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10 January 2022

Chairperson of ICASA
Call Termination Council Committee
Independent Communications Authority of South Africa (ICASA)
350 Witch-Hazel Avenue
Highveld
REDACTED VERSION

By email: CTR2021@icasa.org.za

Dear Sirs

Re: 2021 Call Termination Regulations: Response to ICASA's Discussion Document of 5 November 2021 on the Review of Pro-Competitive Conditions imposed on Licensees

We refer to ICASA's Discussion Document to review the pro-competitive conditions imposed on licensees in terms of the Call Termination Regulations (CTR), 2014 (as amended), as published in the Government Gazette No 45426 ("ICASA's notice") on 5 November 2021.

The Information Communications Technology ("ICT") sector as a whole in South Africa is at an inflection point: the economy is 1.4% smaller than what it was before the COVID-19 pandemic, yet communication services was one of the most significant drivers of growth in the past year. The structure of the ICT sector remains favourable to dominant operators and continues to present barriers to entry and impediments to sustainable competition, for smaller and new entrants. ICASA has the mandate and responsibility to address this reality and ensure the sustainability of licensees. The regulation of Call Termination rates is one such tool, with which ICASA deliver on its mandate to do so.

Cell C therefore, takes this opportunity to emphasise to ICASA, the importance of its decision in respect of this CTR process having a broad pro-competitive outcome. The market needs viable competitors so that consumers have choice and competitive supply of services. This is essential to support the demand for communication services and its enabling role as a tool of development as well as the future development of the South African mobile market.

Accordingly, Cell C has several, significant concerns on the approach outlined by ICASA in its CTR Discussion Document. We discuss these in the body of our submission.

Kindly note that information that is under the sections titled CONFIDENTIAL and underlined is submitted as strictly confidential information in terms of section 4D of the ICASA Amendment Act, No. 2 of 2014, due to the commercially sensitive nature of the information which will cause harm to the commercial or financial interests of Cell C if disclosed to the public and third parties.

Directors: JS Mthimunye (Chairman); LM Nestadt (Deputy Chairman); DJ Craigie Stevenson (CEO); ZA Mahomed (CFO); GD Harlow; LE Mthimunye; MA Nelson-Smith*; DH Shimkins; AMR Smith*; SJ Vilakazi; SV Zilwa
(*British)
Company Secretary: Z Williams

In this regard please see attached Annexure A Form to Request for Confidentiality in terms of section 4D of the ICASA Act and a Redacted version of this submission, Annexure B. Cell C is grateful for the opportunity provided by ICASA to make submissions and we look forward to further engagement with ICASA in this regard.

We also indicate our willingness to be included in any public hearings on this Discussion Document and process, if held and await confirmation in that regard.

Yours sincerely

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Themba Phiri
Executive Head: Regulatory

General comments

Cell C requests the information marked confidential in this document be treated by ICASA as such in terms of section 4D of the ICASA Act.

1. As well as addressing the questions set out by ICASA in its Discussion Document, Cell C wishes to raise some fundamental points which we believe have, in the ongoing market review, not been considered, to the detriment of the market in general and Cell C specifically. These are:

    - The market failures for mobile services in South Africa persist and ICASA must continue to apply the pro-competitive remedies at its disposal, contemplated by the Electronic Communications Act (36 of 2005) and as directed by its objectives.
    - ICASA may not consider or appreciate the extremely negative implications that a move to symmetry in Call Termination Rates would have on entrenching anti-competitive market structures and on disadvantaging Cell C.
    - ICASA may have failed to appreciate how detrimental a move to symmetry in Call termination Rate regulation would be for market outcomes and how inappropriate this would be for the current South African sector, poised as it is, at a critical inflection point.
    - Finally, Cell C is of the respectful view that the Discussion Document lacks any detail on the next steps of the CTR process sufficient to satisfy the requirements of administrative justice.

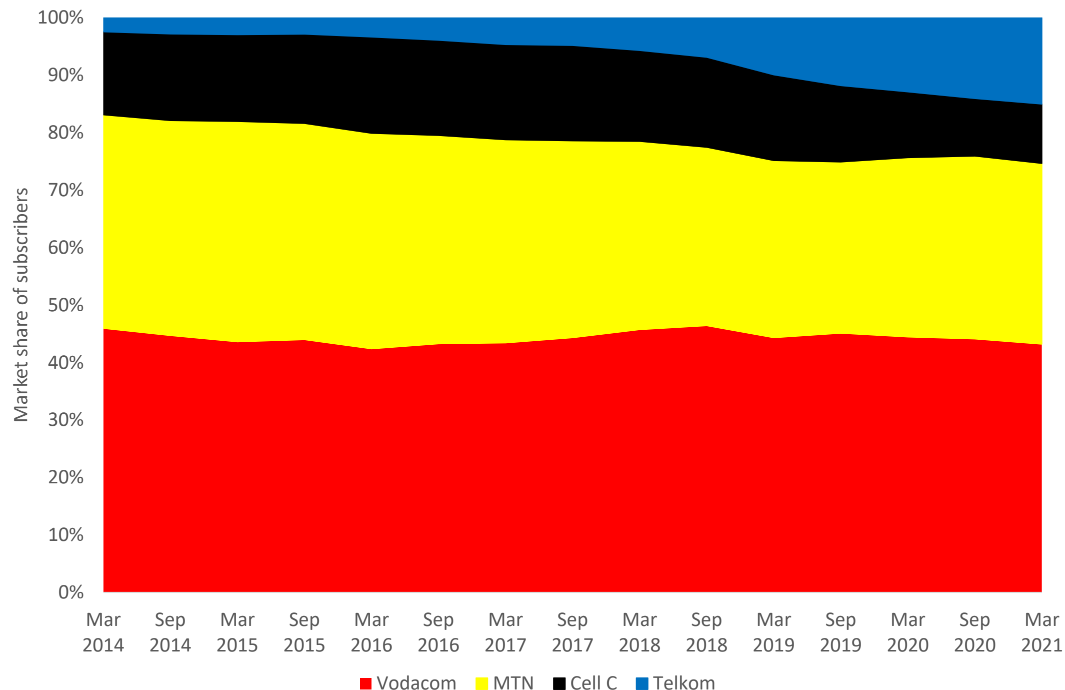
2. We discuss these in turn below first and then respond to ICASA's consultation questions.

The market failures for mobile services in South Africa persist and as the regulator ICASA must therefore continue to implement pro-competitive remedies which contribute to addressing these failures

3. South Africa has had a persistently ill-functioning mobile market structure in both the wider and more narrow markets for as long as Cell C has been in existence. Vodacom and MTN remain the two well-established operators with significant

market shares (consistently in excess of 70% of subscribers combined, as shown below). The other two operators, Cell C (third entrant) and Telkom Mobile (fourth entrant), have been in the market for more than a decade, but still remain unable to achieve the scale of the incumbents due to the continuing market failures.

Figure 1: Market share of subscribers by operator in South Africa, 2014 to present



Source: Cell C calculations (2021)

4. The prevailing skewed market structure is fuelled by the first-mover advantages that not only allowed MTN and Vodacom to grow a large subscriber base, but also allowed them to roll out large networks which later/newer entrants must attempt to match in order to compete.

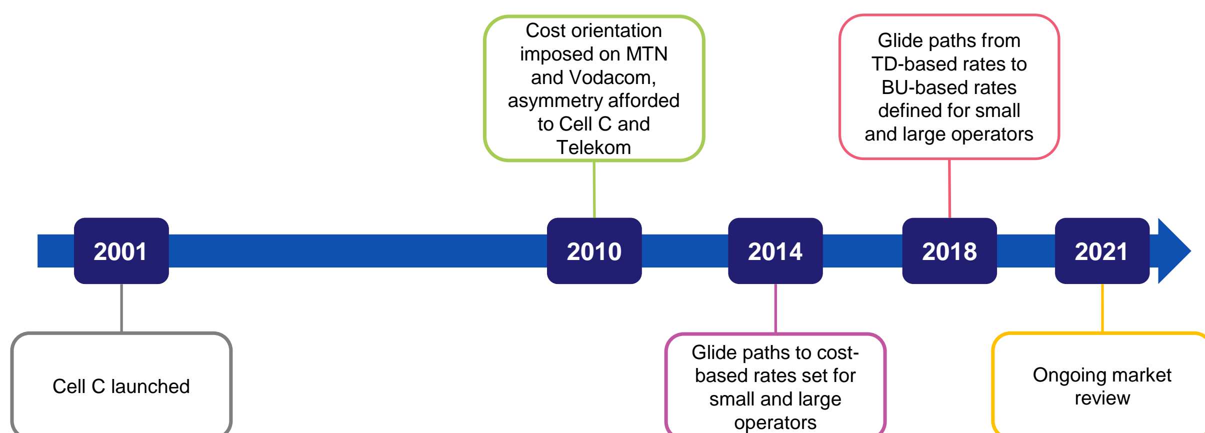
5. Although Telkom's market share has grown recently, it remains significantly smaller than Vodacom/MTN. Telkom's growth will have been significantly supported through the benefits of scale and scope it gains from its dominant incumbent fixed business. These benefits include (i) extensive use of its fixed infrastructure in its mobile network deployment, (ii) common/overhead cost synergies with its fixed business and (iii) competitive fixed-mobile bundle pricing it can offer, including 'on-net' fixed-mobile and mobile-fixed calling. These are all

benefits that Cell C cannot replicate.

6. These factors, along with negatively contracting access to capital in an economy with marginal or flat growth, in addition to mobile on-net/off-net price differentials entrenched by the large operators, and high mobile penetration rates in South Africa, make it difficult for smaller operators to compete with the scale advantages of the larger MNOs.

7. ICASA has repeatedly attempted to address these market failures, most notably in the call termination regulation processes undertaken in 2010, 2014 and 2018. However, these interventions, whilst helpful, have been insufficient to substantially overcome the inherent competitive disadvantages for smaller operators. Figure 2 below outlines the timeline of market regulation for call termination, since the launch of Cell C:

Figure 2: Timeline of call termination regulations in South Africa, 2001 to present



Source: Cell C

8. In the first nine years from Cell C's launch, the market for call termination was unregulated. During this period, the incumbents used their first mover advantage and growing dominance to set termination rates substantially above their costs, which created a distorted competitive situation that curtailed Cell C's growth. This was combined with significant on-net/off-net price differentials in the retail market as a means to constrain the ability of small entrants and challengers to gain market share from the large players. Those price differentials persist today in parts of the retail market.

9. In the first regulatory intervention by ICASA in 2010, cost-orientation was imposed on Vodacom and MTN, and afforded asymmetry to Cell C and Telkom Mobile. However, the asymmetric rates were not based on actual cost data, and ICASA later noted, *"Furthermore, the regulatory period between 2010 and 2013 did not have cost-based asymmetry and the asymmetry afforded for that period was lower than actual cost differences"*[1]. As the asymmetry was inconsistent with the underlying cost differences between the large and the small operators, it had a limited impact in terms of improving the competitive state of the market. In fact, to the contrary, the market share grew for the large operators.

10. In the 2014 CTR process, ICASA imposed glide paths to cost-based rates, for small and large operators. While the glide down benefitted small operators by enabling additional profit, setting a glide path to cost-based rates for the large operators similarly enabled them to earn additional profits. This resulted in a substantial net transfer of funds to the large operators given their larger traffic volumes, yielding an outcome which was more 'pro-large operator' than a 'pro-competitive' one. In other words, the rationale for asymmetry itself, was not realised in the 2014 CTR process.

11. The most recent (2018) CTR process, whilst not rectifying the broader market failures, was more balanced than the 2014 CTR process and more supportive of a pro-competitive and pro-challenger situation. This was because the glide paths were intended (to our understanding) to be entirely cost-based, starting at top-down costs of termination at different (large and small) scales in 2018 and ending at bottom-up costs of termination at different (large and small) scales in 2020. This process gave effect to the rationale of asymmetry.

12. The implication of this is that in 21 years of operation, Cell C has competed in a mobile market with effectively, only three years of balanced, pro-competitive call termination regulation (those being the three most recent years), having been implemented by ICASA. The three year time period has not been adequate to address the historic imbalances in the industry. The governing statute for the

[1] Paragraph 11.10.2 of the 2014 Reasons Document

sector, the ECA, which anticipated a series of pro-competitive measures to address the market imbalance, has been in effect 15 of the 21 years of Cell C's existence. It is therefore with great concern to Cell C, that ICASA's Discussion Document on CTR is now proposing a new, unbalanced regulatory intervention with a proposed, abrupt move to symmetry.

ICASA has failed to consider that a move to symmetry would be extremely detrimental to efficient market outcomes and inappropriate for the South Africa context

13. In Section 2.5 (footnote 24, page 25) of the Discussion Document, ICASA states that their proposed move to symmetry for new entrants would only be for a three-year window:

    is in line with the EC's principle for asymmetric termination rates.[2]

14. Cell C considers benchmarking of recent European regulation for call termination policy in South Africa to be wholly inappropriate, as the progression of South Africa's mobile market does not in any way, resemble modern European markets, but rather the European markets of the early 2000's, prior to the push for symmetry in those markets that only began in the early 2010's.[3] Therefore, if ICASA were to benchmark against European markets, it should realistically expect to need ten years of balanced, pro-competitive regulation to be in place (at least through cost-based asymmetry, as has been the feature of the most recent years) before considering a move to symmetric rates, and certainly without doubt, a period longer than just three years as has been the recent situation in SA.

15. Cell C has identified other countries with market structures and dynamics similar to those in SA, where asymmetric MTRs are still in place and will definitively remain in place in the near-term. Whilst there are none in the European Union, there are examples in both wider Europe (Turkey) and Africa (Cameroon, Eswatini, Morocco and Nigeria). Mexico also has asymmetric MTRs in place for newer entrants versus

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[2] *https://ec.europa.eu/smartregulation/impact/ia_carried_out/docs/ia_2009/sec_2009_0600_en.pdf*

[3] This was driven by the Termination Rate Recommendation released by the European Commission in 2009.

incumbents. Figure 3 below outlines the regulated MTRs in these countries (with an indication of the asymmetry). For reference, we include SA.

Figure 3: Summary of existing cases of asymmetry in MTRs

Country	Most recent year for which MTR is available	MTR (ZAR) for incumbents / large operators	MTR (ZAR) for other operators	Source
South Africa	2021	0.09	0.13	See here, pages 8/11
Cameroon	2020	0.33	0.44	See here
Eswatini	2022	0.10	0.13	See here, page 22
Mexico	2023	0.01	0.035	See here, page 52
Morocco	2022	0.07	0.08	See here, page 2
Nigeria	Since 2018	0.15	0.18	See here, page 16
Turkey	2021	0.05	0.06	See here, page 53

Source: Regulatory decisions, available from regulator websites

16. Figure 4 outlines the reasons provided by the regulators for imposing asymmetry, where they are available in the public domain in published decision documents.

Figure 4: Justification for asymmetry in MTRs

Country	Reasons given for having MTR asymmetry	Source
Eswatini	Imbalance in voice traffic and subscriptions market shares, leading to differences in buyer power between MNOs	See here, page 21
Mexico	To control the market power of the (preponderant) MNOs and eliminate barriers to competition	See here, page 6
Morocco	Imbalance in traffic flows between the operators	See here, page 4
Nigeria	The estimated unit cost of terminating traffic on the networks of new entrants is significantly higher than for established operators of a certain minimum scale	See here, page 9

Source: Regulator websites

17. It must be emphasised that all of four of the above justifications for asymmetry in those countries are also applicable in South Africa.

18. It must also be noted that when asymmetry was previously imposed in European countries, it was commonplace to have it in place for significant periods of time. For example, Belgium (11 years), Ireland (11 years), Italy and France (12 years)

and Switzerland (19 years). In fact, Algeria had asymmetry for 15 years, Peru had asymmetry for 12 years, and the Republic of Korea had asymmetry for 16 years. The focus in these cases was on recognising the need for efficient scale and not necessarily reaching symmetry as a principle. As noted above, by comparison, ICASA has only applied cost-based asymmetry to all operators in South Africa since 2018, and seems inclined to re-introduce symmetry after a mere three years. The argument advanced by ICASA, that this "*is in line with the EC's principle for asymmetric termination rates*", is simply incorrect, when understood in the totality of asymmetric regulation, both from a cost perspective and from the duration for which such regulatory intervention has been implemented in EU and other markets.

19. Regulatory intervention in defined markets was a fundamental principle of Chapter 10 of the ECA. Ensuring sufficient levers available to the authority to promote competition was one of the main drivers of legislative reform in 2005. The first process to review relevant markets or market segments commenced in 2008.[4] However, ICASA has in fact, to date, never completed that process, nor has it carried out the priority market reviews that replaced it and which ICASA commenced in 2017/18 in the mobile access/origination market (where two operators have had in excess of 35% market share for many years). Accordingly, the CTR regulation is the only ex-ante regulation ICASA has in place and it is therefore the only lever it can pull.

20. Given 20 years of absence of any priority market analysis or ex-ante regulation in retail access/origination, Cell C considers it absolutely critical that ICASA applies **material asymmetry in the CTRs** at least as much as the underlying cost differences to recognise the scale disadvantages the small operators face in the wider mobile market.

21. Cell C's view is diametrically opposed to that of ICASA's, in that setting symmetric rates too soon will disrupt the smaller operators' (including Cell C) ability to

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[4] Regulations detailing the schedule within which the Authority will undertake periodic review of relevant markets or market segments pursuant to section 67(4)(e) of the Electronic Communications Act No. 36 of 2005, Government Gazette, No. 30846, 6 March 2008

compete effectively while it remains substantially smaller than the two large operators. Cell C also pauses to point out what may not be obvious to ICASA, that Cell C's small-scale disadvantages – in part due to the lack of pro-competitive regulatory intervention, which was anticipated by the ECA, but not implemented – are present for not just all voice services, but also for data services.

22. Cell C is therefore of the view that CTR regulation and in particular asymmetry to the benefit of small operators with lower economies of scale and higher unit costs, is the only substantial active and arguably, effective, regulatory tool that ICASA has at its disposal to improve the competitive state of the market (and fulfil its mandate to give effect to the objects of the ECA). This is because it allows smaller operators to recover their higher costs per minute when terminating calls, and therefore not face losses from offering termination, which in turn would hamper their ability to compete more strongly in the wider mobile retail market.

Lack of any detail on the next steps of the CTR process

23. In Section 2.5 (page 37) of the Discussion Document, ICASA states:

    Each licensee is required to charge cost-based termination rates determined by the Authority using the top-down and bottom-up cost models in terms of the Regulations.

24. Cell C highlights to ICASA that the Discussion Document does not provide any details on how the price regulation will be undertaken. There is also no proposed approach for pricing, or even a range of options for consideration by industry and other stakeholders.

25. Given ICASA's preference to complete the review by March 2022, Cell C does not see how any new cost modelling of mobile operators will be possible. In the previous review, ICASA, with the co-operation and support of the industry, was able to complete a relatively successful and transparent regulatory costing process between November 2017 and September 2018, i.e. a period of almost 11 months. This period included the development of an approach, data collection, initial

modelling, multiple industry consultations on the models, model finalisation and development of the regulations.

26. Cell C does not consider it feasible to develop a new model, or even update the existing model, in the time remaining between now and the end of March 2022 (less than three months), notwithstanding other extremely pressing issues affecting both the sector and the Authority. Accordingly, Cell C further submits that ICASA must maintain the existing costing principle, i.e. LRAIC+, as there is insufficient time to consider or implement alternatives.

27. Cell C highlights to ICASA that the 2018 models attempted to reflect the prevailing large and small operator realities. It is Cell C's considered view, that reflecting the large and small operator realities remains critical, and this is best achieved using the 2018 models.

28. Cell C has already illustrated in its Phase 1 submission in August 2021 that a simple solution for ICASA to implement in the time remaining would be to roll-forward the costs per minute for the large and small operators derived in 2018–2020 into the period 2021–2024. The potential for this option is obvious given that costs per minute of mobile termination only marginally changed between 2019 and 2020 in ICASA's own model, thus indicating that the future evolution of the costs of termination would be relatively small for both large and small operators.

29. Therefore, Cell C recommends to ICASA that the focus should be on using ICASA's existing model to set termination prices for the next regulatory period through extrapolation of its results. This approach is efficient: it requires no collection of data from stakeholders, is eminently doable in the time available to March 2022 and can take advantage of and leverage off the robust model that ICASA already has at its disposal, and one which ICASA itself has developed specifically for the market situation in South Africa.

30. This approach would also be consistent with ICASA's proposal in the Discussion Document to use cost models to set cost-based rates.

Responses to ICASA's consultation questions

We respond to each of ICASA's consultation questions in turn.

Q1 - Do you agree with the Authority's preliminary conclusion on the product market definition?

31. Cell C agrees with ICASA's preliminary conclusion.

Q2 - Do you agree with the Authority's preliminary conclusion on the geographic market definition?

32. Cell C agrees with ICASA's preliminary conclusion.

Q3 - Do you agree with the Authority's preliminary conclusion on fixed and mobile convergence?

33. Cell C agrees with ICASA's preliminary conclusion.

Q4 - Do you agree with the Authority's preliminary conclusion on the methodology used?

34. Cell C agrees with ICASA's preliminary conclusion.

Q5 - Do you agree with the Authority's preliminary conclusion on the assessment of effectiveness of competition?

35. Cell C does not agree with all aspects of ICASA's conclusions, in particular the consideration of differences in operator costs. We refer to the following aspects of ICASA's analysis in turn below:

    - Actual ability/incentive of small operators to charge termination above cost
    - Superiority of certain market participants (i.e. large operators)
    - Differences in financial resources and access to capital markets
    - Economies of scale and scope
    - Manifestation of inefficient pricing

Actual ability/incentive of small operators to charge termination rates above cost

36. In section 2.3 (page 25) of the Discussion Document, ICASA states:

    The terminating licensee has the ability and incentive to charge excessive prices because the receiving party (terminating licensee's subscriber) is not affected by the increase in termination rates.

37. Although each operator has 100% of the market for call termination on its own network effectively by definition, this does not necessarily give small operators the ability to charge termination rates above costs. The setting of termination rates is not a unilateral decision of the smaller operators. Rather, small operators must bi-laterally agree interconnection with large operators, against which they must compete to gain scale. Thus, even if they have the incentives, small operators do not have the ability to charge high termination rates because in the absence of regulations they would have to negotiate those termination rates with a distinct scale disadvantage to the larger operators, and the lack of countervailing buyer power.

38. MTN and Vodacom have held significant market power in the wholesale call termination market for the last two decades. In the absence of sufficient regulation, these large operators can strongly leverage on their substantial market presence to demand termination rates above cost, while small operators like Cell C lack the countervailing buyer power to pressure large operators to reduce MTRs towards their efficient or actual costs, nor to drive negotiation of MTRs which would bilaterally be beneficial for competition for cross-network calling.

39. When ICASA refers to 'excessive prices', it should also consider the underlying unit cost differences between the small and the large operators. In the 2018 CTR process, ICASA itself demonstrated a clear asymmetry in the network costs of services between large-scale operators and small-scale operators. Since the fundamentals underlying this assessment have not changed to any appreciable extent, it is safe to conclude that this asymmetry in network costs of services persists due to the continued substantial scale differences between small and large operators.

40. It is Cell C's respectful submission that ICASA should recognise Cell C's lack of

countervailing buyer power and continue asymmetry in MTRs because it reflects the real underlying difference in costs for large operators compared to small operators.

Superiority of market participants MTN/Vodacom (i.e. large operators)

41. In section 2.3.4(vi) (page 31) of the Discussion Document, ICASA states:

    … In 2010 and 2014, the Authority determined that the impact of technological advantages or superiority of a given market participant is not relevant, given "absolute barriers to entry" and, therefore, that licensees face "no existing or potential competitors" in the provision of wholesale voice call termination services…
    …The Authority determined that spectrum assignment does not have a significant impact on the assessment of competition in the wholesale call termination markets, but "it may be relevant when considering the appropriate pro-competitive remedies."

42. Vodacom and MTN's market power leads to entrenched network externalities, where their subscribers benefit from having a large number of subscribers on the same network (for example, through making cheaper "on-net" calls to one another). As a result, later entrants to the market, like Cell C find it difficult to encourage higher-value revenue-generating subscribers to churn over into their subscriber base.

43. As this state of affairs has persisted over the decades, this had led to entrenched significant scale benefits for MTN/Vodacom compared to Cell C. Cell C in fact, has a considerably smaller revenue market share and share of terminated minutes than MTN and Vodacom (which as ICASA knows, is disproportionately low compared to its share of the national subscriber base).

44. An understanding of and distinction between, different operator scales is crucial to an understanding of the current structural market issues facing the operators in the South African mobile sector. It is Cell C's view that, with respect, it would be nonsensical for ICASA to recognise that scale is relevant in relation to the

determination of remedies, but then to impose a symmetric rate as a remedy on all licensees, regardless of their size by virtue of using a "one-scale fits all" approach.

45. Stated simply, if for this CTR process, ICASA abandons asymmetric rates and imposes symmetrical MTRs, this action will have severe and deleterious consequences for the South African mobile market:

- If a symmetric rate is set based on the costs of larger national-scale operator, then whilst MTN/Vodacom might adequately recover their costs of termination[5], Cell C would make a "below efficient cost loss" on every off-net minute it receives (under-recovery), to the detriment of its ability to operate as a sustainably effective competitor and effective challenger in the wider market in the long-term.
- If a symmetric rate set is such that Cell C can adequately recover its costs of termination, such as through a suitable small operator model, then MTN/Vodacom will make a significant "above efficient cost profit" on every off-net minute they receive, to the detriment of consumers and effective competition.

46. A symmetric rate would, therefore, have significant negative impact on Cell C.

47. At the same time, the significant scale differences between MTN/Vodacom and Cell C means that the impact of pro-competitive asymmetry on the two large operators is insignificant (less than 0.2% of their total expenses in 2020, whereas these asymmetry impacts are almost 1% of Cell C's revenue) as shown below:

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[5] Including a normal return on investment, typically set by the weighted-average cost of capital (WACC) in the cost model

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48. Cell C strongly emphasises to ICASA that distinct large versus small cost considerations and asymmetric pricing of large-scale and small-scale operators must continue in this process. The failure to do so will sustain the very same market failures identified multiple times by ICASA in the past (and most recently in March 2021 in the mobile broadband services market review). Should these considerations and asymmetric pricing not be continued as an outcome to the current MTR process, these already identified market failures will be sustained and in fact will be exacerbated yet again by inappropriate regulation in the call termination market.

Differences in financial resources and access to capital markets

49. In section 2.3.4(vii) (page 32) of the Discussion Document, ICASA states:

… In 2010, the Authority referred to the discussion on access to capital markets to

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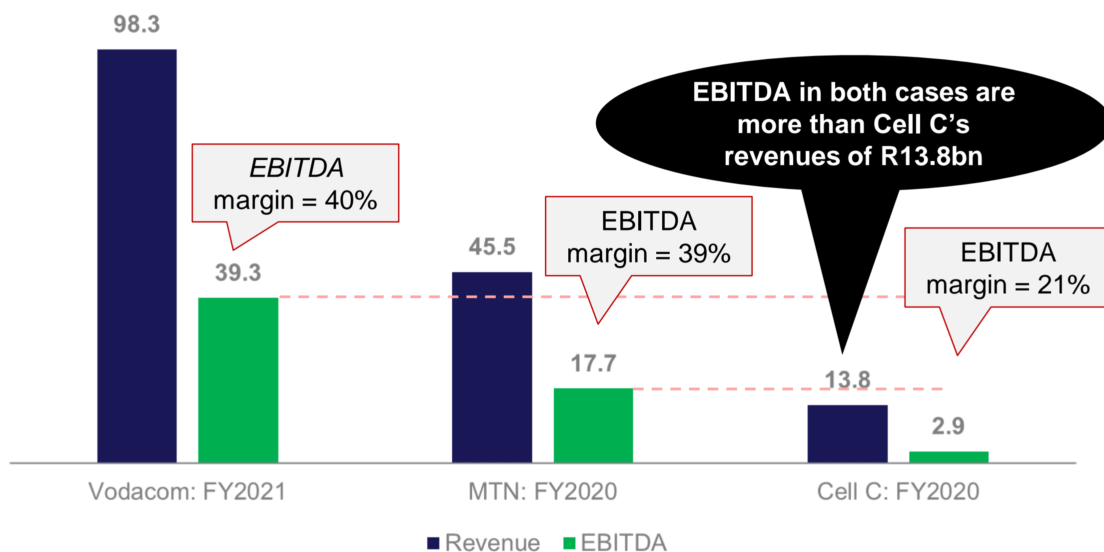
[6] Operators' annual reports and financial year results. Asymmetry payments are based on actual incoming traffic from Vodacom and MTN multiplied with the asymmetry benefit due to Cell C

how this may or may not affect countervailing buying power. In 2014, the Authority determined that access to capital markets plays a role in determining the effectiveness of competition to the extent that different licensees face different weighted average costs of capital. The Authority sees no need to change this determination.

50. MTN and Vodacom have substantial scale benefits as compared to Cell C, and sufficient cash resources available to invest in network expansion and subscriber acquisitions to assist them in maintaining their scale and therefore, securing cost advantages in the future.

51. These scale advantages are illustrated by the key financial indicators of Vodacom, MTN and Cell C in Figure 6 below. It is clear that MTN and Vodacom are able to generate much more EBITDA relative to their revenue, resulting in a higher EBITDA margin than Cell C.

Figure 6: Key financial indicators per operator, for the last reported FY (ZAR billion)



Source: Operator annual reports and results presentations

Economies of scale and scope

52. In section 2.3.4(ix) (pages 32/33) of the Discussion Document, ICASA states:

… The Authority's preliminary view is that economies of scale and scope are not

relevant in the assessment of the effectiveness of competition in the relevant market since each licensee controls 100% of its own termination market. However, the Authority is of the view that economies of scale and scope might be relevant when considering appropriate pro-competitive remedies.

53. In using scale in the application of a suitable pro-competitive remedy, it is Cell C's view that it would be appropriate and proportionate to adopt the same process as was adopted in both 2014 and 2018, and to consider both "large" scale operator and "small" scale operator network costs to determine termination rates.

54. This would also be consistent with sub-regulation 7(2) of the 2018 regulations (Government Gazette 41943, published 28 September 2018), whereby ICASA states that "an ECNS and ECS licensee must charge fair and reasonable prices for wholesale voice call termination". Cell C considers that reflecting the realities of large-scale and small-scale operator differences would be best able to render a "fair and reasonable price" for each operator, to ensure that both (i) Cell C can recover its cost of termination, and (ii) that Cell C does not pay above-cost rates (i.e. provide supernormal profits) to Vodacom and MTN. It is thus critical that ICASA regulate call termination rates with reference to the different costs for large operators compared to small operators (as previously used in the form of the large and small operator efficient cost models).

Manifestation of inefficient pricing

55. In section 2.3.4(xiii)(b) (page 35) of the Discussion Document, ICASA states:

… in the absence of regulations, the Authority is of the view that the following four market failures will exist, either in isolation or jointly:

- *A lack of the provision of access;*
- *The potential for discrimination between licensees offering similar services;*
- *A lack of transparency;*
- *Inefficient pricing.*

56. Inefficient pricing in this context is, firstly, the pricing above cost of traffic for large

operators and secondly, the pricing below cost of traffic for small operators. Both lead to inefficient market outcomes.

57. If large operators charge above their efficient costs, then that provides them with super-profits from termination services (as has happened in South Africa in the past). If small operators charge below their efficient costs (because their efficient unit costs will be higher than the efficient unit costs of large operators), then that forces small operators to suffer with sub-normal profits, and sub-normal profits are inefficient.

58. In particular, sub-normal profits would disincentivise small operators from providing call termination, and importantly, small operators would also have to make up sub-normal profits from the other services in the portfolio i.e. charging more for their mobile retail services. This is inefficient for those other services and reduces the ability of small operators to compete strongly with the large operators, which is in turn detrimental to the mobile market as a whole. If a small operator is unable to compete effectively and sustainably in the long-term with the intrinsically stronger operators, then this could lead to an exit strategy from the market, which would distort the market structure even more greatly.

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60. ICASA's decision of 2018 for asymmetry has at least enabled Cell C to not make a loss on these minutes terminated on its network. That said, there is still no profit element (beyond return on capital employed) to support growth in scale, further investment in network infrastructure and subscriber acquisition, marketing and improvement in quality of service.

61. Setting the rates at cost for small operators arguably still dilutes the value in their

businesses both to competition in general in the retail market, but also in the wholesale market. Most importantly in Cell C's view, is that if ICASA were to set the rates below cost for small operators, then this would destroy value in their businesses both to competition in general in not just the retail market, but also in the wholesale market, and ultimately for consumers who benefit from (stronger) challengers in the market.

Conclusions for Q5

62. ICASA must therefore, recognise the entrenched differences in operator scale that currently exist in South Africa and that the continued use of asymmetry, with cost-based call termination rates for both large and small operators, helps prevent a deepening of that entrenchment. A symmetric rate would either prevent cost recovery for small operators, or facilitate over-recovery for large operators, neither of which are efficient outcomes given the status of the mobile market in South Africa.

Q6 - Do you agree with the Authority's preliminary conclusion on SMP in the Mobile termination markets and Fixed termination markets?

63. Cell C agree with ICASA's preliminary conclusion.

Q7 - Do you agree with the Authority's preliminary conclusion on pro-competitive terms and conditions?

64. Cell C must at this point raise a number of issues and objections in response to this final question by ICASA. These issues are set out below and cover that:

- Applying symmetry is a material change to the pro-competitive terms and conditions
- An obligation to set cost-based termination rates means asymmetry must remain in place
- The restriction of asymmetry to new entrants only goes against ICASA's reasoned considerations of late (small) operators from the 2018 CTR process
- ICASA has both existing evidence and robust argument and foundations that unit

costs are materially different for large and small operators.

Symmetry is a material change to the pro-competitive terms and conditions

65. In section 2.5 (page 37) of the Discussion Document, ICASA states:

… the Authority's preliminary view is that it is not necessary to change materially the pro-competitive terms and conditions imposed on licensees in terms of the Regulations:

66. Cell C agree with this statement, i.e. it is not necessary to materially change conditions. However, we must emphasise that the imposition of symmetry would be a material change in conditions. Had ICASA opted for symmetric rates in the 2018 Regulations, then the resulting outcome would have been considerably worse, as Cell C would have under-recovered its costs of carrying voice termination. The figure below illustrates the additional under-recovery that Cell C would have experienced over the period 2018–2020 if its termination rate had been set to the same level as that of Vodacom and MTN, an outcome that Cell C are concerned would manifest in the current review with even worse results, if a symmetric approach is now adopted by ICASA. We demonstrate this in the figure below:

START CONFIDENTIAL

END CONFIDENTIAL

67. As ICASA is now considering symmetric rates as an option for the future regulation of small operators (that are not new entrants less than three years old), then Cell C must highlight the severe risk and emphasise the deleterious consequences this could have for the South African mobile market:

- If a symmetric rate is set based on the costs of a large national-scale operator, then MTN/Vodacom might adequately recover their costs of termination, but Cell C will make a "below efficient cost loss" on every off-net minute it receives (under-recovery)
- If a symmetric rate set is such that Cell C can adequately recover its costs of termination, such as through a suitable small operator model, then MTN/Vodacom will make a significant "above efficient cost profit" on every off-net minute they receive.

68. On the other hand, given that a small proportion of the large operators' voice traffic

[7] Estimates based on Cell C's actual voice interconnect revenues and outpayments, as submitted in response to Question 4 of ICASA's Annexure B information request. These adjusted to reflect all relevant minutes being priced at a symmetric rate (assumed to be the large operator rate).

terminates on the smaller networks, continuing with asymmetry is highly unlikely to have a disruptive effect on the market. Asymmetry is not financially harmful to the large operators, since the asymmetry payments make up an insignificant portion of their total expenses (less than 0.2%), as we showed in Figure 5 above.

An obligation to set cost-based termination rates means asymmetry must remain

69. In section 2.5 (page 37) of the Discussion Document, ICASA states:

    … This remedy should be seen in the context of addressing the market failure with regards to the incentive and ability of SMP licensees to charge termination rates above cost (inefficient pricing and potential of price discrimination). Each licensee is required to charge cost-based termination rates determined by the Authority using the top-down and bottom-up cost models in terms of the Regulations.

70. The obligation to charge cost-based rates is still proposed, and Cell C agree with this position.

71. Cell C has consistently emphasised to ICASA that separate modelling of large scale and small-scale operators was important. This point was made by Cell C in the CTR process of 2018 and the detailed bottom-up cost modelling undertaken by ICASA demonstrated a clear asymmetry in the network costs of services between large-scale operators and small-scale operators even to the last year of the model (2020), which was used to set the endpoint of the glide path and the prices that remain in place today.

72. The large and small operators modelled in 2018 were consistent with the threshold of a 20% share of terminated minutes that ICASA is proposing to still use as its demarcation between large and small operators. In particular, the operators deemed small in the 2018 decision would still be considered small today (which includes Cell C), as shown by ICASA's statistics in Figure 5 of its Discussion Document. The existing cost models therefore demonstrate the existing and current material difference in unit costs of traffic for large versus small operators.

73. Since the fundamentals underlying this assessment have not changed, it is safe for

ICASA to conclude, as Cell C urges, that this asymmetry persists due to the continued substantial scale differences between smaller and larger operators. There is no reason that in 2022 the models would show a sudden symmetry in efficient costs of large and small operators: the differences due to the substantial scale differences will persist.

74. Cost-based termination rates can thus remain asymmetric (as they are today) and still directly meet ICASA's proposed 'obligation to charge cost based rates'.

The restriction of asymmetry to new entrants goes against ICASA's reasoned considerations from the 2018 CTR process

75. In section 2.5 (page 37) of the Discussion Document, ICASA states:

The Authority is of the view that only new entrants should be allowed to charge temporary high termination rates: for a limited period of up to three years upon entry, in order to account for cost differences, if any, between new entrants and the incumbents. The transitional period of three years, as opposed to perpetual asymmetry, will encourage new entrants to be efficient and grow their market share.

76. It is our submission that ICASA must not apply this proposed new constraint in allowable asymmetry. The late (small) operators in the market as of 2018 remain small and have higher unit costs of traffic than the large operators. ICASA undertook considerable efficient cost modelling to be confident of these differences in unit costs in the 2018–2020 period.

77. We must also strongly emphasise that ICASA's draft briefing note on asymmetry in the previous process (released in February 2018) included a sunset clause to end asymmetry before the end of the regulation period. Following careful consideration by ICASA in the stakeholder responses to that draft, the sunset clause was amended in the final briefing note of June 2018. In particular, the final sunset clause stated that "termination rates should continue to gradually move

towards symmetry".[8] In contrast to its own reasoning, ICASA is now proposing an overnight removal of asymmetry for small operators like Cell C, which completely contradicts this statement from 2018.

Conclusions for Q7

78. ICASA's 2018 policy decision regarding allowed cost-based asymmetry for all small operators in the 2018 Regulations presented some measure of relief for Cell C. Had ICASA opted for symmetric rates in the 2018 Regulations, then the resulting effect on Cell C's ability to be competitive would have been considerably worse, as Cell C would have under-recovered its costs of carrying voice termination to a substantial extent and this would have impacted Cell C's ability to compete with the large operators in the wider mobile market, to the benefit of consumers.

79. Equally, if ICASA had continued to allow above-cost rates for large operators, this would also have impeded Cell C's ability to compete, through the large operators achieving super-normal profits on call termination in a way that the small operators could never replicate.

80. However, now, after only three years of broadly effective and asymmetric cost-based regulation, ICASA is now seeking an abrupt move to symmetry for all operators except new entrants, despite its own models showing that the asymmetry in the efficient unit costs of traffic between large and small operators is still very much present (consider the modelling done to 2020). Moreover, there would be no reason to assume this asymmetry has disappeared in 2021, or will disappear in the near future as the significant scale differences persist.

81. As described earlier in this document, ICASA must not rush to symmetry merely to follow in the footsteps of other regulatory bodies: ICASA is required by the ECA to consider and implement, following robust consultation, the right regulation for the SA ICT sector, its history and its objectives. There are also many countries where asymmetry still exists and the regulator has identified good reasons for it to remain

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[8] See https://www.icasa.org.za/uploads/files/Briefing-note-on-asymmetry-22-june-2018.pdf, page 4

in place.

82. Cell C have demonstrated to ICASA that symmetry within the current market structure further strengthens the position of market power of the large operators. Moreover, the proposed abrupt removal of asymmetry completely contradicts ICASA's own statement of a continued gradual move to symmetry, which it communicated to stakeholders in 2018.

83. It is Cell C's respectful submission therefore, that ICASA should revise its proposed pricing decision of symmetry, which it can do and yet still be consistent with other aspects of its decision making (including not materially changing the conditions, and applying cost-based rates) by continuing to apply cost-based asymmetric rates.