Public Interest Advocacy Centre

(PIAC)

Submission to Industry Canada

Opening Canada's Doors To Foreign Investment In Telecommunications:

Options for Reform

July 30, 2010

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Introduction

The Public Interest Advocacy Centre (PIAC) is a non-profit charity organization that provides legal and research services on behalf of consumers interests for the provision of important public services. PIAC strives to represent the interests of ordinary and vulnerable consumers in the marketplace concerning the rates, policies, rules and regulations associated with the delivery of these services with a view to ensuring principles of access and affordability and fair treatment for consumers. PIAC has developed a strong record of consumer advocacy since its inception in 1976 and is widely recognized as an important and influential voice for ordinary consumers in a variety of marketplace issues. PIAC seeks to ensure that the public interest is served, and not neglected, by decision makers in government and the private sector when decisions are made about consumer issues. PIAC has expertise in the areas of telecommunications, representing consumers before the Canadian Radio-television and Telecommunications Commission (CRTC), energy, representing consumers before the Ontario Energy Board, and in general, financial services, transportation, copyright, privacy, the internet, electronic commerce and consumer protection. It is the experience associated with its representation of consumers in telecommunications proceedings that primarily informs its submission in this consultation.

Foreign Ownership Controls –The Issue

The justifications for controls on foreign ownership of Canadian business enterprise has been articulated both in public debate concerning the governance of the economy, and in support of legislation, such as the *Telecommunications Act* and the *Radiocommunication Act* that compel compliance with rules requiring target percentages of ownership of carriers. It is also fair to say that the question of foreign ownership controls is bound up, to a great extent, with issues associated with perceived requirements for national sovereignty, and the advancement of shared public interest goals for Canadian commerce. We will address some of the perceptual constructs associated with the foreign ownership question later in these comments.

The primary concern with the lessening of controls in telecommunications is the fear that foreign ownership of telecommunications networks and facilities puts key elements of Canada's economic future beyond the control of Canadians, and that the operations of foreign controlled telecommunications companies will be carried out with a view to benefitting the out-of-country shareholder and not the needs of Canadians, and the Canadian economy. Secondly, the premise has been advanced that Canadian owned business will be more attuned to meeting Canadian customer needs, and will be better corporate citizens in relation to matters associated with employees and local community requirements. Finally, there is also the sense that the national importance of telecommunications networks requires a level of security and oversight that is not attainable with foreign owned telecommunications companies.

The principal economic fears arise from intuitive conclusions that foreign ownership of telecom providers would mean revenues from Canadian markets would flow back to foreign shareholders and the corporate treasuries to be invested in foreign operations or facilities that may not be beneficial to Canadian networks and their customers. Head offices, and Canadian jobs would also leave the country with attendant loss of well-paying jobs and tax revenue.

There have been considerable analytic efforts made to refute the central elements of these conclusions in relation to the benefits associated with foreign direct investment in Canada. For example, in a recent study released by Institute for Research of Public Policy (IRPP) the author noted that, although foreign firms engage in less R &D than their Canadian counterparts, they import technology from parent firms that makes them more innovative and productive than domestic firms, and pay higher wages.[1] The study also cited research to the effect that foreign direct investment does not reduce the number of head offices in Canada in drawing upon a Statistics Canada study on the head office effects arising from foreign ownership:

> "Much of the dynamism in Canada's head office sector actually comes from foreign-controlled firms. The head offices of foreign-controlled firms contributed to all of the gains in the number of head offices over the past 6 years and accounted for 6 out of 10 new jobs created. The effect of foreign takeovers has not been to reduce the number of head offices in Canada nor head office employment. As a result of foreign takeovers, more new head offices were created than lost and employment in head offices was as high after the takeovers had occurred than before" [2]

Not surprisingly, there have also been efforts in some sectors of the business community to also support liberalized foreign ownership rules finding corporate takeover effects to be largely positive or benign.[3] Increased markets for sale of

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[1] Hejazi, Walid, "Dispelling Canadian Myths about Foreign Direct Investment", IRPP, January 2010

[2] Beckstead, D., and W. M. Brown. 2006. "Head Office Employment in Canada, 1999 to 2005." Insights on the Canadian Economy, no. 014. Statistics Canada, cat. no. 11-624-MIE.,p.15

[3] Bloom, Michael, "'Hollowing Out': Myth or Reality" Presentation to ITIC", January 29, 2008.

domestic corporate assets, of course, mean higher market valuations of Canadian equity. However, the proposition that foreign investment may drive positive industry developments both in terms of productivity and employment does not appear to be anathema with observed results.

PIAC does not intend to present a definitive analysis on the overall effects of foreign investment on the Canadian economy in the context of these comments. Neither do we believe that the attendant economic effects of foreign ownership can be reduced to a simple yes/no response. There are, however, certain considerations associated with the proposed policy changes in the telecommunications sector that have direct bearing on the position of Canadian telecommunications consumers in terms of their ability to access telecommunications products and services from the standpoint of innovation, price, choice, and quality of service that are relevant to the development of any policy change.

Clearly, there are increasing concerns that Canadian business investment is anemic[4] and that Canadian foreign investment abroad has grown at a faster rate than foreign investment domestically[5], with potential resultant effects on Canadian capital markets. The Bank of Canada Governor, Mark Carney, recently complained that Canadian workers have about half the amount of information and communications technology (ICT) of their American counterparts arising from a failure on the part of Canadian business to invest. The lethargy of our national telecom sector may thus have its origins in the uncompetitive nature of the market that was also the subject of the Governor's comments:

[4] Bank of Canada, Monetary Policy Report, July 2010, p. 19
[5] Hejazi, Walid, "Dispelling Canadian Myths about Foreign Direct Investment", IRPP, January 2010

> "Some possible explanations for why we both under-invest and appear to use capital so poorly include…
>
> - in particular, inadequate competition in some sectors, especially network industries that have spillovers throughout the economy, including telecommunications, electricity, and retail"[6]

The potential effect of competition invigorated by foreign owned entry into the sector has been discussed in reports that inform this current consultation. In particular, the Competition Review Panel Report noted:

> "There is considerable evidence that liberalizing foreign investment restrictions brings demonstrable economic benefit through increasing competitive pressure on all participants in the market. This is as important in new and emerging markets (including Internet-based communications platforms) as in well-established markets. Foreign investment restrictions reduce competitive intensity in a number of ways that are well known. In relation to telecommunications markets, they include placing 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

[6] "The Virtue of Productivity in a Wicked World", Remarks by Mark Carney Governor of the Bank of Canada, Ottawa Economics Association Ottawa, Ontario 24 March 2010

> practices and activities and to be world-class (rather than best-in-country-class) competitors”.[7]

Other analysts have noted similar salutary effects on the behavior of domestic firms:

> “In order for foreign operations to overcome the hurdles of going international and operate profitably when faced with competition by local firms, they must be more competitive. The domestic economy also benefits from the increased amount of competition that comes with the presence of foreign firms. These spillover effects are significant: some estimates say the spillover benefits that come from FDI are twice those of spillovers associated with trade alone.”[8]

Competition and Regulation in the Canadian Telecommunication Sector

It is certainly relevant in the context of the proposed policy options to assess the current state of competitiveness and the performance of the Canadian telecommunications industry under the current regime of ownership controls that are in place. In doing so, the question arises whether increasing foreign ownership in the telecom sector will create new competition that will bring consumer benefits to Canadian telecommunications markets.

In order to assess the performance of the Canadian telecom sector it is necessary to review the current regulatory framework in which the various services operate. The operating regulatory environment in which telecommunications facilities are developed and services are offered is one that looks to market forces as the principal method of compliance with the objectives of the *Telecommunications*

[7] Competition Review Panel Report, “Compete to Win” p.47 referencing McFetridge, D.G., “The Role of Sectoral Ownership Restrictions” prepared for the panel

[8] Hejazi, p.9

Act.[9] Most retail telecommunications services have been forborne from regulation by the CRTC that has found, as a precondition of such forbearance, that there was sufficient competition between incumbents and competitors, to protect the interests of users.

During the past decade, the incumbent local exchange carriers, (ILECs -Bell Canada, TELUS et al.) mounted an energetic campaign to be treated the same as their competitors from a regulatory standpoint, and to be rid of CRTC regulation of their local telephone prices and services. In return for their liberation from the shackles of regulation, the ILECs promised they would use their new ability to bundle services to provide new savings and choices for consumers.

The ILEC lobbyists succeeded in convincing the government that the CRTC was not sufficiently pro- competition. The government amplified the statutory requirement of forbearance contained in sec. 34 of the *Telecommunications Act* with a Policy Direction to the CRTC issued by the Governor General in Council (GGIC) in December 2006[10]. The Direction, issued pursuant to subsection 10(1) of the *Telecommunications Act* provided that the Commission should "rely on market forces to the maximum extent possible as the means of achieving the telecommunications policy objectives" and to use measures that interfere with the operation of market forces to the minimum extent necessary ".

Hard on the heels of the Direction were GGIC Decisions overturning earlier CRTC Decisions concerning the regulatory framework for Voice over Internet Protocols (VOIP) and weakening the requirements for forbearance for local telephone service. The net effect of these interventions into the CRTC

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[9] *Telecommunications Act* 1993, c.38
[10] Order Issuing a Direction to the CRTC on Implementing the Canadian Telecommunication Policy Objectives SOR/2006-355

administration of the *Telecommunications Act* has been to give undue prominence to the objective of "increased reliance on market forces for the provision of telecommunications services". It also effected a likely premature deregulation of local service, and a dismantling of much of the so-called social regulation of ILEC local networks including matters as basic to customers as disconnections and quality of service.

Yet, local telephone service, now a sleepy duopoly dominated by the ILECs and cable providers, is not the only service occupying the no mans- land between regulation and effective competition.[11] Wireless service was forborne from regulation by the Commission in 1996,[12] so that the myriad of billing, additional charges and customer mobility issues that now vex Canadian consumers were never effectively dealt with by the Commission. Number portability, a significant enabler of competition had to be strong-armed into effect by the Government's intention to introduce compelling legislation in the 2005 Speech from the Throne. The reason for the reluctance on the part of existing suppliers was that they were quite happy to forego competition for more market share rather than potentially lose the share they already had. Needless to say, equal access, to enable the provision of third party services on wireless networks has never been mandated. By the time of the 2008 Industry Canada wireless spectrum auction, the government had recognized that the state of competition in these markets was generating inferior results in terms of price and choice. In the result, 40% of the new spectrum was set aside for new entrants.

[11] In fact, largely because of its previous regulation and basic service ceiling it is the leading international performer of telecommunications services according to the most recent CRTC Monitoring Report.
[12] CRTC Telecom Decision

Retail broadband services were forborne from regulation in 1997 by the CRTC at a time when numerous internet service providers (ISPs), furnishing dial-up internet services existed. The advent of the broadband standard for internet service and its overwhelming provision by cable and ILECs only has created a largely unregulated duopoly with attendant results for customer price and choice. Not unexpectedly, Canadian broadband offerings offer at best mediocre value in relation to international standards. [13]

A recent controversy is illustrative of the lack of effective competition in the broadband market. Rogers Communications will be reducing its customer internet download limits in order to squeeze Netflix, an internet subscription service that is a potential competitor for delivery of video services with other Rogers's services such as cable, pay for view, and video rental services. The reduction of service, effectively a price increase, was made ostensibly without concern for loss of market share, a prime indicator of dominance by a vertically integrated player in a market that is supposed to be competitive.

Cable broadcast distribution undertakings (BDUs) have been a particularly egregious example of premature deregulation leading to exploitation of a dominant position. In 1997, the CRTC allowed basic cable service to be deregulated if a competitor obtained 5% of the BDU franchise market and provided a service that was available to 30% of the market[14]. The incredibly low threshold for effective competition prompted an eventual avalanche of BDU forbearance applications. However, unlike the normal economic expectation of price decreases in

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[13] See the report of Berkman Center for Internet and Society at Harvard University, *Next Generation Connectivity: A review of broadband Internet transitions and policy from around the world* (February 2010), online: http://cyber.law.harvard.edu/sites/cyber.law.harvard.edu/files/Berkman_Center_Broadband_Final_Report_15Feb2010.pdf. See also the Organization for Economic Co-operation and Development (OECD), *OECD Communications Outlook 2009*, online: http://www.oecd.org/document/44/0,3343,en_2649_34225_43435308_1_1_1_1,00.html

[14] Cable Broadcasting Decision 1997-25

competitive markets, cable basic service skyrocketed in price, in some cases doubling within a decade of the Commission's deregulation decision. BDU's crammed additional offerings (that were often owned by the BDU) into the basic service package, and passed on price escalations to boot. In the result, cable and satellite BDUs experienced customer revenue increases and profitability levels that were beyond reasonable expected levels in a competitive market.

Notwithstanding the obvious observable decrements in competition and consumer welfare, the Commission has never instituted a proceeding to re-regulate a forborne service. New entrants wishing to access essential facilities of ILECs and cable companies to deliver telecommunications services have faced continual unwillingness to make available surplus network capacity and continued disputes about the necessity and public interest in doing so. The mantra of deregulation as a priority set out in the Policy Direction has been used as a cudgel by incumbent facilities owners such as the ILECs and Cablecos to bludgeon new entrants and their possible protector, the CRTC, into rejecting any mandatory sharing of essential facilities.

It is little wonder that the Report of the House of Commons Committee on Industry, Science and Technology of June 2010 concluded:

> "The recent performance of the Canadian telecommunications industry is, on the whole, unsatisfactory."

A recent Commission report has acknowledged the illusory nature of the benefits promised by swift deregulation urged so fervently by the ILECs in mid-decade:

> "Although it requires further study, it appears that bundling strategies are having the effect of enabling service providers to maintain price levels. The following figure demonstrates that, with the exception of Internet pricing

(which has fallen slightly), telephone and BDU pricing has been on an upward trajectory in comparison with the overall consumer price index."[15]

The fundamental error made by government and regulators associated with the management of the restructuring of the telecommunications industry and the transition to competition has been the willingness to mistake the implementation of deregulation with the onset of real competition. The fact that the impetus for deregulation of the telecommunications sector over the last decade and a half has been largely provided by the incumbent service operators who had formerly been so successful in a regulated environment, is rather revealing as to the ultimate beneficiaries of the process. By deregulation occurring without appropriate consumer safeguards, and while market dominance continued to exist, Canadian customers are being provided with service offerings that are, for the most part, not reflective of true rivalry in the market. Pernicious customer problems with billing practices, connection, disclosure of contract terms and service in deregulated telecommunications services have been handed off to the Complaints Commissioner for Telecommunications Services (CCTS) while the incumbent providers aggressively pursue the abolition of CCTS as an impediment to their untrammeled access to the wallets of their customers.

Clearly, in this environment, the presence of more competitors in the marketplace could help create the conditions that should have been in existence at the time of forbearance. As well, their appearance might be responsive to the trenchant criticisms that the telecom sector as inefficient and uncompetitive. The necessity for multiple competitors to ensure workable competition has been a frequent theme

[15] "Navigating Convergence: Charting Canadian Communications Change and Regulatory Implications", CRTC, February 2010, Para 125

in classical industrial economics, a theme that was unfortunately ignored in the rush to deregulate:

> "Effective competition is the central concept of the field. It requires reasonable parity among numerous competitors, able to apply strong mutual pressure. No one firm dominates, and there is also easy entry by new competitors. Competition can be ineffective when these criteria are not met. Then the public may be misled into thinking that it is getting the benefits of competition when it is not".[16]

The early consumer experience with new entrant wireless competition, facilitated by the 2008 Industry Canada spectrum auction, has largely been positive. Canadian customers have been given access to new service and price offerings by the new arrivals. Existing incumbent wireless providers are hustling to meet their new competition with better offerings and, better prices. [17]In one case, Globalive appears to have been particularly able to resist the low level attempts to frustrate its launch, partly as a result of its considerable access to financial resources and clout provided by its connection to the international telecommunications giant Orascom Telecom. While it is early in the game, its Wind Mobile brand service offerings appear to present the new entrant as a genuine market maverick within an environment known for super normal profits for its dominant incumbents.

Canadian Telecommunications Firms and the Public Interest

One of the underlying assumptions associated with maintenance of Canadian ownership controls in the telecommunications sector has been that such ownership helps to ensure that the decisions and operations of Canadian owned companies

[16] Shepherd, William G., *The Economics of Industrial Organizations* (4th ed.), Waveland Press, p.3
[17] Some of this behavior associated with a fighting brand launched by an incumbent may have crossed the line into anti-competitive conduct.

will differ from foreign owned equivalents when it comes to the pursuit of the objectives set out in sec. 7 of the *Telecommunications Act*. These objectives include accessibility, affordability, and responsiveness to the needs of users in building the "social and economic fabric of Canada and its regions".[18]

Unfortunately, in examining the history of telecommunications in Canada, it is difficult to identify where Canadian- owned carriers pursued policies and offered service that differed from those that would have been motivated by business needs, market conditions and the duty to reward investors. In its infancy, telecommunications was developed in lock step with cross-border schemes to cartelize service and promote the doctrine of natural monopoly to justify attempts to squeeze out smaller municipal and provincial companies. These latter companies had largely developed to remedy the reluctance of Bell to expand its service beyond the main urban centres to less profitable regions. Patterns of cost shifting between local and long distance service were adopted with a view to encourage monopolization largely to customer detriment.[19]

Later, in the era of monopoly regulation of telephone rates (1950-1977), Bell Canada introduced rate increases that were considerably in excess of those required by the provincially owned systems and showed far lower productivity levels than those publicly owned companies. [20]This performance is hardly in line with a conclusion of a Canada-first objective by Canadian owned telecos.

As well, the major telephone service carrier in British Columbia was in American hands since the 1920s until 2004. From 1955 until the latter date, the American GTE and its successor Verizon held ownership shares in BCTel, and subsequently

[18] It is to be noted that sec. 7 also includes the objective of promoting "ownership and control"
[19] Babe, Robert, Telecommunications in Canada, University of Toronto Press,(1990) Part III
[20] Babe, p.175

BCTELUS that were non-compliant with the foreign ownership restrictions in the Telecommunications Act. There is no record of a significant divergence in company policy and operations with its eastern Bell counterpart.

The ILECs behavior in the era of deregulation also belies any “home-team” advantage. Following the imposition of the first price cap in1998, Bell Canada acted swiftly to outsource operator services previously provided in Canada despite vociferous protests from its unions. TELUS refused to agree to a union contract with its employees not to outsource any of its operations in 2005 triggering a lockout. Throughout this decade, ILECs have tenaciously contended for limitations on their regulated obligations to customers with respect to Terms of Service to their customers and are now striving to abolish their customers recourse to mediation of complaints (CCTS) associated with the provision of deregulated services. It may be argued that they are acting in the best interests of their shareholders, but their conduct seems bereft of any desire to advance the greater national interest or the objectives of the Act.

PIAC is strongly of the view that where public objectives in telecommunications diverge from private financial or corporate goals, there must be clear means available to ensure achievement of the public objectives. These means include competition, regulation in the form of universal rules, or, when required, direct regulation of the product or service provided. The nationality of a firm’s ownership is no substitute for more rigorous requirements to achieve the public interest.

There is some merit to the criticism that increasing the number of foreign competitors is increasingly cited as a cure-all for Canadian market failure. One such analyst has noted:

> "A centrepiece of Canada's industrial policy is attracting foreign investment. This seems to me a lack of imagination on the part of our elites; rather than develop genuine industrial strategies, so much the better to just let foreign capital come and create the jobs for us."[21]

In relation to perceived market failure, or dismal performance, PIAC does not submit that foreign competition will remedy all customer welfare problems arising from the operation of the current networks. There is the requirement for implementation and enforcement of standards of service and codes of conduct applicable to all service providers. There is a continuing need for a commissioner of complaints to mediate customer disputes. Effective competition may lessen the necessity of action to enforce such rules or mediate complaints, but competition itself cannot replace the need for their establishment.

On the other hand, PIAC believes that Canadian ownership requirements have frequently been an inadequate substitute for positive expectations or obligations for private interests to act in the public interest.[22] From the consumer standpoint, there is little that commends a strategy that provides for the protection of the interests of users of telecommunications networks and services simply by foreign ownership controls.

National security concerns

Foreign ownership of vital telecommunications networks raises potential issues associated with national security. There is a necessity to ensure that national interests are not compromised by actions by ownership or management that reflects

[21] Lee, Marc, "Foreign Ownership in the Resource Sector", Progressive Economics Forum, at http://www.progressive-economics.ca/2007/07/19/foreign-ownership-in-the-resource-sector/

[22] The issue of foreign ownership controls has been more easily accepted by the business community than issues associated with concentration of ownership. The Davey Committee report of 1970 and the Kent Commission of the 1980's illustrate this observation.

another sovereign country objective. This is particularly important in relation to any acquisition by state owned enterprises of another jurisdiction. PIAC notes that the amendments to the *Investment Canada Act* made in Bill C-10 provide a national security test and review procedure authorizing the Minister to review investments that could be injurious to national security.

Furthermore, it is to be noted that the National Security Review of Investments Regulation PC-2009-1596 increase the informational requirement for non-Canadians in applications for review and notification associated with transactions meeting financial thresholds triggering reviews.

The Federal Cabinet now has broad powers to block transactions or impose terms and conditions prior to authorizing the investment, while the term “national security” is left undefined. As this legislation is relatively new, PIAC expresses no opinion on its effectiveness. It may, however, be wise to provide an independent review to determine the same on a periodic basis.

Mergers and the Merger Efficiency Defense

Pursuant to sec. 91 of the *Competition Act*, a merger involves the acquisition of control whether by purchase, lease of shares or assets, amalgamation or a combination of control over a significant interest in a business of a competitor, supplier, buyer or other person. Mergers may prevent or substantially lessen competition in a market. Sec 92 of the *Competition Act* gives the Competition Tribunal the power to take appropriate steps to prevent this harm.

However, the *Act* recognizes that mergers may also lead to efficiency gains. Sec. 96(1) provides that a merger will be allowed if it is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or substantial lessening of competition that is likely to result. . A substantial lessening of competition is normally accompanied by a significant non-transitory price increase: indeed, this is the measure used by the Competition Bureau and many others. This redistributes income from consumers of the merged firm's products to the firm itself.[23]

From PIAC's perspective, the exercise of encouraging new entrant competition in telecommunications markets can be easily negated by a pattern of mergers that would effectively re-concentrate the market. The federal government's strategy of a decade ago of providing a head start for PCS providers Microcell and Clearnet was cashiered by subsequent mergers with Rogers and TELUS approved by the Competition Bureau. It is thus vital that the efficiency gains accruing to shareholders in a proposed merger involving new foreign owned competitors are not allowed to be set off against the losses accruing to consumers arising from a substantial lessening of competition. This is particularly the case when the gains accrue to foreign shareholders and can be less expected to ultimately benefit Canadian consumers.

Our recommended approach would require that, for the efficiencies defense to succeed, customers should not lose because of the merger. In particular, prices should not substantially increase, relative to what they would be, absent the merger.[24] Equivalently, consumer surplus should not decrease.[25]

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[23] In turn, the increased revenues will be passed on, in part to employees through higher salaries and benefits, and in part to shareholders through an increase in earnings that is translated into increased share prices. The magnitude of the final incidence is an empirical matter. To simplify the discussion, we refer to shareholder effects and do not discuss employee effects. This has no impact on the arguments advanced.

[24] The reader is reminded that here "price" is intended to include non-price attributes, such as quality.

[25] The Federal Court of Appeals has rejected this approach in *Commissioner of Competition* v. *Superior Propane Inc.*, [2003] F.C.A. 53. Thus, a legislative amendment may be required to implement it.

PIAC notes that this consumer surplus standard is used in the four other jurisdictions: the United States, European Union, United Kingdom, and Australia.[26]

Adoption of a consumer surplus standard by Canada would be a step toward harmonization with these countries. This approach is also relatively simple to implement. The focus, from the customer end, is on the level of prices. For ease of administration, a price index for the firm could be constructed, as a weighted average for all the products sold by the pre-merger firms. For the efficiencies defense to be successful, a requirement might be that it be likely that this price index not increase for a given period of time post-merger.[27]

In PIAC's view, a failure to correctly establish a standard for the merger efficiency defense that is in accord with the objective of enhancing consumer welfare will subvert the intent of the liberalized rules and may simply lead to the continuation of non-competitive markets, albeit in different hands.

Recommendations

1. <u>Option 2 of the Consultation is the Preferred Policy Choice for Reform</u>

In PIAC's view, the state of competition in most telecommunications markets and the resultant effect on price, choice, innovation and quality of service in those markets compels consideration of lessening of foreign ownership controls to promote new entry. PIAC believes that, as the incomplete market discipline

[26] According to Massimo Motta, *Competition Policy: Theory and Practice* (New York: Cambridge University Press, 2004) at 274: "So far, the EC in its decisions has not explicitly ruled out the possibility of using an efficiency defense, but it has not showed much sympathy for this argument either. Whenever cost reductions have been claimed by the merging parties, the EC has dismissed those claims on various grounds."

[27] The details of constructing such a price index have been explored in depth in a number of industries in Canada, such as telecommunications and energy that are subject to price cap regulation. A number of industries in Canada, such as telecommunications and energy, are subject to price caps regulation. Simplifying greatly, an average price index is calculated each year for firms that have market power. The firms must obey the constraint that this index cannot exceed a cap determined by the rate of inflation and by the productivity gains that can reasonably be expected in that industry.

provided by the current state of competition to be the most important policy driver for change, a solution that directly links foreign investment with start-up telecommunications companies and existing small industry players, is likely to achieve the best results. (Option 2 provides for relief from current ownership provisions for new entrants and small existing carriers).

2. The Merger Efficiency Defense must be Clarified

For the reasons set out herein, the consumer surplus standard should be applicable in mergers. The ability of the merging parties to offset shareholder gains against consumer price increases arising from a substantial lessening of competition should not be permitted.

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