REGULATORY AND TRADE DEVELOPMENTS

THE NEXT STEP TOWARD NORTH AMERICAN FREE TRADE: SUPPLEMENTAL AGREEMENTS

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As promised in a campaign speech on October 4, 1992, President Clinton is advancing his plan to negotiate supplemental agreements to accompany the implementation of the North American Free Trade Agreement (NAFTA). In his speech, Clinton promised to negotiate side agreements that would safeguard environmental and labour standards and protect U.S. industries from import surges. To that end, the new administration has set up working groups under the supervision of the National Economic Council and the NAFTA countries have scheduled an initial negotiating session for March 15. While President Clinton has consistently assured his Canadian and Mexican counterparts that he will not seek to reopen the NAFTA negotiations, the scope of the side agreements remains unclear, especially in light of increased congressional pressure to modify the pact.

In the October speech, then-Governor Clinton accepted NAFTA as negotiated provided that supplemental side agreements addressing perceived textual deficiencies in environmental protection, labour standards and import surges were concluded. As President, Clinton has consistently repeated his pledge to negotiate supplemental agreements although few details with respect to the content of these agreements have emerged from the White House.

In a pre-inauguration meeting with Mexican President Carlos Salinas de Gortari, Clinton reaffirmed his desire to negotiate these side agreements and noted that he would not send NAFTA implementing legislation to Congress until the side agreements have been concluded. The new administration recently demonstrated its willingness to use the implementation process as leverage to gain concessions from Mexico. On February 15, House Majority Leader Richard Gephardt (D-Mo.) protested an investment fund partially financed by a Mexican government owned bank designed to buy U.S. businesses and move them to Mexico. In a February 17 meeting between United States Trade Representative Mickey Kantor and Mexican Trade Minister Jaime Serra Puche, Kantor reportedly announced that the United States would not begin the side agreement talks (thus delaying NAFTA implementation) as long as the Mexican government supported the fund. A few hours later, the Mexican government announced the withdrawal of its support to the fund and the first set of side agreement negotiations was scheduled for March 15.

For its own part, the Clinton administration has set the wheels in motion to begin formulating its goals in negotiating the side agreements. In early

February, "ad-hoc working groups" were set up under the rubric of the President's new National Economic Council. The working groups have been charged with drafting option papers on the NAFTA side agreements. It is reported that the Environmental Protection Agency will head the study of environmental issues, the Department of Labour will take the lead on labour issues, and the Office of the United States Trade Representative will draw up the plans to combat import surges.

The position of Counselor on North American Affairs, with responsibility for overseeing the side agreement negotiations was reportedly offered to Georgetown University Law Center professor and transition trade official Barry Carter. However, Mr. Carter has recently returned to his teaching duties and Rufus Yerxa is rumoured to be taking the lead in the negotiations. Mr. Yerxa is slated to become the principal deputy U.S. Trade Representative.

While the content of the supplemental negotiations remains unclear, and is probably not yet fully defined, a broad picture of the agreements has emerged from the public statements of administration and transition officials. In a speech before the Women's National Democratic Club, Amanda DeBusk, a Clinton trade policy transition team member, outlined the likely goals of the Clinton administration in negotiating the side agreements. In the area of environmental protection, DeBusk stressed that the agreement would likely be based upon the principle of national enforcement of national laws and the creation of a trilateral environmental watchdog commission. Ms. DeBusk noted that "Clinton has called for an agreement whereby each NAFTA country ensures that its citizens will have access to the courts to enhance enforcement of domestic environmental issues." She added that the President will also likely seek guarantees that procedures for dealing with environmental complaints and remedies will be fair and open. Finally, Ms. DeBusk suggested that the trilateral commission could set minimum standards for environmental protection and could enforce such standards through sanctions or tariffs.

In the area of labour standards, Ms. DeBusk expected the creation of a similar trilateral commission to set minimum labour standards. She noted that through the negotiations, President Clinton would seek to guarantee workers' rights to organize and to bargain collectively with the right to redress in local courts or through the commission.

The President himself gave a broad sketch of his side agreement goals in a speech given in Ohio on February 19. In that address, Clinton reemphasized his pledge to push implementation of the NAFTA only "if we can also get an agreement that requires the Mexican government and the private sector to invest in environmental investments to get their environmental costs up to ours so we don't have people just running down there so they can evade the *Clean Air Act* and all those other acts in America." The President also expressed his dissatisfaction with Mexican labour standards stating, "I want to have some labour standards agreements that will reassure us that the Mexican government will enforce even their own labour laws." In a major trade policy speech given at American University on February 26, President Clinton further noted that "NAFTA holds the potential to create many, many jobs in America over the next decade if it is joined with others to ensure that the environment, that living standards, that working conditions, are honored — that we can literally know that we are going to raise the condition of people in

America and in Mexico."

Although the public debate over protection from import surges has yet to subside, the Clinton administration has been almost silent on the issue since the President's October 4 speech. Members of Congress and labour organizations continue to press for a new import surge provision, but the governments of Mexico and Canada have complained that such talks would require the reopening of NAFTA, since the agreement already contains a "snapback" provision similar to that found in the U.S.-Canada FTA. The snapback provision allows a NAFTA country temporarily to reinstate pre-NAFTA duties on products experiencing import surges. The import surge provision is not a crucial interest to the United States, however, since the major import surges would probably occur in the country making deeper duty reductions (i.e., Mexico).

While President Clinton's strategy for completing the implementation of NAFTA is far from defined, the process for developing that strategy is in place and an overall policy is beginning to emerge. One area that has yet to be adequately addressed, however, is the funding of the President's worker retraining, border infrastructure, labour and environmental programs. Congressman Gephardt has called for "iron-clad resource commitments" for these programs and has suggested a cross-border transaction tax. The Mexican and Canadian governments have criticized such a tax as running contrary to the fundamental theory behind FTAs which is the elimination of tariffs.

If any message has emerged from the new administration concerning NAFTA, it is that the United States will not be rushed into the agreement without having its environmental and labour standards concerns addressed. The call for the completion of the side agreements prior to beginning the implementation process has placed the onus on Canada and Mexico, both of which have emphasized their desire to have the agreement in force on January 1, 1994. President Clinton has noted that the January 1 goal is attainable, and appears poised to use this target date as leverage to obtain the side agreements he has promised.

THE CRTC FACES AN ACTIVE YEAR IN TELECOMMUNICATIONS REGULATION

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1993 promises to be a very active year for the CRTC in the area of telecommunications regulation. Now that the Commission has removed almost all regulatory constraints to competition in long distance services through service resale and through competitor system interconnection with telephone company local assembling and distribution networks, the CRTC is faced with the intractable problem of managing competition in a fashion that satisfies its established social policy objectives while providing a palpably competitive environment in which anti-competitive dominant firm behaviour is avoided and overall industry pricing flexibility is maximized.

To help catch up with reality, in late 1992 the CRTC announced that it would be conducting an all-encompassing proceeding in 1993 to examine the appropriateness of its existing regulatory techniques and to develop appropriate modifications. This so-

called "framework proceeding" is directed at the Commission's regulatory controls applied to the telephone companies under its jurisdiction which exercise market power through the monopoly provision of local access and transport facilities and products. The CRTC's public notice in this proceeding (Telecom Public Notice CRTC 92-78) has invited submissions from these respondent telephone companies and other parties on three broad issues:

(1) methods to streamline or eliminate regulatory requirements in light of changes in industry structure including the modifications to regulatory safeguards which may be necessary to protect against abuse of dominant market power in competitive markets;

(2) methods to reduce the combined local and access service category revenue shortfall in order to encourage economic efficiency and stimulate investment in network infrastructure and services, and possibly to introduce a greater degree of equity in the pricing of monopoly local and access products; and

(3) alternatives to modifications to the traditional rate base/rate of return form of regulating telephone company revenues and profits.

Submissions from the telephone companies and other parties on these issues are due by April 13, 1993. This will be followed by an extended period for the exchange of interrogatories and other particulars leading up to a planned November 1, 1993 public hearing. Given the timing of this proceeding, it is unlikely that any significant resulting changes in CRTC policy or technique may be implemented before the beginning of 1995.

Not surprisingly, the telephone companies are not waiting to see how effective their competitors can become. In fact, the telephone companies have already received interim approval for changes to WATS rates that, to some extent, remove opportunities for reseller arbitrage in this product. More significantly, both BC Tel and Bell Canada have made applications to increase dramatically the portion of total telecommunications traffic that is not message rated, but is provided "free" under the terms of flat rate subscription services. The Bell Canada application, known as the Community Calling Plan, would involve bringing all of Metropolitan Toronto, Ottawa-Hull and greater Montreal and their hinterlands within individual flat rate calling areas. This would take an estimated $250 million worth of traffic out of the message toll category. Telephone company competitors can be expected to oppose vigorously these applications on the ground that they would result in an unjustifiable narrowing of the toll market and possibly inefficient pricing for telecommunication services.

Another possible response to competition is the outsourcing of important inputs to telephone company operations. Outsourcing provides an opportunity to remove businesses from rate base/rate of return regulation and from the direct purview of the regulator, both to allow more flexible transfer pricing as well as increased business opportunities in other markets for the outsourced activity. In this respect, Bell Canada has recently announced a co-venture with MCI Communications for the development of virtual private network services. These are services that allow users to construct hybrid switched/private line networks on command using components of the public switched telephone network and broadband transmission services. Virtual private networks erode the traditional

distinction between switched and dedicated transmission assets and services. Bell Canada has also announced the establishment of Sygma, an outsourcing of the company's billing component.

Both the CCP and the proposed Sygma arrangements will be examined in the context of a general rate increase application brought forward by Bell Canada in early February, which will be the subject of public hearings in late May 1993. In effect, the Bell application is for increased rates applicable to monopoly products (primarily local or primary exchange service and related non-reoccurring services) in order to provide a satisfactory level of overall corporate profitability in 1993 and 1994 based on budget forecasts. Without the proposed rate increases, Bell Canada has forecast that its average return on common equity would be slightly under 11% over the period. It can be expected that parties to this proceeding will not only test Bell Canada's revenue and expense forecasts, but also the proposition that any return on equity of about 11% in current economic circumstances, taking into account the company's overall risk, is inadequate. Given an increasingly competitive environment, some parties may also question whether the CRTC should be obliged to establish a guaranteed level of corporate profitability for the entire company as its application currently proposes, rather than just its monopoly public utility operations. The CRTC's decision on this general rate increase application will likely be issued some time in the late summer or fall of 1993.

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CONCENTRATION OF OWNERSHIP OF TELEVISION STATIONS: CRTC APPROVES WIC PURCHASE OF CHCH-TV

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In September 1989, the Canadian Radio-television and Telecommunications Commission approved an application by Maclean Hunter Limited to acquire Selkirk Communications Limited. As part of the transfer, Maclean Hunter became the indirect owner of CHCH-TV in Hamilton, Ontario, an independent television station serving Canada's largest television market. At the time of the hearing of the application for approval of the transaction, Maclean Hunter also sought Commission approval to transfer some former Selkirk properties, including CHCH-TV, to third parties.

The CRTC denied Maclean Hunter's request for authority to transfer CHCH-TV to a subsidiary of CFPL Broadcasting Limited, the licensee of CFPL-TV London, Ontario, and a member of The Blackburn Group Inc. The application was denied largely on the ground that CHCH-TV had failed to achieve its full potential under the ownership and direction of Selkirk and the belief that, based on the financial projections, business plans and strategies filed by CFPL, it was unlikely that there would be any significant improvement in the performance of CHCH-TV for a period of at least five years. At the time, Maclean Hunter was given six months to file proposals for a business plan and a benefits package at least equal in size to that put forward by CFPL, should it wish to retain effective control of CHCH-TV.

CANADIAN COMPETITION RECORD

In October 1990, the CRTC denied a second application for the transfer of CHCH-TV, this time to a partnership of Maclean Hunter and The Blackburn Group Inc., on the ground that based on the general business plan submitted, the Commission was unable to conclude that the application represented the best possible proposal under the circumstances or that its approval would be in the public interest. For the second time, Maclean Hunter was directed to ensure that another application for the transfer of CHCH-TV to a third party was filed within six months, complete with an acceptable business plan and an appropriate benefits package or, in the alternative, Maclean Hunter's own business plan and benefits package for its continued ownership of the station.

Exactly one year later, in the fall of 1991, the Commission issued its decision on an application by Maclean Hunter to transfer effective control of CHCH-TV to Western International Inc. whose subsidiary is the licensee of CHAN-TV and CHEK-TV, the CTV affiliates serving Vancouver and Victoria respectively. The Commission approved this application, subject to the condition that, within two years, WIC sell either CHAN-TV or CHEK-TV to a third party.

The audience reach of CHAN-TV and CHEK-TV, with a network of rebroadcasters in British Columbia, makes WIC the second largest of the participants in the CTV Network after Baton Broadcasting Inc. WIC's application was heard in the midst of an ongoing ownership dispute among the shareholders of the CTV Network which was a matter of significant concern to the CRTC given the importance of CTV in providing television service throughout Canada. Indeed, at the time of the application, it appeared that the shareholders had reached an impasse with respect to the negotiation of a new agreement among themselves.

It is to be noted that WIC also owns, directly or indirectly, the independent television stations in Edmonton, Calgary and Lethbridge, Alberta and the CBC affiliates in Red Deer, Alberta and Kelowna, British Columbia. In addition, WIC's broadcast holdings include nine radio stations in major cities across Canada, the pay television and the pay-per-view services in Western Canada, 50% of the Family Channel and more than 50% of Canadian Satellite Communications Inc.

CHAN-TV and CHEK-TV have been under common ownership since 1963 although CHEK-TV was operated as a CBC affiliate until 1980. CHEK-TV was apparently failing financially in 1963 and it was felt at the time by the regulator, the Board of Broadcast Governors, that Victoria could not support a stand-alone station. An independent television station has since been licensed by the CRTC to serve Vancouver.

It is not clear whether the rationale for the Commission's 1991 decision was a concern for the CTV Network and WIC's role in it or whether it was the opportunity, in light of the fact that both CHAN-TV and CHEK-TV have enjoyed profitability throughout the 1980's, to bring WIC's participation in the Vancouver-Victoria market in line with the Commission's policy against ownership of two television stations in the same language in the same market.

In its decision, the Commission stated that it was appropriate and timely to rationalize the current ownership situation in the Vancouver-Victoria market by requiring, as a condition of authorizing

WIC to purchase CHCH-TV, the divestiture of either CHAN-TV or CHEK-TV, thereby bringing about the separate ownership of the market's three privately-owned television stations. However, in requiring WIC's divestiture of one of its CTV affiliates in British Columbia, the CRTC also referred to the significant expansion of WIC's role in the independent television sector that the acquisition of CHCH-TV would represent and the possible negative impact of this expansion on the future of the CTV Network. More particularly, the Commission noted the potential for a conflict of interest between WIC's existing responsibilities as a CTV affiliate and its increasing involvement as the operator of independent television stations across the country. The Commission expressed concern that, in stabilizing the ownership and operations of CHCH-TV, it not create a more serious problem elsewhere within the broadcasting system, and especially within the CTV Network. It emphasized that, with the acquisition of CHCH-TV, WIC would find itself in a situation where most of its television revenues would be derived from television stations operated in competition with CTV in three of Canada's major markets. The Commission also referred to the possibility that the growth of WIC's holdings in the independent television sector might hamper the resolution of the ongoing ownership disputes among CTV's shareholders.

WIC chose not to exercise the authority granted to it by the CRTC in 1991. Instead, it reapplied to the Commission for authority to acquire control of CHCH-TV while retaining ownership of both CHAN-TV and CHEK-TV. By then, there were indications that the divisions among the shareholders of the CTV Network might be resolved. In its application and at the hearing, WIC offered several assurances regarding any potential negative impact that approval of the transfer might have on the CTV Network. Such assurances included a commitment to broadcast the CTV Network Schedule as determined by a majority of CTV's Board of Directors, an agreement not to compete in the acquisition of programs in which CTV had declared an interest and a commitment to make available to CTV, at WIC's cost, any program acquired by WIC as part of a package where CTV has declared an interest in such a program.

At the 1992 hearing, WIC and the CRTC also reviewed various financial and other consequences of the divestiture options contained in WIC's second application. In particular, the Commission was presented with the results of a market survey predicting that divestiture of CHEK-TV, the only viable option for WIC, would have a serious impact on WIC's revenues and, therefore, on its continued ability to continue providing the same level of service in the Vancouver market and across British Columbia through CHAN-TV's network of rebroadcasters. WIC also argued that a high level of locally-oriented service to Victoria required continued common ownership of the two stations, with the synergies such ownership makes possible.

At the hearing, an impressive number of intervenors from British Columbia urged the Commission not to require divestiture. Putting an end to the common ownership of CHAN-TV and CHEK-TV, they claimed, would effectively deprive Victoria of its own locally-oriented television service since an independently-owned station would eventually have to aim at the Vancouver market to succeed. At the same time, they argued, divestiture would reduce WIC's financial ability to offer the same level of service to Vancouver and the rest of British Columbia.

In December 1992, more than three years after Maclean Hunter first applied to transfer control of CHCH-TV, the Commission approved WIC's application without making its approval subject to the divestiture of either CHAN-TV or CHEK-TV. In reaching this decision, the CRTC determined that acceptance of the status quo in the Vancouver market would better serve the public interest. The Commission emphasized, however, that its determination in this case represented an exception and should not be interpreted as signalling a departure from its general policy prohibition against the common ownership of two television stations broadcasting in the same language in the same market. Interestingly, CFPL-TV London had by then been purchased by Baton Broadcasting Inc.

THE CRTC'S STRUCTURAL HEARING INTO THE DISTRIBUTION OF TELEVISION SERVICES IN CANADA: THE CABLE INDUSTRY RESPONDS TO THE THREAT OF COMPETITION

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On September 3, 1992, the Canadian Radio-television and Telecommunications Commission announced its intention to review the rules governing the distribution, packaging and carriage of television programming services in Canada with respect to the emergence of alternative distribution technologies that are spurring consumer demand for enhanced viewing choices. According to CRTC Notice of Public Hearing 92-13, this review was to be conducted against the policy goal legislatively enshrined in the *Broadcasting Act* of encouraging the development and exposure of Canadian programming services. Interested parties were invited to file written submissions and to appear at a public hearing commencing March 1, 1993.

The last time the Commission established general requirements for the cable distribution of television services in Canada was in 1987. At that time, new narrowcast services, including a news channel, a weather channel and a youth channel, were licensed and joined existing specialty services such as the sports channel and the music channel under the panoply of Canadian television programming services made available to cable subscribers. At the same time, tiering and linkage rules were incorporated by reference into the regulations governing the distribution of television services by the cable industry.

It is fair to say that Canadian cable television operators did not lose their control over the distribution of discretionary services under the rules established in 1987, despite limitations in the number of non-Canadian services declared eligible for cable carriage in Canada and restrictions on the number of non-Canadian services any cable system was allowed to carry in any given discretionary tier of services sold to cable subscribers. First, cable remained the vehicle of choice for the distribution of Canadian programming services. Second, cable operators continued to enjoy a monopoly in their respective franchise area. Third, cable operators retained the discretion to carry any discretionary service licensed by the Commission. Fourth, the licensees of the Canadian services not eligible for carriage on payment of a regulated fee added to the basic monthly cable access fee were left to negotiate with cable operators, on a case by case basis, the

wholesale fee they would get for a place on any given cable channel lineup and the retail fee to be charged to subscribers for their service. Finally, the packaging of services for sale to cable subscribers as a discretionary tier was left to the discretion of cable operators to determine on a system by system basis, as long as the established tiering and linkage rules with respect to non-Canadian services were respected.

There has been growing evidence that the environment in which television programming services are distributed in Canada may soon change dramatically. Digital video compression technology is reducing bandwidth requirements and expanding channel capacity, which not only reduces transmission costs for the delivery of television programming services but also exponentially increases the potential for virtually unlimited programming choices. In fact, the emergence of direct broadcast satellite technology could lead to the delivery of hundreds of video and audio channels to any Canadian household equipped with an 18 inch parabolic antenna. Coupled with the penetration of video recording devices and the growth of movie rental availability during the last decade, these technologies will provide ever increasing new options to Canadians and should satisfy anyone's television programming needs.

By 1994, the Commission is told, a U.S.-based direct broadcast satellite whose footprint will cover Canada is expected to provide a broad range of video services to any Canadian home prepared to pay a monthly fee. According to the cable industry, these "video stores in the sky" will elude Commission jurisdiction and Canadian cable subscribers will turn to them in droves at the expense of the Canadian broadcasting system. Therefore, unless the CRTC helps the Canadian cable licensees to meet this new challenge, it is argued, American "death stars" will displace Canadian cable systems as the source of programming services to Canadians. Canadian over-the-air broadcasters, pay television and specialty service licensees who depend on the cable industry for the distribution of their services will no longer be assured the distribution priority they have enjoyed once the "death stars" begin transmitting their signals.

Almost 600 parties have filed written submissions in response to Notice of Public Hearing 92-13 and, of these, approximately 150 are scheduled to appear at a public hearing expected to last four weeks. Intervenors range from consumer groups and disgruntled viewers who want the broadcasting industry deregulated, to Canadian program producers and program rightsholders who are pushing increased regulatory protection. Other intervenors include specialty service licensees who seek more equitable access to cable distribution and representatives of the major telephone companies who, with the increasing deployment of optic fibre technology with unlimited bandwidth capacity in their networks, argue that restrictions against the delivery of programming services in competition with the cable industry should be relaxed.

It has become increasingly evident that the Canadian broadcasting industry and the Canadian cable television industry will be pitted against each other during the hearing. Broadcasters, through the Canadian Association of Broadcasters, argue that they are reeling from the effects of the recession and are no longer able, by advertising revenues alone, to generate the funds required to produce television programming that Canadians will be willing to watch. To combat this deficit, broadcasters want a

fee for carriage from the cable industry. Cable operators, on the other hand, through the Canadian Cable Television Association, argue that they will not be able to upgrade their networks to modern technology standards without regulatory concessions. Their position is that the capital cost of modernization, which will be in excess of $7 billion, should be passed on to cable subscribers.

Not surprisingly, the rhetoric employed is cast in terms of cultural sovereignty. In order to ensure that Canada's broadcasting system remains Canadian in the face of an ever-increasing availability of high quality, diverse and popular American programming services, broadcasters argue that more funds to produce competitive programming must be made available. Otherwise, Canadians will turn to attractive foreign programming choices available through DBS. The cable operators argue that in order to continue distributing a wide choice of services that includes Canadian programming, sufficient funds must be raised to permit cable network upgrades relating to digital video compression capability, increased channel capacity and choice-enhancing technologies. Failure to raise the required capital will cause the cable industry to wither and with it, the Canadian services licensed by the CRTC which depend on cable for distribution. In this respect, the Commission has been presented with financial models, capital cost projections, demand profiles, market surveys, inflation assumptions, price elasticity predictions, rate of return expectations, cost of equity calculations and legal opinions to assist it in its deliberations.

For the first time, the CAB is demanding direct compensation from the cable industry in the form of a fee for the use of its over-the-air broadcast signals. In essence, the CAB argues that the cable industry has seen explosive growth since the 1950's and has generated enviable profits selling someone else's product without paying for it. During the same period, the CAB claims, more and more has been expected of television stations with regard to Canadian content production and expenditures while viewing fragmentation has mushroomed. Thus, according to the CAB, the proposed fee for carriage should be a cost of doing business for cable operators and should not be passed through to cable subscribers. If this new source of revenue is not made available, it warns, broadcasters will not have the means to continue providing quality Canadian programming that Canadians will choose for their television viewing. In other words, Canadian broadcasters will not be in a position to compete, and more and more Canadians will turn to satellite-delivered American programming services at the expense of a made-in-Canada broadcasting system.

The CCTA, for its part, argues that massive investments in two-way capacity, universal addressability, digital video compression and plant expansions are required over a very short time frame to ensure a state-of-the art Canadian distribution system capable of providing the programming choices required for the Canadian system to be competitive with American-based DBS. However, with the regulatory regime now in place, the cable industry maintains that it will not be able to attract the equity investment necessary to finance an orderly transition to new technologies. The regulatory environment proposed for the next few years is essentially one in which cable subscribers would absorb the costs of modernizing cable networks as capital expenditures eligible for pass-through in cable access rates so that cable operators can compete effectively in the delivery of Canadian and non-Canadian programming services.

In return for such regulatory concessions, the cable industry has committed itself to devoting a predominance of channels on each Canadian cable system to the distribution of Canadian services (not necessarily to the delivery of a predominance of Canadian services) and to establishing a programming fund of up to $100 million over five years to be devoted to Canadian content programming production.

The CCTA has suggested that the Commission may not have the jurisdiction to impose a fee for carriage on the cable industry while the CAB has argued that the CCTA's financial model is flawed and skewed in favour of its proposed regulatory option. The CAB has also downplayed the significance of the American DBS threat and scoffed at the insignificance of the CCTA's programming fund proposal in light of the size of the cable industry's revenues and of the $1.1 billion, it estimates, is spent annually on Canadian programming by private television, the CBC and Canadian pay and specialty services. Broadcasting, the CAB claims, is a matter of programming and programming must take precedence over technology in the allocation of resources since only Canadian programming of competitive quality can meet the increased foreign competition made possible by new technology.

The CRTC is not expected to issue a decision on its structural review for a number of months.

THE 1993 CABLE RETRANSMISSION DECISION

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On January 14, 1993, the Copyright Board issued its decision establishing the royalty rates payable by Canadian cable systems for the retransmission of distant television signals during the 1992-1994 calendar years. Notwithstanding a 36 day hearing during which the various copyright collectives argued in support of an increase in the royalties approved by the Board in its previous 1990-1991 decision, the Board concluded that there was no justification for such an increase at this time. Accordingly, cable systems will continue to pay royalties to the copyright collectives pursuant to a "sliding scale" tariff methodology which reaches a maximum rate of 70 cents per subscriber per month for systems serving more than 6,000 subscribers. This copyright regime is expected to generate approximately $42 million per year in retransmission royalties. The largest portion of this amount will be paid to American copyright owners.

Superstation Surcharge

In reaching its decision essentially to freeze retransmission rates at their existing levels until the end of 1994, the Board had to deal with a proposal advanced by a number of collectives that would have imposed a separate surcharge on cable systems carrying U.S. "superstation" signals. Such a surcharge would have required cable systems to pay an additional 25 cents per subscriber per month for each superstation signal carried over and above the blanket rate paid for all other distant television signals.

One of the arguments made in support of such a surcharge was that since superstation signals are normally carried on discretionary tiers, cable operators could pass the surcharge directly through to their subscribers without the need to obtain CRTC approval. Furthermore, only those cable systems that actually distributed U.S. superstations would have to pay for them. As a result, the collectives claimed that a superstation surcharge was equitable in its treatment of cable systems.

The Board was not persuaded by such arguments, however, and decided to include the distribution of U.S. superstations in the overall royalty rate structure for a number of reasons. First, the fact that cable systems have the right to pass through the copyright costs associated with superstation signals does not mean, in every instance, that they would have the ability to do so. Second, the Board was not prepared to distinguish between superstations and other discretionary distant signals for which a separate surcharge is not levied as this would "open the door to assessing different values for various categories of signals". Third, the imposition of a superstation surcharge would act as a disincentive for cable systems to carry superstation signals. This, in turn, would have a negative impact on the penetration levels of their CRTC-approved "packaging partners", Canadian pay television services. Finally, the Board found the argument that a superstation surcharge was more equitable to those cable operators carrying few or no superstation signals suggested that the present retransmission scheme, pursuant to which the actual number of distant signals distributed is not relevant, was not fair. This last comment was made even though such an argument had not been made by the collectives. For all of these reasons, the Board rejected the collectives' proposal for a separate superstation surcharge.

Francophone Discount

Another issue of interest which received a great deal of attention at the retransmission hearing related to whether cable systems operating in francophone markets ought to benefit from a reduced royalty rate. During the 1990-91 hearing, no evidence had been presented on this point with the result that cable systems of similar size operating in English and French-language markets paid the same royalty rate.

This oversight was not repeated in the most recent hearing at which a great deal of evidence was put forward to demonstrate that cable systems in Quebec, the proxy used for all francophone markets, operated in a completely different environment from other Canadian cable systems. For example, Quebec cable television subscribers receive fewer distant signals than other Canadians and, of the distant signals they do receive, less than 20% are in the French language. In addition, while Quebecers watch more television than other Canadians, their viewing of distant signals (as a percentage of total television viewing) is only in the area of 5% compared to 18-21% for English Canadians.

Faced with this evidence, as well as the fact that the *Broadcasting Act* itself acknowledges the different characteristics of English and French language broadcasting, the Copyright Board decided to address the issue. For its part, CCC, the largest copyright collective, argued that if the Board should set a lower royalty rate for cable systems operating in francophone markets, the overall rate should be increased for systems serving anglophone markets. In other words, the collectives should be "kept whole" and not suffer any loss in royalty payments as a result of the adoption of a special rate for French language systems.

In rejecting this argument, the Board noted that its function was not to establish the quantum of royalties, but rather the royalty methodology by which the quantum is reached. In the Board's opinion, the monthly 70 cent per subscriber rate set in the 1990-91 retransmission proceeding remained a "fair maximum rate" which was not susceptible to increase for the purpose of compensating the collectives for any loss in revenues occasioned by a special French-language rate. The rate approved by the Board for systems serving francophone markets was 50% of the royalty rate otherwise payable.

Allocation

As in its 1990-91 decision, the Board adopted a "hybrid" allocation methodology which first divided the royalty payments into two pools based on the supply of distant American and Canadian signals and then distributed the royalties amongst the various collectives on the basis of viewing.

This initial step of distinguishing between American and Canadian signals remained very controversial to American rights holders who were of the view that royalties should be allocated purely on the basis of viewing data. PBS accepted the division into pools, but argued that doing so on the basis of "value beyond viewing" (discussed further below) without a separate, third pool for PBS would give a preference to Canadian copyright owners and thus would discriminate between rights holders on the grounds of nationality or residence in contravention of the *Copyright Act*.

The Board responded to this position by noting that the distinction is actually made between American and Canadian signals, not copyright owners. As such, copyrighted works owned by Americans would fall into the Canadian royalty pool when distributed on a Canadian signal, whereas works owned by Canadians would fall into the American pool when distributed on an American signal. Apparently, PBS was unconvinced by this response from the Board as it recently applied to the Federal Court of Appeal for an order quashing the Board's decision because of alleged illegal discrimination between American and Canadian copyright owners.

As for the question of the allocation of royalties on the basis of viewing, the Board considered a number of adjustments that the various collectives proposed should be factored into this calculation. For example, FWS and MLB, the two sports collectives, argued that viewing statistics alone do not measure the willingness to pay for a particular program such as a sporting event. In fact, evidence showed that broadcasters are prepared to pay a premium for the right to air a sports program.

In rejecting this argument, the Board concluded that a sporting event that might have high value to the local "home team" market would not necessarily retain this value when shown on a distant basis. Furthermore, the price broadcasters are prepared to pay for sports programming reflects, to a certain degree, the target audience that such programming attracts for the purposes of advertising. In the Board's opinion, such considerations should not be relevant to the issue of allocation.

A similar adjustment that the Board reviewed had to do with the value of certain signals over and above their viewing share. The collective representing PBS argued that a pure viewing approach consistently underestimated the value placed on PBS signals by cable subscribers. As was the case for sports programming, however, the Board was not persuaded

by this argument and maintained the viewing approach. In doing so, it noted that any allocation to PBS on a basis other than viewing would be unfair to rights holders in other American signals whose works attracted more viewing than PBS.

The Board's allocation decision has resulted in three separate legal challenges in the Federal Court of Appeal. In addition to the PBS action, MBL, the baseball collective, has disputed its drop in share from 3.6% to 1.6% of the overall royalties, while an American rights owner, Worldvision Enterprises, claims that the Board erred in allocating royalties earned by three of its day-time "soap operas" to a Canadian collective.

Quite obviously, with the royalty amounts involved, the retransmission rights regime will remain a prime source of Federal Court litigation for some time in the future.

* Mr. O'Neill acted as counsel to Cancom in the Copyright Board proceeding.

INSURANCE REGULATION UPDATE

INSURING FOR THE FUTURE: PROPOSALS FOR MODERN INSURANCE LEGISLATION FOR ONTARIO

By: Colin H.H. McNairn
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Last November, the Minister of Financial Institutions for Ontario released *Insuring for the Future*, the Report of the Insurance Legislation Review Project. The Ontario Insurance Commission will use the Report to open discussions with the insurance industry, consumers, professional groups and others on the shape of new insurance legislation for the province.

The Report contains 217 specific recommendations. If they are adopted, they will result in significant changes to the *Insurance Act*, the *Registered Insurance Brokers Act* and the *Corporations Act*, as the legislation relates to Ontario insurance companies. The changes would affect insurers, their auditors, actuaries, agents, brokers and adjusters as well as other parties who have not traditionally been part of the regulated insurance sector. This last group includes third party warranty companies, charitable organizations that issue gift annuities, lending institutions and retailers that arrange creditor's group insurance on the lives or health of their debtors, wholesale insurance brokers, insurance managers and various insurance support organizations.

The general objectives that pervade the recommendations are:

1. to rationalize the regulation of insurance industry participants;

2. to expand the role of self-regulation in the insurance sector;

3. to achieve compatibility with other, modern financial services legislation; and

4. to strengthen the level of protection for insurance consumers.

The Report deals with three distinct areas of regulation:

1. financial regulation of insurers, which is designed to safeguard solvency;

2. market regulation of insurance, which influences the way insurance is sold, either directly or through agents or brokers, and the way insurance claims are settled, by insurers or adjusters; and

3. corporate regulation of insurance companies, which determines the manner in which such companies may be organized and govern their affairs.

The first two systems of regulation apply to those who do business in Ontario; the third applies only to insurers who choose to incorporate under the laws of Ontario.

Financial Regulation

Current financial regulation of insurers operating in Ontario involves requirements for security deposits, licensing, financial reporting and official examination. A threshold question often arises as to whether a particular entity is, in fact, carrying on the business of an insurer so as to be subject to these requirements and the Report makes some recommendations as to how that business should be defined.

Under the Report's approach, an insurer would no longer have to make a deposit of securities with the government (for the protection of policyholders upon an insolvency). The theory is that compulsory participation in either of the two industry-run compensation plans would be an adequate substitute. Provincial licences would no longer have to be renewed every year either. Instead, they would have an unlimited term, but could be reviewed under certain circumstances.

Market Regulation

For property and casualty insurance, the Report recommends tighter restrictions on the placement of risks with offshore insurers. It also proposes a new self-governing structure for the licensing and discipline of insurance agents. The legitimation of certain group marketing initiatives for the sale of automobile and homeowners policies is also recommended.

For life and health insurance, the Report recommends a simplified disclosure procedure when a life insurance agent suggests the replacement of an existing whole life policy to a customer. It recommends that the rules for selling variable insurance contracts be similar to those for selling mutual funds, given the similarity of these financial products. It also recommends detailed regulations to curb a number of abuses by lenders and other credit grantors providing creditor's group insurance.

Some recommendations would affect the marketing of both life and health insurance and property and casualty insurance. These include objectives to:

1. clarify and reinforce the unfair practices part of the *Insurance Act*;

2. add new mass marketing rules to govern the sale of insurance by direct mail or media advertising;

3. prescribe certain fair information practices to be followed for the protection of the personal privacy of insurance consumers; and

4. regulate networking arrangements, for the sale of financial services, between insurers and other institutions.

Corporate Regulation

The recommendations of the Report in this area are generally designed to bring the corporate governance of Ontario insurance companies into line with the new federal *Insurance Companies Act*. The result would be that Ontario companies would not be competitively disadvantaged in relation to federal companies. Moreover, they would be subject to the same prudential standards applicable to those other companies.

PHARMACEUTICAL PATENT RIGHT REVISIONS TAKE EFFECT

By: John F. Blakney
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On February 15, 1993, amendments to the *Patent Act* to implement the government's policy of putting pharmaceutical patents on the same footing as all other patents were proclaimed in force (formerly Bill C-91, now Statutes of Canada 1993, Chap. 2).

Compulsory pharmaceutical patent licences issued before December 20, 1991 will continue in effect, subject to the conditions established in the 1987 revision of the *Patent Act* (known as Bill C-22). Bill C-22 permitted working of the patent under a compulsory licence, except for the importation of the active pharmaceutical ingredient to be produced into the drug for sale in Canada during a specified "exclusivity" period laid out in the legislation. However, any compulsory licence granted under the previous patent regime on or after December 20, 1991, is now deemed to have no effect.

The Patented Medicine Prices Review Board (PMPRB), which was established in the 1987 revisions of the *Patent Act* to prevent excessive patented pharmaceutical prices and to report to the government on price and research and development trends, has been continued under the new legislation with substantially revised powers. The structure of the Board, however, remains unchanged. It consists of five members appointed by the Governor in Council having a maximum of two five-year terms. The Board's Chairperson is also its Chief Executive Officer and supervises and directs the work of the Board and its staff. With respect to its proceedings, the Board has all the powers of a superior court. The Board's formal proceedings to determine if the price of a patented medicine is excessive, and if so, what remedy should be issued, are subject to a public hearing requirement. The Board's annual reporting responsibilities to the government with respect to prices, sales and research and development remain unchanged.

The PMPRB is essentially an independent regulatory agency having all the traditional trappings of what is often termed a "quasi-judicial" tribunal: appointed decision makers having fixed terms in office, a public hearing requirement for substantive decisions, and an inability on the part of the government to direct or review specific decisions of the Board.

Although its structure, formal processes, and decision-making standard ("excessive price") are unchanged, the remedial powers that the Board may exercise have been significantly altered to make them consistent with the government's overall policy of eliminating compulsory licences for pharmaceutical patents and maintaining the integrity of private rights surrounding pharmaceutical patents. Under the previous regime, the principal remedy available to the PMPRB was the removal of the patent exclusivity established by Bill C-22, thus permitting competition through compulsory licensees to bring the price of a patented pharmaceutical down to a non-excessive level. As well, the Board had the power to prospectively order the price of a patented pharmaceutical not to exceed a level considered by the Board to be excessive if the Board felt that removal of patent exclusivity would not provide a sufficient remedy.

The Board has retained its capacity to make prospective price orders. However, it can no longer make orders that provide for increased competition in the supply of the subject pharmaceutical product. Instead, the Board has been given the power to order the patentee to give up the revenues generated from the excessive portion of the price of the medicine in the past (i.e. the difference between the actual price and the maximum non-excessive price multiplied by past sales volumes). The Board can elect to require this reimbursement through price reductions of the subject medicine if still patented, price reductions of another patented medicine of the patentee, or payment to the federal government. The new Act contemplates that federal and provincial governments may enter into arrangements for the distribution of such payments to the federal government back to the provinces whose taxpayers may have paid part of the excessive revenues through government supported drug plans.

In order to clarify an uncertainty under the previous regime, the new legislation expressly gives the Board power to make excessive price findings and to issue remedial orders in relation to a "former patentee", subject to a statutory limitation period of three years following the termination of the benefit of the patent in a particular case. As a result, the Board would appear no longer to be exposed to the risk that it may lack jurisdiction to exercise its formal powers in relation to an excessively priced medicine where the patent had recently lapsed or had been surrendered or dedicated. The Board's powers with respect to a former patentee, however, are limited to the reimbursement of excessive revenues.

In order to provide a penalty for serious non-compliant behaviour, the Act permits the Board to order a double excessive revenue reimbursement where it finds that the patentee had engaged in a "policy" of selling at excessive prices.

The matters specified in the *Patent Act* which the Board must consider in determining whether the price of a patented medicine is excessive are essentially unchanged from the previous legislation. The Board must first consider, in a formal proceeding, the following four factors:

- the prices for the medicine in the previous five years;
- the prices of other medicines in the therapeutic class in the previous five years;
- the prices of the medicine and other medicines in the therapeutic class in other countries in the previous five years; and
- changes in the Consumer Price Index (CPI).

However, under the new legislation the government may now specify additional factors by regulation that the Board must give consideration to in this first stage of the excessive price determination process. If the Board is unable to determine whether the price of the medicine is excessive applying these first stage considerations, the Board is then permitted to take into account the costs of making and marketing the medicine, other specific secondary factors that may be specified by regulation, and any other factors which in the opinion of the Board are relevant in the circumstances.

To date, it has been the practice of the Board, as reflected in its excessive price guidelines, to focus on the first set of factors and clearly not to attach initial relevance to information concerning production and marketing costs in Canada.

Under these guidelines, once a medicine has been introduced into the Canadian marketplace at a price which is not excessive, subsequent annual increases in the average fixed patentee price of the medicine are limited to the rate of inflation. To date, this inflation adjustment has been a cumulative threshold permitting patentees to increase prices more rapidly than CPI changes in the current year if in past years prices did not go up as much as the CPI. The Board is now proposing to eliminate this cumulative aspect of the CPI cap to some degree. No final decision on this point however has been taken by the Board.

More complicated guidelines apply to determining whether the introductory price of a new patented medicine should be regarded as *prima facie* excessive and therefore warranting a formal Board excessive price proceeding. Prices of simple line extension medicines must bear a reasonable relationship to other products in the product line as measured by the return on units of active ingredient. Medicines which constitute an obvious therapeutic breakthrough or generate a substantial savings to the Canadian health care system may be priced at the higher of the international median price of the medicine or the upper limit of the price range of the medicines in the same therapeutic class. Medicines which represent a modest improvement over existing therapies presently may be priced at the upper end of the therapeutic class price range regardless of level of the international prices for that medicine. The Board is currently considering the extent to which this last test should be modified to increase the relevance of international price information on the subject medicine in assessing whether the introductory price may be excessive.

The Board has been given clearer powers for the enforcement of both its remedial orders and its orders and regulations requiring the production of price and other relevant information to assist in its enquiries. The enforcement of these orders or regulatory requirements may now be effected by way of either summary conviction proceedings or the registration of the Board's order in the Federal Court (in which case the Act deems the order to be enforceable in the same way as an order of that court).

In recognition of the fact that the Board has been successful in expressing its views on the concept of excessive price administratively through guidelines and in obtaining voluntary compliance with these price guidelines through staff dealings with patentees without holding formal hearings on specific medicines, the new *Patent Act* contains measures to increase somewhat the accountability of the Board in the performance of its informal administrative activities and as well to increase the availability and relevance of informal compliance arrangements

worked out by the Board's staff under the Board's price guidelines.

The *Patent Act* now expressly authorizes the Board to issue non-binding guidelines with respect to any matter within its jurisdiction. However, before issuing any guidelines, the Board must now consult with the responsible Minister (the Minister of National Health and Welfare), provincial Health Ministers, and such representatives of consumer groups and the pharmaceutical industry as the Minister may designate. Although this requirement reflects what has been a Board practice, its presence emphasizes the importance of the Board's guidelines in as much as the Board has not to date generated jurisprudence on the concept of excessive price through its formal adjudicative process. The provision provides governments and interested parties with assurance that the Board will not create new guidelines without having consulted them.

As well, the Board is now expressly authorized to issue certificates at the request of a patentee to the effect that the Board would not have sufficient grounds to make a remedial order with respect to the price of a patented medicine supplied by that patentee. However, unlike advance ruling certificates contemplated under the merger provisions of the *Competition Act*, the PMPRB is not bound by any certificate that it issues. The express authorization for such certificates provides the Board with an opportunity to expand its activities more outwardly, albeit indirectly, into a price preclearance mode. Although the Board has not indicated how this new certificate of authority may be utilized, it is conceivable that patentees may find a compliance certificate to be an asset in obtaining or retaining access to the formularies of drugs reimbursed under provincial drug plans or alternatively that provincial governments may require that a patentee produce a PMPRB compliance certificate as a condition of consideration of inclusion of a medicine within a provincial drug reimbursement plan. Patentees may well seek preclearance before marketing a new medicine to avoid the risk of Board-imposed price changes during the critical roll-out period of the product when the market's perceived value/price relationship is not established and can be unstable. In the event that the Board embarks on issuing such compliance certificates, the Board will have to consider the delicate issue of how to ensure that its capacity to review formally the price of a medicine remains intact, notwithstanding the issuance of a certificate, as the Act clearly states that the Board may not be bound by the views it expresses in that certificate.

The Board may also have to consider whether, and if so how, to involve other interests, such as the provinces acting as consumer surrogates, in the process of reviewing a certificate request.

A number of parties have attached some significance to the fact that the Minister of National Health and Welfare, and not the Minister of Consumer and Corporate Affairs, is now responsible for the Board. At most, this change of accountability probably makes clear what has always been the case: that the Board is not, strictly speaking, an instrument for preventing abuse of patent rights but rather is an instrument for ensuring that the exercise of the pharmaceutical patent rights does not unreasonably undermine the overall objectives of Canadian governments and their fiscal capacities in the delivery of health care within the mixed government/private sector industry structure that has prevailed in Canada for some time. The positioning of the PMPRB within the overall health care policy and

delivery framework of Canadian governments is likely to be reinforced in the event that the Minister of Health utilizes the new authority provided by the *Patent Act* revisions to require the PMPRB to conduct inquiries and to report back to the government with respect to any matter that the Minister may refer to it.

Finally, in order to provide a forum for the communication of views of interested parties to the Board outside the formal hearing process, the Minister of National Health and Welfare is now authorized to convene a meeting consisting of the PMPRB Chairperson, provincial Ministers of Health, representatives of consumer groups and the pharmaceutical industry, and any other persons which the Minister considers appropriate relating to the administration and operation of the *Patent Act* regime or patented pharmaceutical price review.

The *Patent Act* revision also contains provisions for linking drug approval (under the federal *Food and Drugs Act*) for non-patentees to the term of the patent and to provide limited exemptions from infringement action exposure for certain non-patentee activities related to preparing to market a medicine following the end of the patent's term. These provisions, set out in section 55.2, have not yet been proclaimed in force.

Section 55.2 would now deem it not to be infringement to use a patented invention solely for development of information required to obtain product approval in Canada, a Canadian province, or significantly, a country other than Canada that regulates the manufacture, construction, use or sale of the product. As well, it is deemed not to be an infringement of the patent to make, construct or use the invention during a period specified by regulations in order to manufacture and store drug products intended for sale after the date in which the term of the patent expired.

Section 55.2 gives the Governor in Council wide regulation-making power to prevent patent infringement by persons who take advantage of these two infringement exceptions. Included within this power is the capacity to make regulations respecting the conditions that must be fulfilled by a non-patentee before a drug approval may be given, establishing the earliest date on which the non-patentee drug approval may take effect (presumably a date following the end of the patent term), governing the resolution of disputes between patentees and non-patentees with respect to the issuance of non-patentee drug approvals, providing for private enforcement of the boundary surrounding the deemed non-infringements, and, finally, generally for governing the issue of drug approvals in the circumstances where that approval might result directly or indirectly in the infringement of a patent.

This is the first time that Parliament has contemplated the linkage of drug safety approval and patent rights in Canada, although such linkages are made in the United States. It would not be unreasonable to expect that over the coming years, there will be considerable opportunity for disputes between patentees and non-patentees, and between competing supplier interests and the federal government. These disputes will test both the statutory limits to the infringement exceptions as well as the meaning and viability of any regulations made by the government to implement the contemplated relationship between drug approval and patent rights and the government's responsibilities under such regulations.

CANADA-U.S. STEEL TRADE ACTIONS HIGHLIGHT LACK OF DUMPING ALTERNATIVES

By: Paul K. Lepsoe*
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The recent spate of dumping actions launched by Canadian and American steel producers against each other has served to highlight the lack of a dumping code or alternative regime in the *Canada-U.S. Free Trade Agreement* (FTA).

This article will briefly outline the current plethora of steel trade actions in Canada and the United States, and will then analyze the limited role of the FTA in resolving such actions. Possible alternatives including a dumping and/or subsidies code, a multilateral steel agreement, and the replacement of dumping laws by competition laws between Canada and the United States, will be mentioned. Relevant provisions of the new North American Free Trade Agreement (NAFTA) will also be examined. The regrettable conclusion will be that NAFTA indicates that an alternative regime is even further out of reach.

Current Steel cases: United States

On June 30, 1992, several U.S. steel producers filed formal petitions with the U.S. International Trade Commission (USITC) and the U.S. Department of Commerce alleging that various types of steel from a number of countries were being dumped into the American market, and/or subsidized by the government of the country of origin, and that such imports were causing injury to U.S. producers. In total, 20 countries were named in the dumping allegations, including Canada, Germany, Mexico, Romania, Taiwan, and the United Kingdom. On the same day, a countervailing duty investigation on the basis of trade-distorting subsidies was commenced against importers from 13 countries, all but one of whom were also named in the dumping investigation. Canada was not among the alleged subsidizers.

In August 1992, the USITC made a preliminary ruling that U.S. industry was materially injured or threatened with material injury from imports of all countries against whom complaints were launched with the exception of Taiwan.

The International Trade Administration (ITA) of the Department of Commerce made a preliminary determination of unfair subsidization against the 12 countries remaining in the countervail investigation on November 30, 1992. The estimated subsidy rates, on which provisional countervailing duties will be assessed, ranged as high as 90.09%. On January 27, 1993, the ITA made its preliminary determination of dumping against 19 countries, and ordered anti-dumping duties ranging as high as 109.22%, although the maximum against a Canadian producer was 68.7%.

All Canadian steel products subject to the dumping investigation were found to be dumped, with dumping margins ranging from a low of 0.03% for Ipsco to a high of 68.7% for Stelco.

The products under investigation consist of four categories of flat-rolled carbon steel: uncoiled plate, hot-rolled and cold-rolled sheet and strip, and corrosion-resistant.

If the preliminary calculations of dumping and countervail are affirmed by the ITA during its further

investigation taking place until June, and if the ITC makes a final determination of material injury to U.S. industry, the application of anti-dumping and countervailing duties will be confirmed.

Current Steel Cases: Canada

Several complaints of dumping were filed with Revenue Canada by Canadian steel producers throughout the summer of 1992, doubtless in response to the anticipated closing of the U.S. market due to the U.S. trade actions. The countries and products named are in many cases the same as in the U.S. actions, although the scope of the Canadian investigation is somewhat smaller. Two preliminary determinations of dumping against types of steel plate and sheet were made by Revenue Canada in January 1993. Source countries include Belgium, Brazil, Germany, Italy and Romania, with the United States as the largest source country in both cases. Hearings to determine if the dumping is causing material injury to production in Canada will be held by the Canadian International Trade Tribunal (CITT) in April and May. The effect of an affirmative finding by the CITT would be to confirm the application of anti-dumping duties for five years. Preliminary duties now being applied range as high as 185.7% for some exports from Germany and the United States.

A third investigation by Revenue Canada is underway concerning cold-rolled steel sheet from a number of countries including the United States. A preliminary determination is expected by the end of March, with a CITT hearing in the summer for that product. Another investigation may be launched with respect to galvanized or corrosion-resistant steel, thereby ensuring a complete match with the trade actions currently underway in the United States.

The role of the FTA

As stated at the outset, these trade actions are an illustration of the inability of the FTA to prevent this sort of Canada-U.S. trade harassment. In a January news release, the Canadian government claimed that the investigations being carried out by both countries "make no commercial sense in an integrated steel market". In response to Revenue Canada's first preliminary determination of dumping in the various steel complaints, Stelco Chairman Fred Telmer was quoted as saying that the "inclusion of the United States in the ruling emphasizes the absurdity of the current legislation governing trade between Canada and the United States".

Essentially, the FTA allows both countries to retain and use their full range of anti-dumping and countervailing duties provisions against each other. The Canadian negotiators of the FTA would have liked to have achieved more with respect to the elimination of anti-dumping actions against Canadian products through the replacement of such actions by domestic competition or antitrust law provisions directed at predatory pricing and price discrimination. But, just as it was politically impossible for the Americans to agree to that, the inclusion of a strict subsidies code in the FTA would probably have been politically impossible for Canada to accept. The compromise was contained in Chapter 19 of the FTA, which principally provides for binational panel review of dumping, subsidy, and injury determinations made by trade authorities of each country concerning exports of the other. The panels must apply the applicable domestic law in their review.

Article 1907 of the FTA provided for a working group to "seek to develop a substitute system of rules for

dealing with unfair pricing and government subsidization". A new system was to be implemented within five years, with the possibility of an extension to seven years. Failing this, either party could terminate the agreement. Under one interpretation of some rather vague wording in Article 1906 about the implementation of the substitute system of trade rules, the FTA could continue but all of Chapter 19, including the system for binational panel review, would expire if the substitute system of rules were not in place within seven years.

The working group began work on the technical feasibility of replacing the dumping regimes of each country with competition law, the so-called "replacement option". However, little progress was made before it was agreed in 1991 to defer the process pending the outcome of the GATT Uruguay Round. The current draft GATT text would introduce many reforms to the existing international subsidies and anti-dumping codes.

Article 1907 of the FTA is based on the solid assumption that trade actions must be abolished in order to realize the full economic potential of a free trade area. Anti-dumping and countervail actions have long since been abolished between the countries of the European Community.

A 1988 protocol to the Australia - New Zealand Free Trade Agreement (which was initially concluded in 1966 and revised in 1983) provides for the elimination of anti-dumping remedies between the two countries and a reliance on competition laws instead. Provisions for certain extra-territorial administration of those laws were included as a result. The countries also agreed to eliminate certain export-distorting subsidy practices.

Trade actions under NAFTA

Despite the seeming good sense of eliminating trade remedy actions between free trade partners and the explicit commitment to do so contained in the FTA, the NAFTA provisions in this regard are very weak. Article 1504 provides for a "working group on trade and competition" which is to "make recommendations" within five years "on relevant issues concerning the relationship between competition laws and policies and trade in the free trade area." Under Article 1907 of NAFTA, the three countries agree to consult on "the potential for reliance on a substitute system of rules for dealing with unfair transborder pricing practices and government subsidization."

There are effectively no time limits and no commitments concerning the "replacement option" in NAFTA. The Canadian government has argued that NAFTA is, on a practical level, no weaker than the FTA in this regard, while NAFTA is overall more advantageous because the binational panel review process is made permanent. There can be little doubt that the panel system has worked at least to some extent to Canada's advantage by acting as a check on the decisions of U.S. trade authorities.

Although the Canadian government has seemingly virtually given up on the "replacement option" process vis-a-vis the United States, it has been and remains in favour of a bilateral steel accord that would end trade actions between the two countries in that industry. However, apparently supported by the American steel industry, the United States has remained committed instead to negotiating a multilateral steel agreement which would involve all major world steel producers. Such an agreement would address subsidies, reductions to tariff and non-

tariff barriers to the steel trade and would contain an arbitration mechanism. Notably, it would not end dumping actions, to which the prevailing views in U.S. politics seem to remain as committed as ever.

* Mr. Lepsoe is counsel to Preussag Stahl AG, a German steel producer, in one of the Canadian trade actions.

DUTIABLE ROYALTIES AND LICENSING FEES: THE CITT'S DECISION IN *POLYGRAM*

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On May 7, 1992, the Canadian International Trade Tribunal (the CITT) ruled that, under the *Customs Act,* Polygram Inc. must include, as part of the value for duty on its imported records and tapes, an "all-in fee" which Polygram pays to Polygram Record Service B.V. (Polygram B.V.), an exporter of the records and tapes.[1] The fee was paid by Polygram to Polygram B.V. as consideration for Polygram B.V. granting Polygram the right to promote, distribute, sell and manufacture in Canada the music of artists signed to its record label.

The decision is important for international trade law in Canada for two reasons. First, the case gave the CITT an opportunity to consider the meaning of s. 48(5)(a)(iv) of the *Customs Act*, a statutory provision which has received less judicial consideration than it warrants.[2] Second, the decision may have a substantial impact on Canadian companies which engage in the importation of products for which a royalty or licence fee is payable. The importance of this litigation to members of the Canadian recording industry is evidenced by the participation of the Canadian Recording Industry Association as an intervenor in the appeal.

The facts of the case are relatively straightforward. Polygram imported records and tapes from Polygram B.V. and Polygram Record Service GmbH. As consideration for Polygram paying the all-in fee, which was based on the net sale of records and tapes in Canada, it was granted the following rights:

1. the exclusive right to use master tapes for manufacturing purposes in Canada;

2. the exclusive right to market, distribute and sell records and tapes through regular wholesale and retail trade channels;

3. the non-exclusive right to market, distribute and sell records and tapes through record clubs;

4. the non-exclusive right to perform publicly or permit the public performance of records and tapes subject to certain limitations;

5. the non-exclusive right to use the name, likeness and biography of each artist whose performances are embodied in the sound recording in conjunction with the advertising, publicizing and sale of records and tapes; and

6. the non-exclusive right to use the artwork supplied by Polygram B.V. in the manufacture of sleeves, jackets and other packaging of records and tapes and in association with the advertising, publicizing and sale of records and tapes.

All of the issues addressed in this decision relate to

whether the fee was dutiable under s. 48 of the *Customs Act,* which provides:

> 48(1) Subject to subsection (6), the value for duty of goods is the *transaction value* of the goods if the goods are sold for export to Canada and the *price paid or payable* for the goods can be determined...
>
> (5) The price paid or payable in the sale of goods for export to Canada shall be adjusted
> (a) by adding thereto amounts, to the extent that each such amount is not already included in the price paid or payable for the goods, equal to
>
> (...)
>
> (iv) royalties and license fees, including payments for patents, trade-marks and copyrights, *in respect of goods* that the purchaser of the goods must pay, directly or indirectly, *as a condition of the sale of the goods for export to Canada*, exclusive of charges for the right to reproduce the goods in Canada ... (emphasis added).

In its reasons for decision, the CITT stated that "in determining whether the fee payment falls within the meaning of s. 48(5)(a)(iv), three key criteria must be met; (i) the payment is a royalty or license fee paid directly or indirectly; ii) in respect of goods; and (iii) as a condition of the sale of the goods for export to Canada". Since Polygram and Revenue Canada agreed that there was no dispute with respect to the first criteria, the submissions made by the parties dealt with the second and third criteria.

Submissions Regarding the "in respect of goods" criteria

Polygram argued that the fee it paid to Polygram B.V. was not a payment "in respect of goods" since it was not paid for goods but for rights. These rights permitted Polygram to engage in the commercial exploitation of various aspects of the imported records and tapes within Canada. In this respect, it was argued that the granting of these rights was not contingent upon the importation of the records and tapes. Additionally, Polygram stated that payment for the imported records and tapes and payment for the rights granted to Polygram were wholly independent of each other. That is, the value of the fee was calculated based upon sales in Canada of both imported and domestically produced records and tapes and not upon the importation of records and tapes. Counsel for Polygram also drew the CITT's attention to U.S. Customs Service Ruling 543773 which involved a similar fee and a decision that "the royalty payments are not 'related to the imported merchandise'...".

The Canadian Recording Industry Association argued that there was an insufficient nexus between the payment of the fee and the imported records and tapes to hold that it was payable "in respect of goods". Further, the Association stated that the subject matter which represented the consideration for the payment of the fee was intangible rights and not "goods". It was submitted that the importation of the records and tapes was merely incidental to the granting of the rights. Finally, the Association argued that because the payment of the fee was wholly contingent upon sales in Canada, the fee was not ascertainable at the time of importation and the Customs Act could not have been intended to apply where valuation of imported goods for the purpose of calculating duties is not possible.

Revenue Canada submitted that a broader definition of "goods" should be utilized when interpreting the phrase "in respect of goods" and that the value of the "goods" should not be limited to the physical or tangible manifestation of the music, such as a record

or tape. In essence, Revenue Canada argued that when assessing the "transaction value" of the records and tapes, one must include the intrinsic value of the music contained in the recordings. For this reason, it was stated that there was a significant enough relationship between the payment of the fee and the "goods" in question to categorize the fee as being "in respect of goods".

Submissions regarding the "as a condition of the sale of goods for export to Canada" criteria

Polygram argued that the obligation to pay the fee to Polygram B.V. was not "a condition of the sale of the goods for export to Canada" since the records and tapes could be imported without payment of the fee. It was noted that the fee was paid only if sales occurred in Canada and, therefore, if no such sales occurred, no fee would be payable. Furthermore, Polygram argued that the triggering event for the payment of the fee occurred subsequent to the importation of the records and tapes. Thus, it was Polygram's position that there was no liability to pay the fee as a condition of importing the records and tapes. Finally, counsel for Polygram again referred the CITT to U.S. Customs Service Ruling 543733 where it was held that "the royalty payments...are not paid 'as a condition of the sale of the imported merchandise'...".

The Canadian Recording Industry Association submitted that there was "commercial severability" between the importation of the records and tapes and payment of the fee and, therefore, it could not be maintained that the fee was paid "as a condition of the sale of goods for export to Canada". It was the Association's position that because the fee was relevant to, and calculated upon, commercial transactions taking place in Canada, the fee had nothing to do with, and could not be a condition of, the sale of the records and tapes for export to Canada. In addition, the Association argued that s. 48(5)(a)(iv) of the *Customs Act* as well as Revenue Canada Customs and Excise memorandum D13-4-9 were drafted with the intent of implementing relevant portions of the *Agreement on the Implementation of Article VII of the General Agreement on Tariffs and Trade* (the "GATT Customs Valuation Agreement")[3]. As a result, the fee could not be a condition of the sale of the records and tapes for export since it was payable regardless of the geographic source of the imported goods.

Revenue Canada took the position that the fee was indeed a condition of the sale of the records and tapes for export to Canada. It was argued that the fact that the fee was incurred by Polygram subsequent to the time of importation should not preclude its value from being included as part of the "transaction value" of the records and tapes. Revenue Canada stated that because s. 48(5)(a)(iv) incorporates the intention of article 8 of the GATT Customs Valuation Agreement, payments that are incurred by Polygram subsequent to payments made at the time of importation must be added to the value of the goods where to do so would reflect the true transaction value of the goods. Furthermore, Revenue Canada argued that it was part of the agreement between Polygram and Polygram B.V. that Polygram be obliged to agree prior to the goods being imported that the fee be paid. Finally, Revenue Canada noted that, pursuant to the contract between Polygram and Polygram B.V., the fee was payable at the time of importation.

Reasons for Decision

The CITT found that because the Cust*oms Act* contemplated that the value for duty of goods includes the price "paid or payable", the fact that the fee is payable, "at the time of importation, sale of the goods or some other time, is therefore made irrelevant by the wording of the legislation".

In determining that the fee was a payment made "in respect of the goods", the CITT relied upon the testimony of industry witnesses to establish that the amount of the fee fluctuated based on the price at which a specific sound recording was sold and that the price of a record or tape varies according to the artist and the cost of producing the specific recording. As a result, the CITT concluded that a sufficient connection existed between each recording and the payment of the fee to hold that the fee was paid "in respect of the goods".

The CITT also ruled that the payment of the fee was a "condition of the sale of goods for export to Canada" and that, "without the signed fee agreement...Polygram would not have been able to purchase the records and tapes from its foreign affiliates and import them into Canada". The CITT concluded that the act of exporting the records and tapes to Canada was "inseparable from payment of the fee".

Polygram sought leave to appeal the CITT's decision to the Trial Division of the Federal Court. Leave was denied. Based on the potentially far-reaching implications of this decision with respect to the amount of customs duties at stake for Canadian companies which are engaged in the importation of goods, where fees similar to those at issue in this litigation are paid, one can expect that the conclusions reached by the CITT will be challenged in the near future. For this reason, it is safe to assume that the Polygram decision does not represent the final word regarding the interpretation of s. 48(5)(a)(iv).

As noted above, due to the rather vague wording of this statutory provision, further judicial consideration and interpretation is warranted. The court had opportunity to shed light on s. 48(5)(a)(iv) in *Signature Plaza Sport Inc.* v. *The Queen*[4] but failed to do so. It is submitted that, as a result of the CITT's rather cursory analysis of the *Customs Act* as it related to the facts at issue, the *Polygram* decision suffers from the same ills as the court's analysis in *Signature Plaza*. We must therefore look towards future decisions in the hope that the CITT will provide more detailed guidelines with respect to which royalty payments are liable to duty.

1 *Polygram Inc.* v. *The Deputy Minister of National Revenue for Customs and Excise; Canadian Recording Industry Association (Intervenor)*, Appeal Nos. AP-89-151 and AP-89-165 (CITT).

2 See Irish, *Customs Valuation in Canada* (Toronto: CCH Canada Ltd., 1985) at 188 and Sherman and Glashoff, *Customs Valuation* (Paris: ICC Publishing S.A., 1980) at 123.

3 April 12, 1979, GATT BISD. Supp. 26, at 116.

4 (1990), 1 T.T.R. 318, 3 T.C.T. 5120 (F.C.T.D.).

INTERNATIONAL TRADE LAW UPDATE

The following articles are taken from Update, *a newsletter published by the International Bar Association's Business Law Section (Committee on Antitrust and International Trade Law).*

AUSTRALIA

Anti-Dumping

In late 1992, the Government introduced into the Parliament amendments to the method for the calculation and collection of anti-dumping and countervailing duties. The amendments empower the Minister to impose initial "interim duties", quite early in the examination process. Then any initial dumping duty will apply regardless of the export price, but the importer will be able at a later stage to apply for a refund of any excess of duty paid. This differs remarkably from the present method where final dumping duties are imposed later and can be legitimately and immediately avoided by the exporter raising the export price to equal the predetermined "normal value".

Administrative Penalties

The Australian Law Reform Commission has released a report on the administrative (automatic) penalties system, which system has caused considerable disquiet since its introduction in 1989. That report recommends that, inter alia, penalties should apply to careless errors which have the effect of understating the amount of duty payable, penalties should be fixed at 50% of the amount of duty understated, there should be no penalties for errors except where the amount of the duty is understated and there should be a legislated minimum amount of understatement before penalties apply. Possibly in anticipation of the adoption of that report, the Australian Customs Service has announced new guidelines for dealing with remissions of penalties under the present system.

CANADA

Canadian Dumping Actions Increase Sharply Against U.S

There was a sharp increase in Canadian trade actions against U.S. exports in 1992 in the form of dumping complaints to Revenue Canada, affecting a wide range of products.

Under the *Canada-U.S. Free Trade Agreement* (FTA), regular customs duty on products of U.S. origin imported into Canada have been reduced or removed and will be completely eliminated by 1998. However, Canada's domestic laws relating to trade remedies, or "contingent protection" (anti-dumping, anti-subsidy/countervail and safeguard), can and will continue to apply under the FTA to imports from the U.S. Equally, U.S. trade remedy legislation continues to apply to Canadian exports to the U.S., a situation left unchanged by the proposed North American Free Trade Agreement (NAFTA).

The events of 1992 are a clear indication that Canadian manufacturers have now become more active users of Canadian trade remedy legislation to obtain contingent protection against imports from the U.S., particularly as it relates to dumping.

More than 80% of all dumping investigations commenced by Revenue Canada during 1992 involved U.S. exports to Canada, and covered a wide

range of resource and manufactured goods. This is the first time since dumping actions were subjected to GATT disciplines a quarter of a century ago (when proof of material injury to Canadian production was made a prerequisite for protection) that such a large proportion of Canadian dumping investigations have been targeted at imports from the U.S.

U.S. products affected by individual dumping investigations commenced by Revenue Canada in 1992 include products from categories as diverse as steel plate, steel sheet, gypsum wallboard, lettuce, tomato paste, and file folders.

In addition, Revenue Canada continues to enforce recent years' dumping determinations against U.S. products including oil well casing, carpet, electric induction motors, and frozen pot pies.

To date, the Canadian International Trade Tribunal (the Canadian equivalent of the U.S. International Trade Commission) appears sympathetic to the increased complaints of injury (occasioned at least in part by the FTA) claimed by the Canadian industry to be caused by dumping.

EUROPEAN COMMUNITIES

European Economic Area

On December 6, 1992, Switzerland decided in a referendum against the *European Economic Area Treaty* between the EC and the EFTA. As the ratification by all EC and EFTA States is required in the Treaty, it will now not enter into force. Negotiations between the EC and the remaining EFTA States have been taken up again to discuss the conditions under which the European Economic Area could be established without Switzerland. A meeting for signing an amending protocol to the Treaty which then needs to be ratified by all countries concerned is scheduled for February. It is planned that the new Treaty enters into force on July 1, 1993.

EEC/Japan

The EC and Japan have started formal discussions on the relations between the EC and Japan. It is aimed for establishing a working group to monitor Japan's growing trade surplus with the EC.

Anti-Dumping Developments

The following developments have taken place over the period July 1 to December 31, 1992.

Anti-dumping cases were initiated with respect to gum-rosin from China, low carbon ferro-chrome from Kazakstan, Russia and Ukraine, ethanolamine from the U.S.A., isobutanol from Russia, magnetic disks from Hong Kong and Korea, ferro-silicon from China and South Africa, ammonium nitrate from Belarus, Georgia, Lithuania, Russia, Turkmenistan, Ukraine and Usbekistan and colour television receivers from Malaysia, China, Korea, Singapore, Thailand and Turkey.

Provisional duties were imposed on outer rings of tapered roller bearings from Japan, deadburned magnesia from China, DRAMs from Korea, magnesium oxide from China as well as seamless pipes and tubes of iron or non-alloy steel from Croatia, Poland, Czechoslovakia and Hungary. Provisional duties were extended with regard to ball bearings from Japan and synthetic fibres from India and Korea.

Definitive anti-dumping duties were imposed on silicon metal from Brazil, car radios from Korea, calcium metal from China and the former USSR, potassium chloride from Belarus, Russia and Ukraine, cotton yarn from Brazil and Turkey and large electronic aluminium capacitors from Japan.

Definitive anti-dumping duties were modified with regard to 30mm ball bearings from Japan, video tapes from Hong Kong, mononatrium glutamate from Indonesia and Korea, DRAMs from Japan and polyester yarn from Taiwan, Turkey, Romania and the republics of Serbia, Montenegro and Macedonia.

Proceedings were terminated on wire-rod from Argentina, Egypt, Trinidad and Tobago, Turkey and former Yugoslavia, pig-iron from Turkey and seamless pipes and tubes of iron or non-alloy steel from Macedonia, Montenegro, Serbia, Bosnia-Hercegovina and Slovenia. An undertaking was accepted from a Polish producer in connection with the proceedings concerning ferro-silicon from Poland and Egypt.

In June 1992, the EEC published its annual report for 1991 on anti-dumping and anti-subsidies.

GATT

Uruguay Round

As of this writing (mid-January), prospects for an "early" conclusion to the Uruguay Round appear dim to non-existent. Although the U.S. and EC appeared to have resolved many differences over agriculture, market access and services at the end of November, the hard bargaining over the detailed elements to be included in the final package never seemed to get off the ground. Much remains to be done and there is little chance of an agreement in advance of the expiration of fast-track authority in the U.S. at the beginning of March.

Panel Disputes

In the regular GATT agenda, panel disputes continue to dominate the scene. The Director-General, in his biannual report emphasized that the non-implementation of panel reports remained one of the most serious problems in the dispute-settlement system. While the number of panel reports awaiting implementation had not increased, the average period of non-implementation had increased dramatically. In addition to focusing on the continuing dispute between the U.S. and EC over oilseeds, the Council has recently had to address such disputes as the U.S. secondary embargo on tuna imports from the EC, Austria's mandatory labelling of tropical timber and the EC's import regime for bananas.

UNITED STATES

NAFTA

President Bush, Mexican President Carlos Salinas de Gortari and Canadian Prime Minister Brian Mulroney signed the *North American Free Trade Agreement* (NAFTA) on December 17, 1992. It must now be ratified by each government.

President Clinton supports NAFTA. However, he wants to negotiate separate agreements to rectify perceived deficiencies in the areas of workers' rights and the environment. Clinton has assured President Salinas that he will not reopen NAFTA; however, he has not set a specific timetable for ratification and implementation of the agreement.

Export Controls and Trade Embargoes

Congress failed to reauthorize the *Export Administration Act* (EAA). Consequently, U.S. export controls will continue to be administered under the *International Emergency Economic Powers Act*. The EAA expired in September, 1990.

On October 23, 1992, President Bush signed the *Cuban Democracy Act*. The law expands the U.S. embargo against Cuba by prohibiting trade with Cuba by non-U.S. companies that are owned or controlled by U.S. companies. Prior to the Act, foreign subsidiaries of U.S. companies were permitted to engage in certain transactions with Cuba by obtaining licenses from the Treasury Department's Office of Foreign Assets Control.

Eastern Europe and the Former Soviet Union

The United States signed bilateral investment treaties with Armenia and Bulgaria on September 23, 1992.

The Commerce Department suspended uranium anti-dumping investigations of six former Soviet Republics following the negotiation of quantitative restraint agreements. Such settlements are relatively rare in U.S. proceedings.

U.S.-EC Trade Disputes

In a step forward for the Uruguay Round, the United States and the European Community settled major trade disputes over the EC oilseed subsidy and U.S. meat exports to the EC. The U.S. had threatened to retaliate against the oilseed subsidy. The meat dispute originated when the U.S. industry alleged that EC health standards for meat imports constituted an unfair trade practice. These disputes were the subject of petitions to the U.S. government under section 301 of the *Trade Act* of 1974.