globalive and that “[w]hile disparate points of influence may not individually result in control, when combined they can translate into the ability to control in fact.”

The Commission’s decision appears to turn largely on the level of debt held by Orascom in combination with its 65% equity interest, as evidenced by the following quote:

...such a significant concentration of debt in the hands of Orascom, representing the vast majority of Globalive's enterprise value, serves to provide Orascom with leverage over Globalive. Given Orascom's equity interest in Globalive, such a high level of debt in the hands of a non-Canadian is unacceptable.

Certain key elements of the Globalive decision are summarized below.

Equity

The combination of Orascom's voting and non-voting shares translated into 65.1% of Globalive's total equity.

The Commission acknowledged that Orascom's equity participation of 65.1% is consistent with levels of non-Canadian investment previously approved by the Commission. The CRTC also noted that, while in the circumstances of this case the level of equity participation provides an avenue for influence, it is not sufficient on its own to convert that influence into control.

Debt

Orascom is the source of approximately 99% of Globalive's debt, for a total commitment of \$508.4 million.

While the CRTC noted that there are no statutory restrictions on the amount of debt that a non-Canadian can provide to a telecommunications common carrier, where a company is heavily debt financed, the Commission noted that this can

translate into significant influence over the venture by the debt holder.

The CRTC noted that the magnitude of the debt provided by Orascom, the relative debt to equity financing, and the fact that the debt is concentrated in the hands of a single entity all cause the Commission concern. Modifications to the covenants and terms of the loans volunteered by Globalive did little to reduce this concern. Furthermore, the CRTC noted that covenants similar to those deleted from the Orascom loan agreements are still contained in the veto rights in the Shareholders' Agreement.

In addition, the Commission considered that Globalive's dependence upon Orascom for financing may well increase in the near term, given its inability to date to attract substantial third-party financing. The Commission noted that a company's inability to obtain financing from third-party sources may also be relevant to the issue of control in fact. The Commission reiterated its finding in the Unitel decision that "In certain circumstances it may be possible to conclude that a non-Canadian shareholder or lender may have a considerable amount of leverage, and even control, over a cash-strapped telecommunications common carrier.”

Governance

Notwithstanding the structure of the equity, the CRTC required that the nominees of the Canadian shareholder outnumber those of Orascom, in order to offset the influence of the latter. In order to address this point, Globalive would have to amend its board structure so that the Canadian shareholder nominates 5 directors, Orascom nominates 4 directors, and each nominate one Independent Director.

Liquidity

The Commission originally expressed concerns regarding the liquidity rights granted to Orascom as minority voting shareholder; in particular, the

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Commission felt that unilateral drag-along rights were inconsistent with the position of the Canadian shareholder as the majority voting shareholder. While Globalive amended the original liquidity rights to provide for a mutual right, the provision of a guaranteed floor price for the Canadian shareholder should it elect to sell within a certain period concerned the Commission. The CRTC found in the decision that the liquidity rights, even in their revised form, provide an indication of Orascom's influence over the venture, given that it is traditionally the minority voting shareholder which is granted an exit provision at a guaranteed price, not the controlling shareholder. It therefore held that the specification of a floor price and the imposition of a cap on the proceeds generated in the event that the Canadian shareholder sells its shares are inconsistent with the relative voting interests of the shareholders.

The Globalive agreements limit a sale of shares to an "Eligible Purchaser" (i.e., the purchaser cannot be a Strategic Competitor, defined as a person which operates or provides telecommunications business services, whether fixed line or wireless). Notwithstanding that all sale provisions are subject to extensive rights of first refusal in favour of the non-selling shareholder, the CRTC considered that the ability of the exiting investor to find a suitable purchaser is a significant issue with regard to liquidity. The Commission was concerned that the Eligible Purchaser definition limits the pool of potential purchasers to financial investors and restricts the ability of the majority voting shareholder to sell all or some of its shares. Accordingly, the Commission ruled that Globalive should amend the definition of Strategic Competitor to include only entities which, taken together with their affiliates, hold more than a 10% share of the Canadian wireless market on a per-subscriber basis [the 10% limit is to accord with Industry Canada's requirement for the spectrum set aside for new entrants under which Globalive was licensed].

Vetoes

In response to CRTC and intervener concerns, Globalive increased the monetary thresholds of

particular veto rights to 5% of the value of the spectrum it held, but the CRTC held that the value of the spectrum is not an appropriate foundation on which to base the 5% veto threshold. Accordingly, the CRTC held that monetary threshold for vetoes should be set at 5% of Globalive's enterprise value as determined by its board every 2 years, based on a third-party valuation.

Commercial Arrangements

The CRTC found that the Technical Services Agreement ("TSA") between Globalive and Orascom raises concerns with respect to control in fact as a result of the strategic nature of the services provided and the fact that they are provided by the major non-Canadian shareholder and primary lender to Globalive, Orascom. The Commission found that the TSA provides Globalive with benefits that operate as key determinants of its success and that it is this reliance by Globalive on Orascom that defines their relationship and allows Orascom the opportunity to influence a wide range of operating and strategic decisions. Given the significant benefits Globalive derives from the TSA, the Commission found that Globalive will maintain the TSA for the foreseeable future and that Orascom will continue to have influence over operating and strategic decisions related to Globalive's network.

Under the Trademark Agreement, Globalive is provided with a licence to use the WIND trademark in association with its services in Canada. The WIND trademark is used by Orascom affiliates in Greece and Italy. The CRTC found that Globalive's adoption and use of a trademark belonging to an Orascom affiliate provide Orascom (or its controlling shareholder) with influence over Globalive because Orascom has the power to limit how the brand can be used.

Conclusion

Many of the same arrangements that concerned the Commission in this decision, or similar arrangements, are present in the structures of other communications undertakings in Canada; however, as noted above, it was the cumulative

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effect of these arrangements that led to the Commission's decision in this instance.

If you would like to know more about this matter or have any questions with respect to the foregoing, please do not hesitate to contact any member of our Communications Law Group:

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