Telkom

Submission to the Independent Communications Authority of South Africa

Response to Discussion Document dated 5 November 2021 (Government Gazette No. 45426)

Section 1. Introduction and Executive Summary

1. On 5 November 2021, the Independent Communications Authority of South Africa ("**the Authority**") published its Discussion Document on the Review of the Pro-competitive Conditions imposed on licensees in terms of the Call Termination Regulations, 2014 (**"the Discussion Document**") and invited Stakeholders to submit written representations with regards to the Discussion Document by 11 January 2022.

2. Telkom welcomes the opportunity to comment on the issues raised in the Discussion Document, which will have significant implications for competition (including but not limited to price-based competition), the future market structure, investment and outcomes for South African consumers and businesses. The actions that the Authority takes on Call Termination Regulation ("CTR") will also provide a clear indication as to the Authority's commitment to promoting the convergence of services and it's commitment to a genuinely competitive mobile sector that promotes investment and innovation, and delivers the best outcomes for the people of South Africa.

The Authority's proposals are NOT pro-competitive and would entrench the current duopoly, to the detriment of consumers

3. The implication of the Authority's proposals set out in the Discussion Document is the perpetuation of Telkom's effective subsidisation of Vodacom and MTN through the charges arising from the calls made by its fixed and mobile voice customers. The proposed removal of the pro-competitive mobile termination rate ("MTR") asymmetry combined with the retention of the existing fixed termination rate ("FTR")-MTR differential would cause Telkom's net out-payments to Vodacom and MTN to increase substantially, while at the same time preventing Telkom from recovering the costs of calls terminated on its own networks. This will impact negatively on the incentives for Telkom, and other small players, to continue to invest in the South African mobile market, while further entrenching Vodacom and MTN's long-standing dominant positions.

4. The Authority's proposal to remove the pro-competitive MTR asymmetry for existing mobile operators comes at a time when Vodacom and MTN continue to hold a duopoly position in the retail mobile market with a combined market share of 82 percent in terms of mobile voice subscribers, and 88 percent of mobile voice revenues in 2020 according to data presented in the Authority's Discussion Document,[1] while Telkom and Cell C have yet to reach the minimum efficient scale to compete effectively.[2] Meanwhile, in separate proceedings, the Authority is proposing competition measures that will restrict Telkom from acquiring additional spectrum that it needs to compete effectively, whilst enabling Vodacom and MTN to acquire significantly more spectrum and thus strengthen their entrenched dominance. The combined impact of these measures will put at risk any progress the Authority has made to date in facilitating competition in the mobile market.

5. The impact of these unwelcome and damaging regulatory interventions will be compounded by the increasing constraints that network operators, in particular those of smaller scale, face from non-traditional players – in particular from over-the-top ("OTT") application and service providers. It is common cause that OTT providers do not bear the same costs, nor the same regulatory burdens, and

[1] See Figure 1 and Figure 2 of the Authority's Discussion Document.
[2] Telkom notes the mobile segment began as a duopoly with the licensing of Vodacom and MTN in 1994. Although there has been subsequent entry of competitors (i.e. Cell C in 2001 followed by Telkom Mobile in 2010) the duopoly structure of the mobile segment has largely persisted. New entry should have created effective competition and improved market outcomes for consumers. However, this has been hampered by the actions of the incumbent MNOs and by the failure of the Authority to impose adequate regulatory measures.

are able to deploy different commercial models that enable them to offer zero-rated voice and messaging services whilst consuming capacity on fixed and mobile operators' networks, with the end-user only paying operators for data usage. The new commercial models of the OTT players are continuing to erode the value that network operators generate from investing in critical voice services, while increasing network capital expenditure ("capex") requirements to meet rising demand for data traffic. This disproportionally affects small operators, which have lower profit margins and a small subscriber base from which to recover the cost of network upgrades.

The Authority's approach outlined in the Discussion Document is flawed and irrational

6. It is critical in this context that the Authority assesses, in a holistic manner, the collective impact that its proposed regulatory measures will have on the ability for smaller scale operators to compete effectively in the South African mobile market. The Authority's introduction of MTR asymmetry as a pro-competitive measure in 2014 was an important intervention to prevent the further entrenchment of the enduring duopoly and to protect South African consumers from the effects that may otherwise arise. However, the Authority's proposals to remove the current pro-competitive MTR asymmetry measure, and apply this only to new entrants for three years from market entrance, is flawed and irrational in multiple respects:

   - The Authority's approach to developing its proposals is contrary to the objectives of the Electronic Communications Act ("ECA"), resulting in proposals that fail to encourage investment or to promote competition and stability in the ICT sector.
   - The Authority's justification for its proposal rests heavily on the blind application of an arbitrary time-limit on asymmetry that was proposed in a European Commission ("EC") recommendation more than ten years ago, without any consideration of local market conditions, or the relevance of the recommendation to the South African mobile market. Telkom notes in this regard that the guidance that underpins the EC's recommendation advises national regulatory authorities ("NRAs") to consider local market conditions as an input to the determination of an appropriate timeframe over which to maintain asymmetry. The Authority has not undertaken such an analysis to Telkom's knowledge.
   - The competition concerns that the pro-competitive measures were intended to address remain. Vodacom and MTN's combined market share in terms of mobile voice subscribers has remained above 75 percent since 2017 and stood at 82 percent in 2020, while Telkom and Cell C's market shares have both remained well below the 20 percent threshold generally regarded as an indicator of minimum efficient scale.[3] [4] The Authority has not provided any evidence to suggest that competitive conditions have changed (i.e. that the higher costs faced by small players have been eliminated) such that the removal of pro-competitive measures is warranted. Removing the asymmetry at a time when there is clear evidence that the conditions that justified the introduction of asymmetry remain, would clearly be unjustifiable and irrational.
   - Notwithstanding the introduction of the MTR asymmetry in 2014, there is still a lack of effective competition in the South African mobile market. The Vodacom and MTN duopoly still dominate the market and this dominant position allows them to a large extent to price independently of challenger networks.[5]

[3] See Figure 1 of the Authority's Discussion Document.
[4] For example, the European Commission has previously recommended that 20 percent market share is used as a proxy for minimum efficient scale. See para 5.2.3 in INFSO-2008-00118-00-01-EN-REV-00 (europa.eu).
[5] Competition Commission's Data Services Market Inquiry 2019: http://www.compcom.co.za/wp-content/uploads/2019/12/Data-Services-Inquiry-Summary.pdf.

- A number of factors beyond Telkom's control (including access to spectrum, access to sites, barriers to subscriber switching and network effects) have created significant "first mover" advantages and continue to constrain late entrants' ability to reach minimum efficient scale to compete more effectively. These factors have been reinforced by call termination regulation.
- The Authority's suggestion that removing the MTR asymmetry will incentivise late entrants to become more efficient and grow their market shares has no foundation. Late mobile entrants already have strong commercial incentives to become more efficient and grow market share (e.g., to generate a return on sunk investments); it is the effects of market failure and duopoly that are constraining late entrants' ability to compete.
- To Telkom's knowledge, the Authority has not assessed the impact of removing the pro-competitive measures on investment or competition, the impact on price-based competition, or the ultimate impact on consumers. As a result, the Authority has failed to identify the net beneficiaries and net losers; if it had done so it would have identified that the beneficiaries will be the Vodacom and MTN duopoly and that the losers will be South African consumers and businesses. This represents a failure to fulfil its mandate as set out under the ECA.

<u>The Authority's proposals are damaging to competition, investment and regulatory certainty.</u>

7. Removing the pro-competitive MTR asymmetry would have a detrimental, and potentially irreversible, impact on competition and investment, which would far outweigh any risk of short-term inefficiency. Telkom estimates that removing the current asymmetry would result in its net out-payments increasing by a year to in 2022/23, of which more than would be passed through to Vodacom and MTN collectively. To put this into perspective this would represent an increase relative to 2020 net out-payments of and be equivalent to between percent of Telkom's average annual mobile capex investment.
8. A financial impact of this scale could weaken Telkom's incentives to continue to invest in the South African telecoms market (e.g., by reducing its capacity to undertake network investment and its ability to compete on price) and could lead to a softening of competition. This will, in turn, be detrimental to consumers and businesses across South Africa, with less competition and investment potentially leading to higher prices, lower quality services, weakened consumer choice, and less availability and take up of innovative services than would otherwise be the case. Overall, it is clear to Telkom that the net beneficiaries of the Authority's proposals will be Vodacom and MTN, whilst the net losers will be South African consumers and businesses. **The Authority's proposals will lead to the continued transfer of capital from smaller players to dominant players.**
9. More broadly, the Authority's proposals have the potential to increase regulatory uncertainty, which could further weaken incentives to invest. The Authority's previous CTR decision set the clear expectation that operators terminating less than 20 percent of total voice traffic would be able to benefit from MTR asymmetry to help offset disadvantages faced compared to incumbent operators, including the higher costs arising from smaller scale. The Authority's sudden decision to depart from this creates significant regulatory uncertainty for investors in the sector, which could weaken incentives to invest. Investors might rightly ask themselves what other measures and regulations the Authority could introduce, withdraw or amend without appropriate consultation or substantiating market evidence.
10. The impact of the proposed removal of the MTR asymmetry could be compounded further if, as the Authority appears to indicate, the differential between MTRs and FTRs is to be retained. Failure to remove this differential will continue to distort investment and competition between fixed and mobile

operators, which is contrary to the Authority's mandate under the ECA. The maintenance of the FTR-MTR differential is based on flawed assumptions and a failure to consider recent market developments that point to increased substitutability between fixed and mobile voice services.

11. Even if the Authority were to disregard the evidence of increased substitutability between fixed and mobile voice services, it will need to take proper account of the convergence of unit costs for fixed and mobile termination rates. The cost of mobile termination continues to fall rapidly, as more voice traffic is carried over lower cost network technologies (e.g. 4G, 5G and VoWiFi[6]) and more spectrum becomes available. Conversely, the unit cost of fixed termination can be expected to increase as a result of declining volume of fixed voice calls. It is incumbent on the Authority to set termination rates to reflect material changes in the costs of termination; a failure to update rates to account for underlying changes in unit costs risks distorting competition and investment incentives further.

12. Telkom notes in this context that there is international precedent for MTR and FTR convergence. For instance, in Kenya MTR and FTR have been set at the same level since 2013.[7] Similarly MTRs and FTRs are symmetric in Brazil, Nigeria, Namibia and Botswana.[8] These jurisdictions are more appropriate references considering that they are developing economies versus the developed economies on which the Authority has relied. In this context Telkom notes further that when considering regulatory precedent, it may be relevant for the Authority to refer to the **principles applied by other regulators,** and to apply these principles appropriately to the specifics of the South African market context. It is, however, **inappropriate for the Authority simply to consider the outcome of the application of these principles to other markets**, as these outcomes are unlikely to be relevant to the South African market's characteristics and context.

<u>The Authority's proposals should promote competition and investment in the sector.</u>

13. To promote competition and investment in the sector the Authority should:

- **Retain pro-competitive MTR asymmetry** for operators that have not yet reached minimum efficient scale. The minimum efficient scale threshold should continue to be pre-defined and set objectively to provide regulatory transparency, certainty, and stability. The threshold should be based on subscriber market share, rather than share of termination minutes, as the former provides a better indicator of whether an operator has reached the scale required to compete sustainably in the mobile market. For example, the European Regulators Group ("ERG") guidance, which has been applied by the Authority in the South African context to date, suggests that for an operator to reach minimum efficient scale its mobile subscriber market share must be at least 20 percent.

- **Remove the current FTR-MTR differential** to reflect the evidence of fixed and mobile termination markets having converged, **or at least reduce the current differential** to reflect the converging cost of fixed and mobile termination of calls. This will allow small fixed line

[6] Voice-over Wi-Fi (VoWiFi, also known as WiFi Calling) is the capability that enables a smartphone to make and receive calls over a wireless internet connection as opposed to the typical cellular connection: https://www.telkom.co.za/today/media/downloads/FAQs_VoLTE_and_VoWiFi_v2_20180604.pdf.

[7] See https://www.ca.go.ke/wp-content/uploads/2021/07/Proposal-to-Revise-MTR-and-FTR-2021-.pdf and https://hapakenya.com/2021/12/24/telkom-supports-cas-review-of-the-mobile-fixed-termination-rates/.

[8] Telkom refers the Authority to Annexure B of its August 2021 submission for discussion of these international precedents: Submission to ICASA on the notice regarding their intention to review the pro-competitive conditions imposed on relevant licensees in terms of the call termination regulations, 2014 (as amended) published in Government Gazette No. 38042.

operators to compete more effectively with the incumbent mobile operators and reduce distortions to investment and inefficiencies, to the benefit of South African consumers.

- **Maintain the exclusion of international call termination rates (“ITRs”) from the scope of price regulation**. This should continue to help protect South African businesses and consumers from higher ITRs. However, the Authority must undertake an assessment of the impact this is having on the market. If the Authority identifies instances of bypass fraud and consumer harm arising from it, it must take the appropriate actions, within its statutory powers, to prevent or deter it from continuing.

Section 2: The legislative framework and the Authority's mandate (questions 4, 5 and 7 of the Discussion Document)

14. The Authority's proposals as set out in the Discussion Document should be considered in context of the prevailing legal and regulatory framework, which sets out the overall objectives for the sector and for specific regulations.

The Authority has failed to develop its proposals in line with the objectives of the ECA

15. The regulation of the electronic communications sector in South Africa is governed by the ECA. Section 2 of this Act includes the following objectives (emphasis added):[9]

    d) ***encourage investment and innovation*** *in the communications sector;*

    f) ***promote competition*** *within the ICT sector;*

    z) ***promote stability*** *in the ICT sector.*

16. Section 67(4) of the ECA requires, inter alia, that the Authority "*must, following an inquiry, prescribe regulations defining the relevant markets and market segments and impose appropriate and sufficient pro-competitive licence conditions on licensees where there is ineffective competition, and if any licensee has significant market power in such markets or market segments."*

17. Section 67(4A) prescribes that *"[when determining whether there is effective competition in markets and market segments, the Authority must consider, among other things: (a) the non-transitory (structural, legal, and regulatory) entry barriers to the applicable markets or market segments; and (b)* ***the dynamic character and functioning of the markets or market segments****, including an assessment of relative market share of the various licensees or providers of exempt services in the markets or market segments, and a* ***forward looking assessment of the relative market power of the licensees in the markets or market segments.***" (emphasis added)

18. Section 67(8) of the ECA then deals with the review by the Authority of pro-competitive conditions and prescribes the requirements that the Authority must meet in conducting such a review. Under section 67(8) the Authority is obliged to "*review the market determinations made on the basis of previous analysis*" and "*decide whether to modify the pro-competitive conditions set by reference to a market determination*" (section 67(8)(a)(i) and (ii)).

19. As the Authority notes in its Guidelines for Conducting Market Reviews[10], the ECA introduces two key factors into the governance of electronic communications services:

    - A technology-neutral regulatory regime; and
    - An explicit intention to facilitate greater competition in the ICT sector.

20. The Authority's market review guidelines also recognise that the Authority is mandated to balance the encouragement of investment and innovation, and the promotion of competition.

21. Telkom is of the view that the Discussion Document demonstrates the Authority's clear failure to satisfy the relevant requirements of sections 67 (4) and 67(8) of the ECA, to advance the objectives of the ECA and other relevant sections of the legal and regulatory framework for the sector. This is dealt with in more detail below.

[9] Act No. 36 of 2005: Electronic Communications Act 2005, 18 April 2006, available here: https://www.gov.za/sites/default/files/gcis_document/201409/a36-050.pdf.

[10] ICASA (2010), "A Guideline for Conducting Market Reviews", page 3.

22. The Authority's mandate is set out in section 2 of the ICASA Act. It is, in part, to regulate the electronic communications sector in the public interest to achieve the objects contemplated in the "underlying statutes", which include the ECA. To that end, the Authority is mandated to support the development of competition in the electronic communications sector.

23. The primary object under the ECA is, similarly, to provide for the regulation of electronic communications in South Africa in the public interest and, for that purpose, to achieve the objectives listed in sections 2(a) to (z) of the ECA, extracts from which are provided above, again highlighting the importance of promoting competition in the ICT sector more broadly.

24. Section 4 of the ECA is also relevant to the exercise of the Authority's power to make regulations. It states that "*the Authority may make regulations with regard to any matter which in terms of this Act or the related legislation must or may be prescribed, governed or determined by regulation*." Sections 4(a) to (d) set out the matters in regard to which the Authority may make such regulations.

25. In this context, and in the Authority's own words, the Authority's objectives for encouraging competition in the sector should be that it:

    - "brings about affordable prices for goods and services rendered and provides value for money to consumers";[11] and
    - "[ensures] that all people in South Africa have access to basic communication services at affordable prices."[12]

26. In the sections that follow, the impact of the Authority's failure to follow approaches aligned to the requirements of Sections 67 (4) and 67 (8) of the ECA will be described in further detail. It is in this context that the failure in process and outcome of the proposals outlined in the Discussion Document can be better understood.

[11] See: https://www.icasa.org.za/pages/our-mandate.
[12] See: https://www.icasa.org.za/pages/about-us-1.

Section 3: Telkom's detailed response to the Discussion Document

3.1 MTR Asymmetry for small entrants (questions 4, 5 and 7 of the Discussion Document)

The Authority's position

27. The current Call Termination Regulations state that a licensee may charge higher rates (i.e. qualify for MTR asymmetry) if the licensee has a share of total minutes terminated in the wholesale voice call termination markets of 20 percent or less of total minutes terminated to a mobile location as at 31st December 2016. The application of the MTR asymmetry is not time limited based on when a licensee entered the market in the current regulations.[13]

28. The Authority's proposal set out in the Discussion Document is that the application of the higher MTR should be limited to up to three years post-entry (the "transition period").[14] The Authority has proposed three years as an appropriate duration of the transition period, on the basis that it believes this will incentivise new entrants to be efficient and grow, and is consistent with a recommendation made by the European Commission ("EC") in 2009.[15] The Discussion Document does not specify how, nor when, the Authority proposes to implement this material change to the pro-competitive conditions in place in the mobile market.

Telkom's position

29. The basis for the Authority's proposals to remove the current pro-competitive measures, and to apply these measures only to new entrants for the first three years from market entrance, is flawed in several respects, each of which is explained in further detail below:

    - The Authority's approach to developing its proposals is contrary to the objectives of the ECA, resulting in proposals that fail to encourage investment or to promote competition and stability in the ICT sector.
    - The Authority's justification for its proposal rests heavily on the blind application of an arbitrary time-limit on asymmetry that was proposed in an EC recommendation more than ten years ago without any consideration whatsoever for local market conditions, or the relevance of the recommendation to the South African mobile market. In contrast, the Authority has disregarded precedents from other developing markets and has not provided any justification why its reliance on European recommendation is better and more suited.
    - The Authority has failed to provide any evidence to suggest that pro-competitive measures are no longer required to support competition.
    - The rationale and conditions identified by the Authority for retaining the MTR asymmetry in South Africa remain.

[13] See Annexure A of the 2018 Amendment of the Call Termination Regulations, 2014 (Government Gazette 41943).

[14] See https://www.icasa.org.za/legislation-and-regulations/discussion-document-on-the-review-of-the-pro-competitive-conditions-imposed-on-licensees-in-terms-of-the-call-termination-regulations-2014.

[15] European Commission Recommendation on the regulatory treatment of fixed termination rates and mobile termination rates in the EU (2009): https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:124:0067:0074:EN:PDF. In turn, this is informed by the European Regulators Group's common position on symmetry of call termination rates (2007): https://www.berec.europa.eu/doc/publications/erg_07_83_mtr_ftr_cp_12_03_08.pdf.

- Removal of the pro-competitive measures could have a detrimental, and potentially irreversible, impact on competition and investment in the sector, negatively impacting consumers, which the Authority has not considered.
- The long-term damage to competition and investment from removing asymmetry too early will outweigh any short-term loss of efficiency that might be gained.

30. Retaining the pro-competitive measures for operators that have not yet reached minimum efficient scale is critical to supporting competition in the South African mobile market; failure to keep these measures in place risks undoing the limited progress that has been made to date in this regard.

The Authority's approach to developing its proposals is contrary to the objectives of the ECA

31. The Authority's Discussion Document clearly fails to demonstrate that its approach to the CTR Review is aligned with the relevant sections of the ECA outlined in Section 2 above, and in particular:
    - With reference to Section 67(4) of the Act, the Authority has not undertaken a sufficient, or indeed any, inquiry into the relevant markets to determine whether competitive conditions have changed in response to the pro-competitive measures. Had it done so, it would have found that the pro-competitive measures imposed to date have not been sufficient to address prevailing ineffective competition. Based on an adequate market assessment, the Authority would have found no rational or objective basis to conclude that pro-competitive measures should be withdrawn.
    - With reference to Section 67(4A) of the Act, the Authority has not considered entry barriers to applicable markets or provided a forward-looking assessment of relative market power. Indeed, and as noted below, the limited analysis that the Authority has provided in its Discussion Document clearly demonstrates the enduring market concentration arising from the high relative market shares of MTN and Vodacom.
    - With reference to Section 67(8) of the Act, the Authority has not undertaken adequate review of market determinations made on the basis of earlier analysis; had it done so it would clearly have concluded that competitive conditions are unchanged and would not have found any rationale for the revocation of pro-competitive measures.
    - With reference to its own Guidelines for Conducting Market Reviews:
        i. The Authority has failed to demonstrate how its proposals reflect an explicit intention to facilitate greater competition in the ICT sector. Indeed, it would be evident to any objective observer that its proposals present a clear threat to the limited progress to date in achieving greater competition.
        ii. The Authority has failed to take into account the impact on investment incentives in the sector; indeed, its proposals risk damaging investment incentives as well as damaging the promotion of competition.

32. These failures in the Authority's adherence to the objectives of the ECA and its own market review guidelines are procedurally incorrect and, moreover, result in the further flaws in the Authority's analysis outlined below.

The Authority's proposal rests heavily on a blunt application of an EC recommendation without any consideration for local market conditions, or the relevance of the recommendation to the South African mobile market.

33. The Authority's proposal to introduce a three-year time limit on MTR asymmetry rests almost entirely on the basis that this is within the timeframe suggested by a recommendation by the EC in 2009. The Authority has blindly followed this without any consideration whatsoever to whether the recommendation is relevant to the South African mobile market, nor whether market conditions in South Africa have changed such that the pro-competitive measures are no longer required.

34. The Authority has also ignored the fact that guidance provided by the ERG, which underpinned the EC recommendation, provides specific guidance to NRAs to determine the appropriate timeframe to remove the MTR asymmetry based on an assessment of local market conditions (i.e. the appropriate timeframe will differ between markets depending on conditions in the particular market).[16] [17] [18] The ERG guidance suggests that estimating this timeframe should take account of several factors including:

    - The level of competition in the market, based on factors including the number of players in the market, performance of previous entrants and forecasts of operators' market shares;
    - The maturity of the market;
    - The churn rate and propensity for subscribers to switch; and
    - The rate of customer acquisition.

35. The Authority has not considered any of these factors or, to Telkom's knowledge, undertaken any analysis of market conditions that would enable it to conclude on the appropriate timeframe for removal of asymmetry. The Authority's approach is therefore inconsistent with, and not aligned to, the underlying guidance.

36. The ECA requires the Authority to design and apply pro-competitive measures that reflect specific market conditions and the overall policy objectives for South Africa. It would be inappropriate to follow decisions in other countries without due consideration of how conditions in South Africa might be different. For example, there are fundamental differences between many European and South African mobile markets that are relevant when considering the case for asymmetry, for example:

    - The absolute level of MTRs across many European markets is significantly lower than in South Africa, and as a result the competitive distortions created by traffic imbalances is likely to be

[16] The European Regulators Group (ERG) for electronic communications networks and services, is the predecessor to BEREC, was set up as an advisory group to the European Commission. The group was the European Union's primary forum for exchange of best practices, benchmarking, knowledge management, education and in-depth and forward-looking discussions on current and future regulatory challenges in communications.

[17] European Commission Recommendation on the regulatory treatment of fixed termination rates and mobile termination rates in the EU (2009): https://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2009/sec_2009_0600_en.pdf. In turn, this is informed by the European Regulators Group's common position on symmetry of call termination rates (2007): https://www.berec.europa.eu/doc/publications/erg_07_83_mtr_ftr_cp_12_03_08.pdf.

[18] The ERG guidance provides an illustration of how long a new entrant may need to reach the cost level of an efficient operator based on the assumption that there are three incumbent mobile operators, 0 percent market growth rate, 30 percent churn rate and equal acquisition of switching customers by mobile operators. This example partly informed the European Commission's view that it is reasonable to envisage a timeframe of three to four years upon market entry for phasing out asymmetries in mobile markets.

lower in Europe. For example, the MTRs that Vodacom and MTN can charge as a proportion of ARPU in South Africa is double that of the European average.[19] [20]

- The South African mobile market is more concentrated than many European markets, resulting in new entrants facing more significant constraints in competing (e.g., stronger network effects) and therefore in achieving efficient scale. For example, the South African mobile market has a far higher level of market concentration, as measured by the Herfindahl-Hirschman Index (HHI), than any four-player mobile market in Europe.[21] Socio-economic factors such as significant differences in average incomes between South Africa and European countries result in very different market dynamics as well as different policy and regulatory priorities.

37. The Authority has not only placed excessive reliance on guidance provided to European regulators without due consideration of the relevant differences in market conditions in South Africa, but has also failed to take into account regulatory precedent in other markets that may be more relevant to the South African context. For example, in other developing countries with high levels of market concentration such as Brazil, Nigeria and Ghana, NRAs have introduced and retained pro-competitive MTR asymmetry based on an assessment of market conditions rather than blindly following an EC recommendation. The Authority has not provided any explanation as to why it considers an EC recommendation any more relevant to the South African market than these markets where market conditions would arguably be more similar to the South African context than European markets.[22] [23] [24] [25]

38. In accordance with the Authority's mandate under the ECA, any decision on the timeframe for removing MTR asymmetry needs to be based on an assessment of market conditions in South Africa, taking into account whether market conditions have changed such that pro-competitive measures are no longer required, and assessing the impact of removing asymmetry on competition and investment in the sector.

<u>The Authority has failed to provide any evidence to suggest that pro-competitive measures are no longer required to support competition.</u>

39. In the Authority's most recent decision of 22 June 2018 ("2018 decision"), it stated that asymmetry was still needed to "*limit the disadvantages faced by late (small) entrants and new entrants or to limit incumbency advantages over late and new entrants*" and thereby to enable late entrants to compete

[19] Body of European Regulators for Electronic Communications, January 2020: "Termination rates at the European level".

[20] The average ARPU across Europe is €14.9. Source: European Telecommunications Network Operators' Association, 28 January 2020: "The State of Digital Communications 2020". South Africa ARPU is R99.60 in 2020. Source: Analysys Mason, South Africa report data annex, 2020.

[21] In 2020 the South African mobile market had a HHI of 3,245 whereas the most concentrated four player mobile market in Europe had a HHI of 3,081. Source: Analysys Mason, Country report data annex for each of the countries, 2020.

[22] OECD Telecommunication and Broadcasting Review of Brazil 2020, Section 5 on Communication policy and regulation: https://www.oecd-ilibrary.org/science-and-technology/oecd-telecommunication-and-broadcasting-review-of-brazil-2020_30ab8568-en.

[23] Nigerian Communications Commission, Determination of Mobile (Voice) Termination Rate, June 2018: https://www.ncc.gov.ng/docman-main/legal-regulatory/legal-determinations/805-determination-of-mobile-voice-termination-rate-2018/file.

[24] Presentation by Frederick Asumanu, head of the Market Regulation Unit at Ghana's National Communications Authority: https://www.itu.int/en/ITU-D/Regulatory-Market/Documents/Events/2015/Sao_Tome/Session%207-asumanu.pdf.

[25] Telkom also notes that the NRA in India has moved to a 'bill and keep' regime which sets MTRs at zero and therefore effectively removes any competitive distortions arising from MTRs.

effectively with incumbents. The Authority explained that the disadvantages faced by late entrants included:

- Higher unit cost of termination owing to exogenous factors outside the control of these operators and lower economies of scale; and
- Negative network effects in instances where call termination rates are above cost.

40. The Authority has not presented any market or unit cost evidence to suggest that, since its 2018 decision, conditions have changed such that late entrants are no longer disadvantaged in either of these respects, nor that asymmetry is no longer needed to limit their effect on late entrants' ability to compete. The Authority's proposal to remove MTR asymmetry without having demonstrated that the competition concerns which it sought to address no longer prevail, is unjustified, irrational and - in all likelihood - damaging to competition and consumer outcomes.
41. Furthermore, to Telkom's knowledge the Authority has failed to undertake any analysis to demonstrate that there is effective competition. Under Section 67(4) of the ECA, the Authority is required to "*impose appropriate and sufficient pro-competitive licence conditions on licensees where there is ineffective competition*".
42. In determining whether there is effective competition, the Authority is required to consider *inter alia* the non-transitory entry barriers to the market and the dynamic character and functioning of the markets or market segments, including an assessment of relative market shares. The Authority rightly introduced MTR asymmetry as it concluded that competition would otherwise be ineffective, however it has provided no evidence whatsoever that this is no longer the case. Absent this, the Authority has no evidentiary basis to withdraw asymmetry.

<u>The rationale and conditions identified by the Authority for retaining the MTR asymmetry in South Africa remain.</u>

43. The competition concerns which led the Authority to introduce the asymmetry, and which the asymmetry sought to address, remain. Telkom continues to face higher MTR unit costs due to its smaller scale and customer base, over which it recovers fixed costs, compared to the incumbent operators. Telkom's continued lack of efficient scale is illustrated by the fact that it continues to carry less than the 20 percent of terminating mobile voice traffic that the Authority has implicitly assumed to be the minimum efficient scale. Furthermore, Telkom's retail mobile subscriber share also remains below the 20 percent level that the ERG has considered to be a benchmark for minimum efficient scale. The Authority has provided no evidence that mobile termination unit costs incurred by small and large operators have converged over the course of just three years. The Authority appears to be prejudging the outcome by only considering whether to update its cost study after it has made a decision on whether to maintain pro-competitive remedies.
44. Network effects also continue to persist, and act to disadvantage late entrants while reinforcing Vodacom and MTN's dominant position. Vodacom and MTN continue to benefit from a strong incumbency position and the network effects that arise from this. This, in turn, acts to constrain late entrants' ability to grow market share and reach the scale required to compete effectively with incumbent operators. Failing to maintain the current MTR asymmetry would undoubtedly reinforce incumbents' competitive advantage and undermine late entrants' ability to compete for new subscribers.
45. Furthermore, notwithstanding the introduction of MTR asymmetry in 2014, there is still a lack of effective competition in the South African mobile market. Vodacom and MTN continue to dominate the market, as

is evidenced by high and stable market shares, high profit margins and the ability to set prices independently of competitors. For example:

- In its Data Services Market Inquiry 2019, the Competition Commission highlighted that "*the retail mobile market has remained stubbornly concentrated despite the entry of two challenger networks over time. Vodacom has a share in mobile services more generally and data services specifically, that exceeds the thresholds used in the Competition Act for a conclusive determination of dominance. MTN has constantly skirted around the threshold level where there is a rebuttable presumption of dominance. These shares have barely changed over time*." [26]
- Vodacom and MTN's combined mobile voice subscribers share has remained above 75 percent, while their collective share of voice revenues has remained consistently around 90 percent, [27] over the three years since the 2018 CTR decision.
- Vodacom and MTN collectively retained 89 percent of total mobile service EBITDA in 2019/20.[28]
- Price competition remains limited, with the Competition Commission's 2019 inquiry finding that Vodacom and MTN are to a large extent able to price independently of the challenger networks (Cell C and Telkom) in the data market; in Telkom's view, the ability of Vodacom and MTN to price independently also applies to the voice market.

46. There are a variety of factors outside of Telkom's control that created significant "first mover" advantages and continue to constrain late entrants' ability to reach minimum efficient scale to compete more effectively, including access to spectrum, access to sites, barriers to subscriber switching and network effects. These factors have been reinforced, rather than alleviated, by call termination regulation, which has resulted in Telkom making substantial net out-payments of more than R ████ billion to MTN and Vodacom over the last decade. Reductions in MTRs and the introduction of MTR asymmetry have helped to reduce the imbalance, without which MTN and Vodacom's position may have been even more dominant. However, even with the current limited level of asymmetry, MTN and Vodacom continue to benefit from significant net out-payments from Telkom. These effectively amount to Telkom and other small operators subsiding the dominant incumbents.

47. Removing the asymmetry at a time when there is clear evidence that the conditions that justified the introduction of asymmetry remain, would clearly be unjustifiable and irrational. The Authority can, and must, retain MTR asymmetry to help address the clear market failures that persist and to support the market to transition towards effective competition for the overall benefit of South African consumers and the economy. Effective competition in telecoms markets can be expected to deliver lower consumer prices and greater levels of investment, resulting in innovation and improvements in consumer choice and service quality.

<u>Removing the pro-competitive measures could have a detrimental, and potentially irreversible, impact on competition in the sector, negatively impacting consumers.</u>

48. The Authority claims that by restricting asymmetry to a three-year time limit, it will incentivise new entrants to be more efficient and grow market share. However, new and late entrants already clearly have strong commercial incentives to become more efficient and grow market share (e.g., to generate returns on significant sunk investments). Removing the asymmetry would prevent small operators from recovering

[26] Competition Commission's Data Service Market Inquiry 2019: http://www.compcom.co.za/wp-content/uploads/2019/12/Data-Services-Inquiry-Summary.pdf.
[27] See Figure 1 and Figure 2 of the Authority's Discussion Document.
[28] ICASA Mobile Broadband Services Market Inquiry – Public Hearings – 12-13 August 2021.

their costs and therefore, if anything, act to weaken incentives to compete in the market as operators would not be able to recover the cost of network investment.

49. Moreover, removing MTR asymmetry would significantly increase Telkom and Cell C's net out-payments. Furthermore, by simultaneously increasing MTN and Vodacom's net in-payments from MTRs, the removal of asymmetry would also strengthen their cashflow position and serve to re-enforce their persistent dominant position in the market.

50. Telkom already makes significant call termination net out-payments; Vodacom and MTN are the main beneficiaries. Telkom estimates that removing the current asymmetry would result in its annual net out-payments increasing by [redacted] to [redacted] in 2022/23, of which more than more than [redacted] would be passed through to Vodacom and MTN collectively.[29]

Figure 1: [redacted]

51. [redacted]

52. The negative impact on competition of the Authority's proposals could be particularly severe given other regulatory measures beyond Call Termination Regulations that restrict Telkom's incentives to invest and

29 [redacted]

compete in the market. In particular, the Authority's has set out proposals within its invitation to apply for the upcoming multiband spectrum award, that would restrict Telkom from obtaining the spectrum assignments that would provide the network coverage and capacity it needs, as well as reducing the cost of deployment, to compete both on service and price.[30] The cumulative effect of these measures could further constrain Telkom's incentives to invest and compete, further weakening effective competition.

53. Contrary to the Authority's position that removing MTR asymmetry will somehow incentivise late entrants to grow their market share, instead - by constraining Telkom's ability to compete relative to the dominant players - the more likely outcome is that Telkom and Cell C will lose market share to the Vodacom and MTN, thus reinforcing the scale advantages and network effects from which the dominant players benefit. This could in turn weaken Telkom and Cell C's ability to compete on an equivalent basis and therefore lead to market distortion and a softening in competition.

54. Furthermore, the Authority cannot discount the possibility that the cumulative effect of regulation (in particular the removal the MTR asymmetry) could contribute to a situation whereby the market can no longer sustain four national mobile operators (e.g., an operator exits the market). Market exit is by no means a hypothetical outcome. There are several international examples of smaller scale mobile operators with market shares similar to that of Telkom and Cell C being forced to exit the market. For example, Uganda's market has seen a succession of market exits, the latest being the exit of Africell – which had a 4.15 percent share – announced in September 2021.[31] [32] In Kenya, two small mobile operators exited the market in 2015.[33] [34]

55. In this context, it is critical that the Authority considers the potential market impact of its forthcoming CTR decision. Given the benefits of effective competition to consumers identified above a softening or reduction in competition can be expected to lead to higher prices, lower quality of service, and less choice, causing harm to South African consumers and businesses.

<u>Removing the pro-competitive measures would undermine investment in the sector.</u>

56. The Authority's proposals to remove MTR asymmetry at this time, will significantly reduce Telkom and Cell C's capacity and incentives to invest:

- Firstly, if MTR asymmetry were to be removed, Telkom and Cell C would be unable to recover their unit costs of mobile termination, which are higher due to the lower market scale. This would in turn weaken their incentives to invest in mobile voice services since they would be unable to recover the costs of investment. Distortions to incentives to invest in voice related network services could impact Telkom's ongoing investments to improve the consumer mobile experience, which would clearly be to the detriment of the consumers and businesses that rely on these services.

- Secondly, the pure financial impact of removing the asymmetry on Telkom and Cell C's cash flows would significantly reduce their capacity to invest and could lead to a slowdown in network rollout.

[30] The Authority, Government Gazette Staatskoerant, General Notice 717 of 2021, 10 December 2021.
[31] Techcabal, MTN, Airtel dominance forces another telecom operator out of Uganda, 17 September 2021.
[32] TeleGeography, Uganda Loses Number-Three Cellco, 28 September 2021.
[33] Telecoms.com, Essar exits telecoms with yuMobile sale to Safaricom, Airtel, 16 January 2015.
[34] Techweez, France Telecom Orange Exits Kenya Market with Sale of 70% Stake to Helios, 10 November 2015.

.This is supported by economic literature which draws on both econometric analysis of investment outcomes and surveys of chief financial officers, and finds that reduced cash flow tends to lead to reduced investment.[36]

57. Reduced investment could lead to a slow-down in network upgrades and rollout, in particular in areas where the direct return from upgrading existing mobile sites or building new sites is lowest (e.g., rural areas). To illustrate this further, the annual increase in Telkom's net out-payments of that would arise if the asymmetry were to be removed, is equivalent to the cost of building an additional [37] Many of the areas where rollout could be affected by this are where there is strong public policy imperative to improve mobile services to ensure there is equitable access to mobile services and to mitigate the risk of widening digital divides.

58. Furthermore, the softening of competition, arising from the removal of the asymmetry, would severely weaken incentives for all South African operators to invest. Competition is a key driver for operators to invest in networks (e.g., to differentiate on service) and traditional economic theory suggests that a weakening of competition can weaken incentives to invest and can as a result lead to delayed or constrained investment. In this context, Cell C's strategy to withdraw from engaging in infrastructure-based competition will mean that Telkom will represent the only mobile infrastructure-based competitor to Vodacom and MTN.[38]

59. More broadly, the Authority's proposals will create an asymmetric profit shock and significantly increase regulatory uncertainty which could weaken incentives to invest further. The Authority's previous decision set a clear expectation that operators with less than 20 percent of terminating voice traffic would be able to benefit from MTR asymmetry to help offset the higher costs of termination arising from their smaller scale. The Authority's sudden and unjustified proposal to depart from this would send adverse signals regarding regulatory instability to any potential investors in the South Africa mobile market, which could in turn further weaken incentives to invest. Investors might rightly ask themselves what other measures and regulations the Authority might introduce, withdraw, or amend without appropriate consultation or substantiating market evidence. It is well established within the economic literature, as well as by NRAs

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[36] Murillo Campello, John Graham and Campbell R Harvey. December 2009. "The real effects of financial constraints: evidence from a financial crisis." NBER Working Paper 15552. http://www.nber.org/papers/w15552.
David J. Denis and Valeriy Sibilkov. December 2011. "Financial Constraints, Investment, and the Value of Cash Holdings." The Review of Financial Studies, 23(1). http://rfs.oxfordjournals.org/content/23/1/247.abstract
Ola Melander. April 2009. "The effect of cash flow on investment: an empirical test of the balance sheet channel." http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1483016
Simon Gilchrist and Charles Himmelberg. July 1999. "Investment, Fundamentals and Finance." http://www.nber.org/papers/w6652.pdf.

[37] This estimate assumes that the average cost to build a new site is around . In practice, the cost of building new sites can vary significantly from this.

[38] Cell C's press release "Cell C's turnaround strategy yields improved financial performance as the telco aims to transition to a techco by 2024" dated 20th April 2021. https://www.cellc.co.za/cellc/newsroom-detail/turnaround-strategy-improved-financial-performance.

internationally, that regulatory stability can support long-term investment, whereas regulatory uncertainty and ambiguity can serve to undermine incentives to investment.[39] [40] For example, Ofcom in the UK notes:

> "…*it is generally good regulatory practice to avoid large, asymmetric profit shocks wherever possible, as they could be disruptive and contribute to perceptions of a less certain regulatory framework. This could potentially adversely affect incentives to invest in the sector more generally*".[41]

60. The Authority's proposal therefore fundamentally undermines incentives for further investment in mobile network infrastructure and sends the wrong signals to the sector at a time when significant investments are required to further improve the quality and availability of mobile services in South Africa.
61. Any such reduction in investment will have an adverse impact on the quality, reliability, and availability of mobile services, which would be to the detriment of South African consumers, businesses, and the wider economy. For example, it could lead to a significant slow-down in the rollout of 4G and 5G mobile networks. As noted above, the areas most likely to be adversely impacted by this are those where there is the strongest public policy imperative to improve coverage, as this is where the marginal return on network investment is lowest.
62. The Authority's proposal would therefore be wholly inconsistent with its mandate under the ECA to encourage investment and confer the greatest possible benefit on consumers. Clearly this is not a sustainable position and cannot be the intention or effect of sector regulation.

<u>The long-term damage to competition and investment from removing asymmetry too early will outweigh any short-term loss of efficiency that might be gained.</u>

63. It is widely recognised that the risks and impact of regulatory failure from removing or introducing regulatory measures too early, on investment and competition far outweigh those associated with intervening too late. As a result, regulators must take a conservative approach and only remove or introduce measures where there is a high degree of certainty that interventions are no longer required. This is commonly referred to as 'asymmetric risk' of regulation principle.[42] For example in the UK, in the context of setting price controls, Ofcom has stated that:

> "*We [Ofcom] also recognise that the effects of regulatory error are likely to be asymmetric in this case: in that if we intervene too early the harm caused by deterring future investment...may be greater than the harm caused by intervening too late. We will [therefore] tend to err on the side of caution with respect to investment incentives*".[43]

64. The Authority's proposals expose it to a high and entirely avoidable risk of regulatory error, with consequent harm to competition, efficient investment and overall consumer welfare, as outlined above. If the Authority removes MTR asymmetry too early (i.e., before a late entrant has reached minimum

[39] Fourie, Granville & Theron, 'Regulatory ambiguity and policy uncertainty in South Africa's telecommunications sector', January 2018.
[40] Ofcom, Regulatory certainty to support investment in full-fibre broadband, 24 July 2018.
[41] See Ofcom http://stakeholders.ofcom.org.uk/binaries/consultations/spectrumlib/annexes/annex8.pdf (para. A8.109).
[42] The Dutch Independent Post and Telecommunications Authority (OPTA), Regulation, risk and investment incentives, May 2010.
[43] Ofcom (2017), 'Wholesale Local Access Market Review – Annexes', para. A8.9.

efficient scale) there is a significant risk that this will lead to a softening of competition and reduced investment, which could have long lasting and potentially irreversible effects as explained above.

65. By contrast, if the Authority was to inadvertently retain the asymmetry for longer than necessary (i.e., beyond the reasonable time for an efficient operator to reach scale), there is a risk of creating an inefficiency. However, this could be easily addressed without any long-lasting effects by removing the asymmetry once market conditions are appropriate.
66. The Authority should therefore adopt a conservative approach to determining when to remove MTR asymmetry, and only do so when there is strong evidence that it is no longer required to support the development of effective competition.

MTR Asymmetry should be retained to support competition and investment.

67. To promote competition and investment in the sector, including price competition, the Authority needs to maintain MTR asymmetry for operators that have not yet reached minimum efficient scale. The minimum efficient scale threshold should continue to be pre-defined, and objectively set, based on mobile subscriber market shares which provides a better indicator of whether an operator has reached the scale required to compete sustainably in the mobile market. For example, the ERG guidance suggests that for an operator to reach minimum efficient scale, its market share must be at least 20 percent.

3.2 FTR-MTR differential (questions 1, 3 and 4 of the Discussion Document)

The Authority's position

68. The Authority's position expressed in the Discussion Document is that fixed and mobile voice calls are separate product markets. This reflects the Authority's view that fixed and mobile termination are not effective substitutes (or effective constraints) to one another, and that fixed and mobile termination costs still differ. While not stated in the Discussion Document, the implication of these two conclusions is that some differential between the MTR and FTR will be maintained.

Telkom's position

69. Telkom objects to both of the Authority's conclusions that are used to support the continuation of the existing FTR-MTR differential, on the basis that:
    - The Authority's approach to developing its proposals is contrary to the objectives of the ECA, resulting in proposals that fail to encourage investment or to promote competition and stability in the ICT sector.
    - The Authority's preliminary finding of separate fixed and mobile termination markets is based on flawed assumptions and a failure to consider recent market developments that point to increased substitutability between fixed and mobile voice services; and
    - Even if the Authority were to erroneously disregard the evidence of increased substitutability between fixed and mobile voice services, it needs to take proper account of the convergence of unit costs for fixed and mobile termination. A failure to do so would create distortions to competition and investment as well as inefficiencies, and therefore be contrary to the Authority's objectives under the ECA.

<u>Product markets and fixed-mobile convergence</u>

70. The Authority's conclusion that fixed and mobile voice calls are separate product markets rests on findings described in its Discussion Document as well as its findings on Call Terminations Regulations made in 2007.[44] Several of these findings are either based on flawed assumptions or do not take into account recent market developments that point to increased market convergence:
    a. The Authority's assumption that consumers are unaware of voice costs ignores the fact that there are a significant number of price-sensitive customers, many of whom may well switch between a mobile and fixed call, in response to an increase in the wholesale termination rate.
    b. The Authority's assumption that some fixed calls are not substitutable for mobile ignores the increasing use of mobile by business and the lasting impact of 'work-from-home'.
    c. The Authority's assumption that mobile calls are not substitutable for fixed calls on the basis of quality and availability ignores the significant improvements in call quality through voice over LTE, and the increase in 4G and 5G coverage and penetration, which is expected to grow further over the next three years.

71. Other market developments further demonstrate the increasing substitutability of fixed and mobile:

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[44] As specified in the Discussion Document sections 2.1.1.(i) and 2.1.1.(ii), the Authority's preliminary view is informed by findings on retail demand-side substitution for mobile and fixed off-net voice calls detailed in the 2007 Findings Document. See https://www.gov.za/sites/default/files/gcis_document/201409/30449.pdf.

a. Increased mobile penetration has enabled greater substitutability between fixed and mobile.

b. Increasing use of services that enable mobile device users to make and receive calls over fixed line connections (i.e., Voice over Wi-Fi)

The Authority fails to recognise that there are price sensitive customers that would switch in response to a price change

72. The Authority suggests that fixed to mobile voice calling is not likely to pose an effective competitive constraint on fixed termination rates because “end-users are not ordinarily aware of the cost of voice calls” and would therefore not switch in response to an increase in termination rates.[45] However, the Authority has not presented any evidence to support this statement, nor has it demonstrated that a marginal customer would not switch in response to a change in the termination rate. This is despite there being good reason to believe that customers are aware of the cost differential between calls to a fixed number compared to a mobile number, and there are likely to be customer groups that are price sensitive and will switch between calling a fixed and mobile number in response to a price change.

73. Firstly, Telkom notes that many fixed line customers continue to pay for fixed calls on a per minute basis and the price of calls varies depending on whether the call is to a fixed or a mobile number.[46] Consumers can therefore be expected to be aware of the different price they face for fixed to mobile compared to fixed to fixed, and that this may reflect differences in the costs of providing the calling service.

74. Secondly, the Authority has failed to consider that there are price sensitive groups of customers that are likely to switch between fixed and mobile in response to an increase in call termination rates, for example, low-income customers. The level of price sensitivity will clearly differ substantially between different groups of customers. For example, the Competition Commission has previously recognised that pre-paid consumers are more price-sensitive than post-paid consumers in South Africa.[47] [48]

75. Thirdly, Telkom notes that, when assessing market definition, the focus must be on marginal rather than non-marginal or ‘typical’ customers. The mere fact that some (non-marginal) groups of customers may be unable or unwilling to switch to a particular product in response to a price increase does not mean that the product falls outside the scope of the relevant market. Without assessing the impacts of a price increase on the marginal customer including sub-groups of customers (for example, low-income price sensitive customers), the Authority cannot conclude that a sufficient proportion of customers would not switch in response to a price increase.[49]

76. Collectively, these three errors lead the Authority to incorrectly conclude that fixed to mobile voice calling is not likely to pose an effective competitive constraint on fixed termination rates.

Increasing fixed mobile substitution including in the Enterprise market segment

77. South African businesses are demonstrably changing their use of voice services, appearing to favour mobile over fixed. The Authority’s conclusion that fixed and mobile voice calls are not substitutable is in

[45] Page 13 of the Discussion Document.

[46] For example, Telkom’s current ‘Basic’ fixed package includes free minutes for on-net Telkom calls and a pay per minute rate for off-net calls to mobile numbers.

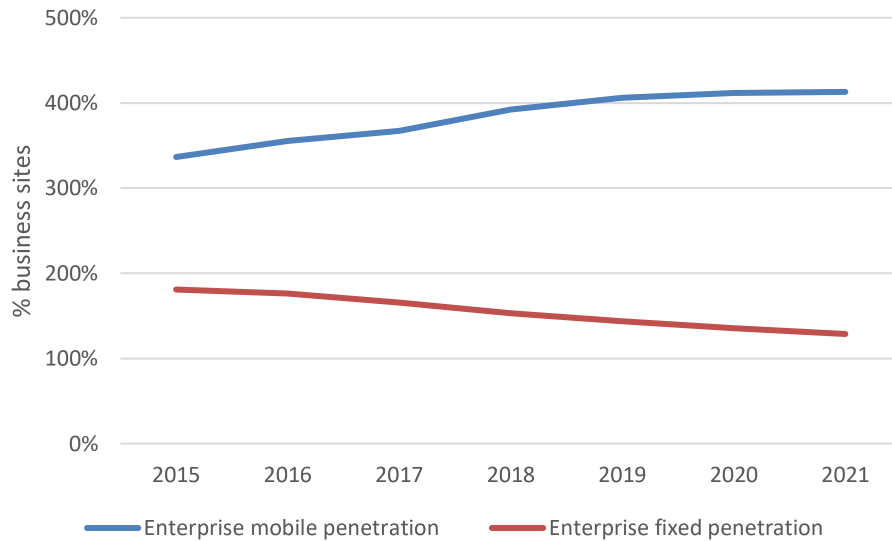
[47] Analysys Mason, Sub-Saharan Africa telecoms market: trends and forecasts 2020–2025.

[48] Ryan Hawthorne (2016), “How competitive are markets for telecommunications services in South Africa?”, available on the Competition Commissions website: http://www.compcom.co.za/wp-content/uploads/2016/07/2.-How-competitive-are-markets-for-telecommunications-services-in-South-Africa.pdf.

[49] See for example, Wolk, A., Skiera, B. Tariff-Specific Preferences and Their Influence on Price Sensitivity. Bus Res 3, 70–80 (2010). https://doi.org/10.1007/BF03342716.

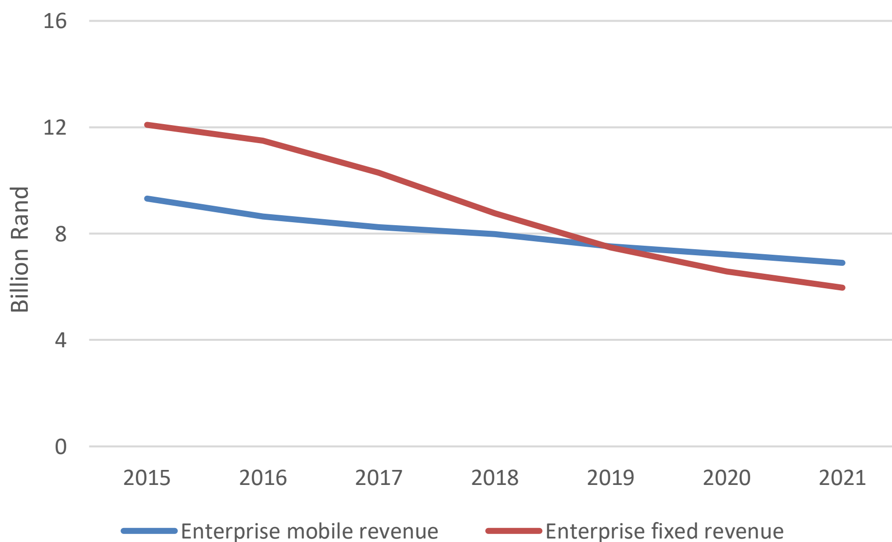
part based on the assumption that businesses will continue to use fixed lines for voice calls.[50] This ignores the trend among South African businesses to switch from fixed to mobile connections, shown by the enterprise segment's increasing mobile penetration and declining fixed penetration (see Figure 2) as well as the changes in spending on voice services (see Figure 3).

Figure 2: Enterprise switch from fixed to mobile connections in South Africa (2015-2021)



Source: Analysys Mason, Sub-Saharan Africa telecoms market: trends and forecasts 2020–2025

Figure 3: Enterprise spend on fixed and mobile voice services (2015-2021)



Source: Analysys Mason, Sub-Saharan Africa telecoms market: trends and forecasts 2020–2025

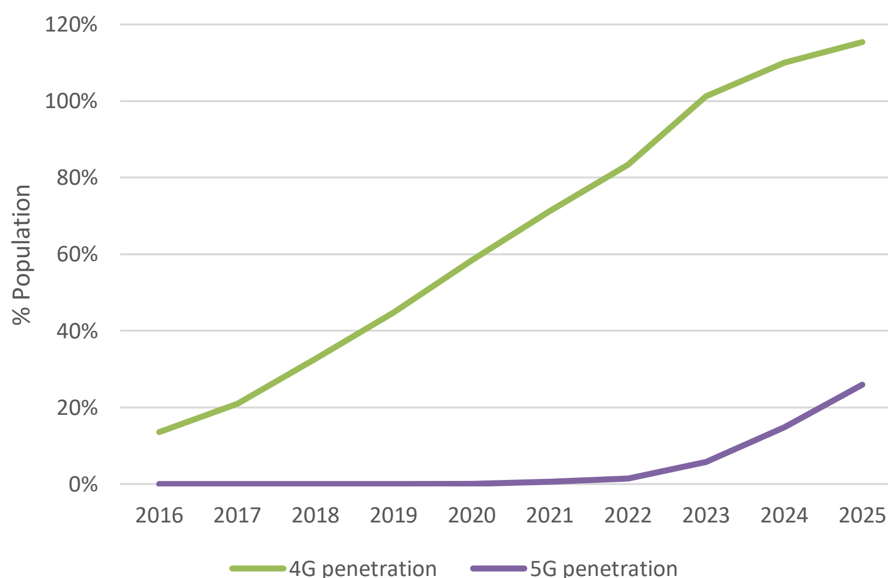
[50] See https://www.gov.za/sites/default/files/gcis_document/201409/30449.pdf.

78. Recent impacts on working habits brought about by the COVID-19 pandemic are also likely to sustain and perpetuate this trend. Restrictions on movement and increased health risk have required an increase in flexible working and work-from-home. This can be expected to drive further switching from fixed to mobile calling, given that household penetration of fixed voice connections is 12 percent, compared 129 percent for businesses.[51]

Increasing quality and availability of mobile voice services makes it an even stronger substitute for fixed voice services

79. The Authority's assumption that fixed and mobile calls are not substitutable continues to rely on its previous conclusion, from as far back as 2007, that mobile voice calls are not of sufficient quality to be considered substitutes.[52] The Authority fails to consider the huge improvements that have been made in the quality of mobile voice calls since 2007, including in relation to acoustic quality, latency and jitter, drop call ratios, call set-up success rate and better coverage on the move. Looking ahead, continued investment in mobile networks, in particular deployment of 4G and 5G are expected to further enhance the availability (as evidenced by Figure 4) and quality of mobile voice services, in particular inbuilding coverage, which will result in mobile voice services becoming an even stronger substitute for traditional fixed voice services.

Figure 4: Forecast 4G and 5G penetration in South Africa (2016-2025)



Source: GSMA Intelligence, Mobile-by-market

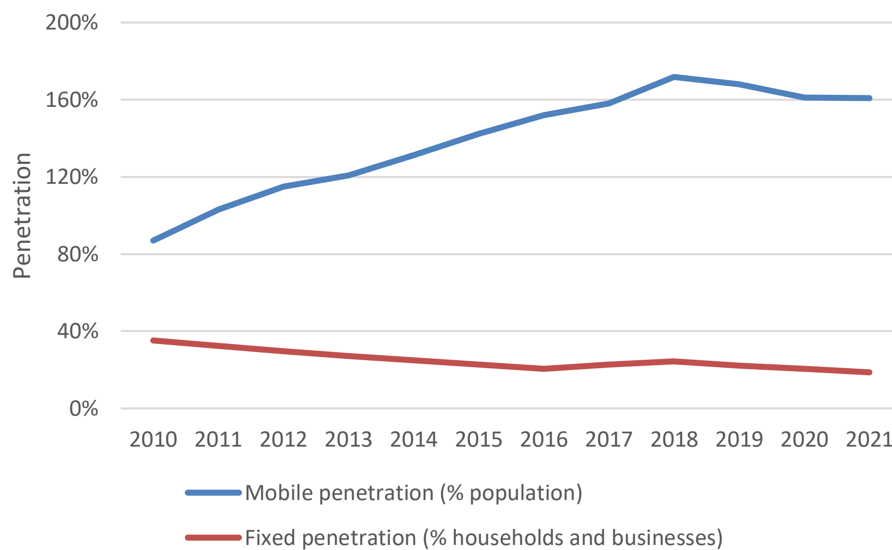
Increasing mobile penetration has enabled greater substitutability between fixed and mobile

80. The Authority has not considered that consumers now have a greater ability to switch from fixed to mobile. This is most clearly observed in the increased mobile coverage and penetration that has been achieved

[51] Based on analysis of data from Analysys Mason, Sub-Saharan Africa telecoms market: trends and forecasts 2020–2025 and Analysys Mason, Operator business services: South Africa forecast 2019–2024.
[52] See https://www.gov.za/sites/default/files/gcis_document/201409/30449.pdf.

over the past decade. In comparison, fixed line penetration has fallen over the same period, reflecting the switch from fixed to mobile. See Figure 5.

Figure 5: Mobile and fixed penetration in South Africa (2010-2021)



Source: Analysys Mason, Sub-Saharan Africa telecoms market: trends and forecasts 2020–2025

Voice over Wi-Fi is increasingly being used as a substitute for traditional fixed calls.

81. The increased use of mobile voice over Wi-Fi is supporting greater substitution between fixed and mobile call services. All mobile operators now enable voice calls to be made and received over a fixed access Wi-Fi connection.[53] This helps improve the call quality and reliability of mobile calls, in particular in inbuilding locations where limited mobile coverage may have meant that mobile was not a substitute for fixed voice services. As a result, mobile calls have become more of a substitute than just complement to fixed calls (e.g., in cases where a caller preferred to call a fixed number because the recipient had limited indoor mobile coverage, with VoWiFi, calling a mobile may present a credible alternative). For example, Figure 6 and Figure 7 show that Telkom's VoWiFi subscribers and calling volumes have been increasing significantly over the last two years, [redacted] . This trend can be expected to continue over the coming regulatory period and should be factored into the Authority's market assessment as an example of increased substitution between fixed and mobile voice services.

[53] See for example, MTN's Wi-Fi calling offer: https://www.mtn.co.za/Pages/wifi-calling.aspx.

Figure 6:

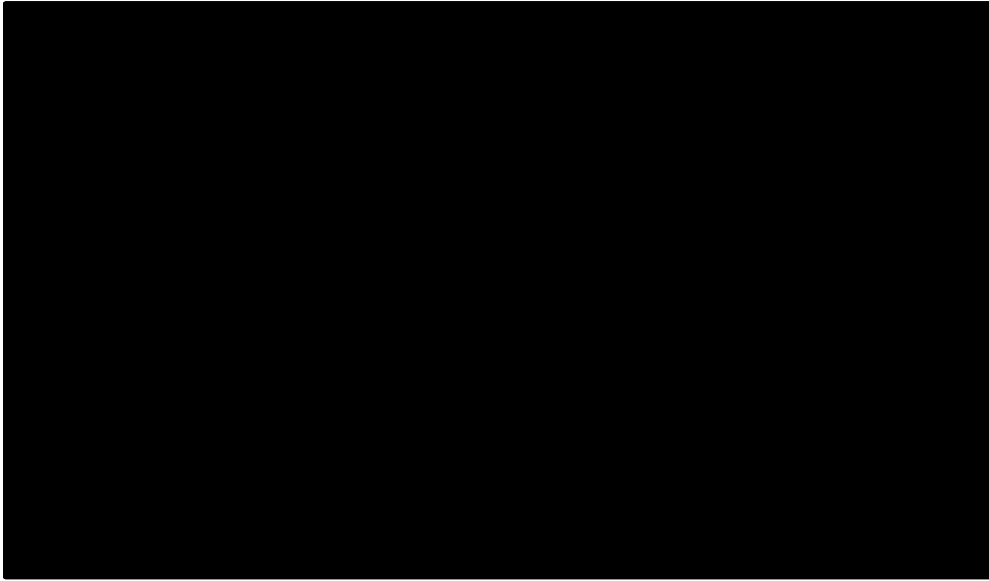
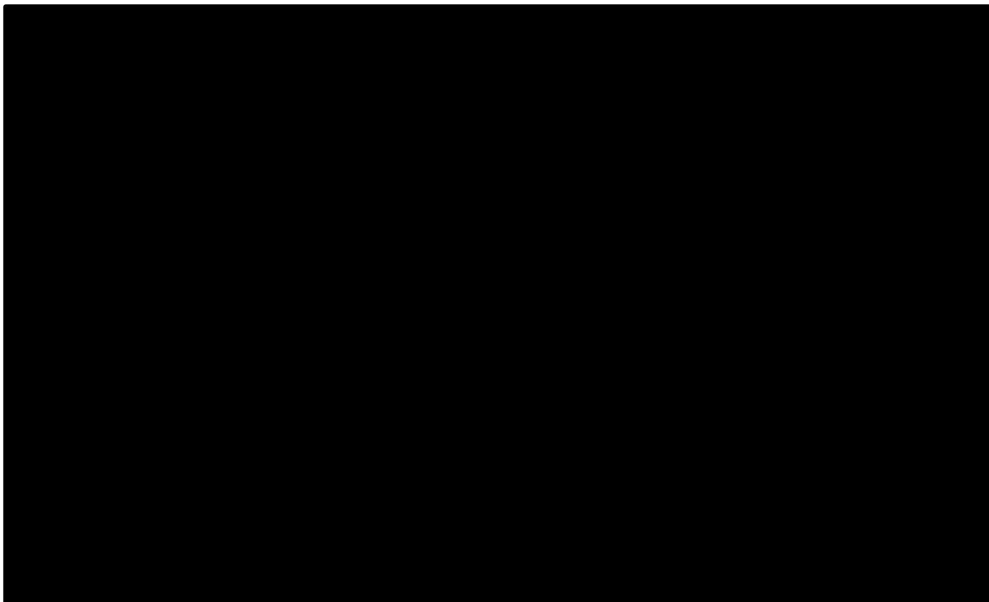


Figure 7:



International precedent for MTR and FTR convergence

82. Telkom notes there is international precedent for MTR and FTR convergence. For instance, in Kenya MTR and FTR have been set at the same level since 2013 (KSh 0.99, equivalent to 0.13 Rand).[54] Similarly MTRs and FTRs are symmetric in Brazil, Nigeria, Namibia and Botswana.[55]

Fixed-mobile cost convergence

83. Regardless of the Authority's determination on product market convergence, it needs to take proper account of the convergence of unit costs between fixed and mobile termination calls. The cost of fixed and mobile termination calls continues to converge, driven by:

   - the rapid decline in the cost of mobile termination services as more voice traffic is carried over lower cost network technologies; and
   - the rapid decline in volume of fixed voice calls which is causing fixed termination unit costs to rise.

84. It is incumbent on the Authority to provide due consideration of the impact of these effects on cost-oriented termination rates. Where there are material changes in the underlying unit costs of termination calls, the impact of these changes must be taken into account so as to avoid further distorting competition.

Falling unit costs of mobile call termination

85. The costs of delivering voice calls over mobile and fixed networks are continuing to converge. This is principally the result of a significant decline in cost of mobile voice termination, which is driven by a range of factors including:

   - **Significantly lower incremental cost of voice services on 4G networks** (i.e. Voice over LTE): It is widely acknowledged that voice services on 4G networks have significantly lower incremental costs than 3G networks, which in turn have lower costs than 2G networks.[56] A significant proportion of voice traffic has already been migrated onto 4G networks since the Authority last updated its cost model; this will have significantly reduced the unit cost of mobile termination, and it is essential that this should be reflected in regulated MTRs. As more traffic migrates to the 4G networks, the incremental costs will continue to fall, and the risk of competitive distortion arising from failure to update the cost analysis for these effects will grow.
   - **Increased use of mobile voice over Wi-Fi which has a near zero incremental mobile network cost:** There has been a significant increase in the proportion of mobile voice calls that are terminated over Wi-Fi (as illustrated by Figure 7), and this is expected to continue with all South African mobile operators offering VoWiFi services. The incremental cost of terminating calls over Wi-Fi is considerably lower than the cost of terminating a traditional voice call over a radio access network. In fact, for the purpose of modelling the impact of VoWiFi, Ofcom assumed in its most recent review of termination rates, that the incremental mobile network cost of a WiFi

[54] See https://www.ca.go.ke/wp-content/uploads/2021/07/Proposal-to-Revise-MTR-and-FTR-2021-.pdf and https://hapakenya.com/2021/12/24/telkom-supports-cas-review-of-the-mobile-fixed-termination-rates/.

[55] Telkom refers the Authority to Annexure B of its August 2021 submission for discussion of these international precedents: Submission to ICASA on the notice regarding their intention to review the pro-competitive conditions imposed on relevant licensees in terms of the call termination regulations, 2014 (as amended) published in Government Gazette No. 38042.

[56] See https://www.ofcom.org.uk/__data/assets/pdf_file/0020/144344/first-consultation-future-interconnection-termination.pdf.

terminated minute is effectively zero because the routing effectively circumvents the mobile radio access network. Ofcom also modelled the effect this has on the blended average unit cost of mobile termination; as the proportion of mobile calls terminated using VoWiFi increases, the average unit cost of MTRs declines in a linear fashion.[57]

- **Increased spectrum deployment and greater use of network capacity for data services**: As mobile operators begin to deploy the additional spectrum that is being made available and enter into spectrum sharing agreements, this can be expected to bring down the incremental cost of voice termination, notwithstanding spectrum licence costs. Furthermore, as a higher proportion of network capacity is used for data services, the incremental costs of mobile voice will fall further.
- **Lower incremental cost of voice services on 5G networks:** As the Authority correctly notes in the Discussion Document, the unit cost of providing voice services on 5G networks is expected to be considerably lower than for previous generations of network technology, including 4G.[58] 5G deployments over the next three to four years are likely to be primarily in high-traffic network dense urban and suburban areas, resulting in a relatively high proportion of total voice traffic being migrated to these networks. For example, it is estimated that by 2025 5G coverage will cover over two thirds of the population and around 14 percent of mobile connections with support 5G by 2024.[59] This will drive down the incremental cost of mobile voice termination even further.

Increasing unit costs of fixed termination

86. The continued decline in fixed call termination volumes is putting significant upward pressure on incremental unit costs of terminating fixed calls. The State of the ICT Sector Report in South Africa 2021 published by the Authority reported that total fixed line voice traffic decreased by 34.5 percent from 6.4 billion minutes in 2019 to 4.2 billion minutes in 2020.[60] Telkom's fixed call volumes have fallen by 29 percent since 2017 (see Figure 8). Given that a high proportion of fixed call termination costs are fixed in respect of volume, a fall in fixed call volumes will drive up incremental unit costs. [61]

87. As with the reduction in mobile call termination costs, this represents a material change in incremental cost and therefore needs to be reflected in the setting of regulated FTRs to ensure that fixed operators are able to recover efficient costs, which might otherwise distort incentives to invest, and to minimise distortions to competition between fixed and mobile operators.

[57] Ofcom, Final Statement Mobile Call Termination Market Review 2018-2021, Annex 9.
[58] ICASA, Discussion Document, page 23.
[59] GSMA intelligence, Mobile-by-market.
[60] ICASA, The State of the ICT Sector Report in South Africa 2021, page 45.
[61]

Figure 8:

The Authority must, as a minimum, reflect the change in costs to avoid distortions to competition and investment

88. A failure to reflect fixed and mobile cost convergence in MTRs and FTRs would lead to several undesirable outcomes that would not accord with the Authority's mandate to support competition and encourage investment, including:

- **Creating further competition distortions**: The current and historic MTR-FTR differential already distorts competition, including price competition, by contributing to Telkom making significant net out-payments to the two large mobile operators, weakening its relative ability to compete. A failure to reflect cost convergence will lead to this imbalance of call termination payments being sustained. It will also enable mobile operators to recover more than the efficient cost of mobile termination, while preventing fixed operators from recovering the costs of fixed termination. This will unfairly favour Vodacom and MTN as the only operators that are net receivers of inbound calling traffic, and which will therefore make a surplus from MTRs being set above cost and FTRs being set below cost. Conversely, Telkom will under-recover costs of fixed termination and, as a net outpayer of mobile termination charges, will continue to pay towards the over-recovery of costs incurred by MTN and Vodacom.
- **Distorting incentives to invest**: If FTRs continue to be set below the efficient cost of fixed termination this would result in fixed operators being unable to recover their costs. This could in turn weaken their incentives to invest in fixed voice services, including Next-Generation Network (NGN) voice infrastructure, since they would be unable to recover the costs of the investment. Reduced investment in fixed voice services would clearly be to the detriment of the consumers and businesses that depend on these services. These effects have been identified by Ofcom in the UK, which has stated that "Charge controls which, in practice, fail to enable recovery of efficient costs may have an adverse impact on investment, which could be detrimental to consumers."[62]
- **Creating inefficiencies**: If MTRs continue to be set above the cost of mobile termination, and FTRs below the cost of fixed termination, this could result in the structure of prices in retail and wholesale markets being inefficient, distorting consumer choice and harming consumers' interests. Some services would be consumed more than would be efficient and others consumed less than would be

[62] Ofcom, 2007 MCT Statement, para 9.168.

efficient (compared to the situation of prices reflecting actual costs). For example, this could lead to the price of calls to mobile from fixed lines being relatively high, and other charges for mobile services (such as monthly access fees) relatively low. This inefficient structure of prices would lead to over-consumption of mobile retail services and under-consumption of other retail services that use mobile call termination services, such as fixed-to-mobile calls.[63]

89. The fact that fixed and mobile costs have already converged significantly since the Authority last updated its cost model means that many of these undesirable effects are already being felt. These effects will become more severe if termination rates are not updated to reflect further cost convergence between fixed and mobile termination services.

Before setting CTRs for the coming period the Authority must update its cost models to remain consistent with its own and international regulatory practice

90. In accordance with its mandate to support competition and convergence while encouraging investment, it is therefore incumbent on the Authority, as a matter of urgency, to update MTRs and FTRs to reflect material changes in costs.

91. Furthermore, updating MTRs and FTRs to reflect material changes in costs would be consistent with good regulatory practice. Regulators typically review their cost model every three or four years and/or in response to a material change in cost; this is done to avoid creating competitive and investment distortions. Indeed this is also a precedent the Authority has itself set, as it has also typically undertaken a review of its cost model every three years.

92. When considering regulatory precedent, it is relevant for the Authority to refer to the principles applied by other regulators to determine MTR and FTRs, and to apply these principles appropriately to the specifics of the South African market context. It is inappropriate for the Authority simply to consider the outcome of the application of these principles to other markets (i.e. the values set), as these outcomes and values are unlikely to be relevant to the South African market's characteristics and context.

93. It is now approaching four years since the Authority last reviewed its cost model and having itself acknowledged that the incremental costs of mobile termination are expected to fall materially, the Authority must surely be aware that an update of termination rates to reflect the changing costs is long overdue. A failure to undertake such an update would be inconsistent with its regulatory approach, and that of other regulators, and would lead to manifest inefficiencies in the pricing of CTRs for another three years at least. Such an outcome can only be to the advantage of Vodacom and MTN.

[63] Ofcom, 20015-18 MCT Statement, para 5.27.

3.3 Deregulation of international call termination (question 2 of the Discussion Document)

The Authority's position

94. Deregulation of ITRs for calls originating outside of South Africa was introduced in the 2017 amendment of the mobile termination markets and fixed termination markets.

95. The Authority's view, set out in its Discussion Document, is that deregulation of the international call termination market continues to be in the public interest. South African licensees have freedom to charge reciprocal rates to licensees in other jurisdictions who may otherwise exploit significant market power in setting rates for terminating calls on their networks. The Authority also notes in its Discussion Document that it does not have authority to regulate rates charged by international operators.

Telkom's position

96. In principle, Telkom supports the Authority's proposal for ITRs to remain outside the scope of price regulation. This should continue to help protect South African businesses and consumers from higher international call termination rates. It does this by providing South African fixed and mobile operators ('local operators') with the commercial flexibility, and therefore bargaining power, to negotiate lower termination rates with international operators for outbound calls terminating outside of South Africa, which may then be passed on to businesses and consumers (e.g., in the form of lower retail international calling rates).

97. In the absence of this commercial flexibility (e.g., if termination rates on inbound calls were subject to regulated call termination rates) local operators' bargaining power with international operators that are not subject to international call termination rate regulation would be severely weakened. This could lead to an increase in the international call termination rates faced by local operators, which may then be passed on to South African businesses and consumers.

98. Telkom notes that this approach has been adopted in many countries, most recently by Ofcom in the UK. The effect of this is that more international operators will have commercial flexibility in setting international call termination rates for inbound calls and therefore bargaining power in negotiating reciprocal rates with local operators. This reinforces the importance of the Authority retaining its current approach for ITRs to be outside of the scope of regulation, in order to protect against increases in ITRs for outbound calls from South Africa.

99. However, Telkom has serious concerns around the bypass fraud activity of several VoIP providers and the impact that this could have on South African consumers. These VoIP providers are seeking to undercut the termination rates being charged by local operators by manipulating the original call line identification number and entering into commercial agreements with international operators to land calls in South Africa and then only pay the local regulated termination rate.

100. These practices enable international operators to potentially obtain lower termination rates by bypassing local operators when landing calls in South Africa. This has the effect of weakening the bargaining power of local operators in negotiations with international operators, putting significant upward pressure on the ITRs that local operators and ultimately the international call prices that South African businesses and consumers face. In Telkom's view, this not only constitutes bypass fraud, but also risks undermining the Authority's principal objective for deregulating ITRs. Unless action is taken against this activity it will lead to consumer harm arising potentially from higher prices as well as lower call quality.

101. Despite Telkom raising these concerns in its August submission, the Authority has yet to respond or set out how it intends to address them. It is incumbent on the Authority at least to undertake an assessment of the impact this is having on the market. If the Authority identifies instances of bypass

fraud and consumer harm arising from it, it must take the appropriate actions, within its statutory powers, to prevent or deter it from continuing.

END OF RESPONSE