SUBMISSIONS BY NASHUA COMMUNICATIONS (PTY) LTD

ON THE

DRAFT CALL TERMINATION REGULATIONS

PUBLISHED IN GOVERNMENT GAZETTE 36919 ON 11 OCTOBER 2013

22 NOVEMBER 2013

Introduction

1. Nashua's Communications (Pty) Ltd ("Nashua") submission on the Draft Call Termination Regulations 2013 published in GG 36919 on 11 October 2013 ("the Draft Regulations") is set out below.

2. Nashua is a wholly owned subsidiary of Reunert Limited ("Reunert"). Nashua provides licensed services under Reunert's ECS (0023/IECS/JAN/2009) and ECNS (0023/IECNS/JAN/2009) licenses.

3. Nashua supports the urgent finalisation of these regulations. Lower call termination rates have benefited competition and consumers in the last few years. Further drops to the termination rates are required in order to decrease the high cost of telecommunications in South Africa.

4. The dominant mobile operators have opposed the glide path proposed in the Draft Regulations and indicated that dramatic drops to the mobile termination rate ("MTR") will erode their future profitability. Their position, however, is not supported by the available data. As outlined below, both Vodacom and MTN recently announced significantly improved profitability despite large drops to the termination rate.

5. This submission discusses a number of key issues identified within the Draft Regulations and questuons raised during Nashua's one-on-one session with the Authority.

Mobile termination rates

6. The MTR should follow ICASA's proposed glide path. R0,10 / minute is an appropriate end point for the glide path in March 2016.

7. After March 2016, ICASA should conduct further international benchmarking exercises to determine whether the MTR should drop further.

8. Vodacom has warned that the proposed cuts to the MTR will require it to adjust its operating expenses and capital investment. Vodacom further stated that the proposed rates may impact its price transformation programme. It seems that Vodacom is threatening to decrease investment, cut jobs and hike prices in response to the proposed MTR drops.

9. This position is not supported by Vodacom's financial data. In its recently published financial results to 30 September 2013, Vodacom increased its headline earnings per share by 10,9% vs. the same period last year. Despite the rapidly declining mobile termination rate, and significant decreases to retail tariffs (to "an effective R0,59 / minute" in the prepaid market), Vodacom's prepaid ARPU increased by 1,4% as a result of a 19,3% growth in minutes of use. This shows high elasticity of demand in the pricing of prepaid mobile voice minutes – as selling prices drop, demand rises substantially.

10. MTN likewise recently published its financial results to 30 June 2013. During its most recent six month trading period, MTN reported a 22% rise in headline earnings per share. Revenue increased by 9.8% to R65bn despite the negative effects of tariff cuts in both South Africa and Nigeria. The lower MTR did impact on MTN SA's profit margin – its EBITDA margin fell by 2.1% to 33.3%. If anything, the current level of profitability enjoyed by the dominant mobile operators indicates that lower costs and more competition is urgently needed.

11. The lower MTR is achieving precisely what ICASA hoped – increased competition and lower prices for consumers.

12. Nashua is concerned that Vodacom Business and MTN Business enjoy an unfair pricing advantage in the fixed market. As outlined in Nashua's response to ICASA's call termination questionnaire, assuming that Vodacom has a 50% market share it only pays 50% of the MTR for outbound mobile calls.

13. It is for the reason outlined above that Nashua supports decreasing the MTR as quickly as possible to the cost of an efficient operator (R0,10 / minute).

14. Nashua supports ICASA's proposal to drop the mobile termination rates aggressively.

Fixed termination rates

15. Nashua supports ICASA's decision to maintain the current fixed termination rates ("FTR"). Fixed operators have been subsidizing the mobile network operators' networks for the last 2 decades by paying mobile operators significantly higher termination payments.

16. Telkom published the following information in its half year report to 31 March 2013:

    Fixed-line voice usage revenue continued its declining trend and decreased 7.7% to R4 071 million (30 September 2012: R4 411 million). This was driven by a 3.0% decline in voice minutes, which continues being affected by mobile substitution, a reduction in fixed termination rates of approximately R55 million and a decrease of approximately R130 million relating to the pass through of the reduction in mobile termination rates to fixed-line customers. Furthermore, the number of lines also declined by 4.6%.

17. It is clear that Telkom's fixed line business is under pressure. Telkom Wholesale is a key supplier to all fixed and mobile operators in the country. Further decreases to the FTR should be carefully considered and, if implemented, imposed over a 3 year glide path.

18. After March 2016, ICASA should conduct further international benchmarking exercises to determine whether the FTR should decrease further.

Fixed Mobile Convergence

19. Nashua supports convergence in the fixed and mobile termination rates in the medium to long term. Fixed and mobile technologies are converging and the line between the two markets is blurring. Customers will increasingly demand services that can switch seamlessly between fixed and mobile technologies (e.g. 3G to WiFi handover).

Asymmetry

20. Asymmetry is an appropriate pro-competitive remedy where new entrants have significantly lower market shares then the dominant licensees. Asymmetry would go some way to compensate for the lower economies of scale enjoyed by smaller operators.

21. Nashua is of the view that asymmetry should not exceed 20%. We would support declining asymmetry of 20% to 10% over the period of the glide path in both the fixed and mobile markets.

22. Nashua does not believe that Vodacom Business, MTN Business and Telkom Mobile should qualify for asymmetry. These operators benefit from the scale economies of and are cross-subsidized by their dominant parent companies.

23. After March 2016, ICASA should conduct further international benchmarking exercises to determine whether asymmetry should remain in both or either of the markets.

24. Nashua supports ICASA's current proposal. However, we have two major concerns with the level of asymmetry proposed in the mobile market: (1) that it may create domestic and international arbitrage problems; and (2) that the dominant mobile operators could use asymmetry as grounds for legal action to delay the next round of termination decreases.

Arbitrage

25. Arbitrage usually occurs when operators are able earn higher inbound call rebates then the cost of outbound call termination to the same operator.

26. The proposed Vodacom / MTN interconnect rate of R0.20 / minute at 1 March 2014 is significantly lower than the proposed Cell C / Telkom Mobile interconnect rate of R0.39. Due to Mobile Number Portability, it may be difficult for certain international operators (not connected to South Africa's number portability database) to identify which calls to send to each operator.

27. If an operator negotiates a large rebate relationship with Cell C / Telkom Mobile, it may be able to spoof traffic to numbers ported from Vodacom / MTN to Cell C / Telkom Mobile and generate inbound revenue that exceeds its outbound call costs.

28. A solution to international call arbitrage is to impose a standard international MTR for all calls to SA mobile numbers. However, if this rate is lower than the domestic MTR, it may result in the international routing of domestic calls bound for Cell C and Telkom Mobile (so-called "tromboning"). And if the rate is higher than the domestic MTR, it may result in international grey routing via domestic operators.

29. This kind of call fraud is not limited to international arbitrage - Nashua was recently defrauded of c. R1m in an incident that involved fraudulent calls to another ECS licensee. Nashua suggests that ICASA imposes an inter operator code of practice and a complaints procedure for these kinds of issues to be resolved.

Discriminatory off net pricing

30. Nashua agrees that discriminatory off net pricing from the dominant fixed and mobile operators may discourage customers from doing business with smaller operators. This issue needs serious attention from the Authority - however, it may be difficult to include retail pricing issues in the call termination regulations.

31. Cell C recently filed a complaint at the Competition Commission accusing Vodacom and MTN of discriminatory pricing. The complaint effectively accuses Vodacom and MTN of discounting their on net tariffs and charging their customers a premium for off net calls.

32. Nashua, then trading as ECN Telecommunications (Pty) Ltd, filed a similar complaint against Telkom at the Competition Commission in 2009. Following a number of extensions, the Competition Commission decided not to refer Nashua's complaint to the Competition Tribunal in 2012. That complaint, its annexures and the Competition Commission's letter in which it explains its decision not to refer the complaint are attached hereto.

Quality of service

33. Price and quality of service are the major determinants of consumer choice. Much of Nashua's business is won through aggressive pricing. However, if the quality of service is not sufficient, customers tend to churn very quickly to other licensees' services.

Market share

34. Market share of the voice termination markets should be measured according to minutes.

Termination Revenue

35. Nashua is a net payer of termination revenue. Inbound calls only accounted for 11% of Nashua's total call traffic at the end of the period under review in the call termination questionnaire (i.e. the half year to 31 December 2012).

In country roaming

36. Nashua believes that in-country roaming is technically equivalent to call termination (although the call flow is in the opposite direction). Roaming, like interconnection, should be provided at the cost of an efficient operator.

37. For these reasons, Nashua supports in-country roaming at roaming rates which are equal to the prevailing call termination rates.

Conclusion

38. Nashua thanks the Authority for the opportunity to comment on the Draft Regulations and hopes that they will be finalised as soon as possible.