
GENERAL NOTICE

NOTICE 227 OF 2006

FINDINGS AND CONCLUSIONS DOCUMENT ON IN TERMS OF SECTION 27 OF THE TELECOMMUNICATIONS ACT (NO. 103 OF 1996) ON THE ENQUIRY INTO HANDSET SUBSIDIES

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■ BACKGROUND

- 1.1 On 24 May 2005, the Independent Communications Authority of South Africa - ICASA ("the Authority"), published under Notice 801 of 2005 in Government Gazette Number 27613, "DISCUSSION DOCUMENT ON HANDSET SUBSIDIES (hereinafter referred to simply as the Discussion Document), for interested parties to make written submissions in the inquiry.
- 1.2 To facilitate an orderly enquiry into the matter, the Authority compiled a list of 24 pertinent questions in the discussion document to which written and oral submissions had to respond in order to allow for a wider participation by interested parties.
- 1.3 The Authority's enquiry into handset subsidies was motivated by, among others, general consumer concerns around transparency for costing and billing of handsets. *Also* at the public hearings for the introduction of Mobile Number Portability the necessity to conduct the enquiry on handsets was raised.
- 1.4 Currently the mobile telecommunications network market in the country that is regulated by the Authority comprises of three licensees namely, CELL C; MTN and VODACOM. The licence conditions of the first two mobile network operators namely, MTN and VODACOM, define the word "Service" in similar terms as follows:-
- 1.4.1 ***"Service" means a service consisting of -***
- (i) the provision of any Licensed Line;***
 - (ii) the conveyance of any message by means of such line;***
 - (iii) the provision of any directory, voice mail, GSM bearer, tele- and supplementary services or information service provided by those means;***
- or***

(iv) the access to Emergency Organizations by those means; together with any billing or other operation which is necessary to provide that service, whether or not the Licensee charges a separate fee for it.

1.4.2 Cell C is a third mobile network operator it was licensed in 2001. Cell C's licence defines "Service" as follows:

(iv) Service means a mobile cellular telecommunications service as contemplated in section 37 of the Act, as authorized by the Authority and provided to Customers and End Users in allocated frequencies within the territory conforming to the technical standards that apply to those frequencies from time to time and including, but not limited to: ((i) to (iv) above)'.¹

(v) Any other services reasonably complimentary to the abovementioned services as these evolve or become available from time to time in conformance with the Technical Standards or as approved by the Authority from time to time².

1.5 From the definition of service above in all instances, it clearly does not define or explain handset or subsidy and it cannot be interpreted or understood to include them.

1.6 In the case of Telkom which had a monopoly over customer premise equipment ("CPE") Telkom's licence defines CPE as:

"An item of approved equipment which does not form part of the Public Switched Telecommunications Network but is connected or intended to be connected to terminal connection equipment, whether fixed or portable,

¹ The main clause in the definition of 'service' in respect of Cell C's ~~latest~~ copy of their licence as published in Gov Gazette No. 27087, dated 09 Dec 2004

² The last subclause in the definition of 'service' in respect of Cell C's ~~latest~~ copy of their licence as published in Gov Gazette No. 27087, dated 09 Dec 2004.

and by means of which signals are initially transmitted or ultimately received,

- 1.7 Exclusivity of CPE by Telkom ceased on 07 May 2002, thus ensuring competition on the supply of CPE.
- 1.8 Unlike CPE licence requirement there is no definition or requirement to offer a handset in any other licence or legislation.
- 1.9 The provision of the handset together with the basic telephone service to the consumer may have had its benefits since its inception in 1993³ but it is not the core business or service of the MCTS licensee.
- 1.10 The Authority noted that regarding handset subsidies there is lack of transparency and lack of consumer awareness when licensee's and/or the service providers deal with a customer. This is evident in the advertising and at the point of sale of their services regarding subsidizing of handset and the exact amount of the subsidy involved. There is also a lack of choice of packages on offer to the new or existing subscriber who in particular may not need a new handset with or without a subsidy but chooses to continue with their own when applying for the provision of telecommunications services.
- 1.11 The Authority is also concerned about the structure of the tariff for charging the subscriber for the provision of telecommunications services that was included in the subsidy of the handset itself and which is apparently recovered from the subscriber over the period of the contract. That put into question whether indeed there is a subsidy on the handset.
- 1.12 The Authority sought to examine whether the handset subsidies offered especially to post paid customers might constitute a barrier to the number portability process. The barrier may be evident in future for the subscriber to change if so desired from one network to the other despite the term of the contract.

³ See discussion document, Government Gazette No. 27613 dated 24 May 2005.

1.13 The introduction of number portability in terms of section 89 (1) (b), of which the sole purpose is to ensure competition in the market, with an ultimate effect of enhanced choice to consumers is a further provision in the Act that the Authority took into consideration. In order to ensure that number portability has the required pro-competitive benefits to consumers. The Authority seeks to remove any possible barrier to porting that may affect competition. In countries where the subsidization of handsets has been regulated, the uptake of number portability was much higher than countries⁴ that do not regulate handset subsidies.

1.14 Section 96 provides for the making of regulations in relation to any matter, which may be necessary or expedient to prescribe for purposes of the Act. The Authority will act within the framework of the Act and in the best interest of the consumer.

2 LEGISLATIVE FRAMEWORK

2.1 The Telecommunications Act, Act 103 of 1996 as Amended, ('the Act') by virtue of section 27 (1) empowers the Independent Communications Authority of South Africa ("the Authority"), to conduct an enquiry into any matter relevant to **'the achievement of the objects mentioned in section 2'**⁶. The following objects are relevant to the subject matter of the enquiry on the regulation of subsidies on mobile handsets with other mobile telecommunication services:-

- a. promote the universal and affordable provision of telecommunication services;*
- b. the development of telecommunication services which are responsive to the needs of users and consumers of telecommunication services;*
- c. the promotion of fair competition within the telecommunications industry;*
- d. protect the interests of telecommunications users and consumers...*

⁴ See Discussion Document published on Government Gazette 27613

⁶ Telecommunications Act (Act 103 of 1996)

- 2.2 The issues raised in the discussion document fall within the objects of the Act that are identified above. It follows that the Authority was entitled to convene a public enquiry into those issues. There **is** a further legal basis for the enquiry held by the Authority, that is the provisions of section 2(b) and (c) of the Independent Communications Authority of South Africa, 13 of 2000, **as** amended ("the **ICASA Act**"). This section provides that the Authority has been established to regulate telecommunications in the interest of the public and to achieve the objects of the underlying statutes, which includes the Telecommunications Act. It **is** clear, from the discussion document that the object of the inquiry held by the Authority is a matter of public interest and which the Authority is desirous to address by means of regulations. The question which then arises is whether the Authority has the powers to make regulations in regard to the subject matter of the enquiry.
- 2.3 Section 96(1) of the Telecommunications Act provides that the Authority may make regulations in relation to any matter which in terms of this Act shall or may be prescribed by regulation. Section 96(1) makes it clear that the Authority has the power to make regulations where any specific provision of the Telecommunications Act imposes an obligation on the Authority to make such regulations, or where the Telecommunications **Act** merely confers discretion on the Authority to make regulations, in the event it decides to do so. The Authority **has** used section 45 as a legal basis to make the regulations on handset subsidies. The Authority is entitled in terms of section 45(1) and (2) of the Telecommunications Act to make regulations relating to handset subsidies.
- 2.4 The precondition to the making of such regulations is that there is no competition, or such competition as may exist in that market is insufficient. Once the Authority has come to that conclusion, then, it shall have met the precondition set out in section 45(2) and would then be entitled to make the relevant regulations in terms of section 45(1) of the Telecommunications Act. It is important to note that section 45(2) does not require the Authority to adopt a particular form or procedure **in order to determine whether competition exists** or not, or that it is not sufficient. The section does not expressly impose an obligation on the Authority to convene an enquiry or investigation in order to determine market conditions so as to arrive at a conclusion that competition exists

or does not exist, or ~~is~~ insufficient so as to enable it to intervene by means of regulations in terms of section 45(1). In ~~so~~ far as section 45(2) is concerned, the Authority ~~is~~ not required to engage in a comprehensive investigation, all that is required is that the Authority conclude that there is no competition, or that there is insufficient competition in the relevant market, in order to justify intervention by means of regulations, in terms of section 45(1).

- 2.5 In order to execute the above object, the Authority appointed a special committee in terms of section 17 of the ICASA Act, Act 13 of 2000. One of the tasks of the Committee ~~was~~ to prepare the relevant discussion document and publish same in the Government Gazette and extend an invitation to members of the public to comment thereon. Further, the committee conducted public hearings, and had to make its findings and recommendation(s) to the Council which will make the final decision on the practice of handset subsidies ~~by~~ the licensees.
- 2.6 On 3 and 4 August 2005 the said committee conducted public hearings in terms of section 27 of the Act as the Authority believes that the inquiry relates ~~to~~ a matter that is relevant to the achievement of the objects ~~of~~ the Telecommunications Act or the performance ~~by~~ the Authority of its functions. The objects of the Telecommunications Act are described in section 2 thereof.
- 2.7 ~~As~~ stated above one of the most important functions of the Authority ~~is~~ to protect consumer interests. In this regard in order to ensure that the telecommunications market ~~is~~ conducive to competition this in turn leads to more affordable prices and better customer service. Due to the nature and history of the telecommunications market, the term "managed liberalization" has become a popular buzz word of describing the regulatory regime in South Africa. Therefore the Authority sees its self ~~as~~ managing the liberalization process, which ~~is~~ the key to ~~a~~ healthy and competitive market place that benefits consumers. The Authority considered the section 27 enquiry process and has determined that section 45 of the Act is the most appropriate section to deal with handset subsidies.

- 2.8 Section 45⁷ provides for fees and charges for telecommunications services which the Authority shall determine and prescribe, ~~as~~ it may deem necessary.

3 CURRENT INDUSTRY PRACTICES

- 3.1 Network operators enter into agreements with service providers, which, among other things, address the issue of handsets offered to customers and the duration of the contract. The most common and popular contract is the one that has a duration of 24 months. The Authority raised questions about the extent of choices available to consumers in terms of the duration of contracts, and highlighted the need to offer more flexibility in terms of the duration of contracts made available to customers. An example of Argentina was put forth, where we were informed that they supply subsidised handsets over 6, 12 **and** 24 months and the value increases substantially in terms of what the customer ends up having to pay?
- 3.2 Service providers are incentivised by network operators according to the period during which a subscriber will be on the network, as well as the number of new connections introduced on the operator's network. It was indicated at the public hearings that the incentive remuneration to service providers is agreed in their contracts with operators, and the allowances offered by the three network operators tend to be similar.
- 3.3 At the public hearings some parties stated that there is no transparency on how the subsidisation of the handsets is done, the value of such subsidies, and the costs thereof. Hence, the need for more transparency on the real cost of the contract, the cost of the handset provided, and how the handset costs are recovered from the customer.⁹

⁷Telecommunications Act (Act 103 of 1996)

⁸ Autopage oral presentation, dated 03 August 2005 Public Hearings

⁹ Telkom Oral presentation, dated 03 August 2005 Public Hearings

3.4 The operators¹⁰ explained their relationship with service providers in provision of services. Operators pay service providers various incentive allowances for marketing their products, ensuring customer acquisition and retention, and managing relations with the post-paid customers through provision of services such as billing and value added services. Further, the operators confirmed that the service providers utilise the incentive allowances to subsidise handsets, since the service providers' revenues depend on the number of connections they acquire and how long they retain such customers on the operator's network. The service providers are incentivised to compete in terms of the quality of service offered as well as monthly access charges, since incentive allowances based on new connections and renewals can be clawed back by operators depending on how long the subscribers remains on the network. However, concerns were raised about the constraints placed by operators on service providers that limit their ability to enhance customer choice? Such constraints include the requirement by operators that an IME number of the handset be produced as proof that customers got new phones before a service provider gets remunerated for retaining customers on the networks.

3.5 Emphasis on marketing and the fact that service providers have more flexibility on monthly access charges; and they tend to use these to market their services against their counterparts in competing for customers¹².

3.6 The Authority was informed¹³ during the public hearings that consumers have a choice of prepaid. Telkom stated this in their oral presentation, when they argued that customers have a choice of three operators and many service providers, as well as a choice of obtaining services on a prepaid basis.

3.7 The possibility of cross-subsidisation was raised in some representations made during the public hearings¹⁴. This concern is based, among other things, that phones for prepaid customers are sometimes subsidised and sold much cheaper,

¹⁰ Vodacom, MTN & Cell C

¹¹ Autopage, 03 August 2005

¹² Autopage

¹³ Nashua Mobile, MTN

¹⁴ Telkom oral presentation, dated 03 August 2005 Public Hearing & Mr Lourie, 03 August 2005

with offerings that allow such customers to receive **calls** for a period of 12 months without making any calls; while in the post-paid market some offerings include other goods and vouchers to redeem other goods from the dealers, in addition to highly discounted monthly subscription fees and free handsets. The mobile operators attributed this to a competitive landscape in the market, as the dealers **try** to outperform their counterparts by utilising the incentive allowances they receive from operators to fund such offerings with the aim of **maximising** the number of connections they **achieve**¹⁵. The dealers are therefore also involved in the subsidization of handsets.

- 3.8 The Authority raised questions on tariffs packages offered to consumers, especially for the subscribers that choose not to receive new handsets when they renew their contracts. Motorola, in their written submission, stated that post pay packages without handsets could pose serious risk to the operator or service provider. It was indicated at the public hearings that customers who choose not to receive new handsets will still pay the same tariffs as those who receive free handsets? .”I actually will tell you that if a subscriber comes to us and says **I don’t want to** ... you know, I’m not going to take the handset, we would say to them but effectively it’s better for you to **do** it, because you are still paying the tariff, the per minute or per second **tariff**.”¹⁷,

4 ANALYSIS OF WRITTEN AND ORAL SUBMISSIONS PRESENTED ON THE DISCUSSION DOCUMENT

- 4.1 The Authority received written submissions from the following: - Autopage, Cell C, the Competition Commission, Mr Ian Mclean, Mr Ivan Roux, Mr Mike Lawrie, MTN, Motorola SA, Nashua Mobile, Telkom, Transtel, and Vodacom.
- 4.2 All the parties referred to above requested to make oral presentations during the public hearings except for Mr Ian Mclean, Mr I van Roux and Motorola SA. The public hearings were held on 03 & 04 August 2005.

¹⁵ Vodacom, 04 August 2005

¹⁶ Vodacom , MTN, Cell C, Nashua Mobile and Autopage

¹⁷ Autopage oral representation dated 03 August 2005

4.3 Telkom¹⁸

- 4.3.1 Telkom, a Public Switched Telecommunication Service Licensee (fixed line operator) was the first party to make their oral presentation at the public hearings. They pointed out that being a fixed line operator they're not involved in the mobile handset market.
- 4.3.2 Telkom described the mobile telecommunications industry as *'characterized by 2 broad categories of end-users; those that have been defined as the prepaid customers that purchase their services and pay in advance to the usage of the network, and the post-paid or contract customers, which enter into contracts with certain characteristics of services and terms, which are essentially the focus of this inquiry, insofar as they are the people, which receive subsidized handsets.'* Their submission went on to say the mobile operators identified the practice of subsidizing handsets as a key strategy to reduce barriers of entry for customers.
- 4.3.3 Telkom is of the view that subsidy as offered by mobile operators is a euphemism in that no customer actually believes that they are getting something for free and that in fact they are paying. Telkom maintain that the problem is that the customer does not know what is he paying for, which is the crux of the matter that is misleading and that should be avoided. The latter paragraph touches on transparency and the lack thereof.
- 4.3.4 Telkom submitted that the consequence of the subsidy is that the cost incurred in the service provider's quest to provide quality of service. Also linked to the subsidy is the nature of the package and the various choices that are offered to the customer. Telkom submitted that Mobile Operators **recover** their initial investment through a lock in period of 2 years. However, stating that Telkom **was not 100% sure, it doesn't appear that there was any reduction in the rental after the 2 year period.**

¹⁸ Telkom oral representation on 03 August 2005

- 4.3.4** With regards to consumer protection, Telkom raised questions as to whether subscribers when entering into a contract are aware of the real costs that they will incur.
- 4.3.5** Telkom, submitted that: *'The subsidies have been identified that there's a potential problem for subscribers insofar as the 24-month lock-in period may restrict or does restrict the ability of customers to change from one service provider to another or from one operator to another.. The lock-in period has also been identified as a possible barrier to the proper utilisation of number portability insofar as it makes it more difficult for the customer to port their numbers because of the contractual commitments that they have subjected themselves to, or that they have been subjected to'.*
- 4.3.6** Telkom stated that customers have a choice between the three mobile operators; many service providers and the prepaid service. The latter, they believe, a majority of customers opt for and the further choice it is what the licensee described as the fairly frequent turnover of handsets that may be used widely in the post paid market.
- 4.3.7** In closing their oral presentation, Telkom recommended regulatory intervention that materially improves the transparencies of the subsidy, both in terms of what it costs and how it is recovered. The written submission in conclusion also echoes the foregoing¹⁹.

4.4 Autopage²⁰

- 4.4.1** Autopage like other service providers acts as a link between the concerned mobile operators and the customer to connect the latter onto the mobile network. This relationship allows customers to access services of the network operators through service providers. Service providers are not licensed in terms of the Telecommunications Act or any other legislation. Although they

¹⁹ is Telkom's written submission p 12

²⁰ Autopage, oral presentation public hearing on 03 Aug 2005

are not licensed, their activities have to comply with the licence terms and conditions of the licensees and the legislative requirements imposed to licensees.

- 4.4.2 In their oral presentation, Autopage stated that they fully subscribe to protecting the consumer from unfair business practice, poor quality service; harmful and unfair products. They are concerned there is no regulation they are aware of stopping a network offering a no-handset deal. Autopage said they tried to do it (i.e. offer a no handset deal), but were not allowed to do so²¹. This limitation Autopage was referring to is in terms of the service level agreement they have concluded with one or all three mobile licensees.
- 4.4.3 A further limitation on service providers is to determine a tariff on call charges is the fact that it is approved by the Authority strictly and it is directed at the mobile licensees who alone have a final say on the matter. Autopage stated that with regards to what is on offer they can only change monthly access fees and not the tariff.
- 4.4.4 Autopage is in support of subsidies to remain to a certain extent. Autopage argues for handset subsidies to remain to a certain extent. In support of this they referred to the uptake of the **3G** service that the licensees are currently rolling out to the public.
- 4.4.5 Autopage argued that the average South African would not afford the price tag of R2 000, **R3 000** or **R4 000** that may be required to invest in a handset with that technology. According to the presentation, subsidies are a form of financing offered by both the network operators and the service providers. They went on to say that the 24 month contract would therefore be a way to recoup their initial investment on the handset. They had however, as Autopage initially offered the 12-month contract but it had very little consumer demand as, one network told **the** service provider **they** could offer **it** but **not at a** different tariff with the result that they abandoned it.

²¹ Autopage, oral presentation during public hearing on 03 Aug 2005

- 4.4.6 Autopage cited customer retention as one of the rationales for subsidies.
- 4.4.7 Autopage, pointed out that one of the mobile networks (Cell C) offers a 12-month contract but on the same tariff (i.e. same call charges). They also indicate that a month to month contract is possible across all networks but on the same tariff.
- 4.4.8 On transparency, Autopage conceded that they need to be more transparent and disclose to the customer the exact value of the handset, how the subsidy is calculated **so** that the consumer could make an educated choice?
- 4.4.9 For comparison purposes with regard to other jurisdictions, Autopage gave the example of Argentina, where handsets are subsidised over 6, 12 and 24 months and found that the costs of contract increases whenever the term of the contract is shorter.
- 4.4.10 Autopage's concluding remarks on whether regulation of handsets would have a positive effect on services based on competition and tariff, it was their view that competition already exists. Further, according to Autopage, introducing virtual network operators would offer some niche marketing to some specific areas for the market²³.

4.5 Transtel²⁴

- 4.5.1 Transtel is a Private Telecommunications Network (PTN) and a shareholder of the Second Network Operator.
- 4.5.2 Transtel stated that the handset subsidy increases the uptake of new technology, new application and new services. They also noted that intervention by the Authority will benefit consumers and new entrants.

²² Autopage, oral presentation during public hearing on 03 Aug 2005

²³ Autopage, oral presentation during public hearing on 03 August 2005

²⁴ Transtel oral presentation during public hearings on 03 August 2005

4.5.3 They however, are concerned that handset subsidy goes hand in hand with mobile number portability as **two** competing interests which present a challenge to the Authority. They pointed **out** that the handset subsidy could impede number portability. They **however** would like to see the Authority conducting some form of market analysis *'to determine whether or not there is actually a need, (1) to continue with handset subsidies in one form or another, or to remove them or to have handset subsidies only apply to a particular class of handsets'*²⁵.

4.6 Mr Mike Lawrie

4.6.1 Mr Lawrie is a consumer. In his opinion there is **no** evidence to indicate that suitable regulations of subsidies **will** have an adverse impact on the market? He was emphatic that *'The regulation should make it a standard practice that the end user buys a handset **from** a handset reseller, and buys the communication service from the networks. I believe these 2 things should be separated totally and completely. Handset sellers do not need to be regulated any more than modem or telephone sellers need to be. With the bundling of the handset price with the service, handset sellers are forced out of the market'*²⁷

4.6.2 As for the specific function of the mobile networks he puts it boldly that *'they (mobile operators) are there to provide a communication service they're not there to provide cell phones'*²⁸. **Mr** Lawrie set out to point by way of example how a certain **dealer** advertised that a potential subscriber could receive a handset at a package of **R139** per month on the standard 24 months contract, on the network of one operator, together with a voucher to the value of **R3 000** to be spent at the same dealer. In his calculations (**i.e. R139** x 24 months = R

²⁵ Transtel oral presentation during public hearing on 03 August 2005

²⁶ oral presentation during public hearing on 03 August 2005

²⁷ oral presentation during public hearing on 03 August 2005

²⁸ oral presentation during public hearing on 03 August 2005

336), the difference (R336) was negligible. In his opinion the voucher was not offered out of the goodness of the dealer concerned.

4.6.3 Mr. Lawrie further argued that *'just as Telkom no longer has monopoly of providing telephone handsets for their voice service, nor modems for their data services. So it should be that the network should not have effectively the monopoly of providing handsets. They don't have such monopoly by any right whatsoever!*

4.6.4 He went on to say, *'Decoupling the handset from the service will lead to the potential subscriber being better informed as to (a) what the handset can do and (b) what the service is about'²⁹.*

4.6.5 In his concluding remarks Mr Lawrie re-iterated his position that he thinks there is merit in prohibiting the mobile networks from having any involvement in the sale of the handset and proposed three steps in that regard. The first is that the Authority should **look** into controlling by forbidding involvement by the network operators into handset subsidies as that would be easier to enforce than controlling the subsidizing of handsets.

4.6.6 A second point would be that forbidding handset subsidies would spread evenly the income from telecommunications services across a wider base as SMME's (Small Micro and Medium Enterprises), would also participate in the industry. The third proposal is that the Authority should look at the fine print, non-optional add on charges that are neither essential nor fundamental to the service. According to Mr Lawrie the specific issues are the charges for CLI (Caller Line Identification) and itemized billing which he emphasized that neither of which is essential. He strongly supports the notion that the subscriber should have the option or not to take up those services.

4.6.7 On the SIM (Subscriber Identity Module) lock as a means of retaining a subscriber, Mr Lawrie expressed his opposition to the practice as a subscriber

²⁹ consumer, oral presentation during public hearing on 03 August 2005 p 93-94 Public Hearing Transcript

would otherwise purchase another handset when moving to another network. Further, it prevents a subscriber from using the handset with a local SIM card while traveling abroad.

- 4.6.8 The consumer cited his personal experience where he could not use his cellphone in Nigeria. In his view, the network should unlock a cellphone on demand?

4.7 Vodacom

- 4.7.1 Vodacom is one of the three licensed mobile operators in terms of the Act. As far Vodacom is concerned, they are not alone in the practice of handset subsidies in that *'not one of the mobile operators is able to act independently due to a variety of competitive constraints and that handset subsidies is merely one competitive dimension of different customer offerings on which mobile operators and their service providers and dealers compete to attract and retain customers'*³¹.
- 4.7.2 The licensee argues that in considering the role of the commercial practices of handset subsidies requires a holistic approach involving an overall impact on the market, the consumer and the operators. They allude to few positive consequences of subsidies such as penetration of growth. The other is that demand for more technologically advanced products and services is stimulated to allow them to bridge the digital divide. A further positive consequence is that Vodacom can pre-configure handsets for the consumer.
- 4.7.3 Vodacom also presented their statistics which indicated growth in the industry in the region of 25 million subscribers spread across all three networks with mobile penetration at 52% to date and they project an ambitious growth rate of 75% in 2008.

³⁰ a consumer, oral presentation during public hearing on 03 August 2005 p 95 Public Hearing Transcript

³¹ Vodacom, oral presentation during public hearing on 04 August 2005 p 6 Public Hearing Transcript

- 4.7.4 They however specifically pointed out that of the 25 million subscribers in South Africa, only 4 million are contract. The other 21 million customers are all pre-paid. Further, according to Vodacom 1 million connections per month take place of which only 10% of contract users are subsidized. Vodacom cautioned the Authority not to intervene too soon especially in the light of the national objective to bridge the digital divide.
- 4.7.5 Vodacom went to say that as Vodacom they have 2 million contract subscribers and that they have put more than 8 million phones. Vodacom stated that 57% of these handsets are in the hands of users in South Africa that have found their way into the prepaid market. These users there have also benefited from subsidies, *'which have removed the barrier to entry for them and has helped to create the astounding growth that we experience in the pre-paid market in South Africa'*³².
- 4.7.6 Vodacom stated that the handset subsidies have assisted them in putting more than 2 million GPRS 3G phones in the hands of consumers.
- 4.7.7 Vodacom stated that subsidies themselves are always linked to a particular tariff plan. They went on further to state that the higher the minimum monthly spend the higher the operator is willing to provide a subsidy.
- 4.7.8 Vodacom also revealed that subsidies take place at three levels. The first is at network level, where Vodacom would compete with Cell C and MTN for data package offerings, etc. The second is at service provider level where various parties would 'differentiate themselves by adding more subsidies'. The third is the dealer level where certain chain stores would also be inclined to add further subsidies 'so that it has a competitive advantage' over other dealers.
- 4.7.9 On number portability *vis-à-vis* handset subsidy, Vodacom maintains that **handset subsidies are a feature of** market competition since operators make commercial responses to changes in the regulatory and market environment.

32 Vodacom, oral presentation during public hearing on 04 August 2005 p 8 Public Hearing Transcript

However, Vodacom was emphatic that ***'Neither the introduction of mobile number portability, nor the introduction of new players is a justification for regulating handset subsidies?'***

- 4.7.10 On transparency of the cost of the handset, Vodacom conceded that there are certain practical complexities. These are by no means disclosed with sufficient clarification for the consumer to make an informed decision. On advertising their products and services and this case of subsidized handsets, Vodacom said they comply with the advertising standards as regards making the consumers aware as to the relevant costs and related matters. Importantly though, Vodacom recognizes 'that the customer does have the ultimate choice'.
- 4.7.11 On the 24 month contract, Vodacom submitted that it cannot be viewed in isolation. Vodacom insisted that tariff and the handset subsidy are based on the expected life span of the handset and the revenue they recover over the contract period.
- 4.7.12 On international jurisdictions, Vodacom maintains that the handset 'subsidies is an internationally accepted commercial practice'. However they conceded that in certain countries the practice is regulated. They referred to Finland where 'handset subsidy regulation is being relaxed' to allow for the uptake of services like 3G. Korea was cited as an example and it was stated that a subsidy ban was limited for a certain period, but that has not necessarily translated into reduced tariffs.
- 4.7.13 Vodacom's conclusion of their oral presentation was that: ***'Handset subsidy is a world wide best practice. Mobile operators should be given the choice to use handset subsidies as a means to compete and differentiate their offerings and roll out of new technology driven offerings to attract and retain customers.'***

Current practice of handset subsidies versus handset financing simplified the customer experience?

- 4.7.14 A member of the public³⁵ put forth a question to the Vodacom panel and he wanted to know if Vodacom would rather consider diverting the subsidy on handsets towards the establishment of local manufacturing plants of established manufacturers such as Samsung, Nokia, etc. Vodacom's response was clear – '*... it is not our core business...*'³⁶.
- 4.7.15 Vodacom proposed in its concluding remarks 'light touch and least intrusive regulatory approach'.

4.8 MTN

- 4.8.1 The second of three licensed mobile operators in terms of the Act. MTN came out in support of the Authority's mandate by stating it unequivocally that '*Regulatory intervention should always advance the public interest and not the interest of competitors*'³⁷. Having said that, MTN pointed out that the Authority's intervention will be justifiable where 'there is demonstrable evidence of market failure or abuse of dominance based on market share computations and pre-defined relevant markets'.
- 4.8.2 **MTN** also share the view with Vodacom that handset subsidies were introduced as a stimulus to market penetration. **However, they believe that the market has grown to a level of maturity where a change in approach to handset subsidies may be appropriate. MTN's argument on market maturity is in line with their view of international trends where in their written submission they allude to operators moving away from practicing handset subsidy and finding other means to stimulate customer acquisition and retention. In the same breath as regards international jurisdictions cited by the Authority in the**

³⁴ Vodacom, oral presentation during public hearing on 04 August 2005

³⁵ Organized Labour during public hearing on 04 August 2005

³⁶ Vodacom, during public hearing on 04 August 2005

³⁷ MTN, oral presentation during public hearing on 04 August 2005

discussion document, MTN cautioned against 'cherry picking arguments to suit a particular **outcome**³⁸.

4.8.3 MTN intend removing handset subsidies from its business model³⁹. They also note that such a move will be a success if all parties in the industry take similar action. MTN **is** of the opinion that the practice of handset subsidies could be phased out over a period of time.

4.8.4 MTN believes that the phasing out can be achieved **by** an industry led initiative through a code of conduct. They also cautioned against absolute banning **of** handsets especially when new technologies are introduced. But the Authority has to endorse such a code of conduct.

4.9 CELL C⁴⁰

4.9.1 The third of three licensed mobile operators in terms of the Act. **Cell C** also concurs with Vodacom and MTN on arguments in support of handset subsidy. They however presented three arguments against handset subsidies as follows: - *The first is that operators compete on the basis **of** the handset subsidies tying consumers into long-term contracts and not on the basis **of** the mobile telecommunication services themselves, which they are licensed to provide.*

4.9.2 *Secondly the true cost of the handsets are in many respects hidden from consumers and thirdly operators **of** subsidised handsets are dependent on customers spending well in excess of the minimum committed expenditure to recoup the losses from the subsidies*⁴¹.

4.9.3 In comparing international jurisdictions with regard to a ban on subsidies, **Cell C** cited Scandinavian countries where they found that the ban 'did not affect

³⁸ MTN's written submission dated 05 July 2005

³⁹ MTN's written submission dated 05 July 2005

⁴⁰ Cell C oral presentation during public hearing on 04 August 2005

⁴¹ Cell C oral presentation during public hearing on 04 August 2005

the shape of the subscriber growth'. The licensee however supports the transparency question on what they referred to as bundled goods and services as a package for the consumer.

- 4.9.4 Cell C indicated that there is indeed confusion on the part of consumer as to the monthly subscription cost, the value of the free minutes, the handset itself and the specific tariff plan, all of which needs to be addressed in the short term by transparency but that in itself was not an ultimate solution.
- 4.9.5 Cell C in their view ***'Regulatory intervention would in the ordinary course be the only means by which subsidies can be limited or eliminated'***⁴².
- 4.9.6 In line with MTN, Cell C in their concluding remarks, also support a phased approach but and they provided three phases in detail how that should be and set it out as follows: - ***'The first phase of that, as spoken to, should be the mandatory transparency in respect of costs and their identification. Secondly limited handset subsidisation consequent to a market study undertaken by the Authority and phase three should speak to the elimination of all handset subsidies?'***
- 4.9.7 As to the specific date of implementation Cell C left that to the Authority to determine accordingly and to 'ensure that subsidies are not redirected to other incentives whereby defeating the purpose of banning subsidies, the Authority should through regulation continue to acquire absolute transparency in the industry'.
- 4.9.8 Finally, Cell C would also prefer the Authority to 'remain flexible' and be in a position to 'prescribe the procedures and time frame for the possible authorisation of future subsidies'. The 'focussed subsidies' as referred to t, 'may be introduced for a limited period of time to boost the uptake of new

42 Cell C, oral presentation during public hearing on 04 August 2005 p 62 Public Hearing Transcript

43 Cell C, oral presentation during public hearing on 04 August 2005 p 66 Public Hearing Transcript

technologies such as 3G whose real cost may be beyond the cost, may be unaffordable⁴⁴.

The Competition Commission

- 4.10.1 The Competition Commission (“the Commission”) is a statutory body established in terms of the Competition Act (Act No. 89 of 1998), to regulate all matters of anti-competitive behaviour having an effect in the Republic and across all industries. In the telecommunications sector the Commission has concurrent jurisdiction with the Authority guided by the Memorandum of Understanding entered into by and between the two regulators in 2003. The Commission in its submission advanced similar arguments regarding the rationale for having subsidies in the first place.
- 4.10.2 On transparency the Commission, believes that is an area of concern that may warrant possible guidelines on good practice. The Commission also relates to the lack of information and transparency around the level and composition of tariffs as well as the numerous tariff plans and packages offered. The Commission stated that the numerous packages offered by service providers and mobile operators tend to confuse consumers.
- 4.10.3 There is no break down of costs by item so that the consumer knows exactly how much goes to paying for the handset, call charges and other services.
- 4.10.4 The Commission cited the difficulties in the number of ‘variables’ in packages a consumer may often be confronted with but which are often unknown upfront. The variables mentioned range from peak and off peak minutes a customer may need in advance free and paid SMSs. ***And I think in respect of that our main proposal is that there should be an option available ... there should be***

⁴⁴ Cell C, oral presentation during public hearing on 04 August 2005 p 67 Public Hearing Transcript

packages available where there is a service only option where you don't have to receive a subsidised handset⁴⁵.

4.10.5 The Commission proposed that the Authority should consider introducing measures to increase transparency and comparability of various options, to enhance consumer choice and to improve the efficiency of consumer decision-making processes.

4.10.6 The Commission also dealt with contract flexibility, they stated that long term contracts tend to lock-in customers such that it becomes difficult or costly for disgruntled customers to switch networks before the expiry of the contract. The shorter the contract period, the easier it is to switch networks and the more service providers would compete on quality of service. But the Commission recognized that a **24** month contract enables the cost of the handset to be defrayed in smaller portions per month.

4.11 Nashua Mobile⁴⁶

4.11.1 Nashua Mobile is a service provider to Cell C, MTN and Vodacom. The relationship that Nashua Mobile has with mobile network operator is similar to that of Autopage above.

4.11.2 Nashua Mobile that they mainly have corporate clients but they also deal with consumers.

4.11.3 Nashua Mobile stated that they are bound by the different tariffs offered by the different mobile network operators and they in turn prescribe the tariffs to the end consumer.

4.11.4 They stated that because of the size of the market, old contract phones find their way into the **prepaid** market.

⁴⁵ Competition Commission, oral presentation during public hearing on 04 August 2005 p 79-80 Public Hearing Transcript

⁴⁶ ~~Nashua~~ Nashua Mobile, oral presentation during public hearing on 03 August 2005.

- 4.11.5 Nashua Mobile, in dealing with a 24 month contract versus the 1 month contract, stated that the 1 month contract has been available for 3.5 years. Cell C when they entered the market offered the 1 month package. Nashua Mobile stated that there was very little demand for this package so was the 12 month contract.
- 4.11.6 Nashua Mobile stated that consumers have choice between contract and pre-paid.
- 4.11.7 Nashua Mobile believes that the current model of contract is working very well. They believe that the Authority should investigate interconnection fees.
- 4.11.8 Nashua Mobile, supports disclosure of the subsidy and transparency of the subsidy and is of the view that it should be incorporated into the contract.

5 TARIFFS

- 5.1 The Authority raised questions on tariff packages offered to the consumer, in cases where the subscriber does not need a new handset upon renewal of the contract. Motorola, in their written submission, stated that a post pay package without handset could be serious risk to network operator or service provider. It was indicated at the public hearings that a customer who chooses not to receive a new handset will still pay the same tariff as those who receive free handsets⁴⁷.
- 5.2 Autopage in their oral presentation stated to prepaid tariffs being higher than post-paid tariffs. A table was presented to illustrate the point.
- 5.3 Autopage indicated that the only price elasticity for service providers is on monthly access charges, as they cannot apply to ICASA for adjustments on the per minute or per second charges that they get from the operators.

⁴⁷ Vodacom, MTN, Cell C, Nashua Mobile and Autopage

- 5.4 Currently tariffs are lodged with the Authority by network operators, who in turn have agency agreements with service providers that have a direct interface with post paid consumers. In terms of their licensees, network operators are required to lodge all tariff adjustments with the Authority for approval.
- 5.5 There is nothing in the operators' licenses or legislation that prevents network operators to charge lesser tariffs.
- 5.6 Furthermore, the approval of the tariffs that is granted by the Authority sets a price ceiling above which the operators and their agents should not charge customers for telecommunication services. This means that discounts on the approved tariffs can be offered to customers; and such reductions would leave customers better-Off.
- 5.7 There should be no requirement prohibiting a service provider from offering a tariff less than what is approved by the Authority.

6 FINDINGS

Arguments have been presented by various stakeholders. It has been submitted to the Authority that handset subsidies are good for increasing mobile penetration in the South African economy, In the absence of a mature market the handset subsidies should offer greater consumer choice and transparency, by providing **flexible** contract periods. However, it was pointed out that when the market has matured then the subsidy might have to be reviewed. In light of the above the Authority has reached the following findings and conclusions:

- 6.1 There is lack of transparency about the cost of the various handsets offered in various packages, which limits the customers' ability to make informed choices. Regulations will be developed that will require the network operators to ensure that their agents and service providers provide customers with all relevant information to enable customers to make informed decisions in selecting their service packages. Customers need to be able to easily compare the value of the various options on offer so that they can choose appropriate service packages.
- 6.2 Consumers are not given real choice in respect of call charged and the different offerings and prepaid call charges are much higher than post-paid charges. The Authority has observed that Operators have opted to use the approved **tariffs as** minimum of what can be charged. The Authority approves the maximum level above which the network operators and their agents are **not** allowed to charge their customers (include the provisions of a licence). However, they can effect reasonable discounts on the approved rates in competing with their counterparts in the market. The regulations that the Authority intends developing will, amongst other things, require network operators and their service providers to offer equally beneficial terms for post-paid customers whether they chose a handset or not in their chosen option.
- 6.3 There is potential cross-subsidisation of the post-paid customers by other services. Regulations will be made that require transparency on where the financing of the

free handsets comes from and the value of the various offerings, in order to ensure that other customers are not unnecessarily burdened with costs of acquiring post-paid customers that account for a major part of the operators' revenue from calls made. The Authority is also not satisfied that a licensee cannot provide telecommunications services without providing the handset in addition.

6.4 The Authority shall require that contract terms be explained verbally to potential customers. It will also be required that small print be enlarged on contracts, and that contract terms be available and printed in all official languages. Printing on contract should be clear, conspicuous and should include complete information about rates, terms and conditions for available and proposed products and services from the service provider.

6.5 The Authority also found that there is limited choice for contract periods. A 24 month contract as well as automatic renewal for the same period can be regarded as customer capture/retention and not loyalty. The Authority is of view is that there should be shorter contract periods with similar terms and conditions (e.g. 6, 12, 18 months etc).

Following the analysis of all inputs made, in writing and orally, together with the relevant discussions, the Authority concludes that there is insufficient competition in the handset market and will enact regulations in terms of section 96⁴⁸ read with 45 of the Act.

⁴⁸ Telecommunications Act (Act 103 of 1996)
