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## Canada

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# *Member States Developments*

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## *Canada*

### **I. Introduction**

The preservation of Canadian culture has been at the center of recent controversies between Canada and the United States. The first controversy involves the removal of Nashville-based Country Music Television (CMT) from Canadian cable systems in favor of the new Canadian-based New Country Music. The second controversy surrounds Canada's desire to tax ad revenues generated by the Canadian edition of *Sports Illustrated*. A third, less-publicized desire of Canada is to impose a tax on blank cassettes sold in Canada thereby diverting the revenue to Canadian artists. These actions have been taken in the name of preserving Canadian culture from drowning in a flood of American "cultural" products. From the perspective of the United States, these actions seem more commercial in nature than cultural.

This update will focus on these controversies and the relevant rules and policies that surround them. There are provisions in both the North American Free Trade Agreement (NAFTA)<sup>1</sup> and the Canada-United States Free Trade Agreement (CFTA)<sup>2</sup> that exempt cultural industries from the general provisions of these agreements. These provisions are the basis for support of the actions that Canada has taken and their applicability and implications will be discussed below. Finally, the future importance of cultural exemptions as they relate to the possible secession of Quebec from Canada and also to the expansion of uses of various technologies will be covered.

### **II. The Controversies**

This section will outline the facts of three controversies surrounding Canada's cultural initiatives. The basic policy behind these actions will be briefly highlighted, but a more complete discussion of policy issues will be presented in section on rules and policies that follows this factual outline.

#### **A. COUNTRY MUSIC TELEVISION**

Country Music Television (CMT), based in Nashville and owned by Westinghouse Electric Corporation, was taken off Canadian airwaves on January 1, 1995. CMT made its Canadian debut in 1984 and was reaching approximately two million Canadian viewers through 450 cable companies when the Canadian Radio-television and Telecommunications Commission (CRTC) removed the station from the air. The station was taken off the

1. North American Free Trade Agreement, drafted Aug. 12, 1992, revised Sept. 6, 1992, U.S.-Can.-Mex., 32 I.L.M. at 605 (entered into force Jan. 1, 1994) [hereinafter *NAFTA*].
  2. U.S.-Canada Free Trade Agreement, Jan. 2, 1988, U.S.-Can., 27 I.L.M. 281 [hereinafter *CFTA*].
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air as a result of a similar Canadian service being licensed and put on the air. The new channel, New Country Music, is owned by the Canadian company Rawlco and Rogers Communications.

After finding no relief in the Canadian court system, CMT filed a petition with the United States Trade Representative (USTR), Ambassador Mickey Kantor's office, protesting its eviction and alleging that the Canadian action violates the investment provisions of the NAFTA.<sup>3</sup> Kantor wrote a letter to Canadian Trade Minister Roy MacLaren stating that the eviction was unacceptable and asking the Canadian government to review the CRTC decision.<sup>4</sup> The USTR viewed the action as a confiscation of investments that CMT had made while servicing and developing its Canadian market over the ten year period that it had been operating.<sup>5</sup> MacLaren's response stated that Canada had always reserved its rights to make policies and maintain the regulatory regime which promotes Canadian culture, expression, and values, and cited provisions of the CFTA<sup>6</sup> and the NAFTA<sup>7</sup> as support.<sup>8</sup>

Led by CMT, an eight-member broadcast industry group demanded that Washington hit Canada with \$750 million in trade sanctions in retaliation for its protectionist cultural policies.<sup>9</sup> The \$750 million represented what the eight complainants claim they could earn annually in Canada without cultural restrictions.<sup>10</sup> The cultural exemption clauses of the CFTA and the NAFTA could allow for blockage of Canadian exports of an equivalent value from entering the United States.<sup>11</sup> Some of CMT's allies directly share its concerns about the actions of the CRTC. The Nashville Network, Court TV, The Travel Channel, and The Weather Channel all have a stake in the Canadian market, and complain that it is unfair that their access is limited or non-existent while Toronto-based MuchMusic has been able to enter the U.S. market without restrictions.<sup>12</sup>

A hint of potential retaliatory action has come in the form of a communication between Kantor and the Federal Communications Commission (FCC) in which Kantor has asked the FCC for information on all pending license applications from Canadian owned or controlled companies.<sup>13</sup> This suggests that Washington could move to block these Canadian companies from buying American cable television and other telecommunication systems. Telecommunication licenses held by Canadian companies cannot be revoked through a retaliatory move, but Washington can block all pending and future license bids.

A possible solution to the CMT case could come in the form of a partnership between CMT and New Country Music. CMT could strike a deal with New Country Music in which

3. Brooker Buckingham, *Canadian Country Barred: Nashville music station rejects artists without U.S. labels*, *Calgary Herald*, Jan. 10, 1995 at C5.
4. *Id.*
5. *Id.*
6. See CFTA, *supra* note 2, art. 2005.
7. See NAFTA, *supra* note 1, art. 2106 and annex 2106.
8. U.S. decries eviction of Country Music TV, *Calgary Herald*, Jan. 6, 1995 at G6.
9. Ian Austen, *U.S. Broadcasters Fight Back*, Mar. 10, 1995 at D7.
10. *Id.*
11. See CFTA, *supra* note 2, art. 2005(2).
12. Ian Austen, *U.S. Broadcasters fight back*, *Calgary Herald*, Mar. 10, 1995 at D7.
13. Ian Austen, *U.S. may block license bid*, *Calgary Herald*, Feb. 7, 1995 at A13.

it would acquire a twenty percent interest in the network—the maximum level allowed for foreign companies in Canadian broadcasters. Even if this partnership is formed, the underlying threat of the Canadian use of the cultural exemption is now out in the open and promises to remain a potential point of confrontation between Canada and the United States.

### **B. CANADIAN SPORTS ILLUSTRATED**

The *Sports Illustrated* controversy is the result of Canadian plans to impose an 80 percent excise tax on advert “split-run” edition is one tailored for Canadian advertisers but which contains predominantly recycled material from the original edition of the magazine. Because the costs of producing the editorial material has already been covered by the advertising revenue generated by the original edition, a publisher running a “split-run” edition can charge very low rates to Canadian advertisers. This siphons-off potential advertising revenue from Canadian domestic publishers who depend on such domestic advertising revenue to cover their costs.

When announcing the proposed tax in December, Canadian Heritage Minister Michel Dupuy cited the cultural exemption clauses in the CFTA and the NAFTA as justification. The *Sports Illustrated* and CMT controversies have been in the limelight and represent a preview of possible trade battles in the future involving Canada and the United States and the cultural exemption clauses of the CFTA and the NAFTA.

### **C. THE BLANK CASSETTE TAX**

Another move by Canada in the name of promoting its domestic culture is a proposed tax on the sale of blank cassettes. This tax has not attracted as much attention because there is not an entity which is directly targeted as in the CMT and *Sports Illustrated* cases. Instead, the plan is designed to be a type of subsidy for Canadian artists. Under the plan, Canada would impose a tax on blank cassettes with the proceeds going to Canadian artists.

The theory behind this plan is that these cassettes are used to record material from original works and thus their sale cuts into the total number of original works sold. Despite the fact that a significant portion of the work recorded onto these blank cassettes is from non-Canadian sources, all of the proceeds from the tax would go to benefit Canadian artists. Thus, while the sale of blank cassettes in Canada can negatively impact the sale in Canada of original works from a variety of sources, only the Canadian sources that are harmed would benefit from the tax.

With the current state of the Canadian economy and its need to cut costs, spending on items perceived as cultural in nature have been sacrificed. The taxation on blank cassettes gives the Canadian government a way in which to raise revenue for a particular cultural project (the subsidy of Canadian artists) through a seemingly logical source of revenue. The fact that non-Canadians are negatively impacted by the sale of blank cassettes in Canada and are not part of the group to benefit from the tax does not seem to be a source of concern to the Canadian government.

### III. The Rules and Policies Behind the Cultural Exemption

The economic integration of countries in bilateral pacts such as the CFTA and multi-national pacts such as the NAFTA can raise particular protectionist concerns by the individual nations which are a part of these pacts. Concerns over the protection of national security or over a valuable national resource are more the rule than the exception. Of particular concern to Canada during its negotiation of the CFTA and the NAFTA was the desire to preserve the distinct aspects of its national culture. This is a legitimate concern as a majority of Canada's population lives within one hundred kilometers of the border separating Canada from the most dominant cultural exporter in the world. With the formal economic integration of these countries by the signing of the two trade pacts, Canada sought a way to preserve some of its cultural identity.

The first way Canada sought to protect its cultural identity was a clause in the CFTA which attempted to exclude or exempt Canada's cultural industries from the general provisions of the pact.<sup>14</sup> While the term "cultural industry" could have a variety of meanings, the CFTA specifically defines which activities fall into the category of cultural industry for purposes of the pact.<sup>15</sup> These categories include print, audio, video, and broadcasting media. When the NAFTA was negotiated, Canada maintained the CFTA's cultural identity clause through an article and annex in Chapter 21.<sup>16</sup> The NAFTA also contains a definition of

14. CFTA, *supra* note 2, art. 2005(1). This article, entitled Cultural Industries states: Cultural industries are exempt from the provisions of this Agreement, except as specifically provided in Article 401 (Tariff Elimination), paragraph 4 of Article 1607 (divestiture of an indirect acquisition) and Articles 2006 and 2007 of this Chapter.

15. CFTA, *supra* note 2, art. 2012. This article entitled Definitions sets out the definition of "cultural industry" in its pertinent part: For purposes of this Chapter:

"cultural industry" means an enterprise engaged in any of the following activities:

- a) the publication, distribution, or sale of books, magazines, periodicals, or newspapers in print or machine readable form but not including the sole activity of printing or typesetting any of the foregoing,
- b) the production, distribution, or sale or exhibition of film or video recordings,
- c) the production, distribution, sale, or exhibition of audio or video music recordings,
- d) the publication, distribution, or sale of music in print or in machine readable form, or
- e) radio communication in which the transmissions are intended for direct reception by the general public, and all radio, television and cable television broadcasting undertakings and all satellite programming and broadcast network services.

16. NAFTA, *supra* note 1, art. 2106 and annex 2106. Article 2106 entitled Cultural Industries states: Annex 2106 applies to the Parties specified in that Annex with respect to cultural industries.

Annex 2106 states:

Notwithstanding any other provision of this Agreement, as between Canada and the United States, any measure adopted or maintained with respect to cultural industries, except as specifically provided in Article 302 (Market Access-Tariff Elimination), and any measure of equivalent commercial effect taken in response, shall be governed under this Agreement exclusively in accordance with the provisions of the Canada-United States Free Trade Agreement. The rights and obligations between Canada and any other Party with respect to such measures shall be identical to those applying between Canada and the United States.

“cultural industries” similar to the one in the CFTA.<sup>17</sup>

Maintenance of cultural identity through protective measures does not come without consequences, however. The CFTA provides that if a country adopts policies with respect to cultural industries that would otherwise be inconsistent with the CFTA, the other country may take retaliatory measures of equivalent commercial effect.<sup>18</sup> On top of this, such measures may be taken without first having to resort to the CFTA’s dispute settlement provisions.<sup>19</sup> The United States House of Representatives has interpreted this countermeasure provision to allow retaliatory response to Canadian actions even when these actions do not directly harm American concerns, but instead serve to subsidize Canadian industries. The House stated: “[i]t is assumed that such measures would be appropriate to allow the U.S. to retaliate against Canadian subsidies or other forms of assistance to Canadian cultural industries.”<sup>20</sup> Thus, Canada can take actions to protect and support its cultural industries, but opens itself up to the risks of retaliation. The implication of these rules is that the more offensive the actions to protect cultural industry are, the more likely retaliation will occur and the harsher and more targeted it will be.

Canada’s ousting of CMT from its airwaves has caused the biggest outcry. Speaking before the United States Council for International Business, Jack Valenti, President of the Motion Picture Association of America, characterized recent Canadian actions in the name of culture as an “infection” sweeping the world.<sup>21</sup> Valenti criticized the existence of the cultural exclusions and complained that Canada was operating “under the canopy, and perhaps they think the sanctity” of the CFTA when it removed CMT from the air.<sup>22</sup> Valenti went on to say that “[t]his infection has to do with the theory that if you baffle the entry of

17. NAFTA, *supra* note 1, art. 2107. Article 2107, entitled Definitions, states in its pertinent part: For purposes of this Chapter:

cultural industries means persons engaged in any of the following activities:

(a) the publication, distribution, or sale of books, magazines, periodicals, or newspapers in print or machine readable form but not including the sole activity of printing or typesetting any of the foregoing;

(b) the production, distribution, sale or exhibition of film or video recording;

(c) the production, distribution, sale, or exhibition of audio or video music recordings;

(d) the publication, distribution, or sale of music in print or machine readable form; or

(e) radio communications in which the transmissions are intended for direct reception by the general public, and all radio, television, and cable broadcasting undertakings and all satellite programming and broadcast network services.

18. CFTA, *supra* note 2, art. 2005(2) which reads: Notwithstanding any other provision of this Agreement, a Party may take measures of equivalent commercial effect in response to actions that would be inconsistent with this Agreement but for paragraph 1.

19. See CFTA, *supra* note 2, art. 2011 (which sets forth dispute settlement procedures to be followed in the case of impairment of benefits but expressly exempts Article 2005 from such procedures).

20. H.R. Rep. No. 816, 100th Cong., 2d Sess., pt. 7, 20 (1988).

21. Laura Eggerston, American Movie Mogul Seeks Curtains on Cultural Defences, Toronto Star, March 17, 1995, at B2.

22. *Id.*

other people's work into your country, that your culture, whatever it may be, will flourish and endure."<sup>23</sup>

But perhaps Valenti has the theory a bit muddled. The purpose is not so much to keep other cultures out as it is to set up the opportunity for your own culture to flourish. The CMT situation is perhaps the worst approach Canada could take since it is directly evicting an established presence in a segment of its cultural industry. CMT had been on the air in Canada since 1984 and is now having to cede its position to a domestic newcomer. The counter-argument to this is that CMT knew the possibility of this happening from the beginning. To some extent, if the goal was to promote Canadian country music artists, the plans backfired. CMT has banned Canadian artists (especially those that are not signed to American labels) from its playlists and thus some Canadian artists which were gaining important exposure to the American market are now relegated to a purely domestic one.

The *Sports Illustrated* controversy is a little less aggressive and a little more understandable than the CMT situation. Canada's proposed tax on advertising revenue derived from "split-run" publications directly addresses a perceived threat by the Canadian publishing industry. The tax does not prevent *Sports Illustrated* from doing business in Canada, but simply makes one of its products less competitive.

"Split run" publications represent a threat to the entire Canadian domestic publishing market if they are allowed to proliferate. By allowing American companies to siphon-off potential advertising revenue from Canadian publications by combining material that is published in another source with advertisers who want to reach a particular market, Canada would be encouraging other U.S. publishers to follow *Sports Illustrated's* lead. The economies-of-scale available to many American publishers combined with the fact that the editorial material for "split-run" editions has already been paid for by the "original" advertising revenue would allow American companies, as it did *Sports Illustrated*, to offer advertising rates that Canadian publishers could not profitably match. If enough American publishers followed the "split-run" system, many Canadian publishers would have a difficult time staying in business.

Canada's concern over the results of not addressing the *Sports Illustrated* situation was explained by Prime Minister Jean Chretien during a question-and-answer session after a speech to the American Society of Newspaper Editors in Dallas, Texas. In response to a question about why there is still a need for cultural protectionism, Chretien responded: "We need to know ourselves. You never talk about Canada. So if we let that happen without protecting ourselves we would read only about O.J. Simpson."<sup>24</sup> Specifically regarding split-run publications such as *Sports Illustrated*, Chretien stated that it is "a form of dumping."<sup>25</sup> He went on to say "[t]here is nothing Canadian in that magazine. They don't talk about curling in that."<sup>26</sup> These comments demonstrate that Canada is not desirous of receiving its culture from American sources.

The proposed tax on split-run publications is one way to prevent this from occurring. *Sports Illustrated* is not prevented from selling its magazine in Canada. In fact, even without split-run publication, *Sports Illustrated* can, and does, profitably sell in Canada. The only

23. *Id.*

24. Derek Ferguson, *Canada Will Guard Culture, PM Vows*, *Toronto Star*, April 7, 1995, at A12.

25. *Id.*

26. *Id.*

thing the tax does is cut off one source of *Sports Illustrated's* revenue in hopes that Canadian advertising dollars flow more readily to Canadian publishers. It is not a choice without some costs in Canada. By imposing the tax, the Canadian government would be choosing the needs of its publishing industry over the potentially more inexpensive advertising opportunities available to other segments of the Canadian economy. The tax on split-run publications cuts off a source of inexpensive advertising and forces those that choose to advertise in print to either choose Canadian publications or compete with all advertisers for advertising space in a more broadly distributed *Sports Illustrated* or equivalent publication.

The proposed tax on cassettes sets up a form of subsidy for Canadian artists. The theory behind taxing blank cassettes and distributing the proceeds to artists is that the artists' ability to sell their work is quantifiably hampered by the sale of blank cassettes. These cassettes allow for the duplicating of the recorded material as a substitute for purchasing the artistically recorded work. Non-Canadian artists (especially American) would argue that the proceeds from such a tax on blank cassettes are kept by those other countries' artists. The response to this is that some countries' artists (especially the United States) would suffer substantially more net losses than net gains.

One of the reasons that this tax on blank cassettes has not garnered as much attention as the banishing of CMT or the tax on split-run publications is that no entity is singled out as a loser in the process. While American artists are theoretical losers and those who ultimately bear the burden of the tax (the consumers of blank cassettes) are losers, the loss is nothing as substantial as being kicked off the air or having a profitable idea taxed out of existence. Retaliatory action by the United States seems possible but unlikely. Congress, as noted above, has discussed the possibility of taking retaliatory action against subsidies on cultural industries, but it seems unlikely that any action would be taken unless some manufacturer or distributor of blank cassettes or some group of American artists were harmed enough to call for action.

The proposal to tax blank cassettes for the benefit of Canadian artists comes at a time when the Canadian government is sending mixed signals about the support and protection it wants to give its culture. The actions against CMT and split-run publications indicate a strong stance, but Canadian fiscal policy would suggest otherwise. Earlier this year, as Canada's budgetary process was in its beginnings, Canada was dubbed as an "honorary member of the third world" by the *Wall Street Journal*.<sup>27</sup> The editorial bestowed this honor upon Canada because of the perceived unmanageability of its debt problem.<sup>28</sup> Cuts in spending were needed, and at least three have been at the expense of cultural industries (as defined by the CFTA and the NAFTA) or other aspects of Canadian culture.

Canada's public broadcaster, the Canadian Broadcasting Corporation (CBC) was heavily hit by budget cuts. The projected budget cuts for the broadcaster over the next three years total CAN\$345 million (\$255 million), or about 24 percent of its annual appropriation from the federal government. It also is facing a major review of its mandate. The cuts caused Anthony Manera, president of the CBC, to resign in protest after only one year on the job.

The book publishing industry in Canada also took a significant hit from the budgetary

27. Bankrupt Canada?, *Wall St. J.*, Jan. 12, 1995 at A14.

28. *Id.*



process. The two principal programs that aid Canadian publishers—the Book Industry Development Program and the Publication Distribution Assistance Program—are being combined into one program with their funding cut by about \$20 million or 50 percent. These cuts have been attacked as being unfair in two ways.<sup>29</sup> First, the publishers, which are losing half of their government funding, are having their funding cut back significantly more than other groups.<sup>30</sup> Second, publishers signed future contracts with authors and printers in reliance on a five-year government funding program that started in 1992 and was supposed to continue through 1997.<sup>31</sup> The editorial that made these points concluded by quoting Prime Minister Chretien from his Dallas speech (“If we want to have a personality of our own, we have to protect things that interest Canada”) and challenging him to start matching actions to words.<sup>32</sup>

One final portion of the budget that has come under attack as being unsupportive of Canadian culture is Ottawa’s decision to stop funding Harbourfront, a Toronto complex that attracts three million people a year to its theater events, author gatherings, and the like. Ottawa’s annual \$8 million in support was half of Harbourfront’s budget and it appears now that Harbourfront may close. Once again, the Toronto Star used Chretien’s “we have to protect things that interest Canadians” quote from his Dallas speech to criticize a perceived conflict between words and actions.<sup>33</sup>

The conclusion to the above actions seems to be that Canada is willing to take actions at the expense of American entities (CMT and *Sports Illustrated*) to promote its own culture, and is willing to find ways to subsidize its cultural industries (the blank cassette tax). At the same time, however, it appears that Canada is not hesitant to sacrifice its funding of various cultural entities to find its way out of the “third world”. The actions seem a bit contradictory and it seems that the Canadian government is doing as much if not more damage to the future of its cultural industries than the American entities that it sacrificed in the name of culture.

#### *IV. Future Applications of the Cultural Exemption*

With Canada’s recent actions that were made in the name of cultural preservation and the damage that the budgetary process appears to be doing to the same, it does seem likely that the Canadian government will find other areas in which to exercise its cultural exemption. These future arenas in what seems to be an endless and ongoing trade war between the United States and Canada are yet unknown, but there are two areas in which the cultural exemption may play an important role.

The first of these areas involves the possible secession of Quebec. If Quebec secedes, it is unclear where the new independent nation would fit in the scheme of the NAFTA. It is doubtful that it would be assumed that it is already a member having once been a province of a signatory nation. While Canada has consistently expressed a desire for a wide variety of

29. Unfair Cutbacks to Book Publishing, Toronto Star, Apr. 22, 1995, at A20.

30. *Id.*

31. *Id.*

32. *Id.*

33. Toronto Is Burning While PM Fiddles, Toronto Star, April 11, 1995, at A20.

countries (including some outside of the Western hemisphere) to be invited to join NAFTA, Quebec would not be high on that list. The United States seems to desire a unified Canada, but might favor the accession of Quebec to the NAFTA in favor of any other potential new signatory to the pact. However, the United States may be reluctant to expand NAFTA to any degree and might welcome the contraction that the secession of Quebec would bring.

If an independent Quebec were to accede to the NAFTA, it would come at a price. Part of that price that would be demanded by the United States would be a lack of the cultural exemption for Quebec. Prime Minister Chretien stated as much in a speech before a trade conference in Montreal in February: "American industries are angry that Canada negotiated an exemption for cultural industries. They will do their best to make sure that a separate Quebec doesn't win similar treatment."<sup>34</sup> Alan Rugman, a management professor at the University of Toronto and an expert on NAFTA agreed with Chretien's assessment, pointing to the protectionist mood in the current Republican Congress.<sup>35</sup> Thus it seems that Canada's current pushing of the envelope on its cultural exemption could stir enough trouble to cause an independent Quebec to accept an invitation to the NAFTA at the cost of giving up a cultural exemption.

Another potential envelope to be pushed in the cultural exemption debate centers on the developing Canadian information highway. Currently under the NAFTA, Canada cannot discriminate against computer on-line services because the NAFTA prevents governments from protecting domestic advance phone services. However, under the cultural exemption, broadcasters can be protected through regulation. The question has been raised about what happens when the on-line services start adding moving pictures. Could electronic newspapers and the like then be classified as broadcasters and thus subject to the cultural exemption?<sup>36</sup> The answer to this question could come once Canada attempts to begin regulating this convergence of phone and cable technology under its Broadcasting Act. If Canada attempts to do this, it is not likely to go unchallenged by the United States. The stakes are high and it is in both countries interest to see how far the cultural exemption can be pushed and to what extent it can be contained.

## V. Conclusion

In the first year that the NAFTA went into effect, the focus of the battles between Canada and the United States seemed to mainly be on traditional trade disputes in areas of agriculture and other typical "trade war" products. In this second year, the focus seems to have shifted to other areas of protectionist activity, with the cultural exemption taking center stage. Canada has taken the initiative in an area that had remained relatively dormant considering the potential uses that could be made of it. The cultural exemption has been a concession that certain American interests have been uncomfortable with since the signing of the CFTA.

The reason for this discomfort is now becoming evident. The Canadian government has taken or proposed a wide range of action. Some of these actions have directly affected

34. John Geddes, PM Warns Quebec of Tough NAFTA Talks, *Financial Times*, Feb. 11, 1995 at 4.

35. *Id.*

36. Alana Kainz, NAFTA Blurs Information Highway's Path, *Ottawa Citizen*, Jan. 18, 1995, at E3.

American commercial entities and have sent a warning to those entities that did not take the first hits. In addition, the potential for the use of the cultural exemption has not been fully realized yet. As technologies converge and the lines of categorization blur, the use of the cultural exemption can only become more controversial. It seems that Canada, which has often been seen as a loser in its trade pacts with the United States is finally making use of an area of the trade pacts in which it may have the upper hand.

—*Tim Baker and Tracey Wallace*