



Submission to ICASA: “Draft General Licence Fees”

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INTRODUCTION

1. Neotel thanks the Authority for the opportunity to make a written submission in regard to the “*Draft General Licence Fees Regulations*” and the consultative approach taken to engage stakeholders on this critical issue.
2. Neotel also wishes to commend the Authority for taking this step in addressing the current administrative challenges in implementing the current General Licence Fees Regulations (Government Gazette no. 32084) published 1 April 2009.
3. In this written submission Neotel wishes to highlight the following points regarding the Draft General Licence Fees Regulations (Government Gazette no. 35819) hereafter referred to as “The Draft Regulations” and the General Licence Fees Regulations (Government Gazette no. 32084) hereafter referred to as “the Regulations”:
 - 3.1. General comments on the Annual Licence fee.
 - 3.2. The effective date of the draft regulations.
 - 3.3. The three (3) year Annual Licence Fee Holiday for new Licensees.
 - 3.4. Penalties for contravention of regulation 4, 5 and 6 in the draft regulations.
 - 3.5. Schedule 2 of the draft regulations, the Annual Licence Fees calculation formula and the proposed applicable of 0.75 percentile.
 - 3.6. Concluding remarks
4. The points listed above are explained in more detail in the sections that follow a number of general comments and observations.

GENERAL COMMENTS

Basis of Amendments

5. At the outset, Neotel strongly supports a sound licence fee regime in the sector to ensure that government’s mandate and objectives for the sector are met, although the fees accrued by the Authority from Licensees do not flow directly back into the sector.
6. Neotel notes however, that the stated rationale for the review of the general licence fees regulations stems from the belief that licensees currently abuse the existing regulations the Authority appears to be of the view that licensees exploit ambiguities in the regulations by pushing up the costs incurred to minimise the Annual Licence fee paid.
7. Arguably, this perception emanates rather from the numerous deficiencies in the existing Regulations which have been highlighted to the Authority in the public

comment process that preceded their promulgation, as well as in various engagements with the Authority on deficiencies in their implementation. These deficiencies are borne out by the efforts of the Authority to publish a “Practice Note” in an attempt to clarify the implementation of the Regulations and remedy its shortcomings.

8. It is the deficiency in the Regulations that needs to be remedied, not arguably, a perception that licensees are attempting to avoid or minimise regulatory fee payments. It is a basic principle of Administrative law that a Regulation or any legislation – primary or secondary should be clear, unambiguous and capable of implementation.
9. The effort to correct the deficiency therefore, needs to consider the above administrative legal dictates and importantly, not discourage investment and competition in the industry, nor unduly impact smaller operators. This view is supported by the objects of the Electronic Communications Act no. 36 of 2005 “ECA”, specifically, section 2 (d) to *encourage investment, including strategic infrastructure investment, and innovation in the communications sector.*

Context of licence fees in the total cost of regulation

10. As a point of departure, it is worth noting that the current and proposed licence fee regime should also be viewed in the context of the total costs of regulation and be viewed in light of the payment of spectrum fees – which have increased significantly over the last 2 years, particularly for smaller operators, and the annual contribution to the Universal Service and Access Fund, none of which collected to date has been used for the benefit of consumers in the sector. That said any effort to remedy deficiencies in the current totality of regulatory taxes levied is welcomed.
11. Neotel believes that if licence fees are not correctly conceptualised and administered, they thus, merely serve the purpose of a regulatory “tax” which ultimately has a directed negative effect on (a) the price paid by consumers, (b) impede investment in the sector (c) a deleterious effect on roll-out to underserved areas and (d) risk sustainability of new entrants and smaller market players.
12. As such, in line with our comments above, Neotel submits that the Authority must also be mindful of the budgetary impact that the recent, significant increase in the frequency spectrum fees will have on Licensees. The annual licence fees and spectrum fees can be viewed as “double taxes” that are only unique in the electronic communications industry as companies in other sectors in the aggregate economy only pay income and company taxes. These “regulatory taxes” affect the overall competitiveness of the communications sector in the wider economy.

13. Thus, Neotel respectfully requests the Authority to consider the financial consequences that annual licence fees have on smaller players and new entrants who are not yet profitable in the sector due to the high start-up costs of operations and the highly competitive market conditions.
14. It has also been argued that this cost of regulation also contributes to the high prices of electronic communications services which continue to limit universal access to communications services uptake and usage for both voice and data services, particularly broadband penetration.
15. This is evident in the remaining visibility of the highly contentious issue of the high costs of communication in South Africa on the political agenda - as was reflected in the recent Parliamentary Portfolio Committee on Communications hearings on this matter.
16. As such, Neotel submits that it is imperative that the underlying basis for licence fees be correctly calculated, based on sound economic principles and rationally connected to the policy outcome sought to be achieved. If the policy intent is increased competition and services penetration, the underlying fee structure that stimulates access to the sector and sustainability of companies, specifically new entrants, needs to reflect that intent in real terms. Global financial markets are under strain and investment in infrastructure faces more challenges than it has in previous years, across multiple sectors. Mindful of this reality, coupled with the goals to stimulate investment and infrastructure build out in the market, Neotel submits that the Authority should reconsider the imposition of a licence fee regime that may place additional strain on the ability of licensees to attract and sustain investor interest and confidence.
17. Licence fee setting exercises as a general rule should be done in the context of the global opportunities and challenges facing electronic communications markets. The Authority should additionally pay attention to current interest rates, lenders requirements, cost of capital and return on investment in addition to domestic market conditions and developments.

Asymmetry

18. Another principle which is not evident in the proposed Draft Regulations, but was a central tenet of the original earlier licence fee regime, is the concept of “asymmetry” whereby the relative entry and hence positioning of licensees in the market is reflected in an asymmetrical approach to the calculation of their fees. By way of example, in that regime, the Mobile operators MTN and Vodacom, had a licence fee contribution in their existing licences of 5% of net operational income (NOI); Cell C had a licence fee

contribution requirement of 1% of audited licence fee income (NOI), while Telkom was required to contribute 0.1% of net revenues, and Neotel, 0.1% net invoiced sales realised from PSTS revenue. This system was designed precisely to address the staggered entry of each operator into the market and the relative advantage early versus later entry had for Licensees.

19. Asymmetry could also be realised in “fee payment holidays” where the metric may be streamlined, but where smaller operators who are not yet profitable, are exempted from paying fees for a defined period. Neotel thus submits that this fee regime revision provides an opportunity for the Authority to enable a phased in graded payment structure for the annual variable licence fee that takes account of the initial investment constraints of profitability yields.
20. Other tools include an exemption from annual licence fees on a specified initial amount of profit, which would be line with the promotion of a policy that encourages investment and which aims to lower barriers to entry for new and smaller players and supports the principles of asymmetric regulation for new entrants
21. Though not included in the current Draft Regulation, given the significant economic impact which will flow from the large scale change to the fee regime being proposed, Neotel submits that asymmetrical regulation in licence fees should be re-considered, either through:
 - 21.1. an asymmetric amount of fee payable;
 - 21.2. graded implementation period to adjust to the new metric, or
 - 21.3. through the enablement of regulatory payment holidays for a defined period.

SPECIFIC COMMENTS

22. Neotel offers specific comments below on the draft regulations

Using Gross Profit vs Turnover

While the use of “Gross Profit” has yielded a number of significant challenges in the past, one way to possibly address the deficiency or ambiguity in the current Regulations, is instead of a further wholesale replacement of the Regulation, rather, by clearly defining direct and indirect costs to accurately determine allowable deductions in the calculation of ‘Gross profit’.

23. Neotel does also however support the proposal to base the licence fee calculation on a percentage of turnover for licenced services. From an accounting perspective, it this

will require fewer resources across the industry and the Authority to calculate, and will result in a fair contribution towards the regulatory costs, provided the percentage amount set is not punitive or deleterious to Licensees.

24. While licence fees collected from operators are not held by the Authority to off-set its operating costs, the principle must be that licence fees collected should only cover ICASA’s regulatory costs and should not over-recover such costs, though the fees are onward routed to the fiscus.
25. Currently, operators make an annual contribution to universal service and access objectives through payment to the Universal Service and Access Fund (“USAF”) and also pay frequency spectrum fees and general company taxes required by all licensees ICASA’s budget expenditure for 2011/2012 financial year was approximately R314 million. It is therefore Neotel’s view that charging 0.75% of turnover would over-recover funds from the industry to cover ICASA’s regulatory costs. The illustration in the tables below suggests that 0.25% of industry turnover would approximately cover ICASA’s costs.
26. According to BMI-T the telecommunications market, is worth approximately R160bn. After subtracting device fees and value added services, the market is worth R134bn see Table 1 below (Nielson *et al*, 2012). The illustration in Table 2 below shows the revenues that would be recovered by through the license fee regime using different percentages of annual turnover, starting at 0.1% and ending at 1%.

Table 1: BMI-T changing landscape market sizing (Rm)				
	Total	Less: Handsets	Less: Other services	Licensed revenues
Mobile	116,003	16,534	4,496	94,973
Fixed	42,817		3,465	39,352
Total licensable revenues				134,325

Source: Adapted from BMI-T, 2012

Table 2	
% annual turnover	Rm
0.1%	134
0.2%	269
0.25%	336
0.3%	403
0.4%	537
0.5%	672
0.6%	806
0.7%	940
0.8%	1,075
0.9%	1,209
1.0%	1,343

Source: Neotel analysis, 2012

27. Neotel thus submits that if turnover is to be used as the basis for calculating the licence fee payable, no more than 0.25% of industry turnover should be used as the measure. This should be implemented with due regard to asymmetry for new and smaller players, and companies not yet yielding a profit either through payment holidays or a phased in period of a number of years on a graded scale, culminating on 0.25%.
28. Neotel's preference however, in line with the promotion of competition in the market would be a percentage measure of "Net Profit" for small and newer operators, of no more than 0.25 – 0.50%,

The effective date of the draft regulations

29. In the draft regulations, the effective date is specified as 1 April 2013.
30. Section 4C of *The Independent Communications Authority of South Africa Act* no. 13 of 2000 ("ICASA Act") requires the Authority to make a finding *within* a period of 180 days

from the date of conclusion of an inquiry. While the period specified is the maximum period allowable, Neotel submits that the effective date as listed in the Draft Regulation will not allow the Authority sufficient time to apply its mind to the submissions made in regard to the Draft Regulations, without fettering its discretion.

31. Given the potential adverse impact these Draft Regulations may have on licensees, Neotel urges the Authority to allow sufficient time to apply its mind to the written submissions made; allow a meaningful period for oral hearings if required and then a period for consideration of the arguments and submissions made, and, if necessary, a re-publication of revised Regulations so as to ensure that the deficiencies of the current regulations are not replicated, albeit in a different form, in the revised regulations.
32. Further, Neotel seeks clarity from the Authority if the draft regulations are finalised and become effective on 1 April 2013, which calculation formula will then apply to 2013/2014 financial year for Licensees?
33. Neotel submits that the effective date has financial implications on budget forecasts and financial planning and the fact that different operators have different financial year –ends, a stipulated date at this point, prior to the conclusion of hearings and argument, may create an unintended consequence of benefitting certain operators, while discriminating against others.
34. Neotel's financial year ends on 31 March annually and we believe that the regulations may not be applied retrospectively. Hence any implementation of new regulations should only apply to 2013/2014 financial year. Such an approach should however be seen in the context of our submissions made above regarding asymmetry and the phased in, graded or payment holiday options available to animate asymmetry and promote competition in the sector.

Exemption from payment of annual licence fees

35. Clause 4 (d) of the draft regulations addresses the exemption of licensees from paying Annual Licence fees. In addition to our comments made above, Neotel believes that the proposed three (3) years exemption is problematic for the following reason: based on findings or growth patterns observed, it takes six (6) to eight (8) years of operation for new entrants to become profitable and sustainable.
36. Network operators require large investments and funds to roll-out infrastructure and in the current market conditions it takes longer to realise returns on investment. New

operators require more than 3 years of operation to be sustainable and to be in a position to afford paying licence fees without this having a substantial impact on their working capital and cash flows for their business continuity. A national operation also requires higher set up costs and higher Capex commitments. New entrants are faced with higher risks based on scale and the nature of the investment and longer periods to attain return on investment.

37. The Department of Communications and the Authority have indicated their commitment to “reducing the costs of doing business” and “lowering barriers to entry” in the Republic. These are laudable objectives that are crucial to stimulate investment by new entrants in a market that is relatively concentrated and vastly saturated in various service segments. Nevertheless, the regime proposed in these draft regulations does not reflect this objective and commitment in a tangible manner.
38. Neotel submits that the licence fee holiday for new licensees should be extended from (3) years to (6) years. As stated above, Neotel believes there should be asymmetric percentages applied in the calculation of Annual licence fees dependant on the years of operation and profitability.
39. Neotel proposes zero (0%) percentage for Licensees in the first six (6) years of operation and a small percentage of Turnover (0.25-0.50%) levied on Turnover generated from the seventh year of operation.
40. Other tools that should be considered by the Authority over and above the licence fee holiday include an exemption from payment of annual licence fees on a specified initial amount of profit. This threshold would be in line with the promotion of a policy that encourages investment (via “regulatory holidays” for a defined period for example) and which aims to lower barriers to entry for new market players and supports the principles of asymmetric regulation for new entrants.
41. Lastly, the Authority should compile and publish a reasons document explaining the basis for the 0.75% or any amount finally settled upon following the Authority’s consideration of the submissions made and argument presented.

Contravention and Penalties

42. In the current regulations the penalties for contravention range between R100 000.00 and R1, 000, 000.00 depending on the nature of contravention.
43. In the draft regulations the Authority has increased the penalty amounts substantially without indicating a basis or rationale for the proposed increase. Neotel submits that the

contravention and penalties clause in the current regulations should remain unchanged and should be kept between R 100 000.00 to R 1, 000, 000.00 instead of five (5) percent of quarter (1) one turnover and the R2 000 000 for regulation 5 and 6.

44. The Authority should also note the error in regulation 7 (1) (b) where the penalty for contravention is stipulated as R 2 000, 000.00 for the entire regulation 4 whereas regulation 4(a); (b) and (c) refer to exemptions. Neotel submits that it is only the contravention of regulation 4 (d) that can attract penalties resulting from contravention of the provision and we submit that this should be corrected in the revised Regulation.

CONCLUSION

45. Regulatory Licence Fees are a legitimate governmental revenue generating mechanism, but must be set and implemented in the context of the complete gamut of regulatory costs and taxes imposed on operators.
46. Moreover, such fees must be set in the context of other government goals and objectives and those specified in the ECA itself, namely, the promotion of competition, investment, investment certainty and innovation,
47. The Authority has a number of competition enhancing tools at its disposal to ensure that the prejudice that will be suffered by Licensees in a change of Licence Fee regime, can be minimized. These include various options available through asymmetric regulation, including: a phased, graded implementation; a regulatory payment holiday and the imposition of asymmetric fees on operators relative to their size and life-cycle in the sector, as well as their profitability and stage of investment.
48. Neotel proposes that the measure of “0.25 -0.50% of Net Profit” should be used to set Licence fees and that the collection of such fees should be limited to a cost-recovery and operational efficiency imperative, notwithstanding, that the fees do not accrue directly to the Authority.
49. Neotel respectfully requests the Authority to conduct a regulatory impact assessment exercise and carefully analyses the costs and overall benefits associated with different options proposed by the industry in this consultative process. The Authority should opt for the licence fee regime that does not outweigh the benefits and the public interest.
50. Neotel requests to make an oral representation on these draft regulations should the Authority hold public hearing in this regard.
51. Neotel remains at the disposal of the Authority to clarify anything in this submission or to assist in the finalisation of this draft regulation.