STATEMENT BY ICASA COUNCILLOR THABO MAHKAKHE ON THE RELEASE OF FINAL CALL TERMINATION REGULATIONS

Good morning all.

I am Thabo Makhakhe, one of the Councillors here at the Authority.

I have been afforded the opportunity today to inform South Africa of the imposition of the first ex-ante pro-competitive measures in the electronic communications industry in the post 1994 economy.

It is a well-known reality that South African citizens are concerned about the amount of money they spend every month on the basic necessity of electronic communications.

The reason posited for these high costs of communication is the lack of effective competition in the ICT sector, as characterised by high termination rates, both to mobile and fixed locations.

Although termination rates are currently high, it is important to recognise the impact of the historical benign regulation of call termination rates. Under the repealed Telecommunications Act only two licensees were to provide mobile telephony services, with the obligation to provide more than 90% coverage of the South African population. This obligation was seen as a crucial requirement in ensuring that citizens had basic access to communications services.

The high mobile termination rate regime allowed for the substantial investment required to provide access to citizens and the Authority is pleased
that more than 90% of the population now receives coverage by mobile networks. This regime also supported the development of greater data services, a critical necessity in the development of a knowledge economy.

However, this benign regulatory environment is no longer suited to the country’s need for a more competitive market for the provision of Information Communications and Technology (ICT) services. In this regard the Electronic Communications Act mandates the Authority to develop regulations in the public interest, with one objective of fostering competition.

It is important for all to note that the objective of fostering competition is not an end in itself. Rather the objective of fostering competition is to ensure that value chains within the communications sector are efficient and effective, thereby maximising total social welfare such that producers receive a fair investment return and, importantly, consumers receive quality services at fair prices.

Our goal is therefore to correct those identified market failures that restrict the fair allocation of welfare between producers and consumers.

A classic case where market failures may exist in the ICT sector is in the market for call termination since every network controls access to its customers and therefore has a monopoly over access to its customers.

During 2007 the Authority conducted an enquiry into the definition of the market for call termination services in South Africa with the following outcomes:

- A commitment to develop a clear and consistent process for market reviews on how regulations on pro-competitive conditions will be developed; and
- A commitment to evaluate the effectiveness of competition in the wholesale voice call termination markets.

After extensive engagement with stakeholders on the process for conducting market reviews the Authority released the Guideline for Market Reviews on the 8th of March 2010.
This guideline is consistent with local and international best-practice in terms of conducting market reviews.

Based on this guideline the Authority released draft call termination regulations in April this year, concluding that the market for wholesale voice call termination services suffered from the following market failures:

- A lack of the provision of access, where interconnection arrangements harmed the development of interoperable networks; and
- Inefficiently high wholesale voice call termination rates to both mobile and fixed locations.

In the draft regulations, the Authority proposed certain pro-competitive terms and conditions to address these market failures, including:

- The development of a Reference Interconnection Offer (RIO)
- Cost-oriented pricing for the charging of wholesale call termination services
- The potential for certain licensees to charge “fair and reasonable” charges. In other words, the opportunity to potentially charge a termination rate higher than that charged by other competitors.

The Authority requested written comments on the draft regulations and held public hearings as well as one-on-one meetings with specific licensees between June and August this year. The major concerns raised by the stakeholders during this consultation phase included the following:

- That the definition of the market for wholesale fixed voice call termination should be technologically neutral and allow for different points of interconnection to foster greater infrastructure competition
- That the criteria for who is to comply with specific pro-competitive remedies should be clarified
- That the implementation of the proposed rate reductions, too soon after the rate reduction of 1 March 2010, would have a detrimental effect on business stability, investment and employment and
- Queries on how the “fair and reasonable” provision would operate in practice

Today's government gazette contains the final “Call Termination” Regulations and the accompanying explanatory note that provides a detailed outline of the
Authority’s response to these and other matters raised during the consultation process.

However, to paraphrase the regulations and explanatory note, I now provide a snapshot of what to expect.

The Authority has determined that two markets exist in the provision of wholesale voice call termination services.

Market 1 is the market for wholesale voice call termination services to a mobile location on the network of each licensee which offers such a service within the Republic.

Market 2 is the market for wholesale voice call termination services to a fixed location on the network of each licensee who offers such a service within the Republic. This market consists of:

- The market segment for wholesale voice call termination to a fixed location within an 0N geographic area code such as 01, 02, 03 etc; and
- The market segment for wholesale voice call termination to a fixed location between 0N geographic area codes.

The “Within an ON geographic area code” is best described as a call terminating on a network at a point of interconnection in Cape Town with the end destination of the call also being in Cape Town.

The “Between an ON geographic area code” is best described as a call terminating on a network at a point of interconnection in Cape Town with the end destination of the call being in Johannesburg.

Both markets 1 and 2 suffer from the existence of the same market failures. However, the imposition of pro-competitive remedies must be proportionate to the scale of the market failures.

Therefore, the Authority has determined that the following pro-competitive terms and conditions apply to all licensees:

- Compliance with the provisions of the Interconnection Regulations
- Compliance with the Compliance Manual Regulations to be prescribed by the Authority.
• All licensees must charge fair and reasonable prices for wholesale voice call termination

To ensure that the existing market failures are addressed, additional pro-competitive terms and conditions are necessary. These are:

• The development of a reference interconnection offer with the objective of fostering greater interoperability;
• Regulatory financial reporting so that the information asymmetry between the regulated and the Regulator is reduced, and
• Cost-oriented pricing of call termination services.

These terms and conditions are only to apply to those licensees who have greater countervailing bargaining power. The Authority determines that the criteria to be used in identifying these licensees are:

• Whether a licensee has historically benefitted from the allocation of more efficient lower band spectrum; and
• Whether a licensee has substantial economies of scale and scope, as measured by maintaining a share of total minutes terminated in the respective markets of greater than 25 per cent as of June 2009.

Using these criteria, both MTN and Vodacom are required to comply with additional pro-competitive terms and conditions in Market 1, and Telkom is required to comply with such conditions in Market 2.

I now turn to the part which I am sure all of you are waiting for – what are the cost-oriented rates to be?

The Authority has amended its initial proposals on cost-oriented rates to ensure that these regulations achieve the goal of fostering competition AS WELL AS maintain employment and investment in the ICT sector.

The amendment takes the form of merging the peak and off-peak termination rates to a single rate over time rather than in one single move. The Authority believes that this action provides licensees with sufficient time to re-adjust their business strategies to account for a more competitive market.
For Market 1, which is termination to a mobile location, the glide path towards 40 cents will start on the first of March 2011, with the following downward trend:

- Termination to a mobile location from 1st March 2011 to 28 February 2012 will be 73 cents at peak and 65 cents at off-peak times
- Termination to a mobile location from first March 2012 to 28 February 2013 will be 56 cents and 52 cents at off-peak times
- Termination to a mobile location from first March 2013 will be 40 cents irrespective of time.

The end-goal of 40 cents as proposed in the draft regulations is still maintained.

For Market 2, the Authority has amended its original proposal of a single rate for termination on a fixed location to account for the amended market definition where two market segments are identified. The glide path has therefore been amended as follows:

- Termination to a fixed location from first March 2011 to 28 February 2012:
  - Within the ON geographic area code: 20 cents and 12 cents at peak and off-peak respectively
  - Between ON geographic area code: 28 cents and 19 cents at peak and off-peak respectively
- Termination to a fixed location from first March 2012 to 28 February 2013:
  - Within the ON geographic area code: 15 cents and 12 cents at peak and off-peak respectively
  - Between ON geographic area code: 25 cents and 19 cents at peak and off-peak respectively
- Termination to a fixed location from first March 2013
  - Within the ON geographic area code: 12 cents and 12 cents at peak and off-peak respectively
  - Between ON geographic area code: 19 cents and 19 cents at peak and off-peak respectively

These rates apply to MTN, Vodacom and Telkom. They do not necessarily apply to all other licensees. Other licensees may qualify for a termination rate higher than the set rate for these three firms depending on the following criteria:
• Spectrum allocation: A licensee who can prove to the Authority that it faces higher costs based on its current spectrum allocation may qualify for an asymmetric (higher) termination rate.

• Economies of scale and scope: A licensee may choose to apply an asymmetric rate if it is an I-ECS licence holder and has a share of total minutes terminated in the respective market of less than 25 per cent as of June 2009

A licensee may qualify to charge a higher rate if either or both of the above criteria apply. However, to ensure that those licensees who qualify for an asymmetric rate develop efficient operations over time, the percentage increase above the cost oriented termination rate is fixed and reduces over the period of the glide path to ensure that all licensees will be efficient over time.

A licensee may charge a maximum termination rate of 20% above the set rate for the period first March 2011 to 28 February 2012, 15% above the set rate for the period first March 2012 to 28 February 2013 and 10% above the set rate from 1 March 2013.

In conclusion the Authority expects that the implemented remedies will redress the existing market failures in the provision of wholesale voice call termination and will foster greater competition.

It is expected that these regulations will lead to a reduction in end-user retail prices over time as natural price competition takes place.

The Authority will monitor trends in the retail market vigilantly to ensure that there is a fair distribution of total social welfare between licensees and consumers.