COMMUNICATIONS AUTHORITY OF KENYA

REVISION OF MOBILE VOICE TERMINATION RATES (MTRs) AND FIXED TERMINATION RATES (FTRs) PROPOSAL

1. INTRODUCTION

1. The Authority is mandated among others; manage competition in the ICT sector, which includes telecommunications, broadcasting and postal and courier services. One of the key activities in management of competition is the regulation of retail and wholesale tariffs for communications services in accordance with the Kenya Information and Communications (Tariff) Regulations, 2010.

2. Interconnection involves the physical and logical linking of telecommunication networks to allow customers of one service provider to communicate with customers of another service provider. This implies that, in order for customers of one operator to communicate with the customer of another operator, the systems of the two operators must be interconnected for the traffic to flow through. Naturally, all network operators are monopolies in their own networks in so far as interconnect is concerned, since the other operators' customers can only reach their customers through their network. Subsequently, interconnect is an essential component in telecommunications and its pricing and access framework can be used as a barrier to entry and expansion, thereby impeding competition. Moreover, high interconnect prices have a correlation with high retail tariffs, which ultimately reduce consumer welfare.

3. Call termination refers to the service of terminating a telephone, fax or other telecommunication call to the called party. A call termination charge/rate is a charge applied by a public telecommunications service provider for terminating a call. A termination charge is synonymous to interconnection charges.

4. Monitoring and adjusting of network cost ensures economic regulations imposed, accurately reflect the current structure of the Kenyan telecommunication market. It is against this backdrop that regulators world over (including the Authority) regulate interconnection rates (wholesale rates).

5. According to best practice, operators ought not to make profits from interconnect, but rather simply recoup their costs for carrying the additional traffic from the other operators' networks in order to facilitate end-to-end connectivity between customers of the two networks. This in turn has informed the costing methodologies adopted in determining the cost of interconnect.

2. BASIS OF REVIEW OF THE VOICE TERMINATION RATES

6. In the past, the Authority undertook two costing studies to determine voice (mobile and fixed) interconnection charges and came up with a glide path for voice and SMS

termination rates, vide: *Determination No.1 on retail and Interconnection rates among the Fixed and mobile Telecommunications Networks in Kenya* (*2007*) and *Determination No. 2 of 2010 on Pure Long Run Incremental Cost (LRIC) Based Interconnection Rate Regime* (*2010*).

7. The last review was in 2010, where the Authority undertook a network cost study whose objective was to develop a new competitive interconnection rate framework that took cognizance of the new developments in the communications market, which included, among others, the introduction of the Unified Licensing Framework (ULF), licensing of two additional mobile service providers (Telkom Kenya and Essar Telecoms) and the landing of three fibre optic cables.

8. Owing to the passage of time (ten years) since the previous review, we recognize that the current rates may not reflect the current cost of interconnect. Moreover, the Authority has been receiving requests from some Mobile Network Operators to review the current termination rates, citing they are too high and are not a reflection of their true costs. They have also argued that the current voice termination rate is preventing them from offering consumers more affordable and competitive prices.

9. The Authority undertook to carry out a network cost study for tower sharing and national roaming (in seven northern counties) and interconnection in the FY2020/2021 that was to inform, among others, whether the current termination rates are sufficient or need to be revised.

10. We propose to carry out a review of the current rates with a view to determine the most appropriate interconnection MTRs and FTRs.

LEGAL BASIS

11. This review is being carried out pursuant to Sections 23 (2) (a - c) and 25 (3) (b) of the Kenya Information and Communications Act No.2 of 1998 (The Act) and the Kenya Information and Communications (Interconnection and Provision of Fixed Links, Access and Facilities) Regulations, 2010 respectively.

12. Section 23 (2) (a-c) of the Act obliges the Authority to *protect the interests of all users of telecommunication services in Kenya with respect to the prices charged for and the quality and variety of such services provided; maintain and promote effective competition between persons engaged in commercial activities connected with telecommunication services in Kenya in order to ensure efficiency and economy in the provision of such services and to promote research and development in relation thereto; and encourage private investment in the telecommunication sector*.

13. Section 25 (3) (b) of the Act provides that *a licence granted under this section may include conditions requiring the licensee to interconnect to the telecommunication system to which the licence relates, or to permit the connection to such system, of such other telecommunication systems and apparatus as are specified in the licence or are of a description so specified, either without charge or subject to a reasonable charge to be determined in accordance with the method specified in the licence.*

14. Regulation 12 of the Kenya Information and Communications (Interconnection and Provision of Fixed Links, Access and Facilities) Regulations, 2010 provides the basis for interconnection charging structure and the principles to be followed.

3. CURRENT STATUS OF INTERCONNECTION RATES IN KENYA

15. As mentioned above, the Authority in 2010 undertook a network cost study that informed the current voice and SMS termination rates. Thereafter, a determination was issued to all mobile and fixed telecommunication service providers (Determination No.2 of 2010), which stipulated the glide path guiding on gradual reduction of the interconnection rates of a four-year period. The rates were to be effected on 1st July 2010 and were to be implemented by all mobile and fixed telecommunication operators in the Republic of Kenya as indicated in the Table 1:

<table>
<tr><th colspan="5">Table 1: MTRs and FTR glide path</th></tr>
<tr><th colspan="5">1. Call Mobile Termination Prices</th></tr>
<tr><th>Nominal KES.</th><th>1st July 2010</th><th>1st July 2011</th><th>1st July 2012</th><th>1st July 2013</th></tr>
<tr><td>Mobile Termination</td><td>2.21</td><td>1.44</td><td>1.15</td><td>0.99</td></tr>
<tr><th colspan="5">2. Fixed Termination and Transit for Existing Regulated Services</th></tr>
<tr><td>Local Termination</td><td rowspan="2">1.67</td><td rowspan="2">1.33</td><td rowspan="2">1.06</td><td rowspan="5">0.99</td></tr>
<tr><td>Single-tandem Termination from Tandem Exchange</td></tr>
<tr><td>Double-tandem Termination from Tandem Exchange</td><td rowspan="3">2.93</td><td rowspan="3">2.61</td><td rowspan="3">2.38</td></tr>
<tr><td>Single-tandem Termination from Local Exchange</td></tr>
<tr><td>Double-tandem Termination from Local Exchange</td></tr>
<tr><td>Transit Local Exchange to Tandem (Single Tandem)</td><td rowspan="4">1.26</td><td rowspan="4">1.28</td><td rowspan="4">1.32</td><td rowspan="4">Not Regulated</td></tr>
<tr><td>Transit Local Exchange to Tandem (Double Tandem)</td></tr>
<tr><td>Tandem to Tandem Transit Local to Local Transit (Single Tandem)</td></tr>
<tr><td>Local to Local Transit (Single Tandem)</td></tr>
</table>

16. The Authority, however, froze the implementation of mobile and fixed termination rates for year 2011/2012 for a further one year so as to evaluate the impact of the reduced rates, following concerns raised by some industry stakeholders. Consequently, on 8th June 2011, the Authority issued *Addendum No.2 to the Determination No.2 of 2010* revising the mobile and fixed termination rates, implying that implementation would run till 30th June 2015.

17. Upon expiry of the glide path in 2015, the Authority took a decision to maintain the rates of the last phase of the glide path in order to see how the market reacts before proceeding

to undertake another costing study. Currently, all the telecommunications service providers are implementing a mobile and fixed voice termination rate (MTR and FTR) of KES 0.99.

4. METHODOLOGY

18. The Authority having taken into consideration the prevailing circumstances at this point in time, proposes to use benchmarking methodology to revise the current interconnection rates.

19. The advantages of using benchmark methodology include the following:

    a. It is based on costs of real-world operations;
    b. It works on the basis of international best practice and is a more realistic interpretation of efficiency;
    c. The cost of carrying out a benchmark is significantly lower than either of the other approaches as it will not involve engaging consultants;
    d. It takes significantly less time to carry out a benchmark in comparison to the other approaches; and
    e. It avoids data confidentiality issues since benchmarks are largely based on publicly available data.

20. There are a number of countries like Namibia, Botswana, New Zealand and Mozambique have adopted benchmarking methodology for determining termination rates. According to International Telecommunication Union (ITU), benchmarking is the second most adopted approach by the telecom regulators after Long-run Incremental Costing (LRIC) model to determine MTR.

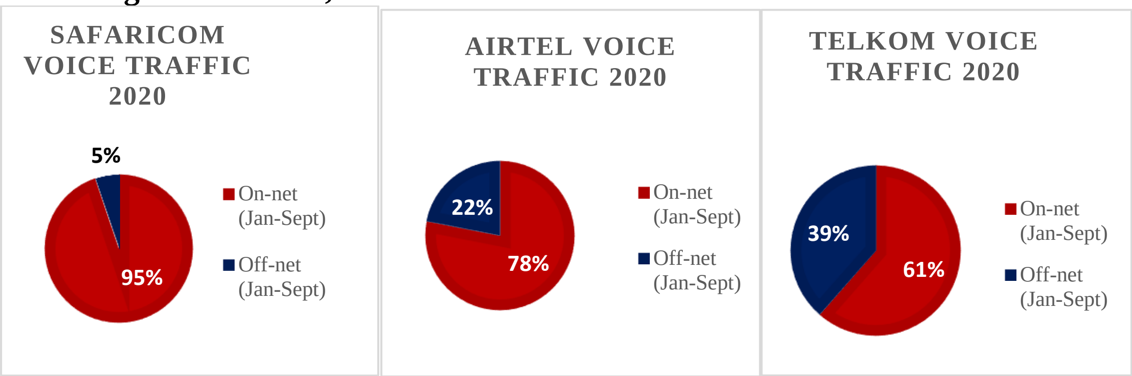
21. In order to identify relevant benchmark countries, the Authority will take into account structural as well as conjectural differences between countries. Benchmark countries will be selected on the basis of similarities with Kenya with respect to the applicability of relevant best practice, economic variables, demographics, stage of development of telecommunications market and geography.

22. In order to arrive at the ideal benchmark rate, the Authority will consider its regulatory objectives, the impact on stakeholders, and the regulatory costs, benefits and risks.

23. **Regulatory objectives** – the Kenya Communications Act 1998 Section 23 defines a set of objectives that should support the Authority's decisions. The objectives include economic efficiency, promotion of competition and stimulation of investments. Economic efficiency can be split into the following main types:

    i. *Allocative efficiency*: in case of allocative efficiency, scarce resources should be allocated in an economically efficient manner. In economic theory, this occurs when price approaches marginal costs. Allocative efficiency "suggests that one group of customers should not subsidise another group of customers". Small mobile operators typically have a higher proportion of off-net calls in their traffic mix. With a high traffic imbalance, an effective transfer of resources from small mobile operators to large operators occurs. The effect of wholesale price reduction would thus be to significantly reduce the transfer of resources from small mobile operators to large operators. Figure 1 Shows the On-net, Off-net traffic imbalance.

Figure 1: On-net, Off-net traffic imbalance



ii. *Productive efficiency*: to be considered as productively efficient, cost of production should be minimised. For the purposes of regulatory costing, productive efficiency is not a primary concern since all operators have enough commercial incentives to be productively efficient, regardless of interconnection pricing.

iii. *Dynamic efficiency*: to be considered as dynamically efficient, operators should remain incentivised to invest in quality and innovation. The type of economic efficiency is indeed captured by the other two objectives that the Authority has set: promotion of competition and stimulation of investments.

24. **Stakeholder impact** – the Authority will consider the likely impact of reduction of MTRs on the stakeholders. The impact on the consumers will be analysed against prices for the telecommunications services, availability of service, service quality and innovation.
The impact on industry players will be analysed against the impact on their revenues, levels of profitability and sustainability e.g will the Net transfer occasioned by the current imbalanced market share be reduced? Will lower voice termination rates facilitate greater retail price flexibility, which should facilitate reduction in overall price levels for mobile services to the benefit of consumers?

25. **Regulatory costs, benefits and risks** – the regulatory decision will consider whether the benefit of revision of the rates outweighs the costs, and the regulatory risks are acceptable. We will also consider whether there is minimal burden on stakeholders and regulators, and that the risk of error is low as much as the decision to revise is made based on a number of issues with imperfect information.