

1. EXECUTIVE SUMMARY

Call Termination is a wholesale input, used by providers of calls from fixed-line and mobile networks to complete calls to subscribers connected to other networks. It is one of the larger costs to operators associated with providing telecommunications services to subscribers.

The market definition process undertaken by the Authority is specified in Section 67(4) of the EC Act. Section 67(4)(a) of the Act states in relevant part, that the Authority must:

“define and identify the retail or wholesale markets or market segments in which it intends to impose pro-competitive measures in cases where such markets are found to have ineffective competition”.

Wholesale call termination is the first of five broad categories of markets to be defined by the Authority (there are numerous markets within each category, potentially up to 41, although not all markets will be a focus of regulation).

To inform the development of these regulations, the Authority released a Discussion Document in January 2007, held hearings in May and is mandated to publish its findings in terms of a section 4B inquiry not more than 180 days after the conclusion of such an inquiry (18 November 2007).

The essence of the Findings Document is for the Authority to consolidate the responses and perspectives regarding the intricacies of the issues listed within the Discussion Document and the public hearings and propose a progressive manner of dealing with the issues arising from such a process. Where appropriate, the Authority's observations and preliminary conclusions are detailed.

It is repeatedly emphasised throughout this document that the views expressed regarding wholesale call termination do not represent the conclusive opinions of the Authority. The intent of this document, very simply, is to provide a stake in the ground as to the current state of affairs regarding call termination market definitions and to provide the parameters of that market, which will still require definition in terms of section 67 of the EC Act.

There are a myriad of arguments considered in this document. This executive summary highlights what the Authority views as the most important of these. Naturally, a full appreciation of the complexity of the arguments (and their linkages) can only be appreciated by reading the document in full.

In regard to call termination, the following markets have been explicitly proposed in the inquiry:

- Wholesale call termination on Vodacom's network in South Africa;
- Wholesale call termination on MTN's network in South Africa;
- Wholesale call termination on Cell C's network in South Africa;
- Wholesale call termination on Telkom's network in South Africa;
- Wholesale call termination on Neotel's network in South Africa;
- Wholesale call termination on all other ECNS providers' networks in South Africa, so long as they provide call termination on their networks. This will include call termination on USAL networks;
- Wholesale call termination on all other ECS providers' networks in South Africa, so long as they are in a position to set call termination rates on their networks. This will include call termination on VOIP networks.

Since this is the final step prior to the release of draft regulations regarding market definitions, the Authority is cognisant that it must provide a roadmap for the market definition process in general and specifically the number and form of the regulations to be released in the future. This is done in the introductory section of this document.

The Authority is also required to respond to substantive arguments made in response to the Discussion Document released in January and the oral presentations in May of this year. The remainder of this document seeks to do that.

The Authority argues that of the major forms of substitution, wholesale demand and supply side substitution are seen as insignificant. Retail supply side substitution is seen, at the current stage in the market definition process, also as insignificant. In short, due to the technological/commercial constraints discussed in the document, retail demand side substitution constitutes the only current potential avenue through which substitution may occur.

Thus the primary focus of the document is in response to arguments regarding retail demand side substitutes. The document provides evidence that retail customers do not face termination fees directly because they do not purchase call termination services directly. Rather their service providers purchase these services and use them as one of a number of inputs in order to provide customers with an off-net call service (which allows their customer to call a customer of the termination provider). Any substitution in response to termination price changes at the retail level is therefore "indirect" and is based on consumers reacting to any feed-through to off-net retail prices, not directly to the wholesale price of call termination.

The indirect nature has various implications for the application of the hypothetical monopolist test ("SSNIP") and the Authority identifies these. The Findings Document also identifies a number of conditions that must hold in order for indirect substitution to occur in the first place, and which at the very least weaken the link between price increases and consumer substitution. It then proceeds to test these conditions in the context of call termination on mobile and fixed line operators.

The fact that there are no direct demand-side or supply-side substitutes significantly reduces the likelihood of identifying effective substitutes. Indirect substitutes at the retail level suffer from three fundamental problems. First, expected switching ratios in response to a small but significant price increase in termination rates will be lower due to a lower percentage price increase realised by the final customer (because termination is only one input to price faced by customer and because there may be limited pass through). Second, there will be more limited awareness of the relative price changes that do occur (based on limits to network and price awareness). Third, the critical switching ratio required to make a small but significant price increase unprofitable is bound to be high because many of the retail switching alternatives will usually entail the termination provider earning revenue on the alternative retail product. In this regard 'please-call-me's' or call-backs, multiple SIM cards, least cost routing and CSTs are considered, and rejected as potential substitutes.

The so-called "Waterbed effect" is also taken into account. This is when price increases for one service result in decreases in others (namely, that forcing price reductions in a regulated retail product might have unintended consequences in the prices of other, associated or complementary unregulated products). ICASA does wish to signal at this stage that the waterbed effect will not necessarily hold perfectly in imperfectly competitive markets.

ICASA also notes that most of the stakeholders' arguments were concerned with the impact of remedial action, not market definition. No stakeholders have provided substantial reasons as to why general linkages between wholesale and retail markets means that they should be defined as the same market. Just because overall competition will be based on dynamics in both markets does not mean that they form a single competitive market. Even if retail services were fully competitive, this would not in any way mean that wholesale call termination would also be competitive. In particular, each mobile operator would still be the only supplier of call termination on their network, and callers would not be able to switch to constraining substitutes.

The Authority then looks at particular substitute products for mobile and fixed line calls. Regarding mobile calls, the Authority considers the possibility that mobile-to-fixed and fixed-to-fixed calls are a substitute for fixed-to-mobile calls and off-net mobile calls. The Authority argues that it is highly unlikely that the required

switching will be generated out of the small customer base that can in fact switch to warrant expanding the market.

In considering off-net mobile calls as substitute for fixed-to-mobile calls the Authority argues that off-net mobile cannot constrain fixed-to-mobile and vice versa because the both face the same call termination fee. Similarly, the Authority argues that on-net mobile calls are highly unlikely to be able to constrain call termination rates, for various reasons including the high relative profitability of on-net calls. The Authority then considers the possibility of changing networks as a potential substitute and argues that consideration of changing networks to avoid higher off-net rates does not warrant expanding the market definition as it is unlikely to constrain the profitability of a SSNIP in call termination rates. Finally, the Authority considers joint constraints because of the interaction of substitute products in constraining a price increase in call termination.

Regarding substitutes for fixed calls, the Authority first looks at on-net fixed-to-fixed as a substitute for mobile-to-fixed calls. ICASA considers it highly unlikely for on-net fixed-to-fixed calls to constrain fixed line call termination. In fact, ICASA considers that this type of switching behaviour may encourage high termination rates rather than constrain them. Overall, given the revenue earned on on-net calls, required switching ratios will need to be very high for these types of services to constrain fixed call termination, if it is possible at all. Regarding mobile-to-mobile calls as substitute for mobile-to-fixed and off-net fixed-to-fixed calls the Authority argues that mobile-to-mobile calls are unlikely to constrain fixed termination rates to a competitive level, for various reasons including significant cost differences.

The Authority looks at common pricing constraints and bundling and argues that the relevant market can be broadened to call termination to all subscribers on a particular network. The Authority also argues that operators do not differentiate pricing due to terminating the call in a different geographical location and as such, there is one geographical market.

This document defines the individual wholesale call termination market, namely that there is a separate market for wholesale call termination on each service provider's network, where each market is national in scope.

The Authority identifies 5 markets specifically (call termination on the following networks: Telkom, Neotel, MTN, Cell C, Vodacom) but other termination is also defined in general terms (and referred to as call termination provided by any ECNS or ECS provider's network).

As this process has been conducted as a section 4B inquiry in terms of the ICASA Act, the Authority only seeks to define the market. No pronouncement is made on the effectiveness of competition in this market. This pronouncement and any remedies that may flow from such a determination will be done by regulation in a process envisaged by section 67 of the Electronic Communications Act.