DETERMINATION NO. 1 OF 2013 ON COST-BASED TERRESTRIAL DIGITAL BROADCASTING SIGNAL DISTRIBUTION TARIFF

1. BACKGROUND

The International Telecommunication Union (ITU), the United Nations agency responsible for telecommunications and radiocommunications, held its Regional Radicommunications Conference 2006 (RRC-06) in Geneva, Switzerland, which amongst others, resolved that June 2015 would be the cut-off date for the transition from analogue to digital television (TV) broadcasting. The migration from analogue to digital TV is necessitated, *inter alia*, by the need to adopt spectrum efficient technologies in order to optimise the use of scarce spectrum resources; and to enhance the quality and experience of TV viewers.

Kenya participated in the RRC-06 and has embarked on the requisite preparations to ensure that the country abides by the aforesaid resolution. Key amongst the preparatory steps is to ensure access to the Terrestrial Digital Broadcasting Platform hence the review by the Commission of the tariffs submitted by licensed signal distributors and the issuance of this determination. This Determination shall be known as the Determination No. 1 of 2013 on Cost-Based Terrestrial Digital Broadcasting Signal Distribution Tariff. The Determination is effective from the 16th day of December 2013 and is binding to all Terrestrial Digital Broadcasting Signal Distributors licensed in Kenya.

2. OBJECTIVES OF THE REVIEW

The primary objective of reviewing the Digital Signal Distribution tariffs was to ensure the development of a cost-based tariff structure that would give the Signal Distributors a reasonable return on their investment without levying unjustifiably high charges on content providers thereby constraining access to the digital platform to the detriment of the consumer.

The Commission holds the view that fair, transparent, just and reasonable tariff for signal distribution services would catalyse uptake of the service by content providers and thus facilitate a smooth migration from analogue to digital television in the country. Indeed, one of the contentious issues in the industry has been the clamour by the Free to Air channel providers to have their own signal distribution platforms citing opaque and exorbitant tariffs charged by existing Digital Signal Distribution service providers.

It is against this background that the Commission makes this determination to set optimal tariffs to be charged on the Terrestrial Digital Signal Distribution Platform.

3. CONFORMITY WITH THE LAW

This Determination is made pursuant to section 46A (a), (d) and (g) of the Kenya Information and Communications Act, Cap 411A, Regulation 16(2) (c) of the Kenya Information and Communications (Broadcasting) Regulations, 2009 (Broadcasting Regulations) and Regulation 3 of the Kenya Information and Communication (Tariff) Regulations, 2010 (hereinafter referred to as the Regulations). The import of the foregoing provisions is that the Commission may require a person granted a license for the provision of terrestrial digital broadcasting signal distribution services to provide the said services on such terms and conditions as to access tariffs and quality of service as the Commission may prescribe. This requirement further finds expression in the digital terrestrial signal distribution licenses.

4. ECONOMIC RATIONALE

Micro economic theory provides ample theoretical basis for regulation of markets or market segments that exhibit non-competitive tendencies such as monopoly, monopsony or oligopoly. Such markets and market segments are prevalent in the network service industries on account of technology, market structure or prevailing laws (i.e. statutory monopolies). It is considered that production; supply and pricing decisions in such markets are not a strict derivative of a competitive market and are therefore inefficient.

Regulation acts as a proxy for competition that seeks to incentivize economic actors in these markets to act and behave as if competition exists with respect to quantity, quality and prices charged for goods and services thus fostering efficiency. Regulation is, however, not considered the best proxy for competition and the ultimate goal of regulation is to create conditions for effective competition to happen, after which the principle of forbearance may take effect.

Due to dictates of technology, including the demand for frequency spectrum resources and the economics of signal distribution, signal distribution services in a market like Kenya's can only be provided by a few licensees and the prospects for unfettered competition in this segment of the broadcasting value chain are therefore unfeasible. Regulation of the signal distribution services in this country therefore has sufficient backing from both the theoretical and practical applications of micro- economic theory.

Based on the foregoing reasons, and guided by its mandate as provided under the Regulations, the Commission considers that, it is in the public interest to intervene in setting of signal distribution tariffs.

5. TARIFF REVIEW PROCESS

The tariff review process adopted a consultative approach which included receipt of written and oral submissions on the tariff review by the signal distributors. The Commission considered the operators' submissions and also applied the best practices and assumptions used in regulatory tariff setting to develop the proposed tariffs.

The review adopted a participatory methodology where the signal distributors were involved through face-to-face interactions and by means of telephone and email consultation. Separate meetings were held with the two signal distributors after they had filed their respective tariff plans which included Capital Expenditure (CAPEX), Operational Expenditure (OPEX), Weighted Average Cost of Capital (WACC), cost of finance, network elements (equipment and assets with their life spans), and the supporting assumptions.

At the preliminary stage, the process involved review of the tariffs submitted by the Signal Distributors. After the initial review, the Commission shared with the Signal Distributors a common template which they were required to populate with the relevant inventory (including asset lives and costs), capital structure and other relevant inputs and assumptions that were used in the development of the costing model.

6. COSTING ASSUMPTIONS MADE BY THE COMMISSION

In the costing exercise, the Commission took into account the prudent investments made by the operators and allowed a reasonable rate of return on adequate capital employed. The determination of the cost of capital, cost of debt and the optimal capital structure was done. This was identified as crucial in this regulatory process, as it has a major impact on the regulated firm revenues, as well as tariffs other operators must pay for access.

The Commission utilized the capital recovery factor (CRF) approach to annualize CAPEX based on the various network elements and their life spans. The formula below was utilized in this exercise:

$$\text{CRF} = \frac{i(1+i)^n}{(1+i)^n-1}$$

Where: i- Discounting Factor;
n – Estimated Asset Life

WACC was used as the discounting factor. The WACC methodology is a widely accepted method for calculating the cost of capital. WACC was used to calculate the overall required return on the firm and is consistent with the discounting factor that is used by regulators when costing for regulated services. The WACC formula below was utilized in this exercise:

$$\text{WACC}=\frac{D}{D+E}*CD+\frac{E}{D+E}*CE$$

Where: D – proportion of debt in the financing portfolio;
E – Proportion of Equity in the financing portfolio;
CD – Cost of Debt; and
CE – Cost of Equity

7. INVESTOR INTEREST

The rates are meant to sufficiently compensate efficient costs incurred by signal distributors in hosting, carrying and distributing broadcasting content on behalf of content providers.

8. THE DETERMINATION

Having considered all relevant factors as explained above, the Commission hereby determines:

i. That all Digital Signal Distributors shall charge Content Service Providers at **KES. 125,993.50 Per Mbit** for Nairobi and **KES. 93,202.75** per Mbit for other sites in Kenya;

ii. That all Digital Signal Distributors shall publish a **Reference Offer** three (3) months of the date of this determination in order to ensure that there is access, transparency and non-discrimination on the terrestrial signal distribution platform;

iii. That all Digital Signal Distributors shall prepare **separate accounts** for each commercial subsidiary, including the appropriate allocation of central overheads, within six (6) Months of the date of this determination.

Dated this..16th.....day of ..December... 2013

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Mutua Muthusi
FOR: DIRECTOR-GENERAL
COMMUNICATIONS COMMISSION OF KENYA