

Independent Communications Authority of South Africa

Attention: Mr Peter Mailula and Ms Fikile Hlongwane
per e-mail: Pmailula@icasa.org.za, FHlongwane@icasa.org.za

4 May 2020

Dear Sir/Madam

SUBMISSION IN RESPECT OF GG43021

Switch Telecom thanks the Authority for the opportunity to make a submission in respect of the draft regulations GG43021.

CONCERNS

Switch Telecom has concerns in respect of the draft regulation. In summary, these concerns relate to the following:

- Dual HDG/BEE obligations
- BEE Level Target
- Definitions of “Control Interest”
- Impact of 20% within “Control Interest”
- Time-frames for processing Control transfer Applications
- Time-frames for achieving B-BBEE level
- Economic impact of the Coronavirus Pandemic
- Application of the “50% Compliance” principle
- Penalties

We expand on each of these points below.

Dual HDG/BEE obligations

One of the key objectives of the review of these regulations, as set out in the Findings Document (GG42234), was to align the HDG and B-BBEE obligations imposed on licensees. Section 5.11 of the Findings Document, in particular, has reference.

In contradiction to this, the draft regulations concurrently impose **BOTH** HDG equity **AND** black equity requirements. The concurrent and conflicting equity requirements are irrational.

Section 5(9) of the ECA requires the Authority to “promote **broad-based** black economic empowerment [..]” The specificity of the wording “**broad-based**” makes it clear that any obligations imposed in terms of this must be “broad-based.” The imposition of a strict black equity obligation is **NOT** “broad-based” as it focuses narrowly on a single empowerment criteria, i.e. black equity.

We have concerns that the regulations, in current form, are ultra vires.

In the absence of an amendment to the ECA, Switch Telecom urges the Authority to remove the black equity requirements from the regulations [clause 4(4)] while retaining the HDG equity requirements along with the obligation to achieve a minimum verified B-BBEE score in terms of the ICT charter.

BEE Level Target

With reference to the Findings Document (GG42234), clause 18.17.15:

Accordingly, given that the B-BBEE Status Level of individual licences will be assessed in conjunction with the minimum equity ownership requirements, the Authority is of the view that the mandatory minimum level of compliance will be a BBEE Status Level Six.

We submit that the new target of Level 4 prescribed in clause 4(1) of the regulation represents an unjustified, irrational and material variation from the Authorities position as published in the Findings Document. The target of Level 6 was, per the Findings Document, rational, justified, based on extensive consultation and represents the appropriate target for the regulations.

The effect of changing the compliance target from Level 6 to Level 4 will be to render many licensees (including some of the very largest on whom the public are relying for critical telecommunication services and that are already in financial distress and on the brink of failure) unable to achieve compliance.

Definitions of “Control Interest”

Sub-clauses (a) and (f) of the definition of “Control Interest”, i.e. the attempt to regard 20% (rather than > 50% as defined in the Competition Act), are incongruous and unjustifiable.

The specification of 20% as the threshold for beneficial ownership is arbitrary and detached from reality and company and competition legislation. It is also curious given that the CCC has recently issued a number of rulings in this regard clarifying its interpretation of control as 50% plus one share.

Impact of 20% within “Control Interest”

In the 2017 discussion document (GG40759), the Authority stated that 37.69% of licensees had no HDG ownership. We can therefore project that at least a couple of hundred licensees will need to enter into transactions to transfer shareholding in order to become compliant with the equity obligations of the regulations.

If 20% shareholding is deemed “Control Interest”, then it follows that at least a couple of hundred licensees will have to submit requests for control transfer to the Authority and will remain non-compliant until such time as the Authority approves such requests.

The Authority is already taking 12 to 18 months to turn around such requests, while dealing with significantly lower volumes. Arguably, if <= 30% equity is deemed “Control Interest”, the Authority itself (and its turnaround time for processing control transfer applications) will be the single biggest obstruction to licensees’ compliance.

It's also important to note that, when a transaction is entered into, the acquiring party will only allow a certain amount of time for approval to be obtained. No transaction can wait indefinitely for approval from the Authority.

How does the Authority intend to deal with the scenario where a licensee has entered into a deal to secure equity compliance within 24 months, however, owing to the Authority's own failure to process the approval promptly, the deal lapses and the licensee is left non-compliant?

It is unconscionable and irrational for the Authority to regulate that a licensee must comply with a condition that it cannot reasonably achieve on its own without impediment. Where compliance is dependent on the Authority approving a transaction, the transaction must be deemed approved within 30 days if the Authority does not specifically reject it.

More importantly, however, this entire issue falls by the wayside if the definition of "Control Interest" as set out in the Competition Act is adopted, as transactions required to obtain compliance would not be subject to a control transfer application and approval process.

Time-frames for processing Control transfer Applications

The equity and B-BBEE level requirements will require most licensees to thoroughly review their empowerment strategies and seek new empowerment partners and transactions. It doesn't automatically follow that empowerment partners will be interested in non-controlling stake or that existing shareholders will want to retain control of an entity with diluted shareholding.

Notwithstanding that the minimum equity target is 30%, many licensees will look to sell a far larger (or even 100%) stake as an outcome of this regulatory intervention. It is therefore important that the regulations not discourage transactions that result in >50% equity being transferred to black shareholders.

The reality, at present, is that the sale of a "Control Interest", by nature of being subject to a lengthy regulatory approval process, is going to be difficult to negotiate, control, obtain approval and effect within 24 months.

This results in the unintended consequence that licensees that may otherwise wish to aim for a > 50% to 100% black equity target will, in fact, avoid doing so, because they can only guarantee compliance within the prescribed time-frames by selling less than a "Control Interest".

If the Authority is serious about promoting black and/or HDG equity (beyond just the minimum prescribed level), it needs to set out clear criteria for approval of licence control transfer applications and regulate that any application meeting the pre-defined criteria is **deemed approved** (either immediately or, failing that, within 30 days of the Authority not rejecting it) so that the approval process does not impede larger empowerment transactions.

Time-frames for achieving B-BBEE level

The ICT charter defines a scorecard based on broad-based targets for measuring B-BBEE compliance. Most of these criteria are measured over the course of a 12-month period. Many are not immediately achievable; for example, if a licensee's staff composition isn't in accordance with the target, it is unlawful for the licensee to dismiss or demote non-black staff and immediately replace them with black staff in order to immediately achieve targets. Procurement

is also particularly tricky as, by nature of the Interconnection Regulations, licensees have limited choice in who they can procure interconnection from and/or deny interconnection to and this may negatively impact their preferential procurement strategy.

A cohesive B-BBEE strategy takes at least a year to develop and implement and many years to achieve the desired targets. There are no “quick wins”. Even once fully implemented, it will then take a further year for that target to be consistently achieved for the duration of a 12-month measurement period. The audit and issuing of a verified certificate will typically only be concluded 3-6 months after that.

It’s curious then that the Authority believes that licensees can practically achieve such targets and be issued a verified certificate within just 24 months. The current time-frames seem to be an attempt to punish licensees for not pre-emptively and voluntarily achieving a particular B-BBEE certification level despite the fact that, until the regulations are promulgated, they are not compelled to.

The ICT charter places an overwhelming emphasis on black ownership equity and management control. In order to achieve a level 6 score (let alone level 4), hundreds of licensees will need to sell shareholding. It is simply not possible for a licensee that isn’t an Exempt Micro Enterprise or Qualifying Small Enterprise to achieve level 6 without significant black ownership equity. Even for a QSE, it is exceedingly difficult to achieve level 6 without significant black ownership equity.

It takes time to find the right empowerment partner with the funds and willingness to invest, negotiate contract terms in conjunction with drafting attorneys, complete a due diligence process in conjunction with auditors, obtain loan funding from financing institutions and conclude the transaction.

Such transactions aren’t mere formalities. Even with the best intentions, deals can fail and new ones need to be sought. To conclude such a transaction within less than 24 months is exceedingly optimistic.

Even once concluded, the company would need to re-embark on a new B-BBEE audit and verification process, taking into account the new shareholding, and this could take a further 6 months. It is questionable whether a verification agency would accept equity and control targets as having been met immediately after conclusion of a transaction; they may, reasonably, argue that targets are meant to be measured over the course of the previous year and only recognise the full score 12 months after the transaction has been concluded.

Given these factors, it is unrealistic to prescribe a B-BBEE level target compliance deadline of less than 60 months.

Economic impact of the Coronavirus Pandemic

The Coronavirus Pandemic has had a devastating economic impact on South African businesses. Many licensees, particularly smaller ones, have already suffered loss of income as their subscribers (particularly business subscribers) have ceased operations, in some instances temporarily, in others permanently. Non-payment is on the rise and the cost of doing business is increasing as staff have to be equipped to work from home and/or additional protective measures taken in the office.

More critically, however, licensees seeking to enter into empowerment transactions will find it increasingly difficult to do so. These transactions – irrespective of structure – are almost all premised on the basis of the empowerment partner loaning funds from the bank and the licensee guaranteeing to pay dividends to a level that secures the loan repayments. This requires both liquidity and profitability in the licensee to mitigate the bank's risk.

Many licensees are not going to be able to guarantee adequate profitability and dividend payments in the year ahead to finance such transactions.

Many investors are not going to be generating sufficient return on their existing investments that they're sufficiently liquid to secure additional loan financing from the banks to invest in new acquisitions.

Many banks are going to be exceedingly cautious about extending loans to finance such transactions at a time they may have concerns about affordability and while they are already extending loans for crisis-related bridging finance and offering payment holidays on existing loans.

All of the above factors are going to delay licensees in complying with the equity requirements and/or corner them into a position where, if forced to comply within 24 months, that they risk becoming over-indebted and suffer business failure, thereby destroying all value for both the existing and new empowerment shareholders.

There is also a further risk that, if the equity target has to be achieved before the economy recovers, only an elite few extremely wealthy and liquid investors will be in a position to benefit from the transformation of licensees envisaged by the Authority to the exclusion of many other potential empowerment partners that, under better economic circumstances, would be able to secure funding. This will only perpetuate the concentration of wealth among a few rather than truly empowering the industry.

There is uncertainty as to how long this pandemic will remain with us, however, it's unlikely that a vaccine will be widely available within less than 18 months or that the greater population will be vaccinated within less than 24 months. The economic impact is therefore likely to last at least 36 months. be able to secure financing.

This further points to a more realistic time-frame for compliance with both the equity and B-BBEE level targets being at least 60 months.

Application of the “50% Compliance” principle

The draft regulations require “50% compliance” within 12 months, however, do not define what “50% compliance” means and/or how, in practical terms, this can be measured.

Is the expectation that, if a level 4 B-BBEE rating is the final target, a level 8 rating would constitute 50% compliance?

Does the Authority realistically expect licensees to conclude transactions for the sale of 15% equity within 12 months, only to conclude a second and further transaction within 24 months?

Or does 50% compliance mean either achieving the equity target, or the B-BBEE rating (but not both) within 12 months? If so, given that the B-BBEE rating is virtually impossible to achieve without an equity transaction, how is this any different from requiring 100% compliance in just 12 months?

Clause 9(2) of the regulations (the “50% compliance” requirement) is impossible to interpret and, by any attempt to guess an interpretation, entirely irrational.

There can be no half-baking these targets; the only rational approach is to set fair and reasonable targets along with fair and reasonable time-frames for compliance.

Penalties

It is unclear how the penalty described in clause 8(2) should be effected in reality as the non-compliance contemplated cannot be remedied instantaneously. It should be clarified that such penalty shall be in respect of “each year that the licensee remains non-compliant.”

This would set a clear parameter for the expected time-frames for a licensee, after having been fined, to secure compliance before being re-charged and/or re-issued with repeated fines. It would similarly prevent the scenario where, once a licensee has paid a fine, it remains non-compliant indefinitely and argues that it cannot be charged or fined repeatedly for the same offence.

While we appreciate that some discretion with respect to the magnitude of the fine should be left to the CCC in case the circumstances of non-compliance are different, it is important to note that, for the largest licensees, R5million represents a drop in the ocean relative to their cost of compliance and, if the fine is capped at that level, it will encourage those licensees to rather pay the fine than achieve compliance. By comparison, 10% of turnover is extremely punitive for any licensee. We would suggest that a maximum fine of no more than 5% of annual turnover for the preceding financial year (with no fixed cap) would be more than sufficiently punitive to motivate compliance among all licensees and would be equally effective and fair against licensees of all sizes.

Conclusion

Switch Telecom urges ICASA to define the 30% equity requirement in terms of HDG’s (not black people) to comply with the ECA, set the B-BBEE target at level 6 (to comply with the 2019 findings document), extend the time-frame for compliance to at least 60 months, pre-define terms for deemed approval of transfer control applications, drop the “50% Compliance” provision, and to clarify the penalties.

Yours faithfully



Gregory Massel

Director: Switch Telecom