

## **SACF Comments on the Draft Regulations on the Limitations of Control and Equity Ownership by Historically Disadvantaged Groups (HDGs) and the Application of the ICT Sector Code**

1. The South African Communications Forum ("SACF") is an industry association in the ICT sector and enjoys a diverse membership in the ICT value chain and includes licensees, prospective licensees, OEMs, OTT. This diverse membership permits us to advance views that are balanced and seek to promote an inclusive, responsive, a competitive sector able to attract investment and sustain growth.
2. We welcome the opportunity to comment on the Draft Regulations relating to the Limitations of Control and Equity Ownership by Historically Disadvantaged Groups (HDGs) and the Application of the ICT Sector Code (Draft Regulations). The SACF would like to participate in any future processes relating to the Draft Regulations, including public hearings and workshops.

### **Introduction**

3. The extended submission deadline on the Draft Regulations has been invaluable as it has given stakeholders the opportunity to submit comments that considers a world post-COVID 19. It is inevitable that this process, as well as other regulatory processes consider the changed environment as a result of the pandemic.
4. Transformation is a critical issue to ensure the inclusion of Black people across the ICT value chain in a meaningful way that secures economic transformation and ultimately wealth creation.
5. There have been two phases of economic transformation in South Africa under a democratic dispensation - the first adopted a narrow-based approach by focusing on equity only and the second, adopted a broad-based approach with an expanded scope which now includes management, skills development, procurement, enterprise development and corporate social investment.
6. While most economic sectors have transitioned to the use of the balanced scorecard from the Broad-Based Black Economic Empowerment Act, the ICT sector maintained the narrow-based approach and added the balanced scorecard.

7. The balanced scorecard and B-BBEE approach is encapsulated in sector Codes which encourages empowerment but does not compel it. Instead, there is a strong commercial imperative for firms to comply.
8. ICASA is enjoined by the Electronic Communications Act to apply a mandatory equity target in specific instances and to apply the B-BBEE ICT Code. Equity remains an important element in economic transformation. The critical question is whether a primary focus on equity is the best way of achieving effective transformation in electronic communications licences.

### **Investment Downgrade**

9. The ratings agencies have downgraded South Africa to sub investment grade twice in March and April 2020. This has made the cost of capital more expensive.
10. Additionally, the economy has contracted between 5 and 7 percent, while the rand fell by 23% in 2020.

### **The Impact of COVID 19**

11. The advent of the B-BBEE Act and Codes highlights the need for a more broad-based approach. Moreover, COVID 19 has changed economies and markets.
12. No one truly knows the impact of COVID19. Experts are working with imperfect information as it evolves and there is no global experience or practice from which we have been able to learn, as this affected and infected the globe at almost the same time. Some countries may be a few steps ahead.
13. The result was concurrent national lockdowns. This combined with globalisation has impacted the manufacturing and supply chains of other countries even before their lockdowns were implemented which restricted the movement of people and goods.
14. As a result most governments introduced stimulus packages to help businesses as a result of national lockdowns and the resultant inability to trade and continues to have a catastrophic impact on revenues. While, some sectors were impacted more heavily than others, it is inevitable that smaller businesses would be more severely impacted, as small businesses are less likely to have reserves to weather such an unprecedented event.
15. While, the essential role of ICTs have been highlighted during the crisis, the share prices of electronic communications companies have been volatile, with significant drops at the beginning of the crisis and some level of recovery since.

16. Electronic communications have proven to be critical to enable working and learning from home to help social distancing. Its importance cannot be underestimated, as it enables critical online platforms that have become key in our new everyday lives.

### **Equity Acquisition in existing Individual Licences**

17. There are several hundred individual licences abound, some are not operational, others have varied levels of operability with a limited number of high-value operations originating from these licences. As a result the value and process of acquisition of equity will vary significantly and so too will the acquisition costs.
18. Equity transactions in smaller licences are likely to be a simpler process and cheaper with a shorter end date.
19. Larger transactions take longer and typically requires funding from bond and capital markets in an environment where the cost of capital has increased. This will almost certainly increase the length of the transaction and may even impact the benefit accruing to the Black shareholder.
20. Finally, equity of any business regardless of the demographic is always held by a limited number of people. Hence, it is imperative that empowerment must be inclusive with the adoption of measures that ensure the greater inclusion of Black people across the value chain.

### **Application of the B-BBEE ICT Code**

21. All sector codes including the B-BBEE ICT Sector Code adopts a balanced scorecard and promotes a holistic approach to transformation through increasing the number of Black people at all levels of the ICT sector, including ownership; management, procurement, corporate social investment, skills and enterprise development.
22. This approach to empowerment strives to improve the positioning and economic status of more people and does not negate the importance of ownership by Black people. It instead balances the importance of equity among the other critical priorities. The use of the scorecard increases the number of people impacted and who benefit.
23. Compliance with the Codes is voluntary however, the ICT Sector Code encourages compliance in three priority elements of the scorecard viz. ownership, skills and procurement. While, compliance is discretionary, non-compliance is punished commercially. In addition, the codes include a negative incentive for firms that fail to achieve the sub-minimum targets for the

priority elements. The firm is penalized and achieves a recognition level one below the actual achievement. For example, should a licensee be verified at Level 4, but fails to meet the applicable sub-minimum targets of priority elements, its compliance level will be dropped one down to Level 5.

24. In our comments on the Information Memorandum in January 2020, the SACF argued for the use of the ICT Sector Code. We had proposed the following:
- a) The Authority has set a minimum target of a B-BBEE Level 4 for licensees.
  - b) Compliance should rather be viewed on an evolving and iterative basis which progressively encourages higher levels of compliance with the inclusion of increased targets for procurement.
  - c) The Authority through its annual compliance reports will be able to assess the success of implementation of the ICT Sector Code and as such should consider the periodic increase in the minimum compliance level applicable.
25. This in our view, will ensure sustained meaningful transformation of the sector.
26. Increased targets for procurement from Black owned and Black empowered companies in all licences, we believe will have the following impact:
- a) Procurement is immediate and will increase the number of Black people included in the value chain;
  - b) It will improve the level of empowerment to Black people while reducing the cost of capital required to participate as licensees may be able to provide advance funding or contracts will increase the company's ability to access credit facilities.
  - c) Small, Medium and Micro Enterprises (SMMEs) would be included in the value chain.

### **Challenge between the Legislative Framework in the current environment**

27. The ECA enjoins ICASA to impose a minimum of 30% HDP equity targets on licensees once they trigger one of the following regulatory or compliance processes:
- a) New Applications for Individual Licences (Section 9 of the ECA);
  - b) Amendment of a licence (Section 10 of the ECA);
  - c) Renewal of a licence (Section 11); and
  - d) Transfer of Control (Section 13 of the ECA).

The ECA enjoins the Authority, to start with a Section 4B Inquiry when making regulations on transformation to determine the need and scope of potential regulations.

While the Authority has followed the legislated process, the changed environment, demands a review and revision to the process and perhaps even the end result.

### **Terminology**

28. The ECA uses the term Historically Disadvantaged People whereas the national overarching legislative framework for transformation, the Broad-Based Economic Empowerment Act (B-BBEE Act) focuses on the empowerment of Black people. Most firms across the economy, including licensees already comply with relevant sector Codes and creates a framework for the empowerment and measurement thereto. Accordingly, the term Black people should be used instead of Historically Disadvantaged People.

### **Application of the Draft Regulations**

29. The Draft Regulations indicate the HDP targets apply to all manner of licences. We understand this obligation to be limited to I-ECNS and I-ECS licences only. The I-ECNS and I-ECS licences are the ticket to give a licensee access to spectrum or numbering. We would appreciate clarity on the following:
- a) Which licences will attract an HDP equity target?
  - b) We understand that licensees should be able to continue to apply for spectrum and numbering, for example. We would appreciate clarity in this regard.

### **Applicable Verification Level**

30. The draft regulations propose a minimum of level 4. Transformation must be viewed as an evolving target with the progressive escalation of targets. Accordingly, while Level 4 may have been applicable when it was originally introduced in regulations, it may no longer be applicable. The Authority ought to continually review the compliance levels of licensees and adjust the minimum level applicable as is required.
31. The use of the Codes offers an obligation that is proportionate to licensee revenue.
32. The verification resulting from the Codes also has commercial application, which is largely a standard requirement for the acquisition of new business.
33. We suggest that the Authority conduct an audit on the current levels of compliance among class licensees to inform the appropriate level.

### **Caution when applying the B-BBEE ICT Sector Code**

34. The B-BBEE Act enjoins ICASA when granting or issuing a licence or a concession to determine the applicable B-BBEE qualifying criteria. While, ICASA is required to set the minimum levels of B-BBEE compliance, it must be cognisant of the fact that it has limited control over the targets included in the ICT Sector Code or amendments thereto.
35. The ICT Sector Council determines and amends the targets of the ICT Sector Code. These are aligned to the generic B-BBEE framework and is amended periodically. In 2016 the ICT Sector Code was amended and radically increased targets. As a result most licensees and measured entities in general dropped several levels as they had no opportunity to mitigate the changes introduced in the ICT Sector Code as the amendments applied immediately. The amendments also applied to verifications that were already in progress.
36. All of our members were able to get back to previous levels of compliance and some even exceeded previous levels. The progression from one level to the next is dependent on the funding available towards empowering Black people through skills development, the procurement of goods and services from Black companies, as well as developing Black enterprises and communities.
37. Therefore, while we support the application of the B-BBEE ICT Sector Code, it is important to recognise that verification levels could fall drastically without warning and mitigation is not always possible. As such the Authority would need to develop a sensitivity to mitigate for this.

#### **Application of the Principles included in the draft regulations**

38. Although it is not clear in the draft regulations, we note the exclusion of the modified flow-through principle in the Findings Document and request that this be reconsidered for the final regulations. The inclusion of the modified-flow through principle will better align with the B-BBEE codes and since the Department of Trade and Industry (DTI) has limited the use of the modified-flow through principle, its potential abuse is significantly mitigated.

#### **Application of 30% HDG Equity Requirements (Section 9(2)(b) of the EC Act)**

39. In terms of the ECA, existing Individual licensees are not required to have 30% HDG equity ownership unless they trigger one of the following regulatory or compliance processes:
- a) New Applications for Individual Licences (Section 9 of the ECA);
  - b) Amendment of a licence (Section 10 of the ECA);
  - c) Renewal of a licence (Section 11); and
  - d) Transfer of Control (Section 13 of the ECA).

40. The Draft regulations seek to bring this obligation forward upon promulgation of a final HDP regulation. We have set out the current context which we believe necessitates a reconsideration of this position.
41. Notwithstanding our comments in this regard, we would urge the Authority to consider our current context and measures that would best achieve the meaningful inclusion of Black people across the entire value chain.
42. We note the inclusion of a minimum level of compliance of Level 4 that will be applicable to licences. The levels of compliance must seek to achieve at least two key objectives:
  - include rather than exclude licensees; and
  - encourage increased levels of compliance.
43. Accordingly, we propose that the Authority review the level of compliance currently held by licensees and then determine the appropriate level of compliance coupled with a medium term target for licensees moving up at least one level.
44. The SACF argued for this in our submission on the Information Memorandum.
45. While, the SACF has consistently advocated for a greater reliance on the application of the ICT Sector Code in the licensing framework, the Authority must build the tolerance to provide for amendments to the ICT Sector Code which may result in a drop in the level of compliance.
46. Amendments to the Code have resulted in a drop in the level of compliance and has taken a few years for licensees to claw their way back to former levels of compliance. This needs targeted funding.
47. The DTI has to date not permitted a compliance period. A transitional period is essential. A reasonable transition period for compliance with amendments to the ICT Code is at least 12 months.
48. Even with a transitional period, a drop in B-BBEE levels is possible. In such an instance the condonation must be linked to materiality of the changes and the resultant drop. Condonations would be supported by evidence.
49. The objective is to promote meaningful transformation without being too onerous and prejudicial to licensees.

### **Treatment of State Owned Entities**

50. The SACF notes the exemption of wholly state-owned entities to this 30% HDG Equity Requirement and urges the Authority to align the HDG Regulations to the B-BBEE Codes of Good practice with regards to the treatment of entities with B-BBEE facilitator status.

### **Use of ICT Sector Codes as the measure for Class Licensees**

51. The SACF welcomes the Authority's decision not to impose equity targets on Class Licences. This in our view aligns to the empowering legislation and provides for flexibility in the application of transformation for class licensees.

52. We do recognize that the revenue of class licences varies considerably and is likely to provide a conundrum for the Authority. However, the approach included in the draft regulations ensures transformation proportionate to the scale of the operations and revenue of the licensee.

53. The application of the ICT Sector Code is directly linked to the revenue generated by the licensee. Accordingly, licensees with a larger turnover will have a bigger yet proportionate compliance requirement than smaller operators.

54. Compliance with the Codes is voluntary nonetheless, the ICT Sector Code encourages compliance in three priority elements, of the scorecard viz. ownership, skills and procurement. While, compliance is discretionary, a penalty applies to firms that fail to achieve the sub-minimum targets for the priority elements. The penalty is a drop in the compliance level achieved. For example, should a licensee achieve Level 4 compliance, but fail to achieve the applicable sub-minimum targets the compliance level will be dropped to Level 3.

### **Transformation Targets for Individual licensees**

55. In our previous submission to the Authority on the Discussion Document, the SACF argued for the standardisation of terminology from HDI to B-BBEE. We reiterate this position and our arguments are set out in that submission.

56. We understand the societal and legislative imperatives for the inclusion of equity targets in individual licences. It is important for Black people to have a greater level of ownership and economic participation in the economy. However, the current economic environment is fundamentally different from when this process began and it is important for the Authority to recognise and reflect this.

57. The South African economy and currency is weaker and the cost of capital has increased. Markets have reacted differently from accepted standard practice, for example, gold has always been the safe haven for investments

during times of economic turbulence. Yet, during COVID 19 the price of gold declined. Experts tell us to expect a new normal and structural changes.

58. We are of the view that the Authority needs to take this into consideration:
- a) When and how to implement equity targets in individual licences; and
  - b) Whether this remains a relevant way to meaningfully include Black people in existing licences.

### **Transitional Period**

59. Equity targets will apply to large listed and unlisted firms as well as small firms. As a result, the SACF does not believe that a single approach could be applied instead, an adaptive approach is required.
60. Given ICASA's intention to licence High Demand Spectrum and the recent publication of the Information Memorandum to that effect, the SACF requests clarity on how the proposed transitional period in these HDG Regulations will affect individual service licensees wishing to apply for spectrum.

### **Definitions**

61. The SACF proposes the amendment of the definition of **Control** to mean as defined in Section 2(2) of the Companies Act, 2008 (as amended) instead of the definition used in the Draft Regulations to mean as defined in the (Section 12(2)) Competition Act, 1998 (as amended[KP1][MOU2]). The Companies Act intends to legislate, amongst others, the interrelation and independence of control in companies whereas the Competition Act legislates towards competition. It is the SACF's understanding that the definition in the Companies Act, intended to ensure the integrity in ownership and control, is best aligned to ICASA's intentions in the promotion of HDG ownership for licensees as opposed to the definition in the Competition Act, aimed at regulating mergers. Furthermore, the Competition Act depends on the now-repealed Companies Act of 1973 as it relates to the treatment of subsidiaries.
62. The SACF supports the definition of **Control** as proposed above and the exclusion of **Control Interest**. Sections 2, 3, 4, 5 and 6 do not address **Control Interest** as defined in Section 1 of the Draft Regulations and it is unclear why this definition is included or its materiality in applying the Regulations.
63. Accordingly, the SACF proposes the use of the term Control rather than Control Interest. We understand the term Control to be better aligned to what the Authority seeks to achieve.
64. We request, for ease of compliance and better alignment, for the HDG regulations to include the forms and reporting in the B-BBEE Compliance

Manual Regulations to be used to ensure compliance with the HDG regulations.

### **Transitional Period**

65. The draft regulations includes a standard transitional period for the introduction of equity targets. This assumes that all businesses have the same prevailing circumstances that would inform the commercial transactions required to ensure that equity targets are met.
66. Licensees have varied shareholding structures which may be made up of individual and institutional investors. The ownership structure typically increases in complexity in listed companies with a higher market capitalisation.
67. Transactions increase in complexity and required levels of consultation and mandates as the value of the transaction increases.
68. The SACF therefore is of the view that a standard transitional period cannot be applied for compliance to the HDG regulations due to the variations in ownership structures for different licensees.
69. It is therefore essential to take elements into consideration when determining applicable timeframes for a transitional period. Moreover, the processes and levels of consultation are likely to vary from transaction to transaction. All of which will be exacerbated in the new normal.
70. Accordingly, the SACF proposes that the Authority consider an approach that may include a defined transitional period for straightforward transactions or licensees that would be required to initiate complex transactions. Complex transactions should be assessed on a case-by-case basis.
71. Transparency and fairness are essential components in the licensing framework. Accordingly, the SACF proposes that the Authority develop a clear set of criteria applicable to determine when a transaction would be considered standard or complex and the resultant processes for each.

### **Clarity**

72. The draft regulations to provide for a transitional period for licensees to acquire 30% HDG equity. However, the draft regulations are silent on the treatment of licensees during this period in relation to spectrum applications and applications for other resources such as numbering.
73. We understand licensees to be eligible to apply for spectrum and other resources during the transitional period. However, we would appreciate the

explicit clarification in the regulations as it would eliminate multiple interpretations and unnecessary confusion in this regard.

## **Conclusion**

74. The SACF would like to see a wholistic approach to transformation that includes Black people across the value chain. Procurement is a key tool available to achieve this quickly and more pervasively.
  
75. The economic environment has fundamentally changed since the beginning of this process and the impact must be taken into account in determining the outcomes thereto. As such the process to finalise these regulations cannot continue as business as usual. The Authority would need to consider the impact of the global pandemic on:
  - a) access to funding;
  - b) the cost of funding; and
  - c) an analysis of the cost of capital acquisition against the benefits to be derived by Black people.
  
76. While, the Authority begins this contemplative journey it has the power to place higher procurement targets on licensees and encourage higher levels of B-BBEE compliance now.
  
77. The SACF welcomes the opportunity to submit comments on the draft regulations and to participate in future processes in this regard. We further respectfully propose the process in developing these regulations be modified to include:
  - a) A review based on the current environment. Economists and other leading scholars are studying current responses to the pandemic and the impact of COVID 19 suggest that there will most likely be many structural changes.
  - b) A collaborative discussion; and
  - c) A further draft of the regulation before continuation of the planned process.