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05 December 2012

Mr Godfree Maulana
Independent Communications Authority of South Africa
Block D, Pinmill Farm
164 Katherine Street
Sandton

Delivered via email to:- gmaulana@icasa.org.za

Dear Mr Maulana,

RE: SUBMISSION ON THE DRAFT GENERAL LICENCE FEES REGULATIONS.

1. On 24 October and in Government Gazette 35819, the Independent Communication Authority of South Africa ("ICASA") published the Draft General Licence Fees Regulations for public comment. Interested parties were given 30 days within which to submit their comments.

2. Smile Communications thanks ICASA for the opportunity to submit its comments contained herein.

3. Our comments appear in separate headers encompassing (i) General Comments on the levying/collection of licence fees and (ii) Specific Comments on the draft regulations.

4. Smile hopes you will find our comments useful and avails itself for further consultations. Smile wishes to record its interest to participate in any further

consultative process ICASA may engage in, including hearings. Kindly acknowledge receipt of our submission.

Thank you and warm regards,

Thato Mahapa
Senior Manager: Legal and Regulatory

SMILE'S SUBMISSION ON THE DRAFT GENERAL LICENCE FEES REGULATIONS

Notice No. 887 issued under Government Gazette 35819
dated 24 October 2012

SUBMISSION DATE: 05 DECEMBER 2012

1. INTRODUCTION

1.1. Smile Communications (Pty) Ltd ("Smile") welcomes the opportunity to comment on the Draft General Licence Fees Regulations published by ICASA in Government Notice 887 of 24 October 2012 contained in Government Gazette 35817. As a new entrant in the sector, the levying of licence fees is a matter Smile considers critical as it can potentially have a significant impact on our entry strategy and continued competitiveness in the sector.

1.2. Should there be any further consultative process which the Authority may undertake including the convening of public hearings, Smile confirms that it would like to participate in such a process.

1.3. By way of background, Smile was awarded an ECNS and ECS licence in South Africa in 2007 as part of the licence conversion process and is presently fully licensed to operate national networks and provide communications services in Uganda, Nigeria, Tanzania and the Democratic Republic of Congo. Whilst Smile is in possession of a network and service licence in SA, Smile has no access to radio frequency spectrum which is a key enabler for our service offering. We are of the firm belief that the expedited awarding of spectrum, enabling Smile to commence operations, will allow Smile to contribute more meaningfully to the societal developmental goals as well as the recently stated objective of bringing down the costs to communicate in the Republic.

1.4. Lastly, Smile believes that, in the near future once the Authority issues the relevant spectrum assignment to Smile, the company will be able to extend its service offering to the citizens of the Republic, uplift the lives of people as well as improve the productivity of communities, schools, and institutions in SA. This will also allow Smile to contribute to the attainment of the government targets in respect of the Information and Communications Technology ("ICT") sector, i.e. 100% broadband penetration by 2020 and the creation of 150,000 direct and indirect jobs by 2020[1].

1.5. Smile's comments on the draft regulations appear below.

[1] Honourable Minister of Communications, "Budget Vote of the Department of Communications" 31 May 2011

2. BACKGROUND TO LICENCE FEES REGULATIONS

2.1. On 24 October 2008, ICASA published the Draft General Licence Fees regulations in Notice No. 1305 published in Government Gazette Number 31542 and proceeded to convene hearings on January 2009 with the final regulations prescribed in Government Gazette 32084 of 1 April 2009. The publication of the Draft Regulations in October 2008 was preceded by the convening of an industry workshop in October 2007 on the levying of licence fees and the need for a revised approach thereto owing to the challenges imposed by licence conversion and the new regulatory framework imposed by the then newly promulgated Electronic Communications Act, 36 of 2005[2].

2.2. A variety of issues were raised by both ICASA and industry at large in the cumulative process and final decisions on these were published by ICASA in its Position Paper published on 6 March 2009 in Government Gazette 31993 and further in the Supplementary Position Paper published on 1 April 2009 in Government Gazette 32085. The two position papers reflected ICASA's decisions on the various issues canvased during the protracted process of arriving at the presently applicable General Licence Fees Regulations.

2.3. ICASA then published the current Draft General Licence Fees regulations on 24 October 2012 in Government Gazette 35817 coupled with an Explanatory memorandum purportedly to provide an explanation for the changes ICASA seeks to introduce. Without going into unnecessary detail, we will highlight the salient points from the previous process we outlined above regarding the prescription of the current General Licence Fees Regulations.

3. PROMOTION OF COMPETITION

3.1. Smile believes it to be imperative to revisit some of the findings therein in order to ensure continuity and guarantee regulatory certainty, particularly for new entrants in the market Indeed there is no prohibition or restriction on the ability of ICASA to depart from an earlier decision it has made. However, such departure should be made clear, not be arbitrary or implied, should be rationally founded on or connected to the reasons which ICASA has highlighted for the departure from the earlier decision and executed in such a constructive manner that it receives sufficient buy-in from industry. ICASA's current proposal amounts to a complete departure from the current dispensation in as

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[2] Since amended.

far as the levying of annual licence fees is concerned. Whilst Smile is generally in support thereof, it cautions that such a decision is not to be taken lightly.

3.2. In addition, the promotion of competition and the development of SMME's as objectives of the EC Act were also highlighted by ICASA. Smile believes that ICASA should take this opportunity to cement its approach towards the achievement of these objectives and should consider introducing further measures aimed at achieving these goals. The proposed inclusion of a regulatory holiday for 3 years from commencement of operations as an attempt to lower barriers to entry for new entrants is recognised as being a means of creating a conducive environment for competition. Smile is however concerned that this proposal and its implementation offers little in the way of protection for smaller players as, on average, it takes between 5 and 8 years in the ICT sector(Broadcasting, Networks and Communications Services all included) for new players to reach the lowest level of profitability. Worse is that at the end of the proposed 3 year "holiday", new entrants will potentially face the introduction of significant costs into their operations irrespective of their size or profitability.

3.3. Furthermore, it is not clear how ICASA's proposal fairs relative to the already existing exemption based on the National Small Enterprises Act as per regulation 4(c) of the current regulations. In any event, although a 3 year exemption is a positive step, Smile believes that that measure alone will not sufficiently promote competition or protect new entrants from a license fee perspective.

3.4. In Smile's view, ICASA can expand on the measures to be introduced to facilitate competition, support the development of SMME's and protect new entrants in the following manner:

3.4.1. The regulatory holiday should be extended to a minimum of 5 years from commencement of commercial operations for the reasons expressed above;

3.4.2. A glide-path should be adopted toward the levying of licence fees on such entrants over a period to lessen the financial burden on new entrants. Such a glide path could be structured such that the payment of licence fees is incremental as follows:

Year	Licence Fee (%)
6	0.1
7	0.2
8	0.4
9	0.5
10	0.75

3.5. This will allow new entrants the ability to compete in some aspects of their business as they will be able to compensate in the absence of super-profits, cross subsidies and entrenched market shares whilst dealing with reduced regulatory obligations

4. GENERAL COMMENTS ON THE LEVYING/COLLECTION OF LICENCE FEES

4.1. ICASA has previously identified the costs of regulating the market as an appropriate benchmark for the levying of licence fees[3].. As it appears, ICASA does not seek to deviate from this principle in the current regulations. However, the level at which fees are proposed to be levied appear has not been properly contextualized by ICASA. In its previous Position Paper on licence fees, ICASA provided a table that summarized a variety of figures including year on year revenue collection, industry growth, ICASA's MTEF figures for the relevant periods as well as the extent to which there was an over collection. The table also showed year-on-year growth of the industry and, in paragraphs 24 to 25, ICASA gave a detailed and clear methodology on how it arrived at the "*1.5% of Gross Profit*" level of contributions.

4.2. The sharing of such detailed information allowed licensees to have a better understanding of the impact of the licence fees being imposed and provided a greater level of transparency offering comfort to licensees as the payment of licence fees is a significant financial burden to be incurred, more so for new entrants. The current draft regulation does not provide any information that allows one to properly calculate the impact of ICASA's proposal on the industry; it furthermore does not enable one to assess whether ICASA adheres to the principles of limiting the collection of licence fees to recouping the costs of regulating the sector. It is definitely in the interests of both ICASA and the sector to have information availed where such information, including forward-looking budgetary information, will assist the regulation making process.

4.3. It is Smile's view that ICASA ought to provide the information that shows the cumulative collection at the new proposed rate to illustrate how the collection will fare against the stated objective of collecting fees to cover the costs of regulating the sector. To ensure that ICASA collects appropriate amounts from licence fees, Smile strongly urges ICASA to use an evidence based approach and to:

- conduct an assessment of the total industry revenues including a separate assessment of the financial contribution of new entrants to the sector revenues;

[3] Position Paper published on 6 March 2009 in Government Gazette 31993, at paragraph 10.

- provide ICASA's budget for the next 5 years (at the very least); as well as

- indicate the methodology that shows how ICASA arrives at the ultimate percentage of turnover to be levied as a licence fee, including specific pro-competition measures for new entrants.

4.4. Smile is quite mindful of the fact that revenues are subject to some volatility and ICASA will not have absolute certainty on projected figures. However, sharing the information requested above will surely go a long way towards providing comfort to the industry through the transparency created.

4.5. In its findings, ICASA, after evaluating the impact of levying licence fees on Gross Revenue[4] finds that:

4.5.1. "*Licence fees levied on gross revenue are counter the objectives of the Act as they reduce the incentive for firms to enter the ICT sector, harm smaller players in a disproportionate manner and may increase rather than decrease the administrative burden of regulation*."[5]

4.6. Similarly, after evaluating the impact of levying licence fees on Gross Profit it finds that

4.6.1. "*…the optimal financial measure on which to base licence fees appears to be gross profit (of licensed activities)"*[6]

4.7. ICASA then goes on to state that: "*Three years of implementing the regulations have brought to the fore certain administrative challenges relating to collecting annual licence fees."*[7] In seeking to depart from "Gross Profit" as the level at which licence fees are levied, ICASA states that: "…*this definition has led to regulatory arbitrage where certain operators subtract from their revenues all manner of costs, so as to declare as minimal a profit as possible*…[and]…[t]*he Authority has not been able to verify that the fees collected are indeed what were due*".

4.8. Whilst ICASA's concern is absolutely justifiable, it is not readily clear to Smile how far the changes to the existing regulations will go to addressing the challenge as identified

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[4] Effectively Turnover as per the new draft regulations.
[5] Cf note 3, para 16.
[6] Cf note 3, para 19.
[7] Explanatory memorandum for the Draft General Licence Fees regulations, appearing on page 15 of the gazette referred to in

whilst continuing and improving on the protection of new entrants and smaller players. The introduction of Gross Profit as the tool of choice was particularly aimed at protecting smaller entities from having to pay licence fees before attaining profitability. Should ICASA wish to move to a Turn-Over based approach, Smile would be supportive of that where ICASA can clearly demonstrate the continued protection of new entrants and smaller players. Smile wishes to reiterate its proposals contained in part 2 above.

4.9. The regulatory challenges on the implementation of the regulations are appreciated, particularly regarding "the lack of disaggregation of information in the financial statements" leading to "information asymmetry". It should be noted that the other principles adopted by ICASA in the earlier process underpinning the levying of the licence fees have not been challenged or identified as being problematic. To the extent that the current Draft Regulations have the effect of moving away from some of those principles, ICASA should be mindful of the goals those principles sought to achieve.

5. SPECIFIC COMMENTS ON THE DRAFT REGULATIONS

5.1. Given Smile's foregoing comments, Smile's comments are limited to minor additions following herein.

5.2. **Regulation 4(d):** The period for exemptions should be extended to at least 5 years from commencement of operations as a reflection of the average time it ought to take an efficient licensee to reach profitability. Thus it should read:

5.2.1. <u>Licensees will be exempted from paying Annual Licence Fees in the first five (5) years from commencement of their operations.</u>

5.3. **Schedule 2:** should retain the proposed form subject to a revision of the percentage to be applied pursuant to the sharing of information evidencing ICASA's calculation of the impact of the 0.75% collection as against ICASA's budgetary allocation and should include a glide path as proposed above for new entrants..

5.4. **Schedule 3:** Smile has further noted the introduction of schedule 3 containing the reporting format. In Smile's understanding, licence fees payments are meant to be verified against audited financials. Licensees report either according to GAAP or IFRS[8]. Smile acknowledges that the two standards are not identical but the bulk of companies are moving towards IFRS as a standard of choice. As such, two separate and distinct forms should be developed for the two prominent financial reporting standards. ICASA should customize a form for GAAP and IFRS. In improving compliance with the regulation, reliance can be had on sections 29, 30 and 31 of the Companies Act[9]. However, given that matters dealing with compliance issues are being centralized in the Compliance Procedure Manual Regulations ("CPMR") prescribed by ICASA, it appears that it would be more appropriate to, in parallel, amend the CPMR and for ICASA to engage with industry on improving the reporting formats to standardize them as much as possible to guarantee the consistency sought. The splitting of total revenue between licenced and non-licenced activity remains necessary in these regulations with the introduction of Turnover as the licence fee levying tool. In addition, the splitting of such revenue in the table that follows is an exercise that licensees currently engage in in their reporting. Thus it is not readily apparent how the new reporting format will cure ICASA's predicament.

6. CONCLUSION

6.1. The current General Licence Fees Regulations were prescribed in April 2009. They have seen their 3rd anniversary of implementation. Whilst ICASA did not label it as such, the prescription of the current regulations appears to have followed the tenants of a regulatory impact assessment associated with the introduction of regulations. A periodic review of the efficiency of the regulations is also another feature of the impact assessment and approximates international best practice.

6.2. Whilst Smile understands and supports ICASA's efforts to improve compliance by the industry with the regulations, Smile would suggest that ICASA equally focus on reviewing and improving the Monitoring and Evaluation tools that are meant to accompany the regulations. Evidently, the form prescribed by the CPMR has not substantially assisted ICASA in discharging its duties efficiently and effectively. It appears to Smile that the main challenge that ICASA seeks to address is the efficiency of the M&E aspect of the regulation and therefore, any amendments need to be restricted thereto.

6.3. Smile also commends ICASA on its commitment to the promotion of competition and various endeavours to that end. Smile proposals in this submission seek to support ICASA's efforts, particularly the encouragement of new entrants into the sector.

6.4. Smile trusts that ICASA will consider its input and find it useful. Once again, Smile reiterates its commitment to assisting ICASA to continuously improve the regulation of

[9] Act 71 of 2008 published in GN 421 of Government Gazette 32121 of 9 April 2009.

the sector. Smile wishes to further participate in any additional consultative process that ICASA convenes, including oral presentations at public hearings.