Introduction

BCE : THE PRIVATE EQUITY TAKEOVER OF A CANADIAN ICON

Hudson Janisch
August 13, 2007

1. Introduction

On June 30, 2007, Bell Canada Enterprises (BCE) Canada’s largest communications company announced that it had entered into an agreement to be acquired by an investor group led by Teachers’ Private Capital (Teachers’), the private investment arm of the Ontario Teachers’ Pension Plan, Providence Equity Partners Inc. (Providence) and Madison Dearborn Partners LLC. The all-cash transaction was valued at C$51.7 billion (US$48.5 billion). The BCE Board of Directors unanimously recommended that shareholders vote to accept the offer.¹ This constitutes the biggest private equity offer ever.²

While the principal purpose of this report is to describe and analyze this massive Canadian takeover, this development, and events leading up to it, raise a number of substantial issues for the telecommunications industry generally. Is a debt-laden privatized operator an appropriate ownership model in a competitive, capital intensive industry? What form will telecommunications ownership take in an era of active pension fund investing? What trade offs need to be made between concentration and competition in the event of the emergence of a domestic publicly-owned “national champion” in response to bids from foreign private equity firms? Can an auction process be designed so as to accommodate both private equity and public strategic investors? Can foreign ownership rules ever adequately address the level of control inherent in foreign private equity investment?

As The Economist observed, the BCE acquisition is the culmination of a dramatic debt-market transformation. “For the past few years the wild men of private equity have rampaged through the public markets. They have ventured
into the drowsy glades of badly managed companies and they have stormed the citadels of multinationals. The wind has been at their backs for so long that it has been hard to imagine how anything could stop them.\textsuperscript{3} Nevertheless, it did go on to suggest that private equity faced serious financial problems\textsuperscript{4} which will be addressed in the specific context of the telecommunications industry later in this report.

While it is appropriate to describe the proposed takeover as a “private equity investment”, it has been pointed out that while driven by quintessential American private equity investors, the major Canadian investors have been pension plans either directly owned, or at least sponsored, by government.\textsuperscript{5} However, as we have just seen, the winner of the BCE auction was not the pension plan itself, but its private investment arm which is collaborating with its American partners precisely according to the by now classic private equity debt-acquisition strategy. This mix of true private equity and an arm of a government-sponsored pension plan does, however, raise the issue of who really will be in control, a matter of some importance in light of the foreign ownership restrictions that figure so large in this report.

The target company will be referred to as “BCE” throughout, although its name was changed back to “Bell Canada” in early June, 2007 as part of a belated effort to refocus the company on its core telecommunication business. As the restored name is not yet being used officially, and because so much took place before the name change, it seems appropriate to use the BCE moniker here with the caution that in some quotations reference is made to “Bell” or “Bell Canada” either nostalgically, or in anticipation of the “new” name.

2. **Background**

While there are many common concerns which run through all advanced telecommunications systems, unique national features need always to be taken into account. A striking feature of Canadian telecommunications is that there has never been a single national incumbent. Instead of a national holding
company similar to AT&T, with Bell operating companies linked by ATT Longlines as in the United States, there were a series of separately owned regionally-based monopolies linked by an agreement to exchange long distance traffic. Bell Canada dominated in the East; in the West, Telus, created by way of a merger between B.C. Tel and Alberta Government Telephones, was dominant. Today, Bell Canada and Telus share the great majority of the Canadian market and are engaged in vigorous competition in reaching out from their regional home bases. While Bell Canada remains somewhat larger, Telus has made recent gains in market share, especially with respect to wireless. And, as will be discussed below, Canadian cable companies have now aggressively entered the telecommunications market.

This lack of a single national incumbent was to play a prominent role in this story. Indeed, Darren Entwistle, CEO of Telus who led a brief, spectacular “national champion” bid for BCE, placed a great deal of emphasis on the need for an “aggregated national incumbent”. Canada had no equivalent of British Telecom, Deutsche Telekom or France Telecom and he felt it needed to rewrite history to bulk up a national champion. However, as was pointed out at the time, this was a misleading analogy for Canada as although it was true that Europe “is cluttered with national phone companies”, there was far more competition there, particularly in wireless, than there would be in Canada if Telus was allowed to take over BCE. The issue of how it might be possible at this stage in the evolution of telecommunications in Canada to assemble a “national champion” without undermining the viability of competition, will be a major theme in this report.

Distinctive history, of course, plays a fairly obvious role with respect to large issues such as the lack of a national incumbent. It can also play a role much less easily perceived from the outside. Consider, for example, the significance of political concerns in Rimouski, a small town in eastern Quebec, at the prospect of a Telus takeover of BCE.
As part of that fragmented approach to telecommunications so characteristic in the past in Canada, Rimouski had had its own local telephone system, Quebec Tel, and when Bell Canada sought to acquire it, it was sold instead in 1966 to GTE in the United States which at that time also owned BC Tel. Telus inherited Quebec Tel when GTE (now part of Verizon) sold its interests in Canada and then used “Telus Quebec” as a beachhead from which it has aggressively expanded into business and wireless services throughout the province of Quebec. Today, Telus Quebec has 4,200 employees, and although half its work force is in Montreal, its head office is still in Rimouski where with 1,400 locals on its payroll, it is the town’s biggest employer.

What gives all this real punch is that the Minister of Industry, Maxime Bernier (who is responsible for telecommunications policy) represents a nearby riding and is in charge of boosting support for the minority Conservative federal government in eastern Quebec. While Bernier himself has long made his pro-market views known and these could well include the acceptance of a BCE takeover, his well-known adherence to free-market principles is in conflict with his political responsibility to deliver eastern Quebec to the government.

This means that the strongest and best informed voice in the cabinet may well be stilled because the good folk of Rimouski are probably quite content to have the state play protector. Such are the unexpected vagaries of history and politics which, while small in themselves, need to be taken into account in any analysis of the much bigger issue of ownership in telecommunications.

3. **BCE’s Recent Unhappy History**

Unlike Telus which has remained resolutely focused on its core business, BCE rushed to adopt a number of passing fads from “diversification” in the 1980’s to “convergence” in the 1990’s, all with disastrous results. This turbulent history of wasted opportunities and wealth destroying forays by BCE management are now the stuff of Canadian corporate legends. Jean de
BCE’s Recent Unhappy History

Grandpré (1983-1988) undertook a sweeping reorganization of Bell Canada and created a giant conglomerate, Bell Canada Enterprises (BCE). The creation of Bell Canada’s parent company had been brilliantly conceived as a means of getting out from under restrictive regulation in order to undertake lucrative foreign contracts, especially in Saudi Arabia. However, it was subsequently used to invest heavily in fields unrelated to telecommunications including commercial real estate and oil and gas pipelines. His successors, Raymond Cyr (1988-1992) and Lynton Wilson (1992-1998) refocused the business at considerable expense and improved the price of shares. Unhappily Jean Monty (1998-2992) reverted to de Grandpré’s grandiose acquisition binge now along much touted “convergence” lines. This included the acquisition of Canada’s largest private television network (CTV) and Canada’s national newspaper (The Globe and Mail). To top things off, Monty got carried away in the optical fibre boom and invested $7.5 billion in Teleglobe.

Michael Sabia was appointed CEO in the wake of Monty’s forced resignation in 2002 after Bell was required to write down almost its entire investment in Teleglobe. He inherited a sprawling convergence empire which lacked workable synergies. During all this time, BCE share prices suffered from a substantial holding company discount. Sabia was thus faced with the challenge of refocusing on his core business while at the same time improving operations in what had rapidly become a highly competitive business. This was a very tall order and Sabia and a “blue ribbon” board of directors drawn from the Canadian corporate elite were to fall short, thereby paving the way for the private equity bid 5 years later. The only surprise is that it took that long, but as we shall see, a combination of restrictive foreign ownership rules and until very recently, passive pension plan investment strategies, held things back.

Sean Silcoff, a commentator at the National Post’s Financial Post neatly summed up Sabia’s strategy. “If you didn’t know better you might think Michael Sabia had been running BCE Inc. on behalf of private equity firms for the
past five years. Only at half-speed, taking half-measures and without all the debt from a leveraged buyout to focus his mind. And with little to show for his efforts.”

Initially, Sabia had had to deal with a raft of problems he inherited from his predecessor, Jean Monty and had then had to proceed to sell off most of BCE’s non-core assets, cut jobs and costs and streamline operations in general. In 2006 alone, he shed 2,750 jobs, bought back 5% of stock and twice increased dividends. As well, he sold BCE’s satellite business Telesat for $3.2 billion. While he knew what had to be done, he seemed to favour cautious half measures, and did not appear to be capable of acting with sufficient decisiveness. By the start of 2007, BCE stock price had risen less than 10% since he had become CEO in 2002.

Sabia did a fair job of cleaning up after Monty, but then ran out of steam. Instead of berating the market for not valuing BCE shares more highly, Sabia and the board had been in a position to do something about it. In their paralysis they ignored a most compelling value creating opportunity. If shareholders under-valued BCE stock (one fund manager who ultimately became a large shareholder pegged BCE’s asset value at more than $45 when it was trading at under $30), the board could for a mere $5 billion have retired nearly 20% of stock. Yet even after the sale of the satellite operator of Telesat, the board dithered.

As Derek deCloet of The Globe and Mail’s Report on Business put it, it seemed as if post-Monty the company was afraid to make a mistake and that it overanalyzed its every move. “When you have so many owners, none of them has much power, and you can take your sweet time – until enough of them get together and rebel, which is pretty much what has happened.”

Spending so much time in over-analysis on how to incrementally undo Monty’s extravagant push into convergence distracted management from the operational side of things. This resulted in a series of mis-steps. First, on the rapidly growing wireless side, BCE allowed cable operator Rogers to bulk up its
national network by acquiring Microcel. Today, BCE trails both Rogers and Telus in the wireless market. In 2005 a massive breakdown of its billing system alienated many customers leading to a loss in market share from which it has yet to recover. Second, some one million local subscribers have moved to the cable companies which offer triple play (cable tv, broadband and phone service) with Rogers being able to offer quadruple play with the addition of mobile wireless. Third, in moving into the growth business of wireless and broadband, there was no smooth transition, but rather abrupt changes in executive ranks and strategic shifts. Fourth, BCE’s move into landline tv service to compete directly with the cable companies on their home turf, is faltering and way behind schedule. Fifth, in enterprise business, BCE has not only lost major accounts to Telus, but has also lost a number of crucial government accounts, including most recently, one with the Department of Defence.

Overall, BCE’s poor operational performance added to shareholder concern that the return to core (now, of course, expanded to include both wireless and broadband) could have been achieved in three years, not left only partially accomplished after five.

In a strikingly frank and perceptive analysis of events leading up to the BCE takeover, Stephen Jarislowsky noted that Bell shareholders needed better marketing, low prices and improved customer relations, not “financial engineering”, to enhance shareholder value. Jarislowsky is Canada’s largest private-money manager with $60 billion under management. “Instead of fooling around selling off things which Michael Sabia has been doing, they just needed to improve customer relations and pricing. That’s how you run a business. There wasn’t any financial engineering needed in that firm, just people who knew how to run it.”

For those like Jarislowsky who believe that all would be well if only management were truly answerable to shareholders, there would be no need for “financial engineering” to throw a debt-laden bucket of cold water over
management. However, as long as it is hard for public shareholders to exercise much control over managers who supposedly work for them, it will be common for managers to indulge in empire-building or self-aggrandizing activities instead of focusing on ones that enrich the company’s real owners. “That’s why, quite often, the lash of a private equity unwilling to tolerate such nonsense can be a very healthy thing.” In the case of BCE, any move toward disciplining management would have to take into account Canadian restrictions on foreign investment in telecommunications.

4. Foreign Ownership Rules

Among OECD nations Canada has maintained one of the most restrictive and inflexible set of rules limiting foreign investment in the telecommunications sector. Section 16 of the *Telecommunications Act* requires that in order to be eligible to operate in Canada, a common carrier must be a “Canadian-owned and controlled corporation”. Subsection 16(3) defines Canadian ownership as requiring (a) 80% of board of directors must be Canadians (b) Canadians must own no less than 80% of voting shares and (c) the corporation must not be controlled by persons who are not Canadians.

In the 1994 regulations, provision is made for holding companies provided 66⅔ per cent of voting shares are Canadian owned. This means that a foreign company that holds 20 per cent of the voting shares in a Canadian company (direct ownership) can also hold 33⅓ per cent of the voting shares of a company that holds the remaining 80 per cent of voting shares in the Canadian company (indirect ownership), provided the foreign company does not exercise control. In practice this means that a foreign investors’ ownership must be less than 47 per cent.

This regime had a distinctly distorting impact on the auction process leading up to the private equity sale and this will be dealt with later in this report. As well, it must be recognized that as these rules are so far out of line with other comparable countries, the imminent prospect of their liberalization or
elimination played an important motivating role for participation in the BCE takeover process both for Telus and three private equity groups.

It seems likely that one of the reasons for Telus’s impetuous charge was its concern that should the restrictive foreign ownership rules be dismantled, as seemed quite likely, next time it would face well heeled bidders from the U.S. such as Verizon and AT&T. For the private equity investors, removal of the restrictive rules would help to ensure the desired high IPO after reorganization. As Catharine McLean, who specializes in reporting on telecommunications for *The Globe and Mail*, noted, the greatest upside from a privatization would come from an easing of the foreign ownership rules and that this was the key bet they were making. “Such a move would expand the range of bidders to include investors from the United States and other countries, assuring the sellers get top dollar when they decide to unload the telephone company.”13

One final point with respect to foreign ownership limits needs to be noted here. As is to be seen in both the Act and the Regulations, “control” is never supposed to pass to foreign investors. However, this piety bumps up against the reality of U.S. private equity investors whose whole purpose in life is to control the companies they acquire. For instance, it was widely recognized that when Kohlberg Kravis Roberts & Co. (KKR) acquires a company, it walks in the door with a six month strategy and woe betide any CEO who does not enthusiastically comply. “If the deal goes down, control of Bell Canada will rest in the capable hands of New York based KKR, the top player in the buy out game”.14 Right from the outset, Teachers’ made it clear that it was only interested in the investment and had no intention of becoming involved in the operations of BCE. However, Providence made it clear that it will bring in its own industry turn-around specialists to run things.15

As Andrew Coyne of the *National Post* bluntly put it, the foreign ownership rules are essentially a sham. “However many Canadian pension plans may be rounded up to front the deal, everyone knows who holds the controlling
stake. The law serves no purpose but to limit the pool of available bidders and thus to depress the price paid to BCE shareholders.”

The reality which everyone knows, but will not acknowledge, is that after the proposed takeover has been blessed by the regulators as conforming to the letter of the foreign ownership requirements, a side agreement will be entered into between Teachers’ and Providence along the following lines: “We the controlling shareholders hereby delegate overall strategy to you and agree to abide by whatever reorganization of the company you consider appropriate”. Technically, Canadians will control, functionally it will be the American private equity operator.

5. **Previously Passive Pension Funds**

An essential prerequisite to the BCE takeover was the new-found willingness of larger Canadian pension funds to become active investors. Historically, they had remained essentially passive investors, unlike in the U.S. where two decades ago radical pension funds such as the California Public Employees Retirement System (CALPERS) began to take up arms against corporate boards. Claude Lamoureux, head of the Ontario Teachers’ Pension Plan, had long been an advocate of quiet, behind the scenes diplomacy to resolve shareholder issues with managers. For years he had embraced the role of “Miss Manners” in the boardroom. It was thus a considerable shock to Sabia and his board when Teachers’ declared that it was going to become an active BCE investor. “BCE directors are aghast at the aggressive tactics Mr. Lamoureux and his colleagues deployed in recent months,” Andrew Willis of *The Globe and Mail* reported, “one director called the pension plan’s activist approach ‘disgusting’.”

While pension funds had flexed their muscles occasionally in the past, a direct challenge to BCE management and its blue ribbon board of directors was a “watershed moment”. It showed how much more like American investors Canadians have become. As a trendsetter in the domestic market,
Teachers’ has guaranteed a more aggressive standard in corporate governance in response to the challenging demographics now faced by pension funds. At the same time, because they are public pension funds, there is concern that should the Canadian Pension Plan, for example, become more active in its investment strategies, it will inevitably face political demands to invest in “worthy” causes. As William Robson, President and CEO of a major think tank, the C.D. Howe Institute, concluded, “More passive investing would be a price worth paying to keep political hands off our national nest egg.” Be that as it may, Teachers’ die is cast and we need to move on to a consideration of the appropriateness of private equity in telecommunications.

7. **Private Equity and the Telecommunications Industry**

This section of the report briefly restates what private equity investment is all about, describes the limited experience of the telecommunications industry with private equity thus far, and identifies four issues which need to be specifically addressed. These are distortions to executive incentives; tax leakage; impact on competition; and most importantly, prospective capital investment in network upgrades.

Private equity takeovers are transactions in which public companies are brought by one or more private equity firms who load them with debt, remove them from the stock market, revamp them from top to bottom and then typically sell them back to stock market investors at a much higher price. Fuelled by rock-bottom interest rates over the past few years, the total price of private equity buyouts has spiraled to an unprecedented US$450 billion including BCE, the biggest such transaction so far. As Catherine Taylor put it, “Private equity firms have a well-known modus operandi: Swoop in and buy an undervalued asset, take it private, work their magic by turning the company around, then flip it at a higher price, usually within the space of five years.”

While private equity firms have been buying up small telecommunications assets around the world, there have been only a few major
transactions up to this point. In 2005 a group of U.S. and British private equity firms bought Denmark’s largest telecommunications company, Copenhagen TDC in a deal valued at US$12 billion. In 2006 Ireland’s main telephone company, Eircom was sold to an Australian investment group in a deal worth €2.4 billion. Smaller transactions have included the third and fourth largest mobile phone companies in Greece (later sold to a strategic buyer) and the Emirate of Dubai’s private equity arm acquisition of stakes in telecommunications firms in Tunisia and Malta. Interestingly, two large private equity transactions had already taken place in Canada, the purchase from BCE of Telesat Canada for $3.2 billion by the Canadian Public Sector Pension Investment Board and U.S.-based Loral Space & Communications Inc., and the purchase by KKR in 2002 of a 60% stake in Yellowpages from BCE which it later monetized by spinning off the company as an income trust.21

A highly controversial aspect of private equity buyouts (as well as “old fashioned” leverage buyouts) is the distortion of executive incentives which is an inherent part of the process. In an article headlined, “700 million reasons to love a buyout” Andrew Willis of The Globe and Mail estimated that if all went according to plan, top management at BCE will receive hundreds of millions of dollars.22 “How can managers fairly evaluate, represent or negotiate a deal on behalf of the current Bell owners when one bidder offers to make them wildly wealthy (Teachers’) and the other doesn’t (Telus)?” asked the National Post’s Diane Francis.23 Interestingly, in a poll conducted at the time, over 53% of Canadian CEOs felt that a special committee should be completely autonomous in deciding on takeovers and mergers, and 72% believed that bonuses paid in mergers and acquisitions were “too generous”.24

What particularly outraged Stephen Jarislowsky was that as the proposed acquisition would constitute a change of control, BCE’s managers will make multi-million dollar windfalls in stock options and golden parachutes. Why he asked, should these people make money for what they have done so badly? After all, the takeover would never have happened if management and the board
had done a better job of running the company in the first place. For Jarislowsky the whole “private equity game” was highly offensive in the way it works “Exploit enticements to managers and boards, borrow money to buy off shareholders and sell off some divisions until an exit strategy comes along.”

Whether one agrees with Jarislowsky or not, it is evident that massive “enticements to management and boards” demand that some way has to be found to set up a credible, independent decision-making process such as will at least address shareholder skepticism about management motivations. Ideally, management should not be involved in the bid process at all. However, as we will see, for one reason or another, BCE was not able to run a credible, independent auction process and there was to be a massive outpouring of criticism from all involved.

Private equity deals raise the issue of tax leakage, a particularly sensitive political issue in Canada these days in light of the Conservative government’s flip flop on income trusts. In opposition, the Conservatives had promised that income trusts would continue to provide means of avoiding corporate taxes. In office, they changed their minds when confronted with the prospect of very large corporations, including Telus and BCE, converting to income trusts. Now with private equity, the amount of tax payable to Ottawa would be vastly reduced as the new owners could structure their deals so that debt would predominate and interest payments could be written off for tax purposes.

Minister of Finance Jim Flaherty had no worries about the loss of annual tax revenues, noting that the federal government stood to reap a very large one-time windfall through capital gains taxes on the sale of BCE shares. Others are not as sanguine. Sean Silcoff has estimated that while the expected one-time capital gains tax will amount to some $1 billion, foregone tax revenues on corporate profits, dividends and interest on debt will amount close to $1 billion per annum. “If you thought the threat of big phone companies converting to
income trusts created a public policy storm, just wait until they do the math on the Bell proposed leverage buyout.\textsuperscript{27} At the very least, it has to be recognized from a public policy perspective that tax avoidance lies at the heart of the success of private equity’s ability to turn around acquisitions and that this achievement (and long-term tax revenue after return to the public market) has to be balanced against shorter-term adverse impact on tax revenue.

In turning to the impact of the entry of private equity on the nature of competition, it should be noted that while the overall price of telecommunications services have steadily declined with the advent of competition in Canada, there have been but few instances of outright price wars, and when they have broken out, they have been quickly snuffed out. For instance, in the wireless market a great deal has been spent on cute and clever advertising and on developing complex (and all too often incomprehensible) consumer plans and packages, but prices remain well above those in Europe or America. When genuine price competition was initiated by new entrant Microcell with its aggressive Fido brand, it was immediately acquired by Rogers in 2004 with the declared intention of “stabilizing prices” and eliminating “irrational pricing.”

Against this background, it seems likely that private equity will further reduce the likelihood of significant price competition. With massively increased debt, BCE will be motivated to keep prices up. Overall, the taking of BCE private will signal competitors that they will not need to engage in price competition. For example Videotron, a Quebec-based cable company which has quite exceptionally engaged in vigorous price competition with BCE, will likely ease up.\textsuperscript{28} At the same time, private equity may improve the quality of competition in the long run should it allow BCE to spend more on network upgrades. For instance, it is presently spending $1-2 billion to push fibre closer to customers’ homes, but for $4 billion it could offer superfast broadband and television over Internet connections. This could be expected to greatly enhance
its sale price when, as expected, the Teachers’ group looks to sell it back into the public market.

This report does not purport to deal with the private equity phenomenon in general, but is focused on its implications for the telecommunications industry. From this perspective, the issue of capital investment is predominant and it has been the subject of some comment in Canada.

Bluntly put there was concern whether a debt-laden private operator was the most appropriate corporate model for a competitive, capital-intensive telecommunications industry. Would loading BCE’s balance sheet with debt impede its ability to finance the massive new investment needed to meet the challenge from cable companies by taking fibre closer to the home? Ironically, while private investment may not be a fan of capital spending, if BCE is to compete successfully, it must spend on upgrades, not simply cut costs. Were there to be any cutbacks on capital expenditures, this would make the company less competitive and thus less attractive when it came time to go public again.

Iain Grant, a respected telecommunications consultant, was particularly concerned that Teachers’ did not fully appreciate that in this industry a private equity acquisition would have to be followed by expanded capital investment. “They’re investing $50 billion in something which still needs work. That’s not the end of the investment. That’s merely the beginning.”29 The usual private equity strategy is to sell assets and cut costs aggressively to increase cash flow. However, this recipe for success cannot be fully followed in a telecommunications context which requires ever greater investment. Indeed, Grant himself thinks that Teachers’ might have to double BCE’s capital expenditures.30

Finance Minister Flaherty indicated that he was confident that Teachers’-Providence would be motivated to and capable of undertaking necessary capital expenditures. His was an expansive list. “Such things as fibre
optic wiring to households or the wireless network would, in turn, increase Canadian productivity. Improved wiring to Canadian homes would allow Bell Canada to deliver faster Internet service to its customers, and allow it to keep pace with its cable company rivals. Bell Canada is said to be years behind its U.S. peers in this type of investment.  

Despite the cheerful optimism of the Minister of Finance with respect to both tax leakage and capital investment, when Telus publicly announced that it was in discussions to acquire BCE, three of the nine benefits it believed could be achieved by combining Telus/BCE in a public company, dealt directly with these concerns. Such a combination would, “Preserve an income tax base for Canadian governments that would otherwise be eliminated by highly leveraged private equity structures with non-taxable equity holders and U.S. sourced debt”. In an appeal to BCE small investors who wanted to avoid the shock of the capital gains tax, Telus pointed out that its proposal would, “Allow current BCE shareholders to participate in an ongoing value creation on a largely tax deferred rollover basis which would be attractive to many BCE shareholders with a low tax cost basis.” Finally, it would, “Retain investment grade credit ratings thereby retaining financial strength to invest in long-term growth with the associated public benefits related to innovation and productivity.”

Eric Reguly, a leading economic commentator, in a particularly disturbing piece in The Globe and Mail cautioned, “High debt loads can hurt. Sometimes they can be deadly.” He went on to contrast BCE’s proposed heavy indebtedness with that of European telecommunications companies. He suggested that those companies had a healthy respect for debt because of its potentially pernicious effect. With high debt, financial flexibility is reduced. “It means high interest payments can squeeze out other spending, such as capital investment. It can mean disaster if interest rates climb or cash flows fall.” He further suggested that interest payment on debt may mean that BCE will have to trim $200 million to $300 million from its capital expenditure. “The network might have to suffer to keep the debt holders happy.”
There is some understandable nervousness in Canada today that things could go badly wrong. Despite reassurances from Jim Leech at Teachers’ that all the necessary financing is firmly in place,34 the risk is that market conditions will not be favourable enough to finance the deal at assumed costs. Success in financing will come down to the market’s appetite for more junk debt. If the banks end up unable to sell all of the debt, this would lead to higher interest costs for BCE. And higher interest costs would mean that it would not be in any position to do what the minister so blithely assumed. The final section of this report will return to this crucial issue of private equity and post-acquisition capital investment in the context of telecommunications.

7. Putting BCE in Play

Teacher’s had been a long-term investor in BCE and by 2006 with 5% of shares it was the company’s largest shareholder. In 2007, it further increased its holding to 6.3% of shares. During all this time, it was concerned that share prices remained flat, but confined itself to its usual polite, behind-the-scenes diplomacy.

In late March, 2007, The Globe and Mail reported that Kohlberg Kravis Roberts (KKR) “the world’s most powerful private equity firm is stalking BCE Inc. in the hope of launching a friendly takeover bid for the owner of Bell Canada.” It was said that BCE’s CEO, Michael Sabia was strongly resisting any idea of a takeover in the belief that despite a long period of weak stock market performance, he and his management team could still boost share value.35 News of KKR’s interest sent BCE shares soaring, but they fell back after the company announced that there were “no ongoing discussions” and “no current intention to pursue such discussions with any private equity investor.”36

BCE’s stance was criticized as being excessively negative in contrast with the open-to-discussion, self confidence displayed by Telus. “Telus’s share price has climbed, perhaps in part because investors appreciate the open-minded approach. Keeping the door open costs nothing. Telus is not ruling out
dancing with the private equity names. BCE is telling them to take a hike. As a shareholder, which company would you rather own? As subsequent events were to show it might have been better if BCE had thrown its doors open, but Sabia saw no reason why private equity investors should benefit from the upside he believed he had patiently created over the last five years.

In the meantime, Teachers’ grew ever more restless and gathered growing support. Nevertheless, it was still assumed that as a passive pension fund, all it was doing was firing a warning shot across BCE’s bows in the hope of getting some improvement in the price of shares or possibly a seat at the boardroom table. But then there was a defining moment.

In early April, 2007, Teachers’ decided that in view of its changing stance towards BCE, it would be necessary for it to submit a 13D filing with the U.S. Securities and Exchange Commission (SEC) indicating that it was preparing to take a more active stand with respect to a public company. A meeting between Jim Leech of Teachers’ and Michael Sabia and Richard Currie, chairman of BCE, ended acrimoniously according to those familiar with the meeting. “They said that he [Sabia] viewed it as an act of war, ‘when they filed that 13D it was Pearl Harbour,’ said a source close to BCE.”

On April 17, 2007 under continuing intense pressure from shareholders, BCE announced that it was “reviewing strategic alternatives.” At the same time, it announced a possible sale to a consortium made up of the Canada Pension Plan Investment Board (CPP), the Caisse de dépôt et placement du Québec (Caisse) and KKR.

It was somewhat surprising that BCE had announced this less than three weeks after it had said that it had no intention of going private. However, “Ma Bell” was always entitled to change her mind. But what was really striking was that after rejecting Teachers’, Sabia had played so active a role in putting together the KKR group. This high level of managerial intervention from the
outset was to set the tone for what was to turn out to be a bitterly contested process.

Looking back on his time as advisor to the Special Committee of BCE directors, Ed Waitzer, a senior Toronto corporate lawyer said that he had been taken aback at the level of nastiness in the auction. “What he wasn’t prepared for was the furious insults, complaints and deal punches hurled at the board, its executives and advisors during what became one of the nastiest auctions witnessed in Canada. ‘There were a lot of noisy grievances from bidders who were trying to tilt the auction in their direction or who genuinely felt it was being tilted away from them,’ Mr. Waitzer said.”

What we now need to do is to analyze how the process went so badly wrong. In particular, were there, when viewed from a telecommunications perspective, any unique or distinctive issues in this particular private equity takeover?

8. **An Awkward Auction**

This section seeks to make some sense of a very confused, often chaotic auction process. In so doing, it will first place the takeover process in the broader context of BCE’s “strategic review”; second, it will analyze the role of the special committee; third, it will identify the role played by CEO Sabia in the process; fourth, it will assess the impact of the foreign ownership rules in putting together bid consortia, and fifth it will deal with a range of issues raised by the attempt of Telus to be included. This section will conclude with an evaluation of BCE’s responses to criticisms, the unprecedented continued criticism by the winner of the auction and Chairman Richard Currie’s outraged response to any and all criticism.

In a bold, straightforward approach, the BCE board would simply have thrown open the doors, invited all comers and gotten out of the way. Once the game was in motion, Sabia and the board should have lost control – that is
An Awkward Auction

the price to be paid for poor managerial performance. Four contenders did indeed seek to line up at the starting gate, but the race itself was far from straightforward.

As Andrew Willis observed in his “Streetwise” column in *The Globe and Mail*, what was supposed to happen at BCE was something like a country auction where everybody gets a chance to inspect what is for sale and when it comes to bidding, everyone in the crowd is on an equal footing, limited only by the size of their wallets. The auctioneer’s role is clear: get the best possible price. The BCE auction was far removed from this simple, but appealing model. It involved constant interference, exclusion of the strongest potential bidder and an auctioneer who really wasn’t in charge.43

Rather than simply put itself on the auction block, BCE decided to embark on a “strategic review” on April 17, 2007, designed to consider a number of alternative scenarios. In addition to a sale, these included a large share buy back using the $3.25 billion proceeds from the sale of Telesat; a breakup of the firm; some asset sales, and a recapitalization, with debt added to the balance sheet to finance either a higher dividend or an additional buyback of shares. At the same time (as we have seen), it indicated that it had now changed its mind about talking to private equity suitors. So for the next 10 weeks, while private equity made all the running with Telus rushing in and out at the last moment, the strategic review played out.

Sabia insisted at the BCE special meeting called to ratify the name change to Bell Canada Inc. on June 6, 2007, that all these options were still open. However, questions from shareholders made it clear that they knew what was really happening.44 Finally, in late June, 2007, BCE unsurprisingly let it be known that its financial advisors “all agree that selling the company offers better value.” than the range of alternatives the company said it had been considering.45

The three private equity consortia and the dates at which they were announced at full strength are as follows: CPP, Caisse, Onex Investments and
An Awkward Auction

KKR (April 17, 2007); Hospitals of Ontario Pension Plan, Richard Li, CanWest Communications and Cerberus (May 17, 2007); Teachers’, Providence and Madison Dearborn (June 5, 2007). It needs to be kept in mind that some of these consortia, especially their Canadian components, turned out to be quite unstable and there will be need to update bidder composition from time to time as our story unfolds.

What then of the auctioneer to revert to Andrew Willis and his country auction model? As we have noted, that is best a role played by an independent committee of independent directors. BCE selected such a group led by a retired lawyer and composed of three other directors. Yet as it turned out, “They were figureheads, simply supervising the potential sale. All decisions had to be made by the full 15-person board. At best it was a cumbersome structure.”46 Sean Silcoff agreed that the independent committee never ran the show. “The committee should have taken control, hiring and charging the investment bankers and keeping management on a tight leash.” No wonder he concluded, Bay Street veterans considered it to be a highly flawed auction.47

There was widespread concern in financial circles that CEO Michael Sabia had not been able to let go and that the board had not insisted that he do so. All of the major private equity firms complained about different aspects of the process, including the role that BCE chief executive officer had played in negotiations over several months. Andrew Willis saw the auction as being botched by an unnecessarily complex process that included an unhealthy amount of interference from Sabia. “For all his considerable intellect, Mr. Sabia should have stayed miles away from the so-called ‘strategic review’ at Bell Canada. He and his colleagues in management have too much at stake, too many potential conflicts.”48

In an auction process variously described by members of the investment community as “clumsy” “bizarre” and “unprecedented”, the requirement of 53% Canadian investment seems to have led hesitant Canadian
investors being induced to join consortia with American private equity investors. This resulted in a good deal of added confusion when they later bailed out of the race. While the Teachers’ group was stable throughout, the same could not be said for the other two groups.

Cerberus, which had a reputation of favouring quick flip-and-strip deals and was thus most in need of a stable Canadian component, was noticeably unsuccessful in attracting such investments. Participation by CanWest (a broadcaster) was seen as particularly thin, and Richard Li of Hong Kong, who had never resided in Canada for any length of time after obtaining citizenship here, was not seen as a particularly credible “Canadian” investor. In an effort to counter this weakness in its bid, Cerberus went out of its way to soften its image by cozying up to Finance Minister Flaherty, promising to retain the Quebec-based management team and to keep BCE headquarters in Montreal, while at the same time making extravagant promises about investing in fibre to the home. In the end, Cerberus was forced to come up with a scheme in which it proposed to enlist existing BCE Canadian shareholders in a novel response to the ownership rules. As for KKR and CPP, both Onex and the Caisse dropped out at the very last minute, leaving it scrambling to meet its Canadian quota.

In light of the foreign ownership rules, BCE considered that far from simply playing the role of Andrew Willis’s simple country auctioneer, it would have to pro-actively orchestrate the creation of bidding groups and to, in effect, parcel out available Canadian capital in order to ensure that there would be at least the appearance of a genuine auction. For example, faced with “the very bizarre dynamic” of the foreign ownership rules when applied to an auction, the special committee abruptly refused to allow CPP and KKR to add additional Canadian pension plans to its consortium – a move to which they strongly objected.
We will return to this aspect of the auction in evaluating BCE’s response to criticism at the end of this section of the report. What we now have to address is how, if at all, a process, initially put in place to respond to private equity investment proposals, could accommodate a simultaneous takeover bid by a competitor public company.

The three private equity groups had been surprised to learn that Sabia had been talking to Darren Entwistle CEO of Telus since mid-May with respect to a possible takeover bid. They were irritated that BCE was allowing Telus into the process as they believed that this diverged sharply from what they had understood was the company’s objective “to solicit offers from private equity firms that would keep BCE as a stand-alone firm rather than exploring a merger with its nemesis.”

This meant that there would be nobody keen to see Telus at the table as both the economic inducements involved in a private equity takeover (discussed earlier) and corporate pride would lead to reluctance on BCE’s part. Fiduciary obligations to shareholders required that Telus be allowed to join the auction, but it was apparent from the outset that Sabia’s heart was not in it and that he was not disposed to be cooperative. Overall, circumstances were not at all conducive to the creation of anything approaching a level playing field.

The attempt to incorporate Telus into the auction process was to raise a number of difficult issues. First, could there ever be “parity of timelines” between two very different types of bids; second, how should access to confidential information be dealt with in the changed context of a bid from a competitor; third, should BCE have insisted on a non-disparagement clause, and fourth, was BCE justified in moving as quickly as it did to a decision? Before addressing these specific issues, we need to stand back a bit and set the scene of Telus’s quest for inclusion.

It had been widely assumed that Telus would sit things out. Onex, Canada’s most astute and successful private equity investor, was convinced of
this and only joined the CPP-KKR consortium on that basis and immediately withdrew when Telus made its intentions clear.

There had, of course, been some speculation that Telus would make a run for BCE. A particularly articulate exponent of a BCE-Telus merger, which he dubbed “Belus”, was Scotia Capital’s John Henderson. In a report in early-April, 2007 he noted that cable companies were becoming increasingly formidable competitors and it was likely that an additional wireless operator would soon be licensed. By mid-April, 2007 amidst much private equity speculation, some analysts were reported to be betting “that rival Telus will emerge from the bushes with an 11th hour merger proposal, potentially the best solution of all for BCE shareholders.” Nevertheless, it still came as a surprise when Telus announced on June 21, 2007 that it was entering the auction as most analysts and commentators had, like Onex, continued to assume that it would sit things out.

With the benefit of hindsight it is possible now to see how Sabia deliberately undermined the presumed exclusivity of a private equity auction. On May 15, 2007, he had met with Darren Entwistle in Vancouver to say that BCE’s board was very interested in a merger and was keen to get things underway as soon as possible. While this was a perfectly appropriate initiative as it was likely to generate the highest value for shareholders (although it might be faulted for not being more forthcoming with the private equity bidders if the auction was to be kept on an even keel), what turned out to be really controversial was what happened after this initial invitation to participate.

Many sources close to what happened believe that BCE did everything possible to block a fully-informed offer from Telus. The initial positive meeting was followed by “six frustrating weeks for Telus, during which time the company felt Mr. Sabia and his team did just about everything possible to thwart it from putting together a fully informed bid.” We need now to look at some of the previously identified specific issues in this controversy.
An Awkward Auction

One of Entwistle’s major concerns was that Telus was faced with a far longer and more onerous review process than the private equity investors. As he put it, “In a world where private equity can get a deal of this magnitude done in a matter of weeks, I don’t think that it is an appropriate situation where we are waiting for a seven-month ruling from the Competition Bureau. All I am asking for is, ‘Could I please have equality or parity of timeline in terms of approval’.”65 He said that he did not want a repeat of Telus’s thwarted purchase of Microcell which ended up being bought by Rogers in 2005. Telus had a deal set and was working on an approval from the competition authorities, but it lost out when Rogers swooped in and acquired the struggling wireless provider because it had fewer regulatory hurdles to clear.66

As Telus’s bid would raise major competition law issues (outlined in the next section of the report) his “parity of decisional timelines” is not really tenable as it equates changes of ownership with mergers.67 While there could well be concern about the pace of merger reviews, the entirely different level of concerns raised by a “Belus” merger surely justified a major difference in the level of review. However, when it came to more specific issues, Telus’s complaints seem to be more justified.

Understandably, BCE insisted that Telus needed a different access agreement from that agreed on with the private equity bidders. Telus was after all a competitor, not a pure financial buyer. As Sabia explained, “We needed to behave in a way that was consistent with competition laws, and we needed to behave in a way that would not impair our business by providing a direct competitor with insights into particular types of information which could have weakened the competitive position of the company going forward.”68 What is striking here is that he did not start from the assumption that fiduciary obligations to his shareholders meant that he had to make all information available, but that this obligation had at some point to be balanced against competition considerations. As is so often true, where one starts from, determines where one
ends up. By the time Telus was finally able to look at BCE’s confidential data, it had less than a week before the bid deadline.

Even once into the “data room”, Telus appears to have been denied information essential to an informed bid. For instance, BCE has four legal actions pending against it with respect to the demise of Teleglobe. BCE’s financial statements provided a boiler plate reassurance that management did not believe that these claims would have a material or negative effect on the company. “Telus wanted more information – what contingencies had Bell planned, its planned defence, expected exposure, legal opinions in support of its case. Bell refused to provide any such information.”

A major sticking point in access to confidential information negotiations, was BCE’s insistence that Telus agree to a “non-disparagement clause.” Richard Currie readily acknowledged that Telus’s refusal to agree to such a provision was one of the key reasons why negotiations took so long to complete. “What we asked was, again in the interests of fairness, ‘go and say whatever you want about what’s positive about your approach, but in the interests of a level playing field, don’t use that platform to undermine or trash the other people’.” Securities lawyers expressed surprise at the use of a non-disparagement clause in a merger situation. Indeed Philip Anisman, an expert on merger deals in Canada had never heard of such a clause being employed in merger negotiations. As he went on to point out, “The effect of that kind of non-disparagement clause is to create a potential impediment to explain why a competing offer is a superior offer.”

In a less careful, non-legal analysis, Diane Francis ridiculed BCE’s insistence on a non-disparagement clause as a breach of the duty it owed to its shareholders. “In other words, Bell’s concern about disparaging remarks, or criticism, stood in the way of their fiduciary obligation which was, and always has been, to facilitate the most open, widely circulated auction possible in order to realize best value for shareholders.”
If Telus was to have a credible opportunity to participate in the auction, it had to have more time to obtain sufficient information on which to base its bid(s) and an opportunity to respond more fully to the immediate competition issues (especially with respect to wireless) a “Belus” prospect aroused. After having delayed so long, Sabia and the board now set a very aggressive bid deadline for the end of June, with BCE advisors pushing for a “quick coronation” within 72 hours after the deadline. Ironically, while criticism of Sabia had always been that he acted too slowly, when it came to the auction the criticism was that he had acted too precipitously.

While it has always to be kept in mind that to be contemporaneous with the private equity bids, any bid from Telus had to be highly conditional on subsequent (and uncertain) regulatory approval. Nevertheless, it does seem that BCE did not take Telus participation seriously. As Richard Currie dismissively put it, “Our attitude was that it was synergies with baggage.” With a little more time and responsiveness from BCE, it might have had a fourth bid from a key industry player likely able to pay the highest price. As Sean Silcoff concluded, the fact that BCE shareholders would not have a fourth option was due to an artificial, overly aggressive deadline that did not serve BCE investors well. And it should also lead to questions “why BCE did everything to thwart the one bidder most likely not to have required the further services of Mr. Sabia.” It seems likely that Stephen Jarislowsky had been right all along.

In the event, six days after publicly entering the auction process, Telus abruptly withdrew on the day bids were due. In a terse, two sentence announcement, Telus stated, “The inadequacies of BCE’s bid process did not make it possible for Telus to submit an offer.” It was widely assumed that this dramatic move was an attempt to buy more time and that the BCE board would feel obligated to extend the bidding deadline in order to maximize the effectiveness of the auction.
The abrupt nature of Telus’s withdrawal and its last minute timing was thought to be bizarre given Entwistle’s enthusiasm for synergy and a national champion. Conspiracy theorists had a field day: Telus never had any real intention of acquiring BCE and had only entered the race to drive up the price so that BCE, post-buyout, would be crippled with debt. However, Derek deCloet was probably closer to the mark when he observed, “The logic of a BCE-Telus merger is real and Mr. Entwistle was truly captivated by it. It’s big, nationalistic and more than anything else ambitious, and the Telus boss is nothing if not an ambitious guy.” As we shall see in a later section of this report, a straight-forward explanation is very much in keeping with Entwistle’s character. Telus had simply concluded that it did not have enough time in which to mount an informed bid.

In announcing the start of the auction with three private equity participants, BCE issued a measured, pointed response to weeks of criticism. “In a deal of unprecedented complexity and size in Canada, we have succeeded in creating a truly competitive process”, Bill Fox said in a prepared statement. “It is not surprising that some party seeking its own advantage wants to complain because we have not tipped the process in any one direction. We have run the process in a manner that seeks to encourage maximum participation with a view to achieving the best result for BCE shareholders.”

Sabia was keen to point out just how far removed the BCE auction had had to be from the “simple country auction” model idealized by Andrew Willis. Most importantly, it necessitated the active involvement of the auctioneer. “To create competition and maximize value in a small market subject to foreign ownership limits, that is a challenging exercise. …That’s why the day to day, hour to hour involvement of the board.”

In an editorial meeting at The Globe and Mail, Canada’s national newspaper, Chairman Richard Currie emphasized that Sabia had not acted on his own, but at the urging of directors. “The board told Michael ‘We can’t have
one horse in this race. We need another horse. Michael, go get another horse."85

It was further explained that in view of the unique Canadian foreign investment limits, BCE had had to create a competitive process and that this required more orchestration than some bidders cared for. As Sabia put it, “If this had been going on in the United States, a board would have sat back and said ‘Sign up whoever the hell you want to sign up with’”.86 However, in Canada, BCE had had to assist in the lineup of bidding groups to ensure the required level of domestic participation. “BCE’s board also had to keep a careful eye as the different parties came together”, the Chairman and CEO said. “They had to ensure one group didn’t tie up too much equity, limiting the number of suitors. Over the course of the auction there were 45 board meetings.”87

It might have been expected that once the auction was concluded with shareholders promised a 40% premium on their investment, criticism of the process would have died down. After all, investors are interested in share value, not the elegance of process. While losing bidders might churlishly complain about the unfairness of the bidding process, winners hardly ever do so. What illustrates just how extraordinarily strong feelings about process had become was that Teachers’ remained publicly critical of an auction process it had just won.88 This last critical straw was to provoke a vitriolic response from Richard Currie.

Claude Lamoureux, chief executive officer of the Ontario Teachers’ Pension Plan Board, insisted that BCE management should have been reined in by the directors, rather than being allowed to take the lead as it did during most of the period leading up to the biggest private equity deal in Canadian history. “I don’t think that it is up to management to approach people to invite them into the race.”89 While Richard Currie had insisted that Sabia had only acted at the board’s behest, Lamoureux insisted that he sensed that he was acting on his own in seeking other bids. ‘That’s what people told us happened’ he said. ‘We felt it, we experienced it.’”90

An Awkward Auction
Currie was outraged that the proposed BCE private equity takeover was not being hailed as one of the most spectacular deals ever done in Canada. It was after all, the largest deal, the largest privatization and the largest leveraged buyout in the world ever. “The fact that it was done in Canada, a small country with a very small private equity pool with a 47% limit on foreign ownership, and that we could get three bids out of it and get a price 42% higher than trading value, we think is spectacular.”

Lamoureux’s criticisms were dismissed as “graceless, unfortunate and beneath the dignity of a person running Ontario’s Teachers’, which has just won a Canadian icon”. As for Telus, “They were complete amateurs”.

While he acknowledged that there had been delays in the merger talks between BCE and Telus, he blamed them entirely on Telus which had refused to abide by the auction rules. More specifically, he said that Telus had demanded that its “senior management” be given access to BCE’s confidential corporate information. “That was an absurd suggestion” only surpassed in stupidity by the proposal that confidential information be given to a third party to determine compliance with federal antitrust laws: “The request was nuts in my view”. He claimed that Telus had insisted on talking to individual members of BCE’s board while the process was on-going, and had even wanted to use Goldman Sachs which was already providing advisory services to BCE. “It was amateur night” he recalled.

It is understandable that for a businessman such as Richard Currie, the ultimate vindication of the auction process would not be whether people were satisfied with the way it was conducted, but adequacy of the sale price it produced. As he pointed out, for all the griping BCE shareholders will be getting $42.75 for shares which were trading at around $30 when the company was put up for sale. But it is somewhat less satisfying when Ed Waitzer, legal advisor to BCE’s Special Committee, adopts essentially the same ends and means justification. Lawyers, after all, are supposed to have a concern for process
values. However, as Jacque McNish reported, “Mr. Waitzer’s strategy was to keep it simple by advising the committee of directors to keep focused on the one thing that mattered most to shareholders: price. All complaints, threats and criticisms would evaporate, he told directors, if they were able to deliver a substantial premium to BCE shareholders who had endured a listless stock price for years.”

In response to critics who said that had Telus been at the table, the price could have been even higher, Waitzer replied that Telus could still come back in with an unsolicited offer. However, this may be somewhat disingenuous given the high break fee to which BCE has agreed. Be that as it may (and it is a matter to which we will return later in this report), we need now to have a look at the somewhat surprising nature of Telus’s proposal.

9. The Telus Proposal: Politics and Competition Law

As we have seen, Telus started talking to BCE in mid-May, 2007, but only publicly confirmed on June 21, 2007 that it had “entered into a mutual non-disclosure and standstill agreement and is pursuing non-exclusive discussions with BCE about a possible business combination as part of the strategic review process announced by BCE on April 17, 2007.” Significantly, it added, “Given the accelerated process that BCE had adopted, among other things, there is no assurance that Telus and BCE will continue discussions or enter into any agreement to proceed with any transaction.” By this time, BCE had announced that bids were to be submitted by 9:00 EST on June 26, 2007. So unless BCE extended its deadline, there could be but five days for public discussion of the Telus proposal.

As was to be expected in a merger takeover situation, synergies were much to the fore. Telus / BCE could, “Create a combined organization poised for improved growth and returns through the realization of significant operating synergies to the ongoing benefit of Telus and BCE investors.” It was
thought that a merged company could achieve annual cost savings of $800 million to $1 billion.\textsuperscript{99}

However, what was most striking about Telus’s short, vigorous public campaign was that it did not highlight standard takeover arguments such as operating synergies and cost savings, but focused instead on broad, public policy considerations. In so doing it confirmed that telecommunications is surely different from widgets. As Terence Corcoran, an ardent pro-market financial journalist lamented, rather than emphasize the excellent business case that it could make for a takeover, Telus was trundling out a long list of nationalistic selling points.\textsuperscript{100} Foremost on Telus’s list was to respond to growing concerns about the “hollowing” out of the Canadian economy. As Entwistle proclaimed in the corporate news release initiating Telus’s public drive, it sought to create “a truly Canadian enterprise”.

Entwistle played brilliantly on growing Canadian popular anxiety about foreign takeovers.\textsuperscript{101} Recently, there has been a series of high profile takeovers of quintessentially Canadian companies. “Canadians may be comfortable with foreign money,” Derek deCloet noted, “but that doesn’t mean they enjoy seeing Swedes and Indians buy our best steel mills, or Saudis grab our most historic hotel chain, or Brazilians take control of our nickel mines or have Wall Street financial engineers own our most famous ski resort and our biggest phone company. The philosophy which has allowed these deals – open and free markets – is the right one. But the politics of it are tough”.\textsuperscript{102}

There was particularly concern that foreign acquisitions would lead to a flight of corporate headquarters, a process which was seem as hollowing out the Canadian economy. In response Entwistle, ever the enthusiast, promised that BCE-Telus would have three headquarters – one in Montreal (where BCE is presently located) one in Toronto (Canada’s financial centre) and one “in Western Canada”.\textsuperscript{103} Corcoran wickedly observed, “It is the new ‘filling in’
strategy for national redevelopment of the Canadian head office industry. If every company had three headquarters, Canada’s head office industry would boom”.104

“It is clear to me,” Entwistle declared, “that if Bell Canada does go private, that is yet another move in the hollowing out of corporate Canada”.105 And in a remark calculated to appeal to Canadian economic nationalists, he opined, “I believe that there is a significant potential for a foreign strategic buyer to acquire that asset [BCE] and then decision-making authority will move outside of Canada.”106 His appeal was not to go unheard.

A lead editorial in The Globe and Mail,107 gave Telus a strong endorsement. While it was conceded that a takeover would lead to substantial competition concerns and job losses, these were not to be considered deal stoppers. Even if in the short term, the deal were to create “a near national monopoly in some business areas”, this would not be an insurmountable problem as new competitors would soon enter the wireless market, and if need be, the federal government could require Telus to sell off some wireless business in some areas. As for job loss, long term viability is ultimately better for the companies and their employees as a vibrant market player with less debt will be able to grow and innovate.

Most importantly, The Globe and Mail fully endorsed Entwistle’s idea of a “national champion”.108 What was needed was a bulked up company which could compete securely and more easily avoid being taken over. “If the federal government should ever act on its musings to open the telecommunication sector in Canada to foreign competition, a national champion could more easily withstand anticipated competition from, or takeover by, larger U.S. rivals.”109 Jeffrey Simpson, regarded by many as Canada’s leading political commentator, also endorsed a national champion on the grounds that, “A Telus-BCE union would give the country what it usually lacks: an all-Canadian firm of sufficient heft to play globally”.110 And in an on-line survey of a representative
national sample, 65% of Canadians said they preferred a merger between Telus and BCE over any private equity partnership with a U.S. company.\footnote{111}  

Notwithstanding these successes, Telus was not able to succeed where it really counted and get the government involved at a political, rather than a bureaucratic level. Caught between BCE’s “accelerated process” and inevitable delays in regulatory approvals, this was to prove fatal to Telus’s immediate aspirations.

There was no enthusiasm on the Conservatives part to grapple with what could turn out to be a political hot potato, one that landed on their laps at the close of a grueling parliamentary session.\footnote{112} Prime Minister Stephen Harper made it clear that any approval of a Telus takeover of BCE would rest squarely with federal regulators. “The government is going to be very loath to substitute political judgment on a matter…which it thinks should be settled at arm’s length from the government.” He went on to say that bids for BCE “raise a range of serious matters” which had to be subject to “serious review”.\footnote{113}  

Telus did not do itself any good by claiming that it had at least the tacit support of government when the hands-on leader of that government had made it clear that it was adopting a neutral stance. Thus the responsible minister, Maxime Bernier (who as we saw earlier was politically compromised) had to deny that he supported Telus’s bid.\footnote{114} Nevertheless in an interview with \textit{The Globe and Mail}, Entwistle stated, “Telus has been talking to the government for two weeks. The government has been responsive to the case for a made-in Canada industry solution”.\footnote{115} The most striking example of counterproductive overconfidence was with respect to the Competition Bureau, an independent agency within the government which takes its status very seriously. It was reported that Telus had said that it had been in contact with the Bureau and was confident it could get the approval it needed. Robert McFarlane, Telus’s CFO said, “We think that there is a strong likelihood that we will get the approval we require”.\footnote{116} In fact, as we will see, it was far from clear that Telus would ever get such approval, especially on
the uncompromising terms upon which it insisted. Indeed, it was just this sort of overconfident, presuming attitude that had very recently provoked the CRTC into rejecting a major part of CTV’s application to acquire additional broadcasting stations.117

In any move towards greater industry concentration a balance has to be struck between synergy gain and market power loss for competition. In a network industry, which has only recently (and painfully) achieved a degree of competition, concentration may readily be seen as threatening re-monopolization. At the same time, the forces of technological innovation which made competition possible in the first place, hold out the promise, if no barriers are put in its way, of yet further competition which in the long run will undermine short-term concentration. Be that as it may, initial reaction to the scale of the concentration proposed was understandably one of shock and dismay. As Michael Janigan, Executive Director of the Public Interest Advocacy Centre was to put it, “The idea that creating a gigantic company with about 70% of all telecom revenues, could be good for consumers belongs in a satire, not in economic policy”.118

While a BCE-Telus merger would not have had much (if any) impact on local service which is provided by the incumbents on a regional monopoly basis (where competition has emerged, it has been provided by the cable companies, not telco incumbents), in the wireless market “Belus” would have had well over 60% market share nationally and 100% in some areas, and the number of competing carriers would drop from three to two.119 This in a mobile wireless industry castigated by the Telecommunications Policy Review Panel (“Are we really in the game?”) in 2006 as lagging behind Canada’s major trading partners. As the Panel observed : “The smaller number of mobile providers in Canada – and the fact that all three national wireless service providers are also owned by large telecommunications service providers that also provide wireline services – may mean that there is less competition in the Canadian wireless market than in the U.S. market, which consequently has
resulted in higher prices, less innovation, lower uptake and lower rates of usage”.120

The other major area of immediate concern was with respect to business services. As noted in the outset of this report, business telecommunications consumers have benefitted greatly from Telus and BCE aggressively entering each others historic regional markets. Somewhat ironically, throughout the negotiations with BCE, Telus continued on its strategy of luring major clients away from its major competitor, such as a $213 million contract to provide and manage telecommunications services for the Department of Defence for five years thereby supplanting BCE.121

What might have been what a competition lawyer hopefully characterized as “the mother of all competition reviews”122 was, of course, never to take place because of Telus’s dramatic last minute withdrawal. Nevertheless, three competition law related issues did come into preliminary focus. First, what could have been the role for the “efficiency defence” which has recently achieved some prominence in Canadian competition law? Second, what conclusions may be drawn from the recent public musings of the Canadian Commissioner of Competition with respect to concentration and duopoly competition (Coke vs. Pepsi)? Third, and most interestingly from a specifically telecommunications point of view, what role could have been played by Telus’s surprising proposal for a “spectrum set-aside”?

John Henderson of “Belus” fame, had suggested that the Competition Bureau was now prepared to apply the efficiencies defence in high market merger share proposals. “We believe the Competition Bureau would approve a BCE-Telus merger. Our work shows efficiencies generated by the merger would almost certainly exceed cost impacts to consumers and on this basis the proposed merger would gain approval.”123

However, the efficiencies defence is not as simple as Henderson would have us believe. While the Competition Act does provide an explicit
defence for mergers which, while likely to have anti-competitive impacts would generate efficiencies that are greater than and offset those negative effects. If the true efficiencies generated by a merger (excluding synergies realized by the exercise of market power) when compared to the anti-competitive effects of the merger are bigger, the merger must generally be allowed. In addition to the anti-competitive effects, the Competition Tribunal will add any “socially adverse” wealth transfers to counter the efficiencies. In other words, it will have to be determined whether a dollar is worth more in the hands of affected consumers than in the hands of the merging parties. Thus, while the defence may have an eventual role to play here, it is not as neat and dispositive as suggested.

As might be expected, there was good deal of speculation as to how the Commissioner of Competition, Sheridan Scott, would have ruled on a proposed Telus takeover of BCE. It was suggested that she had repeatedly signaled in public speeches and private conversations that she was not opposed to concentration in the telecommunications industry, so long as new technologies and/or few regulatory barriers pave the way for new players to compete with the incumbents.\(^{124}\) Some who heard her speak at the 2007 Canadian Telecom Summit on June 13, 2007 thought that her comments appeared to signal that the Bureau would be comfortable with a telecom near-monopoly, provided federal barriers to foreign competitors were struck down.\(^ {125}\)

In her speech, Scott had raised the issue of whether a duopoly could ever be adequately competitive, especially given the large market share of some participants. “Let me respond to that doubt with a very clear – maybe.”\(^ {126}\) She said that it would not depend on the number of competitors in the market. “One does not have to go any further than to look at the Coke / Pepsi rivalry to understand that even duopolies can be extremely competitive under certain conditions.”\(^ {127}\) It would all depend on whether competitors have similar or lower costs; whether bundling is a feature of the market; whether the market is static or continuing to grow; whether competition is driven more by technological innovation that the packaging of products; whether third parties can enter the
market, and the rate at which technology changes or evolves in the market. Later in her speech, she conceded that where few competitors exist, there will be ongoing concerns. “Mergers, for example, will be particularly sensitive issues and the Bureau will be assiduous in conducting our reviews.”

It would appear that Scott has been influenced by the Chicago School’s approach in which even monopolies are acceptable provided there exists credible threats of timely competitive entry. So long as the foreign investment restrictions stay in place, and there is no free entry into markets, she will, no doubt, continue to be “assiduous” in her review of mergers.

Telus was absolutely adamant that it had to keep all the wireless resources of a combined company. As McFarlane insisted, keeping all the wireless was essential, “Because that’s the growth engine that makes the transaction of interest in the first place”. Entwistle struck a defiant Churchillian, “We will not compromise” stance when he spoke to members of the *National Post* editorial board in Toronto on June 25, 2007. He said that Telus would pull the plug on its bid for BCE if it was forced to sell wireless assets belonging to either company in order to satisfy competition regulators.

Telus was, however, prepared to reverse its previously vigorously held position on auction rules being designed to govern the allocation of additional spectrum. Telus, along with the other established wireless carriers, Bell Mobility and Rogers, had been strongly opposed to any suggestion that special provision be made to ensure that new competitors enter the market. Now, however, not only did Entwistle favour spectrum set-aside for a new competitor, but he even promised to help make it successful. “Should Telus’s acquisition of BCE proceed, we believe that new wireless spectrum should be set aside for new entrants to ensure that Canada continues to have a third wireless network competitor. We would also agree to certain other areas of support…to ensure that any emerging third player within the wireless industry was allowed to gain
Telus Proposal: Politics and Competition Law

access to some of our tower infrastructure and was allowed to roam on favourable conditions."\(^{131}\)

The question then was whether the Competition Bureau could have acted on the basis of a new competitor that didn’t yet exist on the assumption that the government would follow through on the Telus solution.\(^{132}\) While there was a report that the responsible minister, Maxime Bernier, was prepared to move up the date of issuance of the new auction rules,\(^{133}\) nothing concrete was to come of it.

To the great amusement of some, Telus immediately after terminating its takeover bid, reverted to its previous position on auctions. Now however, “Sources say its arguments don’t hold much weight in Ottawa”. Telus’s situational flip-flop was seen as driving a spike into the principled argument of the established carriers. “This kills the incumbents.”\(^{134}\)

Overall, for all its drive, dash and enthusiasm, Telus’s corporate “Charge of the Light Brigade” was splendid and heroic, but doomed from the outset. First, Telus failed to get early access to BCE confidential data. Second, it failed to get the government onside. Third, it failed to get shareholders to insist that BCE slow down its hectic rush into the arms of private equity.

To be successful, Telus required support from the government for its “all-Canadian” proposal. However, the Conservatives, unlike the opposition Liberals, are not instinctive economic nationalists. So right from the start, Entwistle’s patriotic appeal had little resonance. Moreover, the Conservatives were still licking their wounds from the recent income trust debacle in which they had had to go back on a specific election promise of support out of concern for massive tax losses. It was not forgotten that it had been Darren Entwistle and Telus which had precipitated the 2006 income trust crisis. Once bitten, twice shy remains the rule in politics.
Contrasting Personalities of Telus and BCE CEOs

In order to better understand events in Canada, it is helpful to keep in mind the very different personalities and business styles of BCE’s Sabia and Telus’s Entwistle. While differing leadership and personality traits cannot alone provide an adequate explanation of events, the impact of leadership styles must at least be taken into account.

Michael Sabia came to BCE after a very successful career as a high-level federal bureaucrat and brought with him a careful (even cautious) analytical approach to decision-making. “His sin” it has been said, “was being overly cautious in an era that celebrated bold leaders.” As Derek deCloet noted, bold risk taking leadership was not to be found at BCE where a “bank mentality” and “paralysis” had led to many missed opportunities. “Each one of these smacked of a company which was afraid to make a mistake and that overanalyzed every move.”

Mark Goldberg, head of a telecommunications industry advisory firm, was more sympathetic, but equally revealing. Noting that Sabia had taken time to implement divestment in a “controlled manner,” he continued, “Some might even say in a compassionate manner, with consideration given to what happens to employees and the buyer. BCE management might be criticized for not being as ruthless as its shareholders might prefer. As CEO of Canada’s most widely held company, and as a former senior civil servant in the Privy Council Office, Michael Sabia may be more cautious with human factors than the average corporate leader.”

It must always be remembered that Sabia was promoted to CEO in the immediate aftermath of the scandal surrounding the forced resignation of the highly impetuous Jean Monty and that this would have greatly reinforced any prior propensity he might had had to overanalyze issues. This tendency was well captured in the headline to a particularly insightful article by Catherine McLean,
telecommunication reporter at *The Globe and Mail*, on the complexities of the auction process: “He didn’t want it to be easy.”

Darren Entwistle’s career has been exclusively in the private sector with a formative period at the then but recently privatized Cable & Wireless in the U.K. Appointed CEO at Telus in 2000 at the age of 37, that same year he acquired a struggling wireless operator, Clearnet for $6.6 billion. Widely criticized at the time as an excessively extravagant investment, it is now recognized as a major strategic coup which gave Telus, relatively early on, a much bigger wireless operation with which to off-set declines in the land-line business. “It is a position that other former monopolies like Bell would love to be in.”

Two other illustrations of his tough decision-making ability may be seen in the way he was quite prepared to take a strike in 2005 in order to get the labour situation he had inherited turned around, and his leadership in last year’s controversial income trust initiative. Entwistle’s ambition is so transparent that it gave credibility to the rumour that he planned to use the acquisition of BCE as a means to a greater end as it was said that his heart was really set on Sprint Nextel.

In his run at BCE, Entwistle may have been a victim of “vaulting ambition which o’er-leaps itself and falls on the other side.” As a very forceful person to whom it is very difficult to say no, he may as a result have misread governments’ tendency to equivocate and avoid commitment. This is particularly true of a minority government just clinging to power. He was possibly tempted to see what he wanted to see. As well, he may have talked himself into really believing his “Captain Canuck” rhetoric. “I believe the destiny of BCE and Telus are inextricably linked” he proclaimed. “It is disappointing to me in the extreme to think that my life’s work could turn out to be a division of Verizon or AT&T.”

However, there was to be no Napoleonic retreat from Moscow as Telus remains a strong-well-run company where Entwistle remains a focused, hard-driving operations taskmaster. Indeed, as we shall see in the final section of
this report, Providence’s CEO paid Telus his highest compliment by conceding that it was too well-run a company to be of interest to a private equity firm.143

11. **The Private Equity Auction**

Initially, the CPP-KKR bid consortium was considered the front runner.144 It had both Canadian and Quebec participation and could thus wrap itself in both the Maple Leaf and Fleur-de-Lis flags. It had the backing of the most prestigious of the private equity firms in the U.S. It had retained as its lobbyist Hank Intven, a leading Canadian telecommunications lawyer who had been a member of the very influential Telecommunications Policy Review Panel in 2006.145 Finally, and most importantly, it had Sabia’s unspoken endorsement.146

However, CPP-KKR was to suffer two major setbacks in the lead up to the auction. First, as we have seen, it was prevented by BCE’s Special Committee from further expanding its Canadian quota by adding additional smaller pension plans.147 Second, just before the auction got under way, both Caisse and Onex abruptly left the consortium. The Caisse, Canada’s largest institutional investor, had grown increasingly dissatisfied with the auction process and was particularly irked by the arrival of Telus at the table. Onex, the leading Canadian leveraged buyout firm, was concerned that it had only had two weeks in which to research its proposed bid and had believed that Telus was going to sit things out. It was also concerned about price.148 Despite the loss of these two key Canadian players, KKR-CPP did manage to pull together its all-cash bid by BCE’s June 26, 2007 deadline.149

Cerberus, as already noted, had had the most difficulty from the outset in putting together a credible Canadian component.150 In the end it gave up on a conventional approach and came up with a novel scheme in an attempt to satisfy Canadian ownership requirements. It proposed a hybrid structure which would see BCE investors receive the majority of their payout in cash as well as a small chunk of equity or “stub” in a new publicly traded company. If Canadian shareholders received about 10% of their payout in new equity, it was thought
that this would bring the bid at least close to compliance with the ownership rules.151

Teachers’ it will be recalled had initially forced BCE into play by filing with the SEC, rounded up widespread support from major institutional investors, further increased its shareholding and linked up with Providence, a U.S. private equity investor specializing in the communications sector.152 Teachers’-Providence turned out to be the one stable group among potential bidders, although it was thought that it was disadvantaged because BCE management had been outraged that the pension plan had dared to become an active investor.153

Initial bids were as follows: Teachers’-Providence just over $42; CPP-KKR just under $41 and Cerberus $36 cash and equity at $12. On the second day, Teachers’-Providence was asked to “sharpen their pencil” and their bid rose to $42.75. The board reacted coolly to Cerberus as it preferred the straight-forward simplicity of an all-cash bid. Cerberus sweetened its bid to $38 a share and equity at $10 and then guaranteed the value of the equity slice in an effort to make its bid as similar as possible to rival all-cash bids. As CPP-KKR appeared to have indicated that it would not go higher than its opening bid, Teachers-Providence had raised what was already a winning bid. The board never seems to have taken the Cerberus bid seriously.154

On June 30, 2007, BCE announced that it had reached an agreement to be acquired by Teachers’-Providence.155 The purchase price represented a 40% premium over the undisturbed trading price of BCE common shares in the first quarter of 2007, prior to the possibility of a privatized transaction surfacing publicly. “This proposed transaction concludes a comprehensive and disciplined review of the company’s strategic alternatives launched April 17”, said Richard J. Currie, Chairman of the Board of BCE.156 “It will deliver substantial value creation for our shareholders. In addition, a majority of the equity will be owned by Canadians.” Jim Leech, Senior Vice-President,
Teachers' Private Capital, noting that Teachers' had been a major BCE shareholder since the early 1990s, observed, “We made it clear in our proposal that we have carefully considered the potential of BCE and its ongoing status as a Canadian icon.”

While there had been continued criticism that BCE was in too much of a rush to conclude the auction, it turned out that it had just got in under the wire as at the time of the bids, there was growing uncertainty in the U.S. high yield market which a winning private equity bidder would have to tap for some $25 billion. As a source close to Telus lamented, “I wish this had happened two weeks ago. It would have filtered into the competing bids and lowered their price”. By July 2, 2007 it was reported that the U.S. debt market had been shaken to its roots by the crisis in the sub-prime housing sector.

One final instance of managerial hubris needs to be noted. Both Sabia and Currie continued to insist that they could have turned BCE around and reached the same shareholder value as a takeover offer. “The shareholders will decide if they want the $42.75 today or some time in the future.” Sabia stated in the BCE acquisition announcement that the transaction “delivers to our shareholders the economic benefit of the work done to focus on our core business and to strengthen Bell with a new cost structure and new competitive capabilities.” He even went as far as to say that his reorganization of BCE had attracted the interest of private equity investors and had led to the 40% premium bid.

12. What Now?

This report concludes by addressing first, the realities Teachers’- Providence now face; second, concerns about capital investment; third, whether Telus will mount a hostile takeover bid; fourth, whether it will itself become a takeover target; fifth, the road to the BCE shareholder vote, and finally, seeks to put the BCE takeover into broader contemporary Canadian concerns about foreign investment and national competitiveness.
In the end, CPP-KKR had not been willing to pay what Teachers’-Providence was prepared to pay. Jim Leech was very aware that simply being willing to pay more than the other guy, isn’t itself the prize. “As I always tell our young people, if you have won an auction, it only means that you’re prepared to pay more than anyone else in the world, and how can you be so arrogant?”

The prize, of course, is the return on the investment. In this respect Leech may not have followed his own advice about not being arrogant. “Teachers’ has a record of 25-per-cent gains on its private equity investments, and ‘we have no intention of diluting it’ with BCE.” Asked how this will be done in view of the price Teachers’ had agreed to pay, he lamely replied that BCE “clearly needs to regain the pre-eminence position in wireless.”

Jim Leech’s lack of knowledge of operational specifics is understandable. Teachers’ is, after all, only interested in BCE as an investment – Providence is concerned with operations. Jonathan Nelson, CEO of Providence gave a wide-ranging interview a week after the conclusion of the auction clearly designed to reassure the financial community that BCE would be in capable hands, especially with respect to post-acquisition capital investment.

Nelson was eager to point out that no other private equity firm had as much experience in telecommunications and media as had Providence. “In our experience, if you’ve done multiple deals in this sector, it’s a competitive advantage. The learning in prior deals makes a difference in future deals.”

The interviewer, Sean Silcoff of the National Post was clearly persuaded that the playbook for BCE would draw on past performance. Providence which had privatized national phone companies in Ireland and Denmark and bought cable operations in Germany and Spain, in 1992 had created what was to become the fourth-largest wireless carrier in the United States, T-Mobile USA. It made a US$760 million return on its investment of US$63 million when it sold the carrier to Deutsche Telekom in 2000. Silcoff said that Nelson favoured building companies over busting them up, and he had no
plans for BCE divestitures. His specialty was to grab telecom and cable companies and focus management on growth opportunities. Instead of starving the firms for cash, he would open taps to support that growth while cutting unnecessary spending. “After investing in German cable company Kabel Deutschland GmbH in 2003, for example, Providence increased capital spending five-fold to support its entry into the phone business and move it from analog video to digital. Ireland’s Eircom Ltd. which previously had divested its wireless division, jumped back into the business under Providence’s ownership and also made a big push into high-speed Internet.”

Nelson dismissed the notion that a highly leveraged telecom company wouldn’t be able to afford necessary capital spending. He said that in his experience, some of the best run companies “coincided” with the discipline of an investor group asking the same tough questions and focusing on cash flow. He said, “If you invest for the long-run and don’t cut any corners, you can do very well in this business.”

Nelson was significantly more specific than Jim Leech when it came to BCE’s wireless business. Considering that just 60% of Canadians have cellphones – well behind rates in Europe and the U.S. – winning new customers was seen as crucial. “We have to offer great service, as expressed in coverage and quality, dropped phone call rates and customer interaction, whether its phone activations or the look and feel of a store.”

Providence, Nelson made clear, was not a detached financial investor, but an investor who selected and closely monitored the plans of operators. “The beginning, middle and end of our story is, we back really good operators.” Providence had recruited key executives from the telecommunications sector to act as advisors. “It’s dangerous to have investors developing plans. You want operators developing plans.”

It would be well to balance this excessively positive (and self-serving) assessment against the critical views of William Melody, a perennial
telecommunications gadfly now living in Copenhagen and Guest Professor at the Center for ICT, Technical University of Denmark. In two chapters for a forthcoming book, Melody looked first at what he sees as an inevitable clash in incentives between private equity and public investment objectives in telecommunications. In the second chapter, he looks at early private equity results at TDC, Denmark’s incumbent telecommunications company.

Melody starts by emphasizing that private equity investors justify their existence by making fundamental changes to management and operations. In so doing, they force attention on maximizing short-term “investor value” by selling and restructuring operations and then selling the residual firm itself. This means that by their very nature they have a clearly biased incentive to maximize short-term investor value at the expense of long-term value. Indeed for Melody, high returns being realized by private equity investors may simply be a reflection of the differential between short-term and long-term investor value. In sectors of the economy which require long-term investments, returns to private equity, especially if financed by LBOs, will be at least in part if not in whole, simply a matter of trading off long-term value for short-term value with negative consequences for industry development and efficient resource allocation.

Private equity short-term priorities and telecommunications long-term priorities were seen as being in direct conflict. After an acquisition, private equity owners will have a powerful incentive to pay themselves the major portion of any large internally generated cash flow that would in other circumstances have been invested in infrastructure expansion. As well, large debt borrowings will dramatically increase debt equity ratios and resultant declining credit ratings will lead to significant reductions in network investment. Private equity short-term priorities will compromise research and development, quality of service and universal service obligations. Overall, any unambiguous improvements in managerial and operational efficiency will be outweighed by the negative impact on infrastructure development and public policy objectives.
In turning to early results of the private equity takeover of TDC, Melody finds considerable confirmation of his short-term incentive private equity model. First, the initial effect of the purchase raised TDC’s debt ratio from 27% to more than 80%, far above acceptable levels for sustainable long-term investment capacity. Second, shortly after the takeover, TDC declared a very large “special dividend” funded from cash reserves, sale of assets and yet additional debt. This was a breathtakingly large payout of about half of TDC’s total capital. Third, very large bonuses were awarded by the new owners to management, presumably for their performance in facilitating the takeover. Fourth, there have been massive and unselective cutbacks in international operations which recently had generated 40% of TDC’s revenues. Fifth, despite being in an industry driven by continuing major technological changes, new services and markets, there is now virtually no research and development being undertaken. Melody concludes that overall the evidence to date suggests that the TDC leveraged buyout is directed to short-term cash generation for the new owners, advisors and managers, at the expense of long-term development.

The most important distinction seems to be between private equity investors who seek to make their money by “sweating the assets”, and those who look for their main return from an IPO three to five years down the road. It would seem that the TDC investors intend to sell a much reduced company. The optimistic assumption in Canada at the moment is that Teachers’-Providence will want eventually to sell a much stronger and more valuable company back to stock market investors and that this will create incentives for longer-term post-acquisition investment commitments. But if this is really so, how will they achieve the level of return on investment associated with private equity takeovers?

While BCE thus faces an aggressive, demanding and highly focused new management, what are the chances of a Telus hostile takeover bid? Hostile bids are tough to mount, but they come with one great advantage. They cut management out of the process by taking a deal directly to shareholders. In the immediate aftermath of his withdrawal, Entwistle certainly wasn’t ruling out
taking another run at BCE. “It’s been a hallmark of our company that we do not close doors,” he remarked, “We keep our options open.”

But how likely is it? First, Teachers’-Providence are proposing to pay what financial analysts believe is a price on the high side. Second, BCE has committed itself not to reopen its data room to any rival bidder, nor will it solicit, initiate or encourage any other bids. At the same time, confidentiality and non-disparagement agreements previously entered into might likely constitute roadblocks to any new initiative. Third, while Telus would now have time to placate officials annoyed by its earlier public overconfidence, all prior regulatory barriers remain in place. Finally, and most importantly, the Teachers’-Providence BCE agreement includes a substantial break fee of 2.3% of the purchase price or 10% of the equity Teachers’ and its backers are putting up. It amounts to some $800 million and it is estimated that it would likely cancel out three years worth of synergies. Overall, as The Economist concluded, hefty break would make a hostile takeover a “daunting prospect.”

On August 3, 2007, Telus formally announced that it would not be making a takeover bid for BCE prior to the completion of the Teachers’- Providence acquisition. For Entwistle, the great goal of a National Champion remained valid, its achievement frustrated by government tardiness. “We put our back into trying to get a requisite degree of regulatory certainty, and unfortunately we couldn’t get it.” As Paul Crampton, one of Telus’s high-level competition lawyers explained, “We did not think the [competition] bureau would ultimately require a significantly more onerous remedy than the entry-oriented solution we were discussing.” Telus had needed enough comfort from the Competition Bureau that it wouldn’t have had to face onerous wireless divestiture or structural constraints, something it was never to receive. However, as Entwistle still insists, this did not mean that the dream itself was misconceived: “I really did believe that the combination of the two businesses would have been a great thing for our country given the fact that our industry is becoming increasingly global in
character. And I think size does matter if you are going to compete effectively and enjoy economies of scale”.

It has now been confirmed that Telus had expected BCE to approach the government in a joint quest to obtain the required regulatory approval for a merger, and that it believes that BCE had gone back on a commitment to do so. This tends to reinforce the view that Telus had been essentially naïve in its approach and spent too much time blaming others for not supporting it when the real failure was not to recognize from the outset that it would not be possible to get the government onside in time. Sinclair Stewart and Boyd Erman in their lengthy post mortem review piece in The Globe and Mail asked: “Did Mr. Entwistle somehow play his cards wrong, missing a prime chance to cement his legacy and create a national telecom powerhouse? Or was the deck stacked against him?” A better question might be: “Should Entwistle have gone ahead in the first place when he should have known that the cards were so heavily stacked against him?”

After a disappointing second quarter at Telus, Entwistle has had to return to “Plan A” and seek to expand his growth businesses of wireless and high-speed Internet. A major decision in this regard, and one that has been put off by the “national champion” push is whether Telus needs to shift its wireless technology from CDMA to GSM. Unlike Telus and BCE, Rogers adopted GSM which allows its customers to use their phones on networks anywhere in the world, something particularly important to business users. As well, GSM carriers have an advantage in having newer and sexier handsets such as Apple’s iPhone. Superior technology is an important factor which is allowing Rogers to continue to pull away from Telus and BCE. In the second quarter of 2007, Rogers added 133,000 customers, Telus 128,200 and BCE 63,000. Telus has a particular reason to convert to GSM in view of the Vancouver Winter Olympics in 2010 when large numbers of international cellphone users will converge on its home turf. As it stands, all that calling revenue and international recognition will go to Rogers. It is estimated that it will cost about $300 to $500 million to convert to...
GSM, and that 10% of Rogers wireless revenue already comes from GSM-using visitors to Canada through roaming charges.\textsuperscript{183}

What are the chances of Telus becoming a target of a private equity bid? There certainly has been some speculation to that effect. However, Providence’s Jonathan Nelson had high praise for Telus which he acknowledged to be a far better operated company than BCE. He went on to suggest that its stock was too richly valued to attract buyout offers. “Anyone who comes along has to be willing to pay a significant premium to get any traction, and I think that private equity would be hard pressed to make a run at Telus, given where they’re trading.”\textsuperscript{184} Nevertheless, Entwistle may decide to emulate private equity by recapitalizing Telus to take on more debt and by buying back a large amount of stock, something we have seen that Sabia was thinking about, but never got around to actually doing.

The agreement between Teachers’-Providence and BCE will have to be completed by way of a plan of arrangement which requires the approval of Quebec’s Superior Court and the support of two thirds of shareholders. A special meeting of shareholders will be held on September 21, 2007 in anticipation of the deal closing in the first quarter of 2008, eight months after the conclusion of the auction.\textsuperscript{185} Transfer of ownership is subject to regulatory approval by the CRTC.\textsuperscript{186}

In the meantime, the price of BCE shares has dropped to $38.80, a substantial discount from the offer price of $42.75. At first, this fall was attributed to the time value of money – some shareholders preferring to sell and invest elsewhere rather than wait for their cash payment. However more recently, it would appear that at least some shareholders are concerned that the deal will be delayed (or even abandoned) in light of the mounting credit crunch. On August 10, 2007 Teachers’ and BCE announced very firmly that there will be no repricing of the proposed takeover, scotching rumours that continuing turmoil in the credit markets might require them to do so.\textsuperscript{187}
It will be recalled that Entwistle had played extensively on the concern of some Canadians about foreign investment and the “hollowing out” of the economy. As we have seen, while this approach did receive some editorial endorsement, Prime Minister Harper did not find it persuasive enough to cause his government to become actively involved. At the same time, the government has indicated that it had some less apocalyptic concerns of its own about unconstrained foreign investment. For instance, it has security concerns with respect to foreign government-owned entities buying up Canadian natural resources (such as oil) and other assets. As the Minister of Finance, Jim Flaherty put it, “We may have to give special attention when we see situations where, directly or indirectly, state-owned enterprises or agencies of state-owned enterprises, are proposing to make substantial foreign investments in Canada. We are conscious of the need to protect our own national security and also to make sure that overall substantial investment in Canada is in the net benefit of Canada.”

The present *Investment Canada Act* has a net benefit to Canada test, but no specific reference to security. Legislation introduced by the previous Liberal government would have given Ottawa clearer authority to block transactions considered to be “injurious to national security”.

As well as this concern about state-owned companies (particularly from China), there have been some questions about foreign direct investment and Canada’s overall competitiveness and whether Canadian out investment needs to be bolstered. All in all, in keeping with the Conservative Government’s general support for free markets, the focus is not specifically on how to restrict foreign investment, but on how foreign investment benefits can be maximized.

On July 12, 2007 the establishment of the Competition Policy Review Panel was announced. The Panel’s core mandate is to review both the *Competition Act* and the *Investment Canada Act* with respect to the treatment of
state-owned enterprises with non-commercial objectives and the possibility of a national security review clause. The Panel will also examine Canada’s sectoral restrictions on foreign direct investment and the competition and investment regimes of other jurisdictions to assess whether there is reciprocity between their rules and Canada’s. The Panel will also inquire into how Canada’s policies may further encourage outward investment. The Panel is made up of four distinguished Canadians (including two senior corporate lawyers) and chaired by Lynton “Red” Wilson O.C. who was BCE’s President and CEO from 1990 to 1992 and Chairman of the Board from 1993 to 2000. The Panel is to report to the Minister of Industry, on behalf of the Government of Canada, by June 30, 2008.193

A major area of sectoral restriction as noted throughout this report, concerns the telecommunications industry where, unlike other members of the OECD, Canada has retained explicit foreign investment restrictions. The influential Telecommunications Policy Review Panel (TPRP) had recommended that the rules be softened in a move away from the current rigid restrictions in favour of a more flexible regime.194 The responsible minister, Maxime Bernier, has already indicated that he personally favours the easing of limits on foreign ownership and has emphasized that the Panel will specifically probe whether Canada should scale back its restrictions in the telecommunications sector.195

It should be noted that the Panel review will take place at a time of increasing interest in Canada by U.S. carriers. It is a regrettable feature of Canadian politics that (unacknowledged) pressure from the U.S. is often required to get things done. In mid-March 2007, Primus Telecommunications Group Inc. (Primus) joined other major American firms that want to significantly expand their Canadian operations to compete directly with BCE and Telus, but cannot do so because of foreign ownership restrictions. Primus had said that it wants the right to build or purchase its own networks and not limit its activities to reselling services offered by Canadian carriers. (Under the Telecommunications Act, resellers are exempt from the foreign ownership restrictions). Primus Canada
would like to be able to offer its own phone, Internet and wireless services. “We’d like the ownership restrictions lifted to give us the flexibility to do that. We would invest in facilities here [Canada] if that were permitted. Today we do it to the maximum extent we can.”196

It is sometimes said that there is little interest by foreign players in the Canadian market, but Primus is now one of three companies which have expressed interest in having restrictions removed. AT&T and Verizon have both indicated that they would like to significantly expand their Canadian operations. AT&T would like to be able to build its own networks, buy other operators and participate in next year’s wireless spectrum auctions. AT&T had previously held minority stakes in Unitel and Rogers and Verizon in Telus, but had found minority investment status unsatisfactory. As AT&T explained to the Canadian government, it had sold its interests because of strategic and competitive difficulties of operating in an environment where foreign direct investment is restricted. Eric Loeb, AT&T’s vice president of international government relations stated, “It’s an important and overdue policy problem and should have changed long ago. It’s equally concerning, if not more so, at a time when there are strong policy directions to rely more on market forces and less on regulation”.197

The principal policy concern remains how it would be possible to liberalize foreign ownership in telecommunications, while at the same time preserving Canadian ownership of broadcasting. This is a particularly difficult issue today as cable companies, which have historically been treated as broadcasters, enter the broader telecommunications marketplace to compete directly with telephone company incumbents. Asymmetrical liberalization with respect to telecom carriers, but not cable operators, could well create unfair competitive disadvantage, especially as it will be the cable companies which will be in particular need of an injection of foreign capital if they are to position themselves to compete fully with the incumbents.
What now?

Looked at overall, it would seem likely that the telecommunications sector will be folded into a new general approach to foreign investment. As the TPRP pointed out, other countries have not simply eliminated all limits on foreign investment. In effect, this would allow for greater foreign investment in telecommunications while at the same time introducing a more comprehensive and structured benefits test focused on the promotion of competition, better services and innovation in markets (such as wireless) which are not performing as well as they should.
END NOTES

6. As Entwistle observed, “When you compare Canada to the rest of the world a single national champion is commonplace and Canada is more of an exception in that regard.” “Telus chief portrays telco as ‘strong national champion’,” *National Post*, June 22, 2007.
15. Sean Silcoff, “‘Stealth Mogul’ key to Bell bid,” *National Post*, July 9, 2007. This is a particularly informative interview with Jonathan Nelson, co-founder and CEO of Providence Equity Partners LLC.
18. Teachers’ may be under considerable pressure to earn more by way of return on its investments as there has been a drastic drop in the ratio of
employees paying in, compared with those collecting pensions, particularly as the baby boom generation starts thinking of retirement. There were 10 members of Teachers’ for every retiree in 1970. That dropped to 4 working teachers for each retiree in 1990, and is now sitting at a ratio of 1.6 contributors for each retiree. This demographic “perfect storm” may have a good deal to do with Teachers’ newfound activism. See generally on Canada’s public sector pension plans, Lori McLeod, “Cover Story,” The Globe and Mail, July 7, 2007.

31. Paul Vieira, “Flaherty keen on Bell deal,” National Post, July 4, 2007. The minister would no doubt find the view of Steve Forbes, the president and CEO of Forbes, Inc. and editor-in-chief of Forbes magazine, greatly reassuring. “Private equity firms re-found companies, improving the performance and increasing the value of the companies in which they invest. Successful private equity investments do this by focusing on longer term growth,…business backed by private equity funds typically see increased R & D spending and investments in capital projects – expenses


33. Eric Reguly, “One error, and BCE’s debt could drag it down,” The Globe and Mail, July 6, 2007. It should be noted that Reguly does not consider that the buyout will necessarily end badly. “Teachers’, Providence and Madison Dearborn are full of bright executives with an amazing ability to use private equity to create wealth. What it does mean is that the new BCE will have a skinnier cushion, less room to manoeuvre, and won’t be able to afford mistakes. That’s what happens when you strip away the equity and replace it with gobs of debt.”

34. Sean Silcoff and Carrie Tait, “Massive Bell bond issue,” National Post, July 6, 2007. Michael Sabia is clearly nervous about the extent of BCE’s proposed debt. He said that post-auction, BCE will have to be “disciplined”. He added, “There are also challenges there, which is managing a business and making those investment choices in a very different leveraged circumstance than we are today,” Catherine MacLean, “BCE faces ‘delicate balance’ on debt,” The Globe and Mail, July 6, 2007.


37. Eric Reguly, “Mr. Sabia has made his message clear. But is it the right one to send?” The Globe and Mail, March 31, 2007.

38. See, for example, Sinclair Stewart and Derek deCloet, “Teachers’ BCE campaign gaining support,” The Globe and Mail, April 11, 2007; Andrew Willis and Sinclair Stewart, “Teachers’ garners support for BCE bid,” ibid, April 16, 2007.


43. Andrew Willis, “BCE auction was no country-style affair,” The Globe and Mail, June 27, 2007.


46. Andrew Willis, above, note 43.


48. Andrew Willis, above, note 43.


64. Silcoff, above, note 56.


67. At a more pragmatic level, Terence Corcoran observed that it would be unlikely that the government could respond because the workings of the CRTC and the Competition Bureau “are not under the control of politicians, even assuming they were inclined to meet the Telus-Bell time demands,” “Telus-Bell needs a better sell,” *National Post*, June 26, 2007.


69. Silcoff, above, note 56.


77. Silcoff, above, note 56.

78. See text at note 25.


82. Jacquie McNish, Catherine McLean and Sinclair Stewart, above, note 80.
83. Text at note 43.
84. McLean, above, note 76.
85. Ibid.
86. Ibid.
87. Ibid.
89. Ibid.
90. Ibid.
92. Ibid.
93. Ibid.
94. Ibid.
95. Jacquie McNish, above, note 42.
96. Telus Investors News Archive above, note 32.
97. Ibid. Presumably the reference to “other things” was to the problems it was having in getting access to confidential information.
98. Ibid.
100. Terence Corcoran, above, note 67.
102. Ibid.
104. Terence Corcoran, above, note 67.
105. Questions and Answers, above, note 103.
108. See text at note 6.
111. “All-Canadian Telus deal preferred, poll shows,” Vancouver Sun, June 26, 2007.


114. As Paul Vieira reported, “Informed sources in Ottawa say Mr. Bernier and his advisors are upset Telus may have suggested that such approval was secured.” “Crunch time for bids,” National Post, June 23, 2007. A spokesperson for the Minister had previously rejected the notion that he had “pre-approved a BCE-Telus deal.” Steven Chase and Brian Laghi, above, note 112.


122. Paul Vieira, above, note 119.

123. Michael Kane, “Telus merger more likely, analyst says.” Vancouver Sun, April 18, 2007.


125. Ibid.


127. Ibid.

128. Ibid.


135. Diane Francis, above, note 25.
136. deCloet, above, note 10.
138. See section 3 above, “BCE’s Recent Unhappy History,”
139. Above, note 84.
141. Derek deCloet, “BCE faces growth – or butcher’s knife,” *The Globe and Mail* June 26, 2007. In a thumb nail sketch, Sean Silcoff well captured his dynamic character, “Darren Entwistle, the chief executive of Telus Corp. speaks in precise and punched out sentences whenever he is selling people on his vision and strategy. Imagine a stockier, even more revved-up Tom Cruise who eschewed stardom for MBA school, and you will have a sense of the fearsome force the 44-year old Mr. Entwistle can be when he talks up Canada’s second largest phone company.” “Captain Canuck to Bell’s Rescue?” *National Post*, June 22, 2007.
145. Paul Vieira, “CPP bid adds policy maker to bid team,” *National Post*, June 26, 2007. Iain Grant, Montreal-based managing director of telecom consultancy Seaboard Group, regarded Intven’s hiring as a brilliant manoeuvre. “It suggests to me that the bidders, while not Canadian, are clever enough to know who’s who. Because if you want anyone to articulate your position to the government, then Hank is the guy you want.”
147. See text at note 54.
150. See text at notes 49-52.
152. See text at notes 49-51.
153. Text at note 40.
154. Sinclair Stewart and Derek deCloet, “It was mountains of cash and some last minute calls that finally helped put Teachers’ over the top,” *The Globe and Mail*, July 2, 2007.
156. *Ibid*.
160. *Ibid*.
162. Catherine MacLean, “He didn’t want it to be easy,” *The Globe and Mail*, July 4, 2007. Currie remained convinced that he and he alone had been right all along. “So many of the pundits have been shown to be totally wrong about the company, about the process, about everything associated with it. They were all wrong and we got it right.” Theresa Tedesco, “Dealmaker’s parting shot,” *National Post*, July 7, 2007.
166. *Ibid*.


184. “‘Stealth Mogul’,” above, note 167.


186. *The Bell Canada Act*, S.C. 1087, c.19, enacted in 1987 repeals and replaces the Act of 1880 incorporating the company. Under s.11 (1) any person who controls the company is prohibited from selling or disposing of voting shares in the company without prior approval by the CRTC.


188. Text at note 112.


