Vodacom (Pty) Ltd submission in response to the Portfolio Committee on Communications' invite to comment on the measures to reduce interconnection rates and the high cost of telecommunications in South Africa

INTRODUCTION

Vodacom (Pty) Ltd ("Vodacom") wishes to thank the Portfolio Committee on Communications ("the Committee") for the opportunity to comment on the measures to reduce interconnection rates and the high cost of telecommunications in South Africa.

Vodacom's written comments are structured as follows:

A. GENERAL COMMENTS -

1. Background.
2. Chapter 10 market review process.
3. Commercial bi-lateral negotiations to lower interconnection rates.
4. Use of benchmarks.

B. SPECIFIC COMMENTS-

1. Mobile and telecoms operators drop their interconnection rate with effect from 1 November 2009 to 60 cents per minute during peak times; and interconnection rates be further reduced by 15 cents annually on 1 November for each successive year until 2012.

2. As a general rule, the progressive reductions in interconnection rates between 2009 and 2012 should yield concomitant reductions in the actual consumer (retail) price of telecommunications.

C. CONCLUSION

A. GENERAL COMMENTS

1. BACKGROUND

Vodacom notes that the Committee, in the call for written submissions, stated that the Committee believes that "Interconnection rates in South Africa set at R1-25 per minute during peak times are exorbitant and excessive, resulting in extremely high telecommunications prices."

Mobile termination rates (MTRs) were agreed *via* commercial negotiations between affected operators as then determined in the Telecommunications Act of 1996[1] ("the Telecoms Act") and Independent Communication Authority of South Africa's (ICASA) Interconnection Guidelines. As a matter of fact all proposed adjustments to MTRs following commercial negotiations were approved by ICASA.

While MTRs may be arguably high, sight should not be lost of the levels of telephony penetration, and lately radio- based broadband, that South Africa – compared to peer markets with significantly lower MTRs – has achieved over the last decade. The World Economic Forum's Global Technology Report for 2008 - 2009[2] stated that "emerging countries [including South Africa] tend to get a number of things right such as high coverage levels and low minimum cost of ownership." Such countries that have achieved high mobile penetration levels tend to have very minimal cost of ownership resulting in the removal of barriers affecting access to communication services in developing countries. These barriers include: handsets costs, pervasive network coverage, SIM card costs and connection fees. South Africa's benign MTR regime has been one of the instruments that have enabled the mobile industry to significantly eliminate cost of ownership as a barrier to access. Moreover, this regime has also made it possible for mobile operators to maintain on their networks marginal subscribers who barely originate calls.

The Competition Commission (Commission) expressed a similar view in its submission to the Committee dated 11 September 2009 by declaring that high call termination

[1] Act no. 103 of 1996.
[2] The Global Information Technology Report 2008-2009 World Economic Forum, p. 68.

rates reduce the mobile operator's costs of acquiring customers. The Commission further stated that higher call termination rates are therefore to some extent passed back to consumers through lower monthly access fees or lower on-net call charges. This is one explanation for the rapid rise of mobile penetration in South Africa which has reached low income consumers in the prepaid market. The Commission also indicated that there are explanations for high call termination rates that are consistent with efficiency.[3]

In our view, the benign MTR regime was a deliberate policy initiative which was aimed at increasing access to communications services to all South Africans. To a great degree South Africa has been successful in this and maybe the time has now arrived for all role players to review our MTR regime and indeed Vodacom is keen to play a constructive role in this regard.

To the extent that the aforementioned policy objectives have not been met, particularly in respect of universal provision of access and service to communications services, other innovative strategies should be deployed to address the remaining gaps. Such measures should include the establishment of a framework for access to and utilization of the Universal Service & Access Fund ("USAF") to subsidize the roll-out of coverage and services to marginal rural areas which still remain under-serviced as contemplated under section 88 and 90 of the Electronic Communications Act No. 36 of 2005 ("the EC Act")[4].

<u>Vodacom further notes that the Committee believes that interconnection rates are "the consequence of apparent historical collusion between dominant mobile operators in the country … and the incapacity of ICASA to effectively regulate this matter."</u>

Vodacom draws the Committees attention to the confirmation, in the Committee hearings on 15 September 2009, by the Commission that there is no evidence – to date - that there has ever been collusion between the mobile operators in South Africa country. The Commission also pointed out in its submission to the Committee that the

[3] Competition Commission submission to Parliamentary Portfolio Committee on Telecommunications on high call termination charges dated 11 September 2009, paragraph 2.4 on page 9 and 10.

[4] The USAF is believed to have accumulated an amount in excess of approximately R1 billion over the past 12 years of its existence. This amount is collected by virtue of the statutory obligation imposed on licensees in the industry in terms of the EC Act to contribute 0,2% of their annual turnover to the USAF.

Interconnection Guidelines and regulations tacitly permit the operators to negotiate variations to the interconnection rate.[5]

The transition from the Telecoms Act to the EC Act necessitated an overhaul of telecommunications and broadcasting regulations as well as the licence conversion process. The work load that ICASA has had since the promulgation of the EC Act may have contributed to delays in finalising the section 67(4) regulations required by Chapter 10 of the EC Act. However, now that the licence conversion process and most of the basic regulations have been finalised, Vodacom is of the view that ICASA should be able to finalise the section 67(4) regulations without undue delay to enable them to conduct the required market review and ensure that any findings of market failure are addressed and proportionate remedies to correct market failure are imposed.

2. CHAPTER 10 MARKET REVIEW

2.1 Chapter 10 Competition Assessment: beneficial instrument

The Commission, in its submission to the Committee dated 11 September 2009 recommended that ICASA apply itself urgently but diligently to the matter of call termination consistent with the relevant provisions of Chapter 10 of the EC Act, discussed in more detail under paragraph 2.2 below.[6]

The Commission stated that although regulatory intervention in respect of mobile call termination rates may well be warranted, such intervention should take into account the waterbed effects of any arbitrary, unjustified and excessive reduction in call termination rates that may result in:[7]

- higher access charges;
- less discounts for on-net calls;
- higher prices for SMSs and data;
- increase in retail voice call charges for prepaid customers; and

[5] Competition Commission submission to Parliamentary Portfolio Committee on Telecommunications on high call termination charges dated 11 September 2009, paragraph 3 on page 16.
[6] Competition Commission submission to Parliamentary Portfolio Committee on Telecommunications on high call termination charges dated 11 September 2009, paragraph 4 on page 13.
[7] Competition Commission submission to Parliamentary Portfolio Committee on Telecommunications on high call termination charges dated 11 September 2009, paragraph 2.4 on page 9.

- warned that any regulatory intervention in mobile call termination rate setting should therefore be undertaken with a degree of caution.[8]

The Commission further suggested that in this regard it is necessary to determine an appropriate cost orientated level for termination rates. The determination as to an appropriate level for termination must be weighed against the competitive constraints that do exist as well as potential unintended and harmful consequences.[9]

In this regard the Commission indicated that the EC Act provides a sound framework in section 67(4) based on competition policy principles that will allow ICASA to determine appropriate and proportionate *ex ante* remedies. The Commission expressed the view that ICASA should conduct a thorough market study, consistent with the requirements of section 67(4) of the EC Act, in order to ensure that the appropriate regulatory intervention is applied.[10]

Vodacom agrees with the Commission's aforementioned approach and confirm that ICASA is mandated and best positioned by the EC Act to make determinations on MTRs by following the process prescribed in Chapter 10 of the EC Act. Parliament can continue to oversee ICASA's process to ensure that there are no inordinate delays in the finalisation of processes that will lead to the regulation of MTRs should market failure be found to exist.

The mobile communication industry is fundamental to South Africa's economy. An arbitrary and ill-considered intervention could have unintended consequences which could result in the disconnection of marginal customers who makes up at least 30% of our customer base.

2.2 Chapter 10 Competition Assessment process

The underlying steps of the market review process, that the section 67(4) "enabling" regulations inform and guide, are essentially summarised in four key steps:

[8] Competition Commission submission to Parliamentary Portfolio Committee on Telecommunications on high call termination charges dated 11 September 2009, paragraph 2.4 on page 10.
[9] Competition Commission submission to Parliamentary Portfolio Committee on Telecommunications on high call termination charges dated 11 September 2009, paragraph 4 on page 12.
[10] Competition Commission submission to Parliamentary Portfolio Committee on Telecommunications on high call termination charges dated 11 September 2009, paragraph 2.4 on page 10 and paragraph 2.5 on page 11.

1. Market definition
2. Determination of SMP
3. Assessment of the effectiveness of competition in relevant markets
4. Development and implementation of remedies (pro-competitive measures)

Vodacom's understanding of the Chapter 10 market review process and the interrelationship of the various aspects of the section 67(4) regulations is illustrated in Figure 1 below.

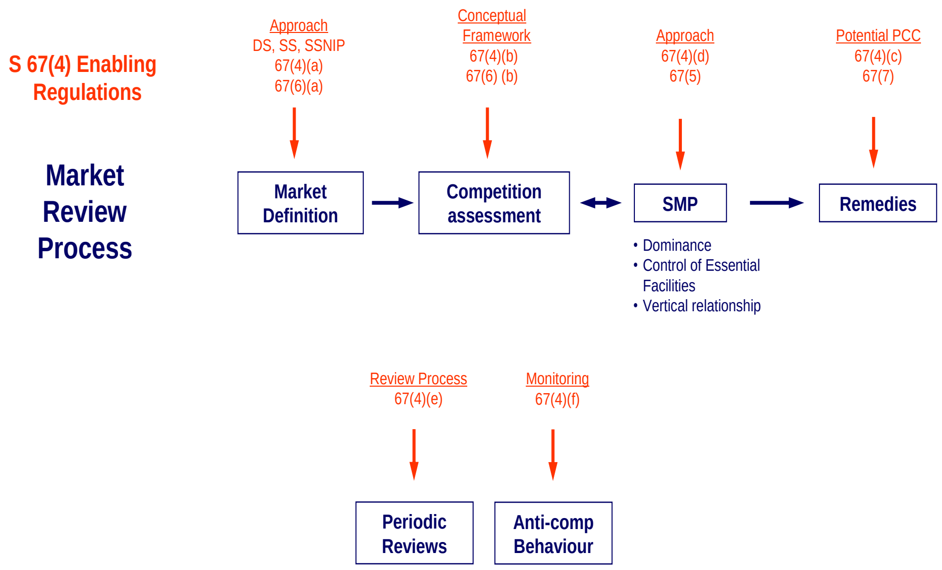

Figure 1: Overview of Chapter 10 Market review process

Vodacom is of the view that, if ICASA focuses on the above process and consults relevant stakeholders, any competition concerns in the telecommunication industry that anyone may have can be rapidly addressed. Vodacom therefore submits that ICASA failure to intervene in MTRs or any other market is not as a result of Chapter 10, but is probably a function of a lack of focus on the part of the regulator and other work pressures.

2.3 Progress to date

In January 2007 ICASA published a Discussion Document for comment on the wholesale call termination market definition process pursuant to section 4B of the ICASA Act[11], and in May 2007 held public hearings in this regard. Findings of this process were subsequently published in November 2007. In the findings document ICASA stated that the intention of the discussion document was to provide a stake in the ground as to the state of affairs regarding call termination market definitions and to provide the parameters of that market, which would still require definition in terms of section 67 of the EC Act.

Subsequently, in March 2008 ICASA published draft regulations in terms of section 67(4) to which written comments were provided and public hearings held in June 2008. However, to date these regulations have not been finalised and hence the market review process could not be concluded. Having the section 67(4) regulations in place is a critical first step in the market review process as these are the enabling regulations for ICASA to be able to conduct a proper market review process upon which subsequent findings and rulings can be made.

Vodacom reiterate that there is no reason why ICASA should not be able to finalise the section 67(4) regulations without undue delay to enable them to conduct the required market review and ensure that any findings of market failure will be addressed appropriately.

3. COMMERCIAL BI-LATERAL NEGOTIATIONS TO LOWER MTRs

Subsequent to ongoing public discussions around the cost of call termination in the country, ICASA met with representatives of Vodacom, MTN, Cell C, Telkom, Neotel and the Internet Service Providers Association (ISPA) during September 2009 to discuss possible reductions in termination rates. Acknowledging the public outcry on "high cost of communication", the meeting after extensive deliberations, resolved to:

[11] Act no. 13 of 2000 (as amended).

- embark on an industry led commercial process (outside of Chapter 10) to reduce mobile termination rates, with ICASA exercising an oversight responsibility;
- ensure that the commercial process to reduce termination rates takes into account the requirements of competition law;
- Conclude negotiations between the mobile operators by the end of December 2009, with ICASA proposing an implementation date of 1 February 2010.

The agreed process will result in a voluntary price reduction of mobile termination rates over an agreed time period (glide path) *via* bilaterally negotiated commercial agreements between the mobile call termination providers, with ICASA overseeing the process. Although commercially negotiated, ICASA will have to approve the bilaterally negotiated reduced mobile termination rates before they can be implemented.

Vodacom is of the view that the aforementioned process will bring a quicker outcome under the circumstances. Furthermore, ICASA will in parallel to the commercial process proceed to finalise the section 67(4) "enabling" regulations and conduct a Chapter 10 market review. The outcome of a properly conducted market review process will allow ICASA to adjust the commercially negotiated mobile termination rate to a regulated mobile termination rate set at an appropriate level to remedy the perceived market failure in the mobile wholesale termination market after the commercially agreed glide path period has ended.

4. USE OF BENCHMARKS

Vodacom submits that there is nothing inherently wrong with the use of international benchmarks and furthermore supports the use of benchmarks to obtain an initial indicative overview of markets. However, benchmarking is not a sound basis to justify regulatory interventions.

Benchmarks, do not always meet the criteria of transparency, objectivity, and accuracy. Flawed or biased benchmarks lead to ill-informed decisions.

There are inherent risks and limitations that need to be considered carefully. For example, some benchmarks contain material mathematical errors, include inappropriate and incompatible comparisons (e.g. comparing just peak tariffs with peak tariffs, while excluding off-peak or access charges).

<u>Example: biased benchmark</u>

Recently, an MTR benchmark was done and used as part of the MTR review in Namibia. Figure 12 on page 29 of the report indicates comparative MTRs in N$ and show that Namibia is the 'most' expensive in the sample.

What the study fails to illustrate is the total sample of countries that forms part of the source report published by the ERG (European Regulatory Group) on MTRs applicable within OECD countries. If the full sample was used Namibia would have ranked substantially better and just 12.7% above the average MTR of 0.94 N$, as indicated in expanded selection in Figure 2 below.

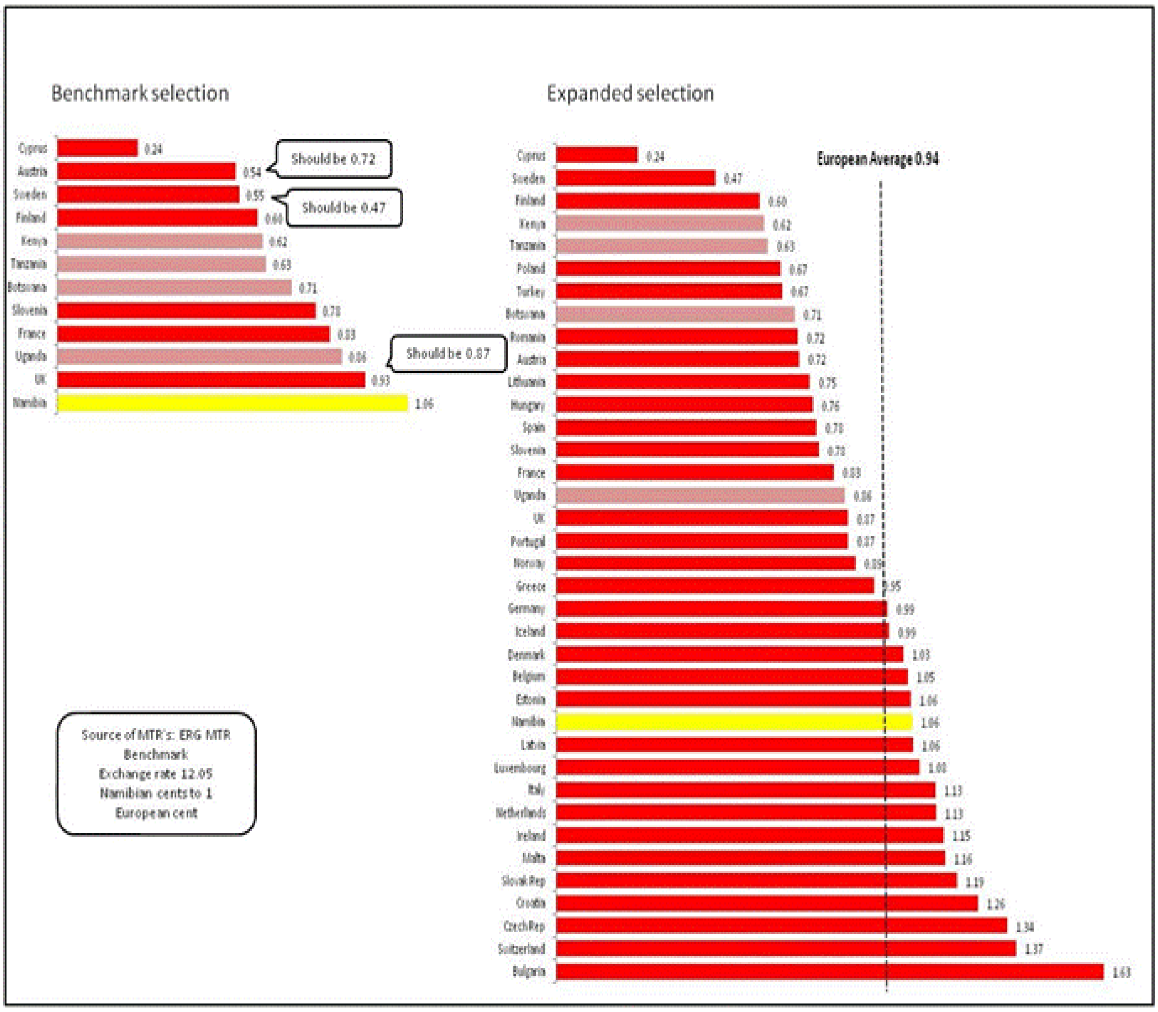

Figure 2

Furthermore, the study fails to address and benchmark the achievements linked to the public policy objectives of access and the impact that a major reduction of MTRs may have on these policy initiatives. For example, whilst most of the benchmarked countries have reached 100% plus penetration, Namibia has yet to reach these levels. MTRs in general were only decreased from very high levels *gradually* in the benchmarked countries after achieving penetration (and high coverage) levels of more than 100%. In addition, MTR decreases in the benchmarked countries have been implemented over a glide path period, whilst Namibia decided to implement a decrease of 40% immediately.

B. SPECIFIC COMMENTS

1. Mobile and telecoms operators drop their interconnection rate with effect from 1 November 2009 to 60 cents per minute during peak times; and Interconnection rates be further reduced by 15 cents annually on 1 November for each successive year until 2012

The proposed rates appear to Vodacom to be a cut too fast and a cut too low. As emphasized by the South African Competition Commission during the previous Parliamentary deliberations on the matter, a too fast and too low cut would have unintended consequences that may be detrimental to government access objectives and telecommunications industry. This concern was also recently highlighted by Deloitte Consulting in their Telecommunications Predictions TMT Trends report for 2009.

Two aspects require separate comments in this regard:

- the applicable charge that should apply, and
- the glide path and implementation date to any target rate.

1.1 The applicable charge

1.1.1 Arbitrary rate reduction

With regard to the applicable charge, it has generally been international practice, to implement any price regulation only after concluding a rigorous and detailed financial modeling, starting with fully allocated historic cost (similar to the existing COA/CAM) and subsequently moving to current cost and long run cost modelling, taking into account the costs and other financial data from all the prominent operators in the relevant market.

Proposing a target rate of 60 cents initially, dropping to 15 cents in 2012, is unsubstantiated and misses the fundamental purpose of regulating interconnection, i.e., the introduction of cost based charges. The question that Parliament has to consider is whether R0.15 reflects the true cost of terminating a call on a network. ICASA has costing data that operators have furnished and R0.15 is not a number that represent the cost of terminating a call on a mobile network.

To illustrate:
The cost of providing a base station in rural areas is generally much higher compared to the equivalent in a city or town. Mobile customers in rural areas tend to receive extensively more calls than what they originate. Due to this phenomenon recovering the cost of rural base stations roll out is highly dependant on termination revenue. Generally access to mobile communication services by marginal subscribers is at risk as a result of the reduction in mobile termination rates. Where such subscribers will be accommodated on the mobile network for a period of time, mobile operators may not afford to keep connected subscribers who do not originate calls if the reduction of mobile termination rates is drastic and abrupt.

1.1.2 Informed rate reduction

Vodacom has always provided costing data to ICASA in compliance with the COA/CAM regulations for the last couple of years.

The objective of the COA/CAM is to set out a structured accounting and regulatory reporting framework for Operators that would ensure that Operators provide information that would allow the Authority to meet its regulatory objectives. Three of the Authority's stated objectives (Notice 1302 of 2004) for the COA/CAM are to:

- confirm that charges for interconnection and essential services to other Operators are cost based;
- determine the extent to which interconnect charges contribute towards affordability of retail tariffs; and
- determine the extent to which interconnect charges promote competition in the telecommunications market.

Based on the aforementioned and all the other stated objectives, after much deliberation by all parties and external consultants over an extended period of time, the Authority engineered the COA/CAM to facilitate reporting at a level of detail that will enable the Authority to meet these responsibilities. The COA/CAM regulations consequently require Operators to report financial information at the required level of detail, hereinafter referred to as Regulatory Financial Statements (RFS), whilst adhering to the fundamental principles of cost causality, objectivity, consistency, transparency and sampling. The Authority reviewed and approved Vodacom's Operating Procedures Manual, including its detailed cost allocation, methods etc., against the above rigorous fundamental principles and other COA/CAM requirements. It is in terms of this approved framework that Vodacom have prepared and submitted its independently audited annual RFS.

ICASA therefore has access to rigorous audited cost data that could assist them to obtain an understanding of the indicative costs of the industry involved in providing interconnection services in the South African market for mobile and fixed service providers. As ICASA has not yet conducted a market study which would involve a comprehensive cost modeling, the cost information submitted in the RFS is the *only* accurate and reliable cost information available to ICASA today and should therefore be used to inform the current rate review debate.

1.2 Glide path

In broad terms, as highlighted by Ofcom (UK regulator), the glide path of reductions in rates should give due consideration to balancing two objectives:

- reductions should be achieved sufficiently quickly in order to deliver substantial benefits to customers, and
- reductions should allow sufficient time for operators and customers to adjust to new levels and structures of mobile charges and take these changes into account in their business plans and planned capital expenditure.

The first point seeks to ensure that consumers are able to benefit from the lower prices, including fixed to mobile calls. The second point notes that benefits to callers to mobile should not be at the expense of unacceptable disruption to the mobile sector, the industry and consumers more generally.

It is internationally recognised that compliance with charge controls may require adjustments to business plans and operators are likely to be subject to contractual notice periods which must be observed before changes can be implemented. Operators commit, for example, to service and product offers provided through various distribution channels that may need to be revised, following a change in the interconnection rates. It has therefore generally been good regulatory practice to allow sufficient time when imposing charge controls.

2. <u>As a general rule, the progressive reductions in interconnection rates between 2009 and 2012 should yield concomitant reductions in the actual consumer (retail) price of telecommunications</u>

Vodacom recognises that in focusing on call termination rates, "benefits to the consumer" are important in addressing long standing concerns around high telecommunications costs in South Africa.

The benefits to consumers resulting from a drop in mobile call termination rates are anticipated to be direct through retail tariff pass-through to fixed line customers and indirect by virtue of the fact that lower call termination rates result in lower barriers-to-entry for new competitors. Thus, there will be retail tariff pass-through for Telkom-originated calls terminating on mobile customers subsequent to a drop in mobile call termination rates as Telkom is obliged to pass reductions in mobile termination rates through to fixed line customers, *via* retail tariffs, in terms of the current interconnection agreement between Vodacom and Telkom. Consequently, calls originating on the fixed network and destined for mobile termination will come down in price, delivering a primary benefit to fixed line customers.

C. CONCLUSION

In conclusion, Vodacom would like to summarise as follows:

- The mobile operators in South Africa has to a great degree been successful in achieving public policy objectives aimed at increasing access to communications services in South Africa.
- Vodacom acknowledge that maybe the time has now arrived for all role players to review our MTR regime.
- Mobile operators have resolved to embark on the industry led commercial process to reduce mobile termination rates – a process which will be overseen by ICASA
- Vodacom is of the firm view that ICASA is mandated and best positioned by the EC Act to make a determination on MTRs by following the process prescribed in Chapter 10 of the EC Act. Vodacom reiterate that there is no reason why ICASA should not be able to finalise the section 67(4) regulations without undue delay to enable them to conduct the required market review and ensure that any findings of market failure will be addressed appropriately.
- As ICASA has not yet conducted a market study which would involve a comprehensive cost modelling, the cost information submitted in the RFS is the *only* accurate and reliable cost information available to ICASA today and *should* therefore be used to inform the current commercial rate review debate.
- A dramatic reduction of charges is likely to have a negative impact on government policy objective of universal access and would be disruptive to the economy and communications industry. The benefits to consumers resulting from a drop in mobile call termination rates are anticipated to be direct through retail tariff pass-through to fixed line customers and indirect by virtue of the fact that lower call termination rates which will result in lower barriers-to-entry for new competitors.
- Vodacom reiterate the concern expressed, by the Competition Commission, which we echo, that any regulatory intervention in mobile call termination rate setting should be undertaken with a great degree of caution.