

# Torlys on Technology and Communications

T&C 2008-1  
January 4, 2008

## Licensing Framework for Auction of AWS Spectrum and the CRTC's CanWest Decision

By [Charles Dalfen](#) and [Paul Cowling](#)

Since our recent communication on the framework for the auction of advanced wireless services (AWS) (see *Canadian Government Sets Out Rules for Auction of Spectrum Licences*, which is linked at the end of this document), two regulatory documents have been issued that are relevant for prospective bidders in the auction. First, Industry Canada (IC) issued ground rules for the auction (the Licensing Framework). Second, the Canadian Radio-television and Telecommunications Commission (the CRTC) approved, subject to certain amendments in the governance documents, the transfer of Alliance Atlantis Broadcasting Inc.'s (AA) broadcasting companies to CanWest MediaWorks Inc. (CanWest). The AA/CanWest decision makes key determinations relating to the ownership and control of a licensed entity financed with substantial foreign capital. Copies of both documents are linked at the end of this document and the key points from each document are summarized below.

### The Licensing Framework

The Licensing Framework outlines the rules and requirements for the AWS competitive bidding process. The main points include the following:

#### Key dates:

January 22, 2008:	Deadline for submitting questions on the Licensing Framework
February 27, 2008:	Posting by IC of answers to submitted questions
March 3, 2008:	Deadline for filing applications to participate in the auction
March 24, 2008:	Posting of qualified bidders
May 21–23, 2008:	Mock auctions for qualified bidders
May 27, 2008:	Auction begins
10 days after the close of bidding:	Deadline for the submission of ownership and control documentation

To discuss these issues, please contact the authors. For media calls, please contact [Stuart Wood](#), Director, Marketing & Business Development, 416.865.8205.

Torlys' bulletins are available on our website at [www.torlys.com](http://www.torlys.com), under Publications. If you usually receive our bulletins by regular mail and would prefer to receive them by email, please inform us at [info@torlys.com](mailto:info@torlys.com).

*This bulletin is a general discussion of certain legal and related developments and should not be relied upon as legal advice. If you require legal advice, we would be pleased to discuss with you the issues raised here in the context of your particular circumstances.*

© 2008 by Torlys LLP.  
All rights reserved.

**Anti-collusion rules:** The Licensing Framework prohibits bid-rigging, and as part of its application materials, an applicant will be required to sign a declaration that it has not entered into, nor will enter into, any agreements or arrangements of any kind with any competitor regarding the amount to be bid, bidding strategies or the particular licence on which the applicant or competitors will or will not bid.

For these purposes, *competitor* means any entity (other than the applicant, its affiliates or associated entities) that could potentially be a bidder in this auction on the basis of its qualifications, abilities or experience. An *affiliate* is a person who controls or is controlled by the applicant, whether directly or indirectly, and *control* means control in any manner that results in control in fact. *Associated entities* are those who enter into any partnerships; joint ventures; agreements (including agreements in principle) to merge; consortia; or any arrangements; agreements; or understandings of any kind, either explicit or implicit, relating to the acquisition of the licences being auctioned or to the post-auction market structure. Direct or indirect ownership of at least 20% of the voting shares, or of the beneficial ownership, of an entity will result in a refutable presumption that the owner controls the entity.

Pending IC's review of the materials required to be filed to refute the presumption of affiliate status or to dispute the existence of an associated entity, the relevant entities will be regarded as competitors and will be subject to the anti-collusion rules.

**Financial deposits:** A bidder will be required to submit a pre-auction financial deposit with its application to participate in the auction, in the form of an irrevocable standby letter of credit. The deposits will differ depending on the number of eligibility points assigned to the licences on which the applicant wishes to be eligible to bid. Each licence's eligibility points are proportionate to the population covered by the licence. One eligibility point is approximately equal to 100,000 people per 5 MHz of spectrum. However, to avoid disadvantaging applicants who may want to obtain spectrum in only a few areas, the financial deposit will be \$40,000 per eligibility point for the first 300 points, and \$140,000 per eligibility point requested thereafter. Additional financial deposits may also be requested during the auction, depending on such factors as the standing high bids on a licence and the bidding activity. The eligibility points for each licence are set out in Appendix B of the Licensing Framework.

**Bidder qualification:** On March 7, 2008, IC will publish the list of all applicants on its website (<http://ic.gc.ca/spectrumbauctions>). Following an initial review, applicants will have an opportunity to correct any errors or inconsistencies in their applications or letters of credit, or to provide additional information on affiliates or associated entities. On March 24, 2008, IC will publish the list of qualified bidders.

**Withdrawal of applications:** Applicants who wish to withdraw their application materials and have their letters of credit returned may do so, without prejudice, by delivering a written request to the AWS Auction Manager before 5:00 p.m. (EST) on the business day preceding the opening of the auction.

**Auction design and rules:** The auction will be run electronically over the Internet with a related set of licences offered simultaneously and bidding organized into a series of an unspecified number of bidding rounds. Bidders may withdraw their high standing bids, but a penalty will be imposed in an amount equal to the loss of auction revenue caused by the withdrawal. Other key features and full details of the auction process are set out in section 6 of the Licensing Framework; opening bids for each licence are set out in Appendix B of the Licensing Framework.

**Post-auction bid payment and eligibility:** Each winner will be required to submit an initial payment of 20% of the total of its high bids (plus 100% of all withdrawal penalties) within 10 business days of the close of bidding, with the balance due within thirty business days of the close of bidding. Unpaid amounts

will be satisfied by drawing on the letters of credit, and if the letters of credit are insufficient, the winner will forfeit its right to the licence and will be required to pay the applicable forfeiture penalties.

Each winner will also be required to submit documentation supporting its eligibility to hold the licence under the Canadian ownership and control rules within 10 business days of the close of bidding. Failure to comply with the eligibility requirements will also result in forfeiture of the right to the licence and applicable forfeiture penalties.

**Key conditions of licence:** Once issued, the licences will be subject to the standard conditions for spectrum licences won by auction, such as the requirement to invest a minimum of 2% of gross revenues in research and development activities related to telecommunications. Some additional conditions will be imposed on licences that are issued to new entrants. For example, for five years from the date of issuance, a new entrant licensee may not transfer, lease, divide or exchange its licence among or with entities that do not meet the criteria of a new entrant.

## The AA/CanWest Decision

The key question in the AA/CanWest proceeding was whether the relationship between CanWest, a Canadian company, and GS Capital Partners (GSCP), a non-Canadian private equity affiliate of Goldman Sachs, would result in a non-Canadian controlling the AA broadcasting companies (the AA Companies). Under the Canadian ownership and control rules that apply to broadcasters, a licensee must be Canadian-controlled. If the CRTC determines that an applicant is controlled by a non-Canadian, whether on the basis of personal, financial, contractual or business relations or any other considerations relevant to determining control, the applicant is deemed to be a non-Canadian. Even though the AWS spectrum auction is being conducted under the *Radiocommunication Act* and the AA/CanWest transaction was approved under the *Broadcasting Act*, the Canadian ownership and control rules under the two Acts are largely similar, and IC and the CRTC generally try to achieve consistency in applying the rules.

The AA/CanWest transaction involved the transfer of the AA Companies' shares to an entity owned indirectly by CW Investments Co. (CW) for approximately \$1.5 billion. Under the purchase price allocation considered by the CRTC, CanWest contributed approximately \$262 million (representing 35% of the equity), GSCP contributed approximately \$480 million (representing 65% of the equity) and debt financing funded \$790 million. CanWest will hold two-thirds of the voting shares of CW, and GSCP will hold the remaining voting shares. CanWest- and GSCP-related entities entered into a shareholders' agreement whereby CanWest is obliged to merge its existing licensed Canadian television business (the Contributed Business) with the AA Companies in 2011, subject to any necessary regulatory approvals (the Combination Transaction). In examining whether the participation of GSCP constitutes control in fact, the CRTC applied the test set out in the National Transportation Agency's 1993 *Canadian Airlines* decision, which found that control in fact generally can be viewed as the ongoing power or ability, whether exercised or not, to determine the strategic decision-making activities of an enterprise or the ability to manage and run the day-to-day operations of an enterprise. Ultimately, the CRTC was satisfied that, subject to certain amendments to the governance arrangements, as summarized below, the proposed transaction did not raise any de facto control concerns and that, as described by the parties at the hearing, GSCP's role was limited to acting as a financial investor. The CRTC focused its analysis on certain issues, including the following:

**Quorum for directors' proceedings:** Under the shareholders' agreement, CanWest is entitled to appoint three of the five directors of CW, and GSCP is entitled to appoint two. Each CanWest nominee must be a Canadian citizen ordinarily resident in Canada; one GSCP nominee may be a non-Canadian. As

originally filed with the CRTC, the shareholders' agreement provided that a quorum for a board meeting was a simple majority of the directors. The CRTC was concerned that this would permit a valid board meeting to be held where the GSCP nominees constituted a majority of the directors present. To eliminate these concerns, the decision requires the shareholders' agreement to be amended so that a quorum requires CanWest's nominees to represent the majority of board members present.

**Composition and mandate of the Reporting Committee:** The shareholders' agreement contemplates the creation of a Reporting Committee to gather information on CanWest's management of the AA Companies and the Contributed Business. The CRTC expressed concern about the lack of specificity regarding record-keeping, quorum and the scheduling of meetings of the Reporting Committee and about the Reporting Committee possibly becoming a de facto executive committee that would make key decisions regarding the AA Companies and the Contributed Business. The decision therefore requires the shareholders' agreement to be amended to, among other things, (i) clarify that the Reporting Committee will have no authority or right to make any decisions regarding the AA Companies and/or the Contributed Business; and (ii) require that at least 80% of the members of the Reporting Committee be Canadian.

**The level of GSCP's equity:** A number of interveners in the proceeding expressed concern that GSCP's contribution of more than 50% of the equity in CW prior to the Combination Transaction would provide it with de facto strategic control of the AA Companies. However, in the CRTC's view, prior to the Combination Transaction, CanWest would operate the AA Companies and the Contributed Business as one business, and CanWest's de facto contribution should be viewed as 35% of the equity in the AA Companies plus the value of the Contributed Business. On the basis of a confidential third-party valuation of the Contributed Business, the CRTC determined that CanWest's share of the equity in the venture would be more than 50%, and found no merit in the argument that GSCP's equity position would give it control in fact. Given the basis for the finding regarding CanWest's equity share, it may be difficult to determine the precise importance of the 50% threshold in future transactions with different ownership, financing, governance and other arrangements.

**The role of Goldman Sachs in debt financing:** The CRTC expressed concern about the potential additional influence that a Goldman Sachs entity could gain as a result of substantial participation in the debt side of the transaction, either as the lead syndicator or as the major holder of the debt. However, on the facts before the CRTC, Goldman Sachs played neither role, and the CRTC was therefore satisfied in this regard.

**GSCP veto rights:** The CRTC expressed concern about GSCP's rights to veto transactions out of the ordinary course of business and the acquisition of material liabilities involving the AA Companies and the Contributed Business. In particular, the CRTC objected to the requirement that each GSCP nominee waive GSCP's veto rights over such transactions; the shareholders' agreement's definitions of *ordinary course of business* and *material liability*; and the threshold amounts on out of the ordinary course transactions above which GSCP would have a veto right. To resolve these concerns, the decision requires the shareholders' agreement to be amended to define ordinary course of business and material liability; allow for one GSCP nominee to waive GSCP's veto rights; and raise the GSCP veto thresholds on out of the ordinary course transactions to \$30 million in the case of transactions that occur before the Combination Transaction, and to 5% of the value of the broadcasting undertakings as of the date of the Combination Transaction in the case of transactions that take place after the Combination Transaction.

For further information, please click on these links.

[\*Canadian Government Sets Out Rules for Auction of Spectrum Licences\*](#)

[\*Licensing Framework for the Auction for Spectrum Licences for Advanced Wireless Services and Other Spectrum in the 2 Ghz Range\*](#), December 3, 2007.

[AA/CanWest Decision](#) 