

NETSCOUT SYSTEMS INC
Form SC 13D/A
February 10, 2006
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

SCHEDULE 13D/A

(Rule 13d-101)

(Amendment No. 2)

**INFORMATION TO BE INCLUDED IN STATEMENTS FILED PURSUANT
TO RULE 13d-1(a) AND AMENDMENTS THERETO FILED PURSUANT TO RULE 13d-2(a)**

NetScout Systems, Inc.

(Name of Issuer)

Common Stock, \$0.001 Par Value

(Title of Class of Securities)

64115 T 10 4

(CUSIP Number)

Narendra Popat

c/o NetScout Systems, Inc.

310 Littleton Road

Westford, Massachusetts 01886

(978) 614-4000

Edgar Filing: NETSCOUT SYSTEMS INC - Form SC 13D/A

Copy to:

Miguel J. Vega, Esq.

Sullivan & Worcester LLP

One Post Office Square

Boston, Massachusetts 02109

(617) 338-2448

(Name, Address and Telephone Number of Person Authorized to Receive Notices and Communications)

January 31, 2006

(Date of Event which Requires Filing of this Statement)

If the filing person has previously filed a statement on Schedule 13G to report the acquisition that is the subject of this Schedule 13D, and is filing this schedule because of Rule 13d-1(e), 13d-1(f) or 13d-1(g), check the following box [].

Note. Schedules filed in paper format shall include a signed original and five copies of the schedule, including all exhibits. *See* Rule 13d-7 for other parties to whom copies are to be sent.

¹ The remainder of this cover page shall be filled out for a reporting person's initial filing on this form with respect to the subject class of securities, and for any subsequent amendment containing information which would alter disclosures provided in a prior cover page.

(Page 1 of 8 Pages)

The information required on the remainder of this cover page shall not be deemed to be filed for the purpose of Section 18 of the Securities Exchange Act of 1934 (Act) or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act (however, see the Notes).

(Page 2 of 8 Pages)

1 NAMES OF REPORTING PERSONS

I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS (ENTITIES ONLY)

Narendra Popat

2 CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP
(SEE INSTRUCTIONS)

(a)
(b)

3 SEC USE ONLY

4 SOURCE OF FUNDS (SEE INSTRUCTIONS)

Not Applicable

5 CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED
PURSUANT TO ITEMS 2(d) or 2(e)

6 CITIZENSHIP OR PLACE OF ORGANIZATION

United States

7 SOLE VOTING POWER

**NUMBER OF
SHARES
BENEFICIALLY
OWNED BY
EACH
REPORTING
PERSON
WITH**

8 **1,498,535**
SHARED VOTING POWER

9 **823,197**
SOLE DISPOSITIVE POWER

10 **1,498,535**
SHARED DISPOSITIVE POWER

823,197

Edgar Filing: NETSCOUT SYSTEMS INC - Form SC 13D/A

11 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

2,321,732

12 CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11) EXCLUDES
CERTAIN SHARES (SEE INSTRUCTIONS)

[]

13 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)

7.4%

14 TYPE OF REPORTING PERSON (SEE INSTRUCTIONS)

IN

(Page 3 of 8 Pages)

1 NAMES OF REPORTING PERSONS

I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS (ENTITIES ONLY)

Jyoti Papat

2 CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP
(SEE INSTRUCTIONS)

(a)
 (b)

3 SEC USE ONLY

4 SOURCE OF FUNDS (SEE INSTRUCTIONS)

Not Applicable

5 CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED
PURSUANT TO ITEMS 2(d) or 2(e)

6 CITIZENSHIP OR PLACE OF ORGANIZATION

United States

7 SOLE VOTING POWER

**NUMBER OF
SHARES
BENEFICIALLY
OWNED BY
EACH
REPORTING
PERSON
WITH**

8 **1,381,943**
SHARED VOTING POWER

9 **625,536**
SOLE DISPOSITIVE POWER

10 **1,381,943**
SHARED DISPOSITIVE POWER

625,536

Edgar Filing: NETSCOUT SYSTEMS INC - Form SC 13D/A

11 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

2,007,479

12 CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11) EXCLUDES
CERTAIN SHARES (SEE INSTRUCTIONS)

[]

13 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)

6.4%

14 TYPE OF REPORTING PERSON (SEE INSTRUCTIONS)

IN

(Page 4 of 8 Pages)

This Amendment No. 2 to original Schedule 13D filed July 30, 2003 by Narendra Popat is being filed to reflect the transactions referenced in Item 3 below and to update certain other information.

Item 1. Security and Issuer.

The title of the class of equity securities of NetScout Systems, Inc., a Delaware corporation (the Company), to which this statement relates is the Company's common stock, par value \$0.001 per share (the Common Stock). The address of the principal executive offices of the Company is 310 Littleton Road, Westford, MA 01886.

Item 2. Identity and Background.

(a) This statement is being filed by Narendra Popat and Joyti Popat.

(b) The business address of Mr. Popat is c/o NetScout Systems, Inc., 310 Littleton Road, Westford, MA 01886. The residential address of Ms. Popat is 355 Pope Road, Concord, MA 01742.

(c) Mr. Popat serves as Chairman of the Board and Secretary of the Company, a provider of network management solutions. The address of the Company is 310 Littleton Road, Westford, MA 01886. Ms. Popat is a homemaker.

(d), (e) Mr. Popat and Ms. Popat have not, during the last five years, been (i) convicted in a criminal proceeding (excluding traffic violations or similar misdemeanors) or (ii) a party to a civil proceeding of a judicial or administrative body of competent jurisdiction and as a result of such proceeding were or are subject to a judgment, decree or final order enjoining future violations of, or prohibiting or mandating activities subject to, Federal or State securities laws or finding any violation with respect to such laws.

(f) Mr. Popat and Ms. Popat are citizens of the United States.

Item 3. Source and Amount of Funds or Other Consideration.

On January 31, 2006, The Jyoti N. Popat GRAT III 2003, distributed 916,171 shares of Common Stock of the Company to the Revocable Trust of Jyoti Popat (the Revocable Trust), a trust of which Ms. Popat is the sole trustee and has sole voting and dispositive control over the shares held by the Revocable Trust. The shares were transferred to the Revocable Trust without consideration. Immediately, after such transfer, the Revocable Trust transferred such 916,171 shares and an additional 83,829 shares of Common Stock of the Company to The Jyoti N. Popat GRAT IV 2005 (the GRAT IV), a trust of which neither Mr. Popat nor Ms. Popat has voting or dispositive control over the shares held by such

trust. The shares were transferred to the GRAT IV without consideration.

Item 4. Purpose of Transaction.

Mr. Popat and Ms. Popat have no plans or proposals that relate to or would result in any of the transactions described in subparagraphs (a) through (j) of Item 4 of Schedule 13D.

Item 5. Interest in Securities of the Issuer.

(a) Aggregate Beneficial Ownership: Mr. Popat beneficially owns an aggregate of 2,321,732 shares of Common Stock, which constitute approximately 7.4% of the 31,243,126 shares of Common Stock outstanding on February 3, 2006 (as provided by the Company). Ms. Popat beneficially

(Page 5 of 8 Pages)

owns an aggregate of 2,007,479 shares of Common Stock, which constitute approximately 6.4% of the 31,243,126 shares of Common Stock outstanding on February 3, 2006 (as provided by the Company).

Sole Voting or Dispositive Power: Mr. Popat has sole voting or dispositive power over 1,498,535 shares of Common Stock. Ms. Popat has sole voting or dispositive power over 1,381,943 shares of Common Stock.

Shared Voting or Dispositive Power: An aggregate of 333,717 shares of Common Stock are held by two trusts for the benefit of Mr. Popat's children, of which Mr. Popat is one of two trustees of each such trust; 340,000 shares of Common Stock are held by a family limited partnership, of which Mr. Popat and Ms. Popat are the general partners and trusts for the benefit of their children are limited partners; 149,480 shares of Common Stock are held by The HOPE Foundation USA 1999, a charitable trust, of which Mr. Popat and Ms. Popat are co-trustees; and 136,056 shares of Common Stock are held by two trusts for the benefit of Ms. Popat's children, of which Ms. Popat is one of two trustees of each such trust.

Disclaimed Beneficial Ownership: Mr. Popat may be deemed to beneficially own the 2,007,479 shares of Common Stock beneficially owned by his spouse, Ms. Popat. Mr. Popat disclaims beneficial ownership of 1,517,999 of such shares. Ms. Popat may be deemed to beneficially own the 2,321,732 shares of Common Stock beneficially owned by her spouse, Mr. Popat. Ms. Popat disclaims beneficial ownership of 1,832,252 of such shares.

The amounts beneficially owned by Mr. Popat and Ms. Popat do not include an aggregate of 130,000 shares of Common Stock held by The Popat Family Trust 2001, 1,000,000 shares held by the GRAT IV, 400,000 shares held by to a blind trust established by Mr. Popat in connection with a Rule 10b5-1 sales plan established by Mr. Popat. Neither Mr. Popat nor Ms. Popat have voting or dispositive power over the shares of Common Stock held by such trusts.

(b) Number of shares of Common Stock as to which Mr. Popat has:

(i) Sole power to vote or to direct the vote: 1,498,535

(ii) Shared power to vote or to direct the vote: 823,197

(iii) Sole power to dispose or to direct the disposition of: 1,498,535

(iv) Shared power to dispose or to direct the disposition of: 823,197

Number of shares of Common Stock as to which Ms. Popat has:

Edgar Filing: NETSCOUT SYSTEMS INC - Form SC 13D/A

- (i) Sole power to vote or to direct the vote: 1,381,943
- (ii) Shared power to vote or to direct the vote: 625,536
- (iii) Sole power to dispose or to direct the disposition of: 1,381,943
- (iv) Shared power to dispose or to direct the disposition of: 625,536

Mr. Popat and Ms. Popat share the power to vote or to direct the vote and the power to dispose or to direct the disposition of 340,000 shares of Common Stock held by a family limited partnership, of which Mr. Popat and Ms. Popat are the general partners and trusts for the benefit of their children are

(Page 6 of 8 Pages)

limited partners, and 149,480 shares of Common Stock are held by The HOPE Foundation USA 1999, a charitable trust, of which Mr. Popat and Ms. Popat are co-trustees.

Mr. Popat and Sharon Cohen, as the two trustees of trusts for the benefit of Mr. Popat's children, share the power to vote or to direct the vote and the power to dispose or to direct the disposition of 333,717 shares of Common Stock held in such trusts. Ms. Popat and Ms. Cohen, as the two trustees of trusts for the benefit of Ms. Popat's children, share the power to vote or to direct the vote and the power to dispose or to direct the disposition of 136,056 shares of Common Stock held in such trusts. The business address of Ms. Cohen is c/o Atlantic Trust Company, N.A., 100 Federal Street, Boston, Massachusetts 02110. Ms. Cohen is a employee of Atlantic Trust Company, N.A., a trust company. The address of Atlantic Trust Company is 100 Federal Street, Boston, Massachusetts 02110. To the knowledge of Mr. and Ms. Popat, Ms. Cohen has not, during the last five years, been (i) convicted in a criminal proceeding (excluding traffic violations or similar misdemeanors) or (ii) a party to a civil proceeding of a judicial or administrative body of competent jurisdiction and as a result of such proceeding was or is subject to a judgment, decree or final order enjoining future violations of, or prohibiting or mandating activities subject to, Federal or State securities laws or finding any violation with respect to such laws. Ms. Cohen is a citizen of the United States.

(c) Other than as discussed above at Item 3, Mr. Popat and Ms. Popat have not effected any transactions in shares of Common Stock during the past 60 days.

(d) No other person is known to have the right to receive or the power to direct the receipt of dividends from or any proceeds from the sale of the shares of Common Stock beneficially owned by Mr. Popat and Ms. Popat.

(e) Not Applicable.

Item 6. Contracts, Arrangements, Understandings or Relationships with Respect to Securities of the Issuer.

Mr. Popat and Ms. Popat are co-trustees of The HOPE Foundation USA 1999, a charitable trust dated November 19, 1999, which holds 149,480 shares of Common Stock. 340,000 shares of Common Stock are held by The Popat Family Limited Partnership dated August 21, 1997, of which Mr. Popat and Ms. Popat are the general partners and trusts for the benefit of their children are limited partners. Mr. Popat and Ms. Cohen are co-trustees of The Saagar Popat Trust and The Sajeev Popat Trust, each of which is dated August 21, 1997 and collectively hold 333,717 shares of Common Stock. Ms. Popat and Ms. Cohen are co-trustees of The Narendra Popat Family Trust f/b/o Saagar Popat and The Narendra Popat Family Trust f/b/o Sajeev Popat, each of which is dated December 1, 1995 and collectively hold 136,056 shares of Common Stock.

All of the shares of Common Stock held by the aforementioned trusts and family limited partnership are held for investment and estate planning purposes. No agreements exist with respect to the voting of the shares of Common Stock held by the aforementioned trusts and family limited partnership.

Item 7. Material to be Filed as Exhibits.

Edgar Filing: NETSCOUT SYSTEMS INC - Form SC 13D/A

Agreement to file joint Schedule 13D/A, dated September 29, 2005 (incorporated by reference to Exhibit 1 to the filing on Schedule 13D/A by Narendra Popat and Jyoti Popat, dated September 29, 2005).

(Page 7 of 8 Pages)

SIGNATURE

After reasonable inquiry and to the best of his knowledge and belief, the undersigned certifies that the information set forth in this statement is true, complete and correct.

Date: February 10, 2006

/s/ Narendra Popat
Narendra Popat

/s/ Jyoti Popat
Jyoti Popat

(Page 8 of 8 Pages)

presence of

Table of Contents

competitors in geographic areas which are smaller and therefore more appropriate than those set out in Telecom Decision CRTC 2006-15 and (ii) amends the forbearance criteria related to meeting certain quality of service indicators for incumbent local exchange carriers' wholesale services. The proposed order would also streamline the forbearance process and eliminate the winback and promotional restrictions in regulated and deregulated areas. The proposed variance of the CRTC decision will be published in the *Canada Gazette* and is subject to a 30-day public comment period. Although the proposed changes to the decision are positive for the Bell Canada companies, there can be no guarantee that the Cabinet will, in fact, issue the order. Moreover, there can be no guarantee that the order will not be amended prior to its issuance.

Commitment Under the CRTC Deferral Account Mechanism

On February 16, 2006, the CRTC issued Telecom Decision CRTC 2006-9, where it concluded on the ways that incumbent telephone companies should clear the accumulated balances in their deferral accounts. As required by the CRTC, on September 1, 2006, Bell Canada filed proposals with the CRTC to clear \$479.3 million from its deferral account. On November 30, 2006, the CRTC issued Telecom Public Notice CRTC 2006-15 initiating a proceeding to consider the proposals submitted by the incumbent telephone companies. The CRTC intends to issue a decision on this proceeding by December 2007. If approved by the CRTC, the proposals would improve access to communications for persons with disabilities and extend broadband access to some 220,000 potential customers in 264 communities across Ontario and Quebec where it would not otherwise be made available on a commercial basis. Due to the nature and number of uncertainties which remain concerning the disposition of accumulated balances in the deferral accounts, we are unable to estimate the impact of the decision on our financial results at this time. Please refer to BCE Inc.'s 2006 Third Quarter MD&A dated October 31, 2006 under the heading *Liquidity Commitment under the CRTC Deferral Mechanism*, for more information on Bell Canada's and Bell Aliant's commitment under the CRTC deferral mechanism.

Price Cap Framework Review

On May 9, 2006, the CRTC issued Telecom Public Notice CRTC 2006-5 initiating a proceeding to establish the price cap framework to replace the existing framework that ends May 31, 2007. On July 10, 2006, Bell Canada, Bell Aliant and Saskatchewan Telecommunications filed a pricing framework proposal which reflects the dramatic changes that have taken place in the industry. The proposed framework would come into effect on June 1, 2007 and apply for a period of two years.

The above-mentioned entities proposed that there should be no regulatory limits on price increases in areas where services are available over alternative facilities, allowing consumers and competition in these areas to drive market prices. In areas where alternative facilities are not available, the above-mentioned entities proposed that service prices remain subject to regulation with upward pricing capped, on average, at current levels. In keeping with both the recommendations of the Telecom Policy Review Panel issued in March 2006 and the recent draft policy direction for the CRTC outlined by the Minister of Industry, the proposed regulation would interfere with market forces to the least extent possible. The entities' evidence was subject to an interrogatory process as

Table of Contents

well as a public hearing which took place in October 2006. The CRTC intends to issue a decision on this proceeding by April 30, 2007.

There is a risk that the CRTC may not accept the entities' proposals to rely on market forces to the maximum extent possible and may impose limitations on the Bell Canada companies' marketing flexibility, impeding their ability to respond to market forces.

Competitor Digital Network (CDN) Service

On February 3, 2005, the CRTC released Telecom Decision CRTC 2005-6 on CDN services. This decision set the rates, terms and conditions for the provision of digital network services by Bell Canada and the other incumbent telephone companies to their competitors. The CRTC determined that CDN services should include not only digital network access components but also intra-exchange facilities, inter-exchange facilities in certain metropolitan areas, and channelization and co-location links (expanded CDN services). This decision affected Bell Canada and Bell Aliant as providers of CDN services in their own operating territories and as purchasers of those services elsewhere in Canada.

There are two important financial aspects to note in this decision:

the prices for all CDN services were applied on a going-forward basis, as of the date of the decision, and Bell Canada will be compensated from the deferral account for the revenue losses from this decision

Bell Canada will also be compensated through the deferral account for applying reduced rates retroactively for the CDN access components that were tariffed at interim rates prior to the decision.

Retail quality of service indicators

On March 24, 2005, the CRTC released Telecom Decision CRTC 2005-17 which, among other things, established the rate adjustment plan to be applied when incumbent telephone companies do not meet mandated standards of quality of service provided to their retail customers. As a result of this decision, incumbent telephone companies are subject to a penalty mechanism when they do not meet one or more service standards for their retail services. For Bell Canada, this maximum potential penalty amount equates to approximately \$239 million annually, based on 2005 revenues.

In the penalty period of January 1 to December 31, 2005, the CRTC standard for several indicators was not met on an annual average basis because of the strike in 2005 by the CEP at Entourage. Bell Canada has requested that the CRTC approve its December 5, 2005 application for the purpose of excluding below standard strike-related results as a *force majeure* type exclusion. However, there is no assurance that the CRTC will issue a favourable decision and Bell Canada may be required to pay a penalty of up to \$18 million. It is not expected that Bell Canada will be required to pay any penalties related to retail quality of service for the period of January 1 to December 31, 2006.

The CRTC determined that Bell Aliant did not meet certain service standards during the period of January 1 to December 31, 2004. Bell Aliant applied to the CRTC for an exclusion from having to pay a penalty in 2004, as well as in 2005, due to below-standard

Table of Contents

service results caused by its labour disruption in 2004. In Telecom Decision CRTC 2006-27, which was issued on May 16, 2006, the CRTC determined that the labour disruption was partially, but not totally, beyond the control of Bell Aliant. In total, Bell Aliant was directed to provide customer credits totalling \$3.5 million on its customers monthly bills starting no later than June 16, 2006. These customer credits have been applied.

At the same time, Bell Aliant has filed with the CRTC an application to review and vary Decision 2005-17, as applied in Decision 2006-27, so as to indicate that when quality of service is negatively affected by a labour stoppage, the CRTC will only impose penalties where a telephone company has been found to have violated labour relations law or policy, or that it has deliberately sacrificed quality of service to increase profits. The application also seeks a remedial order to recover the cost of the credits already provided to customers. It is likely that the CRTC will not deal with Bell Canada's December 5, 2005 application until it reaches a decision on Bell Aliant's review and vary application. Furthermore, the Federally Regulated Employers' Transportation and Communications (FETCO), a national organization representing employers and employer associations across Canada, filed a petition with the Governor-in-Council to vary and rescind Decision 2006-27 on the basis that it oversteps the CRTC's jurisdiction and puts at risk well balanced and well defined Canadian labour relations policies and law.

Decision on VoIP Regulation

On May 12, 2005, the CRTC released Telecom Decision CRTC 2005-28 which determined the way the CRTC will regulate VoIP services. The CRTC determined that VoIP services (other than peer-to-peer services, defined in the decision as IP communications services between two computers) provided by Bell Canada and other incumbent telephone companies will be regulated in the same way as traditional telephone services.

As a result of this decision, local VoIP services that use telephone numbers that conform to the North American numbering plan, and that provide universal access to and/or from the public switched telephone network will, for incumbent telephone companies, be treated as regulated local exchange services. Accordingly, tariffs have to be filed by incumbent telephone companies, but not by their competitors, when they provide customers with local VoIP services using a telephone number associated with that incumbent telephone company's territory. In addition, the winback rules will apply, which means that incumbent telephone companies cannot attempt to directly contact a former residential local service customer for a period of 3 months from the time the customer decides to buy traditional local telephone service or VoIP service from a competitor. Other restrictions on promotions and bundling that apply to traditional local wireline services also apply to VoIP. These regulatory requirements could reduce Bell Canada's and Bell Aliant's flexibility to compete with both traditional and new competitors, which could have a material and negative effect on their business and results of operations.

Table of Contents

Also as a result of Decision 2005-28, incumbent telephone companies as well as competitive local exchange carriers will have to fulfill, in relation to VoIP services, other requirements that apply to traditional telephone services, such as:

- allowing customers to keep their local number when they change service providers within the same local area (local number portability)
- allowing customers to use any long distance provider of their choice
- listing telephone numbers in the directory associated with the local telephone number chosen by the customer
- offering services for the hearing impaired
- implementing safeguards to protect customer privacy.

These regulatory requirements could increase operational costs and reduce Bell Canada's and Bell Aliant's flexibility to compete with resellers, and could therefore have a negative effect on their business and results of operations. Bell Canada and several other parties petitioned the Governor in Council to overturn the CRTC's decision in August 2005. In Order in Council P.C. 2006-305, dated May 4, 2006, the Governor in Council referred Decision 2005-28 back to the CRTC for reconsideration, directing the CRTC to complete its reconsideration by September 1, 2006. The CRTC initiated Public Notice CRTC 2006-6 to undertake this reconsideration.

On September 1, 2006, the CRTC issued Telecom Decision CRTC 2006-53, reaffirming its findings in Decision 2005-28 concerning regulation of VoIP services. Pursuant to section 12(7) of the *Telecommunications Act*, the Governor in Council, if it chooses to do so, has 90 days to vary or rescind the CRTC's findings. Coincident with Decision 2006-53, the CRTC issued Telecom Public Notice CRTC 2006-12, in which it is seeking comments regarding whether the market share forbearance criterion threshold of 25 percent for local exchange services set out in Telecom Decision CRTC 2006-15 is appropriate, among other issues.

In 2005 and 2006, Bell Canada introduced four retail VoIP services in Québec and Ontario, Bell Digital Voice (BDV), BDV Lite, Business IP Voice for Broadband and Business IP Voice Standard. These services are offered pursuant to tariffs that have received interim approval from the CRTC, and in the case of BDV Lite, final approval. CRTC public processes relating to these filings were held in 2005 and 2006 and decisions on final approval of the tariffs for BDV, Business IP Voice for Broadband and Business IP Voice Standard are expected by the end of 2006. The CRTC has permitted Bell Canada to file VoIP tariff notices for the CRTC's approval, on a confidential basis, which provide for minimum and maximum rates associated with each proposed VoIP service plan. Once the minimum and maximum rates are approved, for all future price changes within that range, Bell Canada can issue new tariff pages on their effective date. No additional CRTC approvals are required for price changes within the ranges. The CRTC has also, on an interim basis, permitted Bell Canada to price its BDV service differently on a province-wide basis in Ontario and Québec. A final decision from the CRTC regarding these tariff notices could result in a different outcome, and could therefore have a negative effect on our business and results of operations.

Table of Contents

On November 16, 2006, the Governor in Council issued Order in Council P.C. 2006-1314 essentially requiring the CRTC to refrain from price regulation of retail local access-independent VoIP services, such as BDV Lite and Business IP Voice for Broadband.

Forbearance from Regulation of Local Exchange Services

On April 6, 2006, the CRTC issued Telecom Decision CRTC 2006-15 which established a framework for the forbearance from regulation of local exchange services. The decision denied Bell Aliant's application for regulatory forbearance in 32 exchanges in Nova Scotia and Prince Edward Island. The denial of Bell Aliant's forbearance application in respect of the Halifax market is the subject of an appeal to the Federal Court of Appeal by Bell Aliant. The Federal Court of Appeal granted Bell Aliant leave to appeal the decision in an order dated September 22, 2006. On May 12, 2006, Bell Canada, Bell Aliant, Saskatchewan Telecommunications and TELUS Communications Company (TELUS) filed a petition to the Governor in Council requesting that the Minister of Industry recommend to the Governor in Council that Decision 2006-15 be referred back to the CRTC for reconsideration. Specifically, the companies requested that the CRTC be directed to reconsider the pre-forbearance, forbearance and post-forbearance rules in Decision 2006-15 in light of the conclusions and recommendations contained in the Telecom Policy Review Panel's Final Report issued in March 2006.

On June 16, 2006, the CRTC issued Telecom Public Notice CRTC 2006-9, in which it sought comments regarding whether mobile wireless services, or a subset thereof, should be considered in the market share loss calculation for local forbearance analysis purposes. On September 1, 2006, the CRTC issued Telecom Public Notice CRTC 2006-12 in which it sought comments regarding whether the transitional market share loss threshold of 20 percent as a precondition to the repeal of the winback rule and the market share loss threshold of 25 percent for forbearance established in Decision 2006-15 are appropriate.

On October 5, 2006, TELUS applied to the CRTC to review and vary one of the forbearance criteria defined in Decision 2006-15. TELUS' application requests that the CRTC remove or amend the forbearance criteria related to meeting certain quality of service standards related to incumbent local exchange carriers' wholesale services. There is no guarantee that the outcomes in any of these proceedings will improve the likelihood or speed with which Bell Canada and Bell Aliant will be granted forbearance for local exchange services.

Winback Rules

On April 6, 2006, the CRTC issued three decisions relating to winbacks, namely Telecom Decisions CRTC 2006-15, 2006-16 and 2006-17.

In Decision 2006-15, the CRTC reduced the length of the no-winback period for residential subscribers to 3 months from 12 months. Under the amended winback rule, incumbent telephone companies are now precluded from contacting former residential and business local exchange service customers from the time of the local service request

Table of Contents

until 3 months after their local service is transferred to a competitor. In Decision 2006-15 the CRTC also ruled that incumbent telephone companies may apply to have the winback rule repealed in any local market where they have lost 20% market share and in which they have met the relevant competitor quality of service indicators in the 3 months preceding the date of the application. This aspect of Decision 2006-15 could have a positive impact on the business performance of the Bell Canada companies. In Telecom Decision CRTC 2006-72, the CRTC denied an application by Primus Telecommunications Canada Inc. to review Decision 2006-15 and extend the no winback period for residential subscribers back to the previous one year period.

In Decision 2006-16, the CRTC determined that the winback rule is constitutional because it is justifiable under the *Canadian Charter of Rights and Freedoms*. The CRTC also decided that, going forward, incumbent telephone companies are now permitted to market non-residential local telecommunications services to a former local exchange customer during, and following, the 3 month no-winback period, if that customer did not switch those other services to the competitor at the same time they migrated their local service.

In Decision 2006-17, the CRTC determined that Bell Canada had violated the winback rule when it sent former local residential customers a thank-you card that contained an invitation to customers to call Bell Canada if they required assistance and provided a contact telephone number for doing so. Bell Canada amended its customer thank-you cards to ensure compliance with Decision 2006-17. On June 16, 2006, Québecor Media Inc. (Québecor) complained to the CRTC that Bell Canada's amended customer appreciation cards violate the winback rule on the basis that they contain a summary of the winback rule and inform customers that the rule does not prohibit customers from contacting Bell Canada. In Telecom Decision CRTC 2006-69, the CRTC denied Québecor's complaint and ruled that the amended cards do not violate the winback rule.

On May 5, 2006, Bell Canada, Bell Aliant, Saskatchewan Telecommunications, and TELUS filed leave to appeal applications with the Federal Court of Appeal on the basis that the winback aspects of these decisions infringe the constitutionally-protected freedom of expression of the applicants and their customers under the *Canadian Charter of Rights and Freedoms* in a manner that is not justifiable under the *Charter*. The Federal Court of Appeal granted leave to appeal each of these three decisions on the constitutionality issue in an Order dated September 22, 2006. Bell Canada's and Bell Aliant's flexibility to compete may continue to be encumbered if the Federal Court of Appeal determines that the winback rule is constitutional because it is justifiable under the *Charter*.

On May 18, 2006, the CRTC released Telecom Decision CRTC 2006-28, *Regulatory issues related to the implementation of wireless number portability*. In that decision the CRTC confirmed that the winback restrictions on incumbent telephone companies do not apply to a wireline-to-wireless port request by a customer in the context of wireless number portability such that there will be no restrictions on the ability of either Bell Canada or Bell Mobility to contact a wireline or wireless customer that has transferred to a competitor.

Table of Contents

Price floor safeguards for retail services

On April 29, 2005, the CRTC issued its decision on price floor safeguards and related issues. A price floor safeguard is the minimum price that an incumbent telephone company can charge for regulated services.

In its decision, the CRTC made changes which, in some circumstances, may result in future higher price floors for new services and bundles that could negatively limit Bell Canada's and Bell Aliant's ability to compete.

Application to change bundling rules

On September 2, 2005, Bell Canada applied to the CRTC to modify the bundling rules that apply to customer specific arrangements (CSAs). CSAs are arrangements tailored to a particular customer's needs for the purpose of customizing the offering in terms of rate structure and levels.

The CRTC currently requires any CSA involving both tariffed and non-tariffed services (Mixed CSAs) to be filed for approval with the CRTC before it can be provided to customers. Bell Canada's proposal would exempt a Mixed CSA from the bundling rules and associated tariff requirements if:

total revenue from the CSA is higher than the price of the tariffed components of the CSA

the CSA is not part of a practice designed to circumvent tariffs.

Bell Canada's and Bell Aliant's flexibility to compete may continue to be encumbered if the proposal is not approved.

Telecom Policy Review Panel's Final Report

On March 22, 2006, the Telecom Policy Review Panel (Panel), a panel of experts appointed by the Minister of Industry to review Canada's telecommunications policy and regulatory framework and make recommendations, released its final report. The report, which contains over 100 recommendations, calls for significant changes to the structure and nature of telecommunications regulation in Canada.

The Panel's report calls for many changes to the regulatory environment which could have a material impact on the business performance of the Bell Canada companies. The thrust of the report is that the state of competition in Canada has progressed to the point where, at least for economic regulation, the CRTC should remove most of its existing regulation and instead rely on market forces.

The Panel calls for short-term changes to regulation through a variety of Government programs and, more significantly, through a policy direction – an instrument whereby the Cabinet can give binding directions of general policy to the CRTC. The Panel also calls for significant changes to the *Telecommunications Act*.

The Panel also recommended that there be a relaxation of Canada's foreign ownership restrictions as they apply to telecommunications common carriers. In addition to the recommendations addressing wireline regulation, the Panel also made a number of

Table of Contents

recommendations separately addressing issues related to wireless regulation in Canada. These included, among other things, a recommendation for the continued use of regulatory mechanisms such as spectrum caps (aggregation limits) where spectrum is scarce to provide an opportunity for new entrants to acquire spectrum in order to have an expanded choice of service providers. Other recommendations concerning competitive access to wireless antennae sites and support structures could serve to facilitate competitive entry into the Canadian wireless industry. If implemented, the cumulative effect of such recommendations could affect the competitive intensity of the wireless environment in which the Bell Canada companies operate.

There can be no guarantee that the Minister of Industry and Parliament will implement the Panel's recommendations in whole or in part. However, the Minister has announced that he intends to implement the Panel's report through a draft policy direction, as well as propose new legislation. The text of the draft policy direction is discussed in the next section.

Policy Direction

On June 13, 2006, the Minister of Industry tabled in both houses of Parliament a draft policy direction to be issued by the Cabinet to the CRTC. The draft policy direction calls on the CRTC to rely on market forces to the maximum extent feasible and to design regulations that interfere with the operation of competitive market forces to the minimum extent necessary. Among other things, the draft policy direction would require the CRTC to conduct a review of its rules which force incumbent telephone companies to provide wholesale access to certain telecommunication services to competitors. The purpose of the review would be to determine which wholesale services are not essential and should be phased out. The regulatory impact statement that accompanied publication of the draft policy direction stated that maintaining the current regulatory framework is not a viable option... and that the proposed direction is designed to rectify that by guiding the CRTC toward reduced and more targeted regulation that will reduce regulatory cost and burden. The direction does not direct the CRTC to reach any particular outcomes on any specific files.

Before a direction from Cabinet can be implemented, it must sit in each house of Parliament for 40 sitting days, and be subject to public consultation. The public consultation process occurred in the third quarter of 2006. Furthermore, the 40 sitting days have passed and the Government is now in a position, if it so chooses, to formally issue the direction. However, the Standing Committee on Industry, Science and Technology of the House of Commons issued a recommendation to the Government requesting that the Government impose a moratorium on implementing instructions respecting telecommunications policies to allow the Committee to hear more witnesses and subsequently present a report to the House on the impact of deregulation, no later than March 1, 2007. This recommendation is not binding on the Government and there is now no legal impediment to the Government issuing the direction. Although the policy direction is positive for the Bell Canada companies, there can be no guarantee that the Cabinet will, in fact, issue the direction. Moreover, there can be no guarantee that the policy direction will not be amended prior to its issuance.

Review of regulatory framework for wholesale services

Table of Contents

On November 9, 2006, the CRTC released Public Notice CRTC 2006-14 in which it initiated a comprehensive review of the regulatory framework for wholesale services. As part of this review, the CRTC will examine the appropriate definition of essential services and the pricing principles for such services. In addition, the regulatory treatment for non-essential services, if any, will also be examined. A final decision is expected in July 2008. Although the potential outcome may be positive for the Bell Canada companies, there is no guarantee that the CRTC will issue a favourable decision.

Bell ExpressVu

On June 12, 2006, the CRTC initiated a proceeding to review the regulatory framework for over the air broadcasters. Among the issues to be addressed is the possibility of requiring cable and satellite operators to pay over the air broadcasters for the right to carry their signals. Under the current copyright and regulatory framework, the signals are carried at no charge to the cable and satellite operators. Bell ExpressVu will argue vigorously against the fee-for-carriage concept. Submissions were filed on September 27, 2006 and a public hearing occurred in November and December 2006. A decision from the CRTC requiring cable and satellite operators to pay over-the-air broadcasters for signal carriage could have a negative effect on our business and results of operations.

Access to Bell Canada loops for Competitor Local Exchange Carriers customers served via remotes

On September 2, 2005, Rogers Telecom submitted an application requesting that the CRTC direct Bell Canada to make unbundled loops, which are transmission paths between the users premises and the central office that are provided separately from other components, available to competitors in a timely manner in certain specified areas where Rogers Telecom is present. On October 3, 2005, Bell Canada responded to Rogers Telecom's application and explained the reasons why in some areas where competitors are present and the competitors potential end customer is served via a Bell Canada remote, unbundled loops should not have to be provided unless Bell Canada is compensated by competitors for the costs it incurs on their behalf.

The cost to equip Bell Canada's network in order to provide unbundled loops to competitors in locations where a potential competitor's end customer is currently served via a Bell Canada remote could be significant should the CRTC grant Rogers Telecom's request. It is anticipated that the CRTC will institute a further process to examine this matter prior to rendering a decision.

Wireless number portability

The Government of Canada in its 2005 Budget announced that it intended to ask the CRTC to implement wireless number portability. Number portability enables customers to retain the same phone number when changing service provider within the same local serving area. On December 20, 2005, the CRTC released Telecom Decision 2005-72. Among other things, the decision directed Bell Mobility, Rogers Wireless and Telus Mobility to implement wireless number portability in Alberta, British Columbia, Ontario and Quebec by March 14, 2007. This accelerated timeframe will be challenging for Bell Mobility and the rest of the wireless industry to meet. The CRTC requires quarterly reports on the status of wireless number portability implementation.

Table of Contents

On February 6, 2006, the CRTC issued Telecom Public Notice 2006-3, *Regulatory issues related to the implementation of wireless number portability*, a proceeding to address a wide range of issues associated with the implementation. A decision on this proceeding was issued on May 18, 2006. In Telecom Decision CRTC 2006-28, *Regulatory issues related to the implementation of wireless number portability – Follow-up to Public Notice 2006-3*, the CRTC made a number of policy determinations, but did not consider that there was sufficient information on the record of the proceeding to make any determinations on issues relating to the tariffs for interconnection between incumbent telephone companies and wireless service providers or incumbent network-related start-up costs for wireless number portability. In an application dated May 12, 2006, Bell Canada requested that it be allowed to recover wireline costs related to the implementation of wireless number portability through a drawdown from Bell Canada's deferral account. Bell Canada filed reply comments on June 26, 2006. The CRTC has requested further information from Bell Canada on its application and responses were filed on December 4, 2006.

Licences

Companies must have a spectrum licence to operate cellular, PCS and other radio-telecommunications systems in Canada. The Minister of Industry awards spectrum licences, through a variety of methods, at his or her discretion under the *Radiocommunication Act*.

While we expect that the licences under which Bell Mobility and Bell Canada provide cellular and PCS services will be renewed at term, there is no assurance that this will happen. Industry Canada can revoke a company's licence at any time if the company does not comply with the licence's conditions. While we believe that we comply with the conditions of our licences, there is no assurance that Industry Canada will agree. Should there be a disagreement, this could have a material and negative effect on the Bell Canada companies.

Wireless and radio towers

In February 2005, Industry Canada released a report concerning its procedures for approving and placing wireless and radio towers in Canada, including the role of municipal authorities in the approval process. Among other things, the report recommends that the authority to regulate the siting of antennae and supporting structures remain exclusively with the Government of Canada. In August 2005, Industry Canada presented a revised draft policy for comment. The wireless and broadcasting industries both have a number of concerns with the draft policy and are now working with Industry Canada to attempt to resolve these concerns. However, there has been no recent activity on this issue and it is not possible to predict at this time if or when the final policy will be issued. If the final policy requires more municipal or public consultation in the approval process, there is a risk that it could significantly slow the expansion of wireless networks in Canada. This could have a material and negative effect on the operations of the Bell Canada companies.

Mobile spectrum

Industry Canada has signalled its intention to initiate a consultation which will result in the licensing of additional mobile spectrum, likely through a spectrum auction, in the 1.7

Table of Contents

GHz and 2.1 GHz bands. The consultation may be initiated as early as the fourth quarter of 2006 followed by a spectrum auction occurring as early as the third quarter of 2007. It is anticipated that this consultation will be open to potential new entrant wireless service providers. In addition, Industry Canada's consultation may also consider the adoption of policies such as new entrant spectrum allocation, tower sharing and digital roaming requirements that could, if adopted, facilitate both the entry and participation of additional competitors in Canada's wireless market. Such a development would heighten the degree of competition in the already highly competitive wireless segment and could erode current margin levels. The outcome of Industry Canada's consultation could have a material and negative effect on the operations of Bell Canada's wireless business.

Federal Government's announcement on income trust structures

Bell Aliant and the Bell Nordiq Income Fund (Bell Nordiq) are structured as income trusts. On October 31, 2006, the federal Government announced significant changes to the tax treatment of income trusts. For income trusts that were publicly traded before November 2006, as is the case for Bell Aliant and Bell Nordiq, these changes, which effectively include the taxation of trust income at corporate rates and the taxation of distributions made to unitholders as if they were dividends from a corporation, will be delayed to 2011. The Government specified that this transitional delay in implementing the new rules is subject to the possible need to foreclose inappropriate new avoidance techniques. For example, the Government stated that while there is now no intention to prevent existing income trusts from normal growth during that transitional period, any undue expansion of an existing income trust could cause this to be revisited.

Legislation that will implement these measures has not been made public so there is uncertainty as to the reach of this announcement. As an example, the ability of income trusts to issue units, including for financing purposes or to make acquisitions, is unclear, as the Government did not define what constitutes normal growth and undue expansion. It is therefore possible that the 2011 start date of the new tax measures for existing income trusts may be jeopardized, which would result in the earlier application of these measures. As a result, the growth of Bell Aliant and Bell Nordiq could be materially hampered.

Cash distributions made by Bell Aliant are not guaranteed and may fluctuate with the performance of the business

Although Bell Aliant intends to make cash distributions to its unitholders, including BCE, there can be no guarantee regarding the amounts of these cash distributions, which may fluctuate with Bell Aliant's performance. The actual amount of distributions paid by Bell Aliant will depend upon numerous factors which are susceptible to a number of risks and other factors beyond the control of Bell Aliant or BCE. Bell Aliant also has the discretion to establish cash reserves for the proper conduct of its business. Adding to these reserves in any year would reduce the amount of cash otherwise available for distributions in that year. Accordingly, there can be no assurance regarding the actual levels of distributions by Bell Aliant.

Revenue from major customers

Table of Contents

A significant amount of revenue earned by Bell Canada's Enterprise unit comes from a small number of major customers. If we lose contracts with any of these major customers and cannot replace them, or they no longer require our services because of their adoption of new technologies, it could have a material and negative effect on our financial results.

Competition Bureau's investigation concerning system access fees

On December 9, 2004, Bell Canada was notified by the Competition Bureau that the Commissioner of Competition had initiated an inquiry under the misleading advertising provisions of the *Competition Act* concerning Bell Mobility's description or representation of system access fees (SAFs) and was served with a court order, under section 11 of the *Competition Act*, compelling Bell Mobility to produce certain records and other information that would be relevant to the Competition Bureau's investigation. Bell Canada has complied with the court order and provided the requested information.

Bell Mobility charges monthly SAFs to its cellular subscribers to help it recover certain costs associated with its mobile communications network. These costs include maintenance costs, the cost of installing new equipment and retrofitting new technologies, and fees for spectrum licences. These costs also include the recovery of the contribution tax the CRTC charges to support telephone services in rural and remote areas of Canada.

Bell Mobility may be subject to financial penalties by way of fines, administrative monetary penalties and/or demands for restitution of a portion of the SAFs charged to cellular subscribers if it is found to have contravened the misleading advertising provisions of the *Competition Act*.

Potential legislation restricting in-vehicle use of cellphones

Some studies suggest that using cellphones while driving may result in more motor vehicle collisions. It is possible that this could lead to new regulations or legislation banning the use of handheld cellphones while driving, as it has in Newfoundland and Labrador and in several U.S. states, or other restrictions on in-vehicle use of wireless devices. If any of these happen, cellphone use in vehicles may decline, which may negatively affect the business of the Bell Canada companies.

Health concerns about radio frequency emissions

It has been suggested that some radio frequency emissions from cellphones may be linked to certain medical conditions. Interest groups have also requested investigations into claims that digital transmissions from handsets used with digital wireless technologies pose health concerns and cause interference with hearing aids and other medical devices. This could lead to additional government regulation, which could have a material and negative effect on the business of the Bell Canada companies. In addition, actual or perceived health risks of wireless communications devices could result in fewer new network subscribers, lower network usage per subscriber, higher churn rates, product liability lawsuits or less outside financing being available to the wireless communications

Table of Contents

industry. Any of these could have a material and negative effect on the business of the Bell Canada companies.

Bell ExpressVu

Bell ExpressVu currently uses four satellites, Nimiq 1, Nimiq 2, Nimiq 3 and Nimiq 4-Interim, for its video services. Nimiq 4-Interim became operational at the end of February 2006. Telesat, a subsidiary of BCE Inc., operates or directs the operation of these satellites.

Satellites are subject to significant risks. Any loss, failure, manufacturing defects, damage or destruction of these satellites, of Bell ExpressVu's terrestrial broadcasting infrastructure, or of Telesat's tracking, telemetry and control facilities to operate the satellites, could have a material and negative effect on Bell ExpressVu's results of operations and financial condition. Please see *Risks that could affect certain BCE group companies - Telesat* for more information on the risks relating to Telesat's satellites.

Bell ExpressVu is subject to programming and carriage requirements under CRTC regulations. Changes to the regulations that govern broadcasting could negatively affect Bell ExpressVu's competitive position or the cost of providing its services. Bell ExpressVu's DTH satellite television distribution undertaking licence was renewed in March 2004 and expires on August 31, 2010. While we expect this licence will be renewed at term, there is no assurance that this will happen.

Bell ExpressVu and Bell Canada continue to face competition from unregulated U.S. DTH satellite television services that are sold illegally in Canada. In response, they are participating in legal actions that are challenging the sale of U.S. DTH satellite television equipment in Canada. This competition could have a material and adverse impact on the business of Bell ExpressVu and Bell Canada.

Bell ExpressVu faces a loss of revenue resulting from the theft of its services. Bell ExpressVu introduced a smart card swap for its authorized digital receivers that is designed to block unauthorized reception of Bell ExpressVu's signals. The smart card swap was introduced in phases and was completed in July of 2005. As with any technology-based security system, it is not possible to eliminate with absolute certainty a compromise of that security system. As is the case for all other pay television providers, Bell ExpressVu has experienced, and continues to experience, ongoing efforts to steal its services by way of compromise of Bell ExpressVu's signal security systems.

On October 28, 2004, the Court of Québec ruled in *R. v. D Argy and Theriault (D Argy Case)* that the provisions in the *Radiocommunication Act* making it a criminal offence to manufacture, offer for sale or sell any device used to decode an encrypted subscription signal relating to the unauthorized reception of satellite signals violate the freedom of expression rights enshrined in the *Charter*. On March 31, 2005, the Québec Superior Court overruled the Court of Québec's decision in the *D Argy Case* and held that the Court of Québec improperly ruled on the constitutional validity of those provisions in the *Radiocommunication Act* based on facts not before the Court. On September 26, 2006, the Québec Court of Appeal upheld the decision of the Québec Superior Court. The

Table of Contents

defendants in the *D Argy Case* are now seeking leave to appeal the ruling of the Québec Court of Appeal to the Supreme Court of Canada. It remains a criminal offence throughout Canada to manufacture, offer for sale or sell any device used to engage in the unauthorized reception of satellite signals. While it is unlikely that the Supreme Court of Canada will grant leave to appeal to the defendants in the *D Argy Case*, should leave to appeal be granted and should the ruling of the Québec Court of Appeal be overruled by the Supreme Court of Canada and Parliament does not enact new provisions criminalizing the unauthorized reception of satellite signals, Bell ExpressVu could face increasing loss of revenue from the unauthorized reception of satellite signals.

TELESAT

Satellite industry risks

Satellites utilize highly complex technology and operate in the harsh environment of space and therefore are subject to significant operational risks while in orbit. The risks include in-orbit equipment failures, malfunctions and other kinds of problems commonly referred to as anomalies. Telesat's satellites may suffer from other problems that could reduce their commercial lives. Acts of war, terrorism, magnetic, electrostatic or solar storms, space debris or micrometeoroids could also damage Telesat's satellites. Additionally, due to the specialized nature of the Ka-band payload on Telesat's Anik F2 satellite, its largest and most expensive satellite, and the fact that it is partially uninsured and that no alternate satellite capacity is available, a partial or complete failure of Anik F2 could result in the total loss of revenues associated with this service with no restoration possible.

Any single anomaly or series of anomalies or other failure (whether full or partial) of one of Telesat's satellites could cause its revenues, cash flows and backlog to decline materially, could require Telesat to repay prepayments made by customers of the affected satellite and could materially and adversely affect its relationships with current customers and its ability to attract new customers for satellite services. A failure could result in a customer terminating its contract for service on the affected satellite. It may also require that Telesat expedite its planned replacement program, adversely affecting its profitability, increasing its financing needs and limiting the availability of funds for other business purposes. Finally, the occurrence of anomalies may adversely affect Telesat's ability to insure satellites at commercially reasonable premiums, if at all, and may cause insurers to carve out additional exclusions in policies they issue.

Launch failures

Satellites are subject to certain risks related to failed launches. Launch vehicles may fail. Launch failures result in significant delays in the deployment of satellites because of the need to construct replacement satellites, which typically takes up to 30 months or longer, and to obtain another launch vehicle. Such significant delays could materially and adversely affect operations, revenues, cash flows and backlog. Although Telesat has had launch insurance on all of its launches to date, should Telesat not be able to obtain launch insurance on reasonable terms and a launch failure were to occur, Telesat could directly suffer the loss of the cost of the satellite and related costs.

Table of Contents

Construction and launch delays

The launch of satellites is subject to certain delays. Launch delays can result from the delays in the construction of satellites and launch vehicles, the periodic unavailability of reliable launch opportunities, possible delays in obtaining regulatory approvals and launch failures. If satellite construction schedules are not met, a launch opportunity may not be available at the time the satellite is ready to be launched. Delays in the commencement of service could enable customers who have contracted for transponder capacity to terminate their contracts, could affect plans to replace an in-orbit satellite prior to the end of its useful life, could result in the expiration or cancellation of launch insurance and could result in the loss of orbital rights. The failure to implement a satellite deployment plan on schedule could have a material adverse effect on Telesat's financial condition and results of operations.

Market for satellite insurance

Telesat's current satellite insurance does not protect it against all satellite-related losses that it may experience, and it does not have in-orbit insurance coverage for all of the satellites in its fleet. Typically, Telesat does not insure against all possible partial failures. The insurance will not protect Telesat against business interruption, lost revenues or delay of revenues. Telesat's existing launch and in-orbit insurance policies include, and any future policies that it obtains can be expected to include, specified exclusions, deductibles and material change limitations. Any failure of a revenue-producing satellite, whether insured or not, could require additional, unplanned capital expenditures or an acceleration of planned capital expenditures, and may result in interruptions in service, a reduction in contracted backlog and lost revenue, any of which could have a material adverse effect on Telesat's results of operations, business prospects and financial condition.

The price, terms and availability of satellite insurance has fluctuated significantly in recent years. These fluctuations can be affected by recent satellite launch or in-orbit failures and general conditions in the insurance industry. Launch and in-orbit policies on satellites may not continue to be available on commercially reasonable terms or at all. To the extent Telesat experiences a launch or in-orbit failure that is not fully insured, or for which insurance proceeds are delayed or disputed, it may not have sufficient resources to replace the affected satellite. In addition, higher premiums on insurance policies increase Telesat's costs, thereby reducing its profit. In addition to higher premiums, insurance policies may provide for higher deductibles, shorter coverage period, higher loss percentages required for constructive total loss claims and additional satellite health-related policy exclusions.

Telesat may elect to reduce or eliminate insurance coverage relating to certain of its existing satellites, or elect not to obtain insurance policies for its future satellites, especially if exclusions make such policies ineffective or the costs of coverage make such insurance impractical or if the use of back-up transponders and self-insurance is deemed more effective.

Table of Contents

Ground operations infrastructure failures

Telesat owns and operates an extensive ground infrastructure. These ground facilities are used for the provision of end-to-end services for Telesat's customers.

Telesat may experience a partial or total loss of one or more of these facilities due to natural disasters, fire, acts of war or terrorism or other catastrophic events. A failure at one of these facilities would cause a significant loss of service for Telesat's customers. Additionally, Telesat may experience a failure in the necessary equipment at the satellite operations center, at the back-up facility, or in the communication links between these facilities and remote teleport facilities. A failure at one of Telesat's facilities or in the communications links between Telesat's facilities could cause Telesat's revenues and backlog to decline materially and could adversely affect its ability to market its services and generate future revenues, its profitability, its financing needs and its ability to use available funds for other purposes.

Business risks

For the nine months ended September 30, 2006, two customers together accounted for approximately 38% of Telesat's revenues, and its top five customers together accounted for approximately 48%. Any of Telesat's major customers could refuse to renew their contracts, or could seek to negotiate concessions, particularly on price, that would have a material adverse effect on Telesat's business, financial condition and results of operations.

There are a limited number of manufacturers that are able to design and build satellites according to the technical specifications and standards of quality Telesat requires, as is the number of agencies able to launch such satellites. The loss of any of Telesat's manufacturers or launch agencies could result in the delay of the design, building or launch of its satellites. Even if alternate suppliers for such services are available, Telesat may have difficulty identifying them in a timely manner, it may incur significant additional expense in changing suppliers, and this could result in difficulties or delays in the design, manufacturing or launch of its satellites. Any delays in the design, building or launch of our satellites could have a material adverse effect on Telesat's business, financial condition and results of operations.

Telesat's provision of services into the South American markets is subject to certain risks such as changes in foreign government regulations and telecommunication standards, licensing requirements, tariffs, taxes and other matters. Telesat's South American operations are also subject to risks associated with economic and social instability, regulatory and licensing restrictions, exchange controls and significant fluctuations in the value of foreign currencies.

Competition risks

Telesat provides point-to-point and point-to-multipoint services for voice, data and video communications and for high-speed Internet access. Telesat competes against other global and regional satellite operators and against suppliers of ground-based

Table of Contents

communications capacity. Some of Telesat's direct and indirect competitors, both those in and outside of the satellite industry, have greater financial resources and operating flexibility than it does. This may permit them to respond better to changes in the industry. Telesat's primary business activities (broadcast, business networks and carrier services) have been largely dedicated to the Canadian domestic market. This market is characterized by increasing competition and rapid technological development among satellite providers. Telesat also faces significant and intensifying competition in the satellite industry in both North America and South America. Telesat's business is also subject to competition from ground based forms of communications technology. For many point-to-point and other services, the offering provided by terrestrial companies can be more competitive than the services offered via satellite. Telesat's failure to compete effectively would result in a loss of revenue and a decline in profitability, a decrease in the value of its business and a downgrade of its credit rating, which would restrict its access to the capital markets.

Demand risks

The market for fixed satellite services may not grow or may shrink due to downturns in the economy and competing technologies that provide lower cost or better service. As a result, Telesat may not be able to attract customers for the services that it is providing as part of its strategy to sustain its business. Decreasing demand could reduce the number and value of Telesat's contract renewals and could have a material adverse effect on its business and results of operations going forward.

Developments that Telesat expects to support the growth of the satellite service industry, such as continued growth in data traffic and the proliferation of high definition television, may fail to materialize or may not occur in the manner or to the extent Telesat anticipates. For example, the sale or license of the Ka-band capacity represents a new area of business which may not be adopted as Telesat expects.

Regulatory risks

Telesat is subject to the laws of Canada and the regulation of regulatory authorities of the Canadian government, primarily the CRTC and Industry Canada, as well as the laws and regulations of countries to, from or within which Telesat provides services. Such laws and regulations may limit or prohibit Telesat's ability to sell its services in certain markets. In addition, the laws, regulations and practices of some countries may make it harder for Telesat to compete against a domestic or regional satellite system operator from that country. Telesat needs to renew its spectrum licenses upon expiry. Furthermore, Telesat's spectrum licenses are subject to periodic review during the term of the license. Telesat's radio licenses also need to be renewed on an annual basis.

If Telesat fails to obtain or maintain particular approvals on acceptable terms, such failure could delay or prevent Telesat from offering some or all of its services and adversely affect its results of operations, business prospects and financial condition.

In fiscal 1999, the U.S. State Department published amendments to the International Traffic in Arms Regulations which included satellites on the list of items requiring export

Table of Contents

permits. These provisions have constrained Telesat's access to technical information and have had a negative impact on its international consulting revenues.

Provision of services into Latin American markets could be materially adversely affected by changes in applicable government regulations and telecommunication standards, licensing requirements, tariffs, taxes and other matters. Latin American operations are also subject to risks associated with economic and social instability, regulatory and licensing restrictions, exchange controls and significant fluctuations in the value of applicable currencies.

Foreign exchange risk

A substantial portion of Telesat's capital expenditures is in U.S. dollars. Telesat's satellite insurance policies are also denominated in U.S. dollars. The currency denomination of its revenue and earnings that may be received from satellite infrastructure investments is subject to individual customer contractual arrangements. As a result, Telesat may become exposed to foreign exchange risks which it attempts to mitigate through the use of forward currency contracts.

-35-