# Comments on the draft Call Termination Regulations, 2018

10 September 2018

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# THE CELL C TEAM

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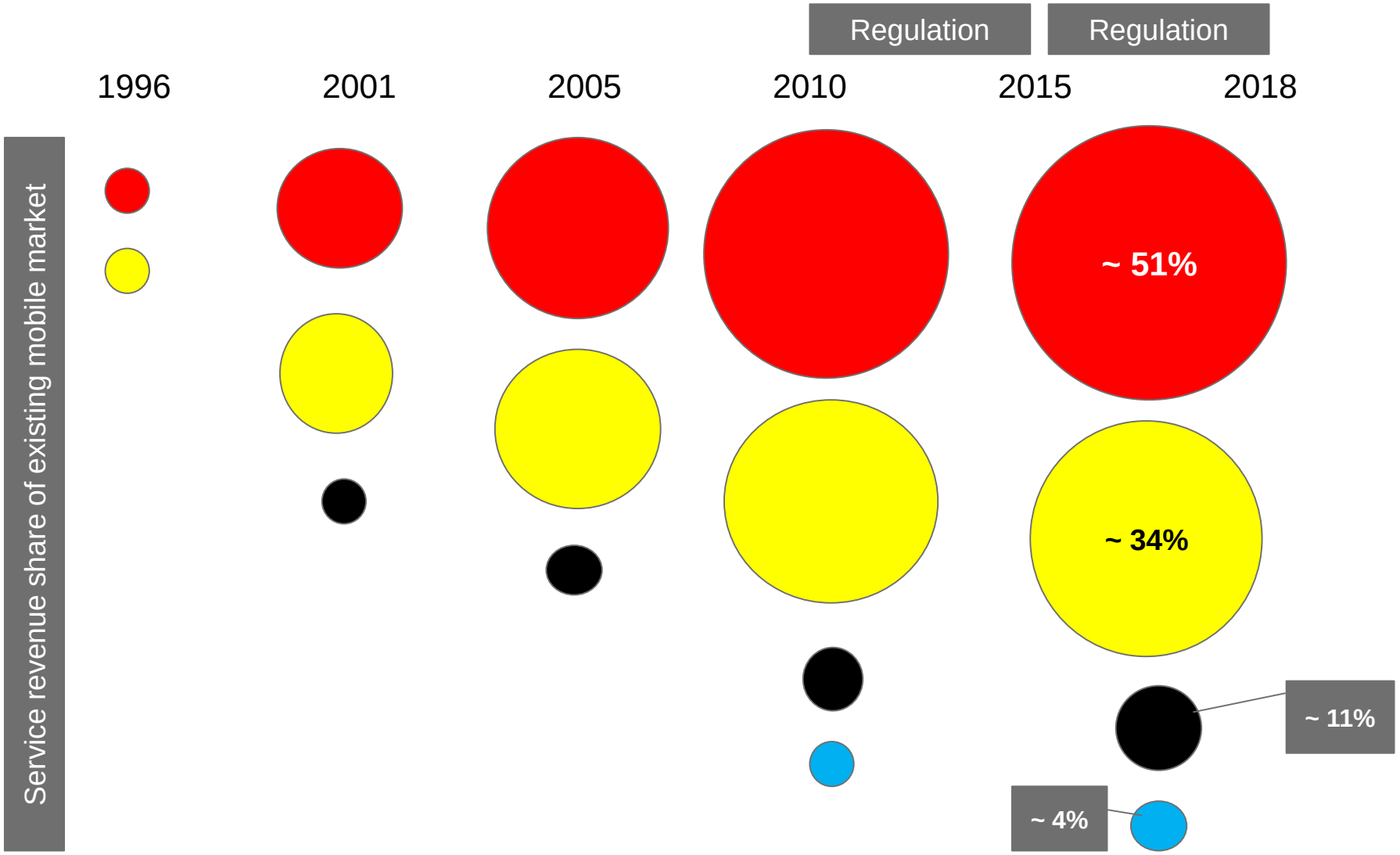
# CONTENT OF THIS PRESENTATION

1. The current market structure
2. The history of call termination regulation
3. Market failure persists
4. ICASA's powers and duties: competition
5. Asymmetry as a remedy
6. Termination rates and the BU model
7. Conclusion and recommendation

# THE CURRENT MARKET STRUCTURE: A HISTORY





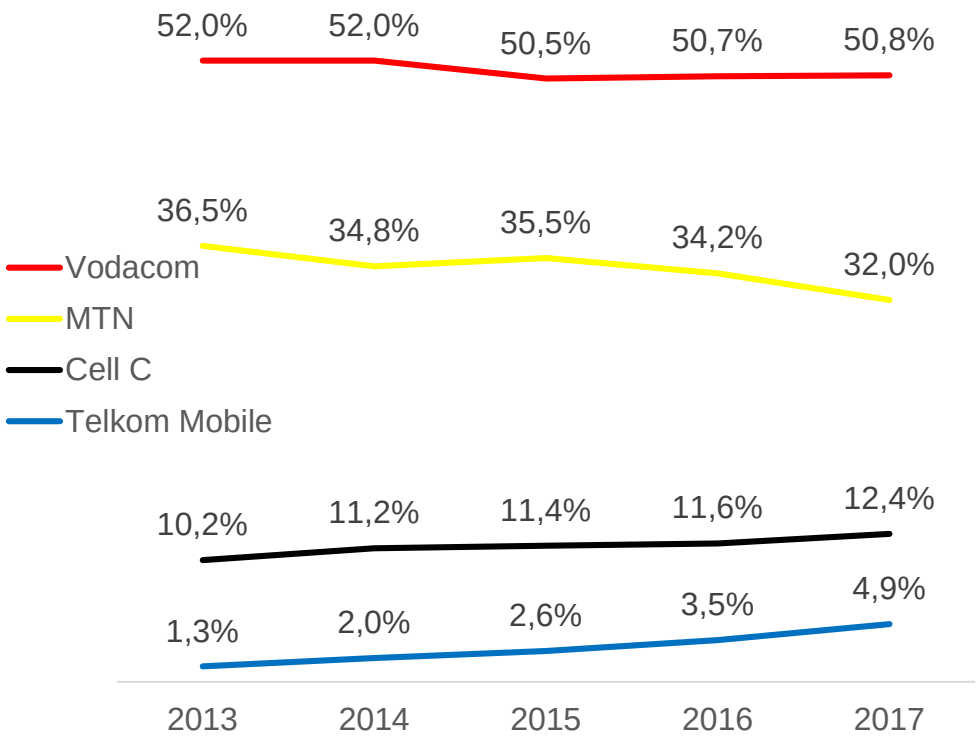

Notes:
This illustrative diagram is not to scale

# THE CURRENT MARKET STRUCTURE: STILL A DUOPOLY

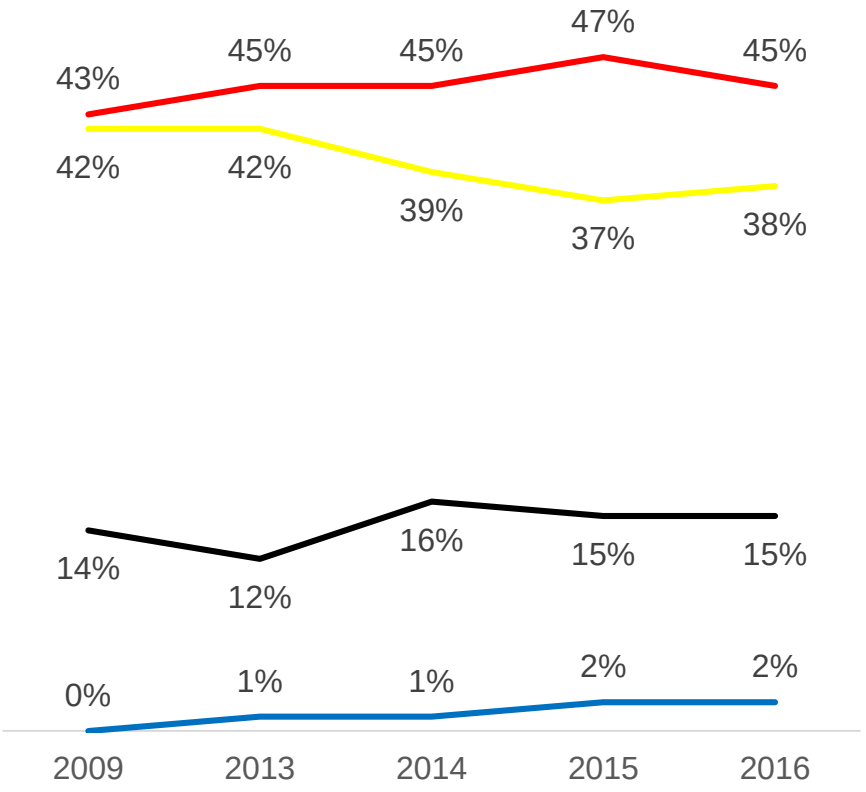
1

A duopoly structure persists in both the wider retail and narrower regulated markets

## Service Revenue share by Operator




## Term. MOUs share by Operator *




Source and Notes:
All results per Calendar Year. Operators' annual reports and quarterly results. Cell C estimates.
Telkom Mobile service revenue share based on annual figures as at end of March for each respective calendar year.
* Term MOUs share as per the ICASA published "Analysis of review of pro-competitive conditions, June 2017" – (with Cell C's interpretation of Table 5)



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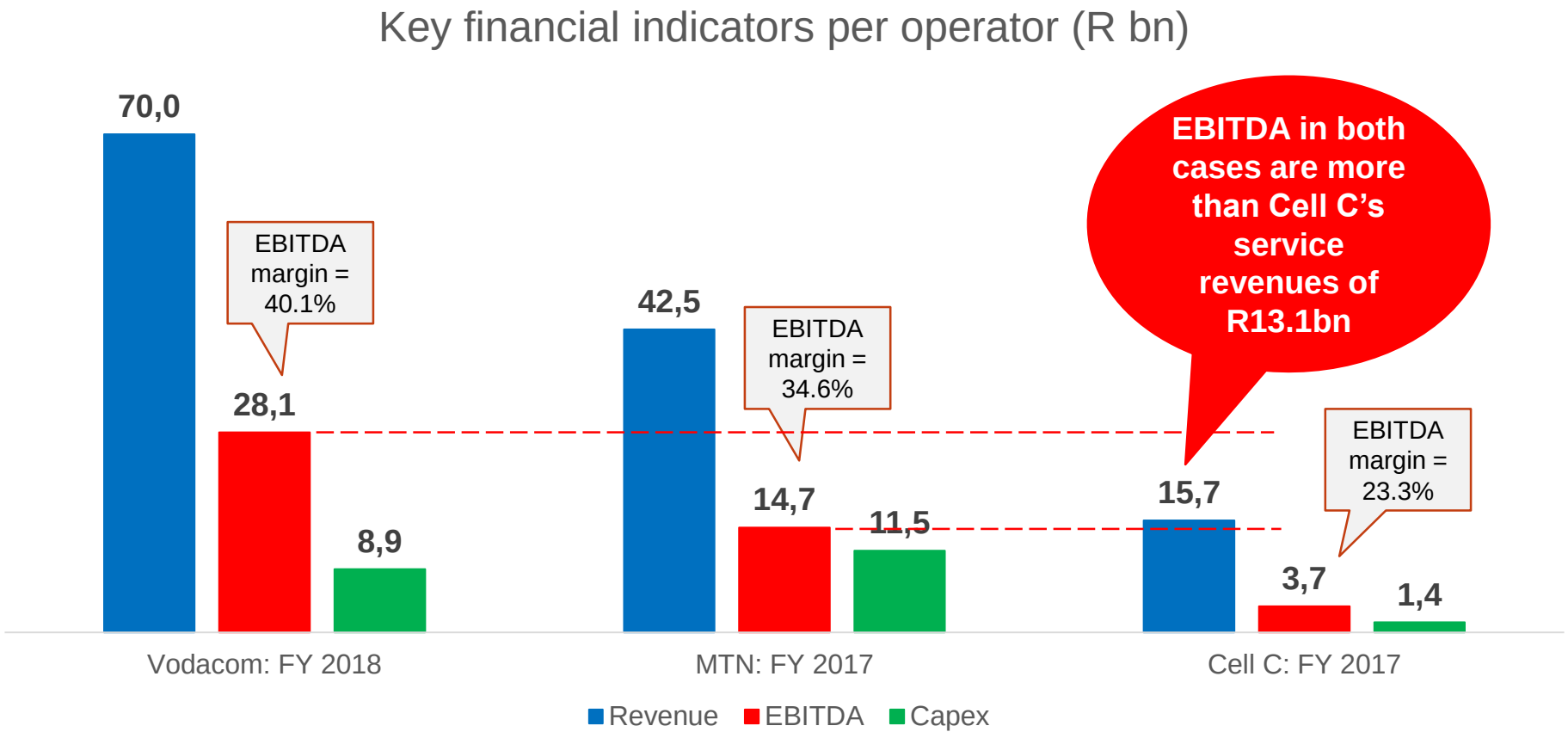
# THE CURRENT MARKET STRUCTURE: SUBSTANTIAL SCALE IMBALANCES ARE STILL PRESENT

Continuing scale benefits to the large operators have cost & profitability advantages




Source and Notes:
All results per Financial Year. Operator annual reports & results presentations. Cell C estimates.
Vodacom results, FY ended 31 March; MTN & Cell C results, FY ended 31 Dec.
Cell C EBITDA is normalised and Capex excludes intangibles and financial leases.



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# THE HISTORY OF CALL TERMINATION REGULATION



National policy required ICASA to intervene to address the high cost to communicate

- 2010: ICASA reviewed the market for wholesale voice call termination according to its published Guidelines, in line with international norms for market reviews –
  - ICASA identified 4 market failures i.e. competition was ineffective:
    - **A lack of provision of access;**
    - **The potential for discrimination between licensees offering similar services;**
    - **A lack of transparency; and**
    - **Inefficient pricing**
  - It then used cost data at hand to formulate an approximation of operator costs, and imposed pro-competitive terms and conditions on all operators to charge fair and reasonable prices for call termination. In addition, it regulated termination costs, and allowed a measure of asymmetry to smaller operators
- 2014: ICASA began a swift review of the market, and appointed a cost modelling expert to assist with top down and bottom up cost modelling to determine actual and hypothetically efficient costs.
  - ICASA found that competition was still ineffective with the same 4 market failures
  - ICASA imposed the same remedies as in 2010, with a reduction in rates and a reduction in asymmetry to reflect only cost differences between large and small operators

# THE 2018 MARKET REVIEW PROCESS

2017/2018: ICASA announced a further market review and a review of the pro-competitive conditions imposed on licensees in 2014, and a committee was appointed by Council to carry out this work

- ICASA noted in its Reasons Document for the Call Termination Regulations, 2014 that "…*termination rates in South Africa were priced significantly above cost for a very significant period following the entry of the two smaller mobile licensees and remained well above cost even in the first regulatory period until March 2014. This created a distortionary competitive situation that hindered the growth of these smaller networks*." *Gazette* 38609, 25 March 2015

- ICASA published 2 briefing notes on asymmetry, in February and June 2018, stating:
  - *"..the Authority is still of the view that asymmetry is necessary to minimise the impact of the disadvantages faced by late (small) entrants and new entrants for a defined period to enable them to compete with the incumbents"…*
  - *"After considering submissions by licensees, national circumstances and international precedent, the Authority has determined that asymmetry is still appropriate for the current review period to limit the disadvantages faced by small (late) entrants and new entrants or to limit incumbency advantages over late and new entrants albeit for a limited period to promote efficiency, sustainable competition and maximise consumer benefits"*

# MARKET FAILURE PERSISTS: REMEDIES ARE REQUIRED

3

ICASA is required to review pro-competitive conditions to determine if they are still proportionate

- After two interventions to date, ICASA has identified the same 4 market failure persists, scale imbalances continue, and the large operators benefit from increased profitability
- Larger scale:
  - enables large operators to spread their fixed costs across a larger base of subscribers
  - reduces per unit costs for large operators
- As has been shown on the previous slides, regulation to date has benefited large operators by enabling them to grow or maintain scale, while maintaining excellent profitability
  - The pro-competitive remedies determined by ICASA were based only on estimated cost differences
  - ICASA applied a glide path which benefited the large operators with rates above LRIC+ for a number of years
- As will be shown on the subsequent slides, the effect of further regulation on large operators is unlikely to have any significant effect on their bottom line – but it will have a very significant effect for small operators



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# ICASA'S DUTIES AND POWERS: COMPETITION

ICASA is empowered and obliged to review a market in terms of ss2 and 67 of the ECA to promote competition, and to impose proportionate remedies

- MTRs have reduced over the period of 8 years, and call prices have also declined, to the benefit of the consumers – however there has been little change in the state of competition in the market as a whole
  - Asymmetric rates have been set to estimated cost in 2010, and absolute (hypothetical) cost in 2014
- ICASA must give effect to section 2 of the ECA, and implement the section 67(8) obligation to review terms and conditions imposed on licensees to ensure that they are *proportionate*
  - Proportionately, the imposition of asymmetric rates on MTN and Vodacom constitutes a negligible portion of expense, whilst offering small operators an opportunity to catch up by not only covering their expenses, but assisting in achieving scale
    - There have been some "transient" quarter-on-quarter declines, but Vodacom's annual voice volumes have consistently increased over the past 10 years
    - Despite all claims to the contrary, both MTN and Vodacom have substantial scale benefits as compared to Cell C, and sufficient cash resources available to invest in network expansion, subscriber acquisitions and retention of high-value customers, to assist them in maintaining their scale, securing cost advantages in the future

# ASYMMETRY: ENABLES COST RECOVERY

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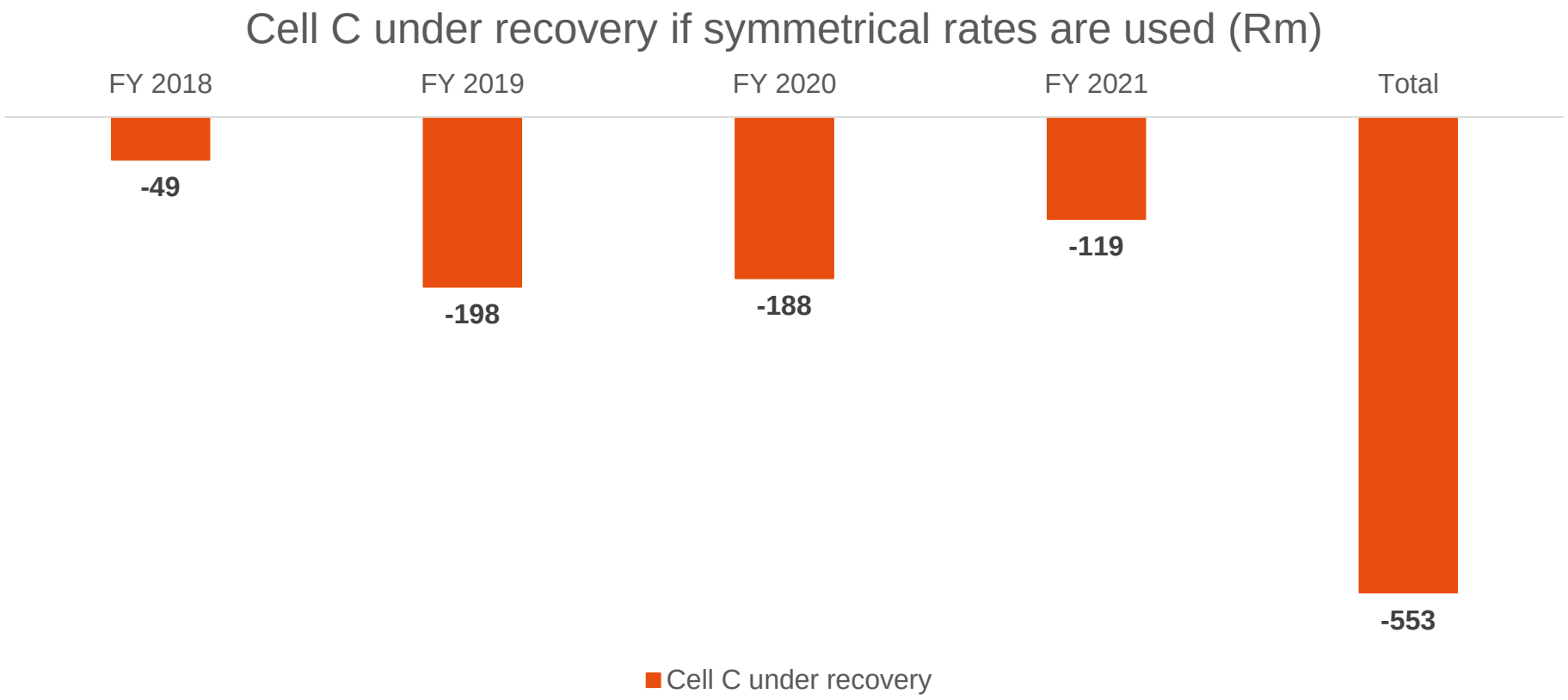
If small operators are not allowed to recover their cost of termination (i.e. if termination rates are set symmetrical using a larger operator cost), it would negatively effect their ability to compete




Source and Notes:
Cell C estimates using actual interconnect traffic received multiplied with the absolute asymmetric benefit for each year as published in the draft regulations by ICASA, Aug 2018.



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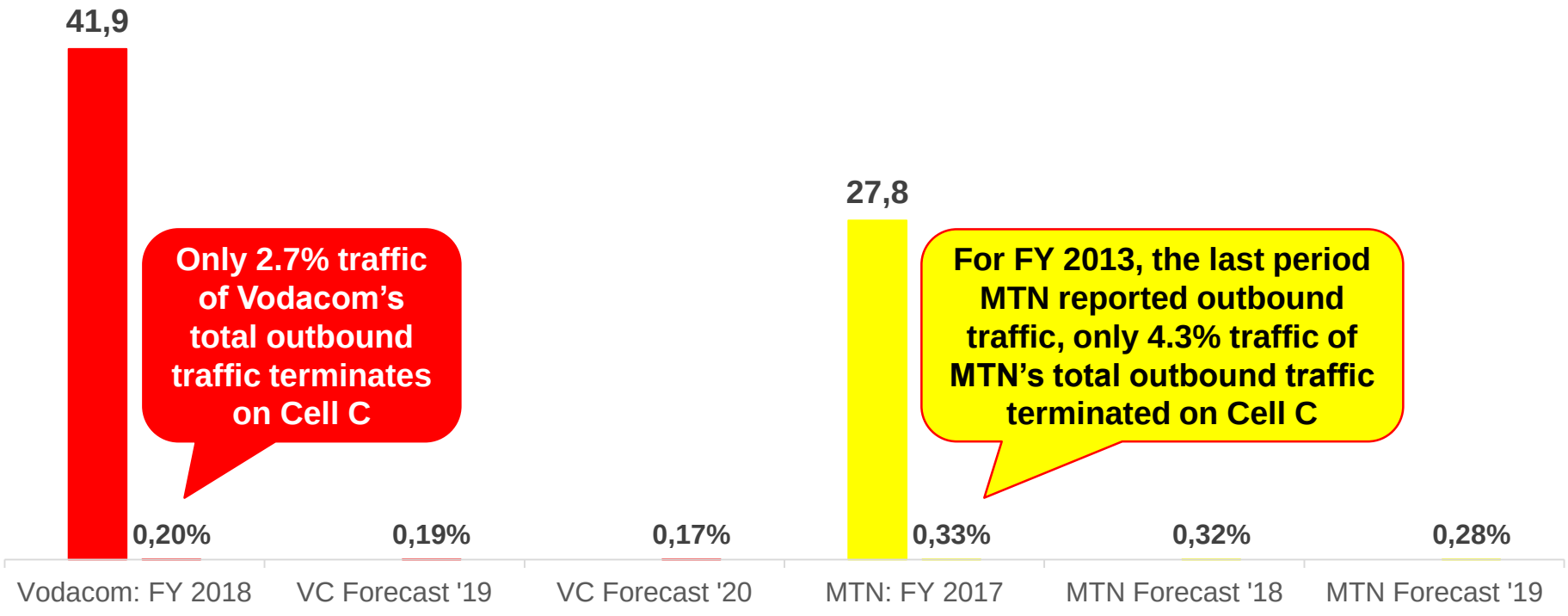
# ASYMMETRY: NOT HARMFUL TO THE INCUMBENTS

The effects of asymmetric MTRs on the small operators is insignificant to the large operators

Total expenses for the last reported FY (R bn) & asymmetry payments to Cell C as a % of the total expenses of Vodacom and MTN




Source and Notes:
Total Expenses for the last reported Financial Year as per operator annual reports & results presentations.
Cell C estimates using actual interconnect traffic received from Vodacom and MTN multiplied with the absolute asymmetric benefit for each respective year (including the forecasted benefit as per the draft regulations published by ICASA, Aug 2018).



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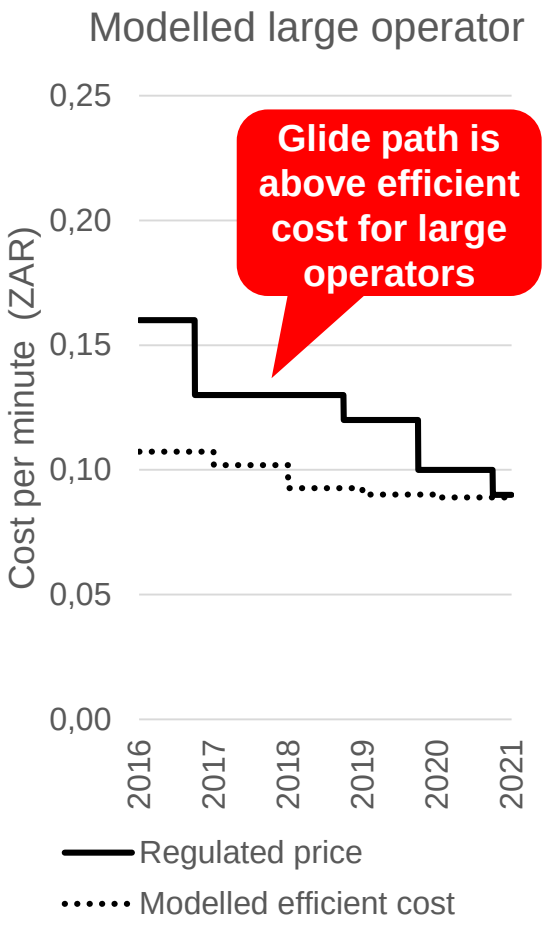
# TERMINATION RATES AND THE BU MODEL

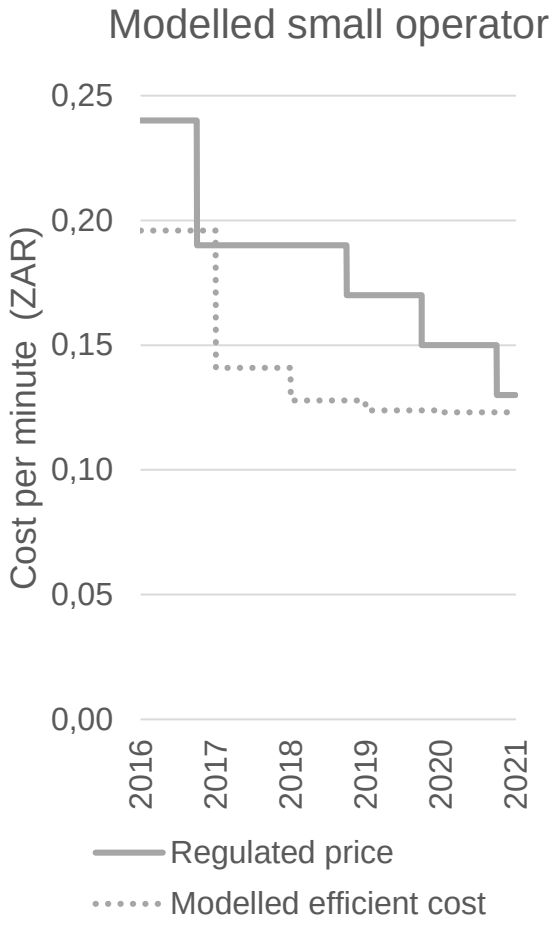
Termination rates in the past have enabled over-recovery for large operators, and under-recovery for small operators

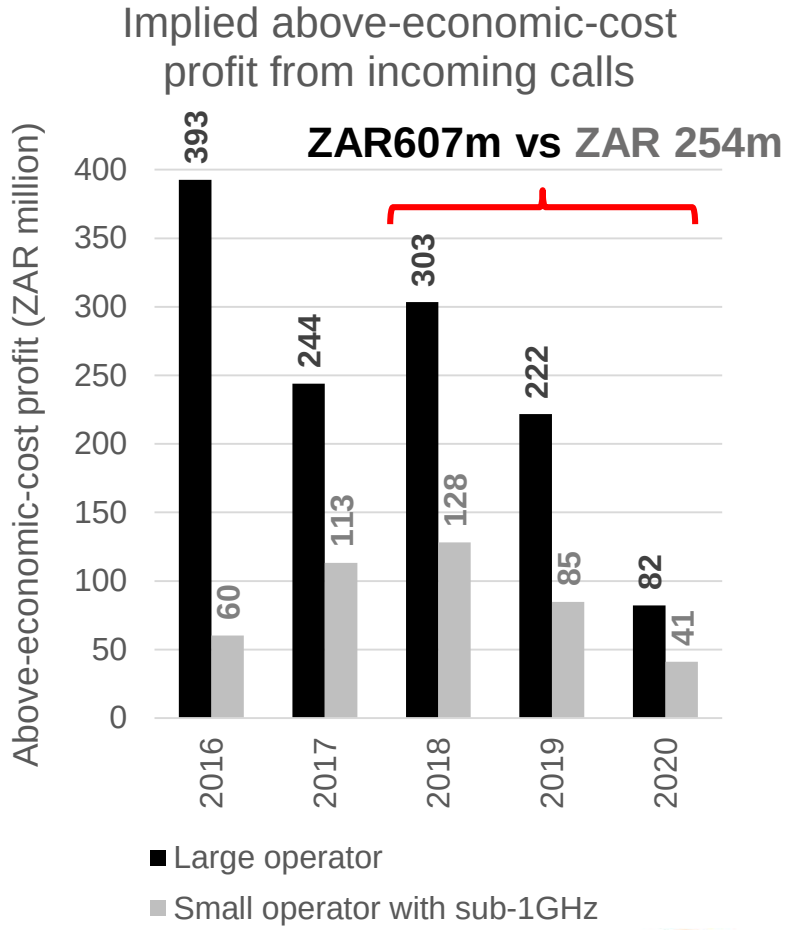
- ICASA has determined its rates for small and large operators on the basis of a TD and BU model
  - However the assumptions underpinning the draft final and the final models appear to have changed and this is not explained, or are difficult to rationalise
- The assumptions for small operators include that its subscribers will consume more data per subscriber than the market average, but not only must Cell C maintain this above-average performance to 2020, it must in fact accelerate further beyond the market-average usage levels
- By contrast, large operators are forecast to increase data usage per subscriber at a far slower rate than the market-average, and are assumed to further fall behind the market-average usage
  - This is a diverging and discriminatory forecast which will be harder for the small operators to achieve, and easier for the large operators to achieve
  - This will make it extremely unattractive to potential investors in this sector if they are not investing in one of the duopoly operators, and even more unattractive to potential new entrants and investors in small operators like Cell C

# TERMINATION RATES AND THE BU MODEL

The glide paths in the draft Regulation may provide the greatest benefits to the large operators




Source and Notes:
Charts derived using ICASA's final BU model and ICASA's Draft Regulation
Efficient costs are for the hypothetical operators only



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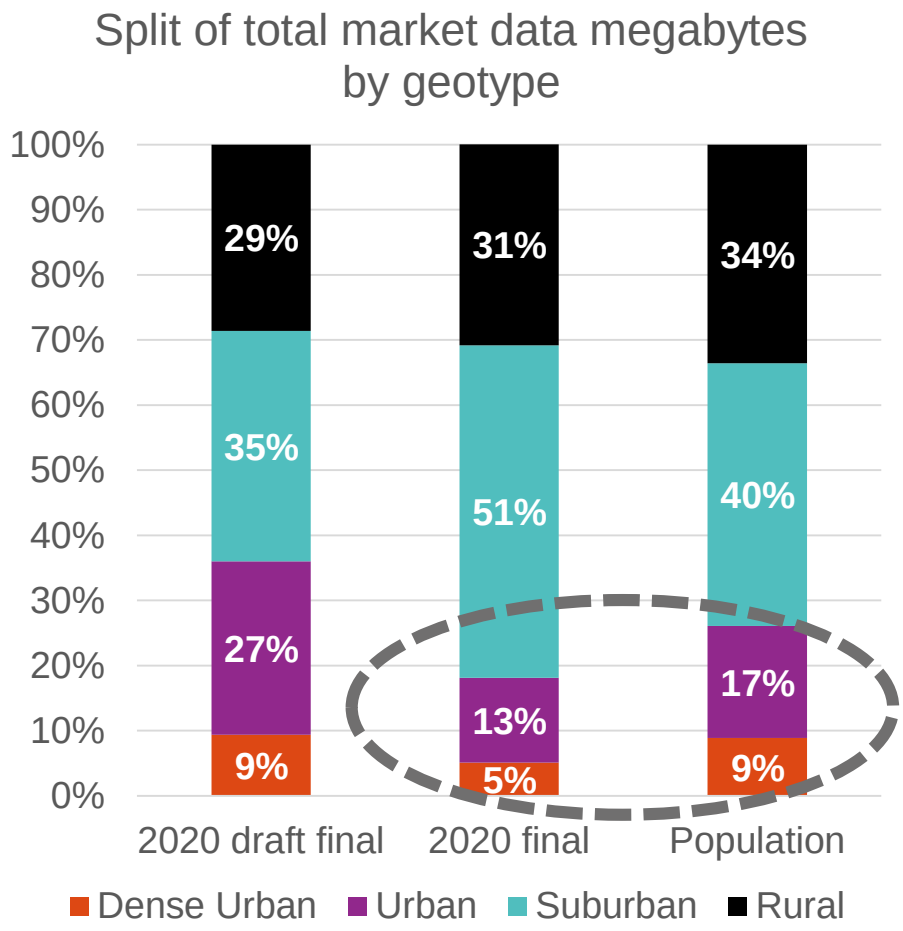
# TERMINATION RATES AND THE BU MODEL




- In each submission on the BU model, Cell C has raised concerns on the distribution of traffic by geotype
- In the final version of the BU model, densely populated areas are under-represented in traffic loads
  - This assumption appears to be flawed and contradicts traffic distribution information Cell C has provided
  - This “skew” of traffic away from urban areas is also apparent in the total voice volumes
  - This is inconsistent with Cell C’s network measurements and conventional radio planning expectations

Source and Notes:
Derived from ICASA’s draft final BU model, June 2018 and ICASA’s final BU model, August 2018
Split of population sourced from ICASA’s final model documentation, slide 20 of 76



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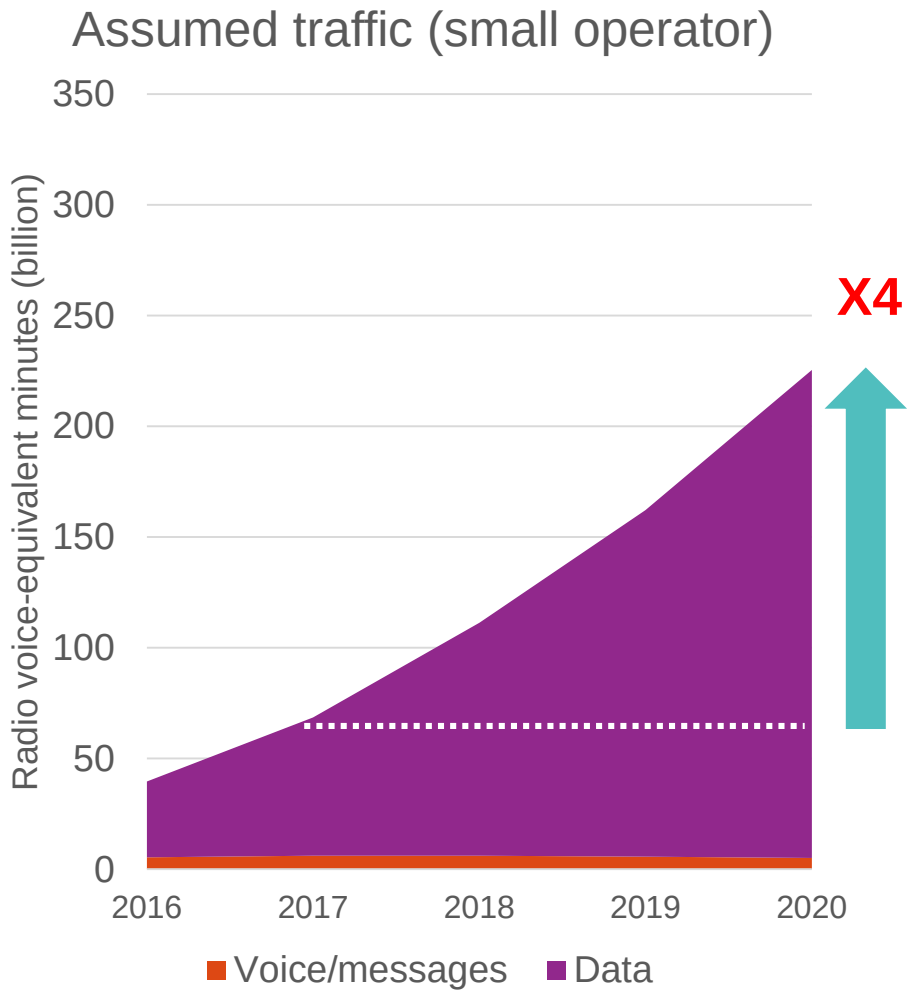
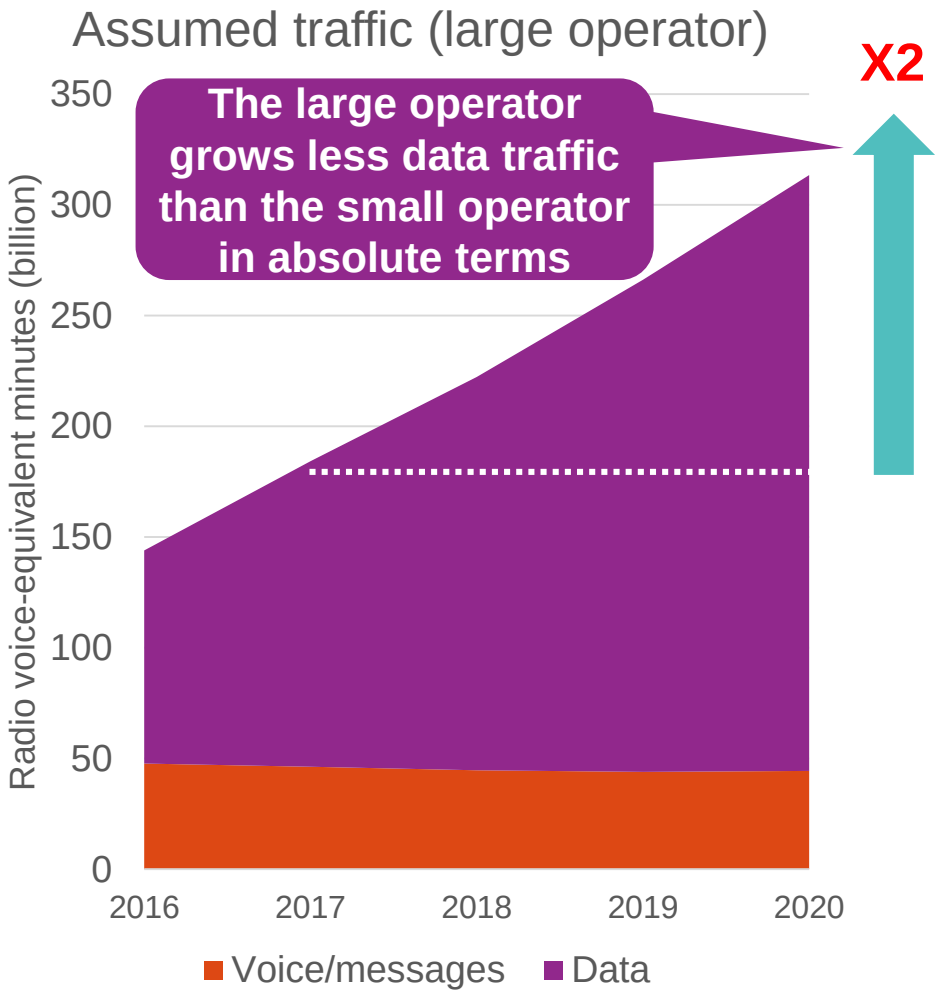
# TERMINATION RATES AND THE BU MODEL

ICASA's forecasts for data growth appear less aggressive for large operators




Source and Notes:
Derived using "commercial" traffic from ICASA's final BU model, August 2018, using the calculation for the "Small MNO (With Sub-1GHz Spectrum)"

# CONCLUSION AND RECOMMENDATIONS

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Our full set of comments is contained in our written submission

- Cell C is grateful for the open consultative process conducted by ICASA
- However, the proposed regulations do not recognise that two previous regulatory interventions have not yielded the intended wider market improvements
  When asymmetry is based only on cost differences, and glide paths are granted to large players, the regulation only serves to support the status quo
- The draft Call Termination Regulations do not go far enough to address the persistent barriers to competition
  - The application of a glide path for large operators, alongside a similar path for small operators, although well-intentioned, has the effect that large operators benefit substantially from earning termination revenues above efficient LRAIC+, with these benefits being contributed to by small operators
- Wider asymmetry is required on the basis of fairer forecasting and assumptions for smaller operators relative to large operators
  - ICASA should make a bold decision on asymmetric regulation for the benefit of the wider market and competitiveness, and ultimately for the consumer
- Cell C recommends that ICASA consider the detailed written inputs provided by it, in order to apply asymmetry beyond only cost differences, to support small operators to compete more strongly and gain scale



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