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south africa

MERGERS AND ACQUISITIONS' REPORT

CASE INFORMATION

Case number: 2014Jul0382
Primary Acquiring Firm: Vodacom Proprietary Limited
Primary Target Firm(s): Neotel Proprietary Limited
Category of merger: Mergers and Acquisitions (large) - Phase 3
SIC Code: 619 - Other telecommunications activities

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RECOMMENDATION

Approval with conditions

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IN THE COMPETITION TRIBUNAL

REPUBLIC OF SOUTH AFRICA

Held in Pretoria

CC case No: 2014Jul0382

CT Case No: 019299

In the merger between:

VODACOM PROPRIETARY LIMITED

PRIMARY ACQUIRING FIRM

And

NEOTEL PROPRIETARY LIMITED

PRIMARY TARGET FIRM

A. EXECUTIVE SUMMARY

- [1] On 18 July 2014, the Competition Commission (Commission) received a notice of a large merger whereby Vodacom Proprietary Limited (Vodacom) intends to acquire the entire shareholding of Neotel Proprietary Limited (Neotel). Vodacom is controlled by Vodacom Group Limited, while Neotel is controlled by Tata Communications Limited. Vodacom submits that Neotel will operate as a wholly-owned subsidiary of Vodacom post-merger.
- [2] Vodacom is a licensed mobile network operator (MNO) and provides voice, messaging and data services. Vodacom also offers certain fixed line services. In this respect, Vodacom offers retail fixed line services to business customers, while also offering fixed leased lines on a wholesale basis to third parties. Neotel also offers retail fixed line services to business customers and fixed leased lines on a wholesale basis to third parties, including MNOs and other firms that compete with both Vodacom and Neotel for the provision of retail fixed line services to business customers. Neotel also provides a fixed-wireless service offering to residential and business customers.
- [3] The implementation of the proposed merger will result in Vodacom acquiring all of the shares of Neotel, together with shareholder loan funding claims. Neotel will continue to operate as a wholly-owned subsidiary of Vodacom post-merger. The total consideration for the acquisition by Vodacom is approximately R7 billion.

- [4] Vodacom submits that the implementation of the proposed merger brings together complementary businesses as Vodacom is primarily a MNO, while Neotel offers fixed line services. Vodacom submits that the acquisition of the fixed line assets of Neotel will provide Vodacom with the ability and incentive to challenge Telkom for the provision of fixed line services. Vodacom also submit that the spectrum assets of Neotel will enable Vodacom to accelerate the roll-out of its long-term evolution (LTE) mobile network, which is likely to have consumer benefits as Vodacom can continue to compete with other MNOs. Neotel submits that in order to remain competitive in the South African market, it requires further investment from its shareholders who, at this point, are not prepared to provide any additional funding.

RELEVANT MARKETS

- [5] The Commission's approach in arriving at the relevant markets is that fixed telecommunications markets are separate from mobile telecommunications markets. Fixed line markets include traditional technologies such as copper, fibre and fixed wireless services such as those offered by Neotel and Telkom utilising their Time Division Duplex (TDD) spectrum.
- [6] Following the above approach, the Commission's assessment of the proposed transaction identified the following relevant markets which form the basis of its assessment:
- 6.1 Market for the supply of fixed leased lines (upstream market)
 - 6.2 Market for the supply of mobile infrastructure (upstream market)
 - 6.3 Market for the retail supply of managed network services ("MNS") to enterprise businesses
 - 6.4 Market for the retail supply of value added network services ("VANS") to enterprise businesses
 - 6.5 Market for the retail supply of hosting services to enterprise businesses
 - 6.6 Market for the retail supply of mobile services (voice, data and sms).

COMPETITIVE ASSESSMENT

(a) Spectrum and likely effects in mobile markets

- [7] As part of the merger, Vodacom is acquiring Neotel's spectrum which will facilitate and accelerate the roll-out of Vodacom's LTE network and enhance its retail mobile offerings.

- [8] The Commission finds that spectrum is an essential input in the provision of mobile telecommunications services. Consequently, there are advantages that arise from spectrum holdings by an MNO over its rivals, which advantages mainly accrue at the retail level in relation to service rollout, speed and capacity. If rivals with lower spectrum holdings are unable to match the offerings derived from the merged entity's spectrum advantages (high speed services and capacity) and the resulting retail service offerings, consumers may be faced with reduced choice, higher prices, reduced quality and investment relative to the pre-merger scenario. The ability of rivals to match the merged entity depends on factors such as the availability of spectrum and/or the ability to increase the number of sites. It is important to note that adding new sites is likely to increase costs significantly and may be constrained by a number of other factors which will be discussed below. Spectrum constraints and higher costs are also likely to adversely impact on the ability of rivals to innovate, and effectively constrain Vodacom. Such anti-competitive effects are likely to be exacerbated where first mover advantages are durable and likely to persist in the market, allowing a leading firm to entrench its position in the market. It is important to note that these various elements are mutually reinforcing in terms of effects on competition.
- [9] In light of the above in relation to likely effects of spectrum holdings in retail mobile markets, the Commission finds the following:
- 9.1 In spectrum designated for mobile use particularly in the 1800MHz band, Vodacom will post merger hold double the amount of spectrum available to each of the MNOs namely MTN, Cell C and Telkom. Vodacom will have 40% share in the 1800MHz band with an accretion of 20%.
- 9.2 In addition, Vodacom will be the only MNO possessing the 800MHz spectrum currently designated for broadcasters. Although not yet available for use by MNO, the merged entity could potentially have a lead time advantage once the spectrum is available for use. Similarly, Vodacom is acquiring additional 3500MHz spectrum which may also afford Vodacom with a lead advantage over rival MNOs should this spectrum become available for mobile use in future.
- 9.3 The Commission finds that rivals such as MTN are also experiencing significant growth in data demand and are also capacity constrained in terms of current spectrum holdings. Whilst spectrum constraints can be mitigated by adding new RAN sites, adding new sites is expensive, time consuming and is increasingly subject to barriers relating to obtaining requisite approvals and land/property on which to build the sites. The Commission finds

that Vodacom has significantly more LTE ready sites meaning that the impact of spectrum advantages are likely to have a more immediate impact on the rollout of LTE by Vodacom relative to rivals.

9.4 The additional spectrum holdings advantages which will accrue to Vodacom include enhanced network speed and capacity and a network quality that cannot be matched by rival MNOs. Accordingly, the additional spectrum from Neotel will result in lower costs for Vodacom that is unlikely to be matched by rival MNOs.

[10] The Commission also finds that Vodacom is the largest provider in the provision of retail mobile services based on:

10.1 revenue for voice services

10.2 revenue for data services

10.3 the number of active mobile subscribers.

[11] The advantages that will accrue to Vodacom having more spectrum than its rivals are likely to further entrench Vodacom's current dominant position in the retail markets.

[12] In addition, the Commission finds that the South African mobile markets are characterised by first mover advantages that have proved to be durable and are likely to persist. This is demonstrated by Vodacom's leading position which has endured over a long period of time in both mobile voice services and data markets. Since the introduction of mobile telecommunications in South Africa to date, the first two entrants (Vodacom and MTN) account for over 86% of services by revenue during the period 2010 to 2013. There are structural barriers in the markets which will likely prevent rivals from effectively challenging and constraining Vodacom once it acquires the advantages described above. In particular, the remaining rivals (Cell C and Telkom Mobile) are significantly weaker because of these structural barriers to expansion, hence, they are currently subscale with this situation unlikely to change in the short to medium term.

[13] Further, the Commission notes that the data advantage that Vodacom will enjoy includes smart devices and this advantage may also translate into advantages in the provision of mobile voice services. In the long term, consumers are likely to be faced with higher prices and reduced choice as Vodacom will unlikely to have any incentives to pass on cost savings to consumers given that it will unlikely face strong competitive constraints. The Commission also finds that Vodacom has no incentive to reduce prices now as rivals are also capacity constrained. In addition, the increase in data demand (due to the emergence of smart devices) represents a

shift in the demand curve as opposed to movement along the demand curve (a response to changes in prices), and as such, Vodacom is unlikely to have an incentive to lower prices.

[14] The Commission also investigated whether Vodacom required access to additional spectrum in order to remain competitive against other MNOs and finds the following:

14.1 The Commission has excluded from its analysis all TDD spectrum given that this spectrum is currently predominantly designated for other uses.

14.2 The figures used by the merging parties in the argument that MTN is better placed to re-farm spectrum understate MTN's constraints thereby overstating the ability of MTN to re-farm spectrum for LTE services relative to Vodacom. In any event, the ability of MTN to effectively take advantage of having fewer 2G subscribers relative to Vodacom is limited by the fact that MTN has fewer base stations than Vodacom. As already noted above, installing new base stations is costly, time consuming and increasingly difficult.

14.3 Vodacom's leading and durable market share of data services suggests that it is not at a competitive disadvantage relative to its rivals.

14.4 The more recent Ookla tests undertaken by the merging parties over a period of time reflect that Vodacom has greater speeds than MTN and that MTN is no better placed than Vodacom to achieve higher speeds on current spectrum holdings.

[15] The Commission is therefore of the view that the acquisition and access to additional spectrum by Vodacom relative to its rivals is likely to result in a substantial lessening of competition in the provision of mobile services in South Africa.

(b) Horizontal effects in relation to fixed line services

[16] The Commission is of the view that Vodacom is likely to alter focus of its investments primarily towards enterprise and end-customers and this may impact on Neotel's ability to continue to invest in wholesale fixed leased lines, thus potentially chilling competition in the upstream market for wholesale provision of leased lines. However, evidence provided to the Commission suggests that other providers have plans to increase their fixed leased line footprint and are likely to continue to offer alternatives to the merged entity. As such, the merger is unlikely to raise competition concerns in the provision of fixed leased lines at a metropolitan level.

- [17] In relation to MNS, VANS and hosting markets, the Commission finds that the merger is unlikely to raise unilateral or coordinated effects in those downstream markets. This is mainly because of the relative post-merger position of the merged entity in these downstream markets.

(c) Vertical effects in relation to provision of fixed leased lines

- [18] In the instance case, the market shares (at national, metropolitan and last mile segments of fixed leased lines) suggest that the merged entity is unlikely to have the ability to foreclose rivals.
- [19] The Commission also considered potential foreclosure via a mobile traffic offload strategy by Vodacom. Firstly, the Commission finds that should Vodacom engage in the mobile traffic offload as argued by third parties, it would have to divert traffic from its current fixed leased line providers such as DFA. Such a strategy would imply that Vodacom will incur two costs, that is, the cost of rental paid to DFA as well as the cost of using Neotel's network. At the same time, they will incur revenue losses on the contracts that Neotel could possibly have with OLOs and MNOs due to the alleged reluctance to deal.
- [20] Second, to the extent that Neotel has additional capacity or could create additional capacity (which would lower its per unit costs), then it is unlikely that foreclosure from access to Neotel's network would be profitable for the merged entity as it would likely simply be foregoing revenue it could possibly generate without incurring significant costs. Therefore there appears to be no incentives to engage in such a foreclosure strategy.
- [21] The Commission also finds that the merged entity is unlikely to engage in anticompetitive customer foreclosure even if the ability and incentive may exist to foreclose suppliers such as DFA. This is primarily because there are significant financial penalties as well as costs associated with having to replicate the current DFA network that Vodacom uses.

(d) Barriers to entry

- [22] The Commission finds that barriers to entry and expansion to compete in the retail mobile market and fixed lease line market are inherently high and that there are slim prospects of new entry or expansion to constrain Vodacom post-merger.

(e) Conclusion on competitive assessment

- [23] The Commission is of the view that the acquisition of additional spectrum is likely to entrench Vodacom's market position in a market where outcomes have not traditionally served consumers well. As such, the proposed merger is likely to substantially prevent or lessen competition in retail mobile markets.
- [24] In respect of the fixed line services markets, the Commission finds that the merger is unlikely to raise significant competition concerns in the upstream and downstream markets affected.

EFFICIENCIES

- [25] The Commission notes that the merging parties' approach to the merger seeks to argue pro-competitive benefits arising from the merger in the fixed line market. In this regard, the Commission finds the following:

- 25.1 The pro-competitive arguments raised by the merging parties relate to the fixed markets and do not outweigh the concerns arising in mobile markets. Fixed line benefits alone, if they exist, do not address competition concerns in the mobile market.
- 25.2 Both Vodacom and Neotel are already in fixed lines markets, and as such any claimed incremental benefits in this market may be minimal since absent the merger, Vodacom appears to already have strategic plans to grow its fixed line business.

PUBLIC INTEREST CONCERNS

(a) Employment

- [26] The Commission notes that the merging parties have undertaken not to retrench any employees as a result of the proposed merger.

(b) Impact on a particular sector

- [27] The proposed merger will also have a significant impact on the structure of the South African mobile market and will shape future competitive dynamics. The proposed merger is likely to reshape the structure of the mobile industry, by erecting larger a dominant firm that is unlikely to be significantly constrained by rivals. South Africa generally experiences higher mobile services prices than most comparable countries in the world. More access to broadband services, in line with government policy, is unlikely to be achievable in such a market structure as broadband access is dependent on mobile prices reducing. The proposed merger places Vodacom in a

position which will likely entrench its position, further reducing the likelihood of mobile prices coming down, at least to the same extent that prices would decline in a competitive environment.

- [28] Although the merger may improve LTE service provision by Vodacom, this benefit is likely to accrue only to a small proportion of end consumers, with the majority likely to be negatively impacted by a lack of price reductions and lesser competitive choices. More so, the past competitive behaviour of Vodacom shows that end-customers have not enjoyed pass-through benefits in the form of lower prices. The reduction in mobile prices observed before have been a culmination, *albeit* limited, of competition from smaller rivals or new entrants and the reduction of mobile termination rates through regulation.
- [29] Lastly, the spectrum problems cited by incumbent leading MNOs may be short term problems which may eventually be addressed through the policy implementation and appropriate regulatory forum.
- [30] The Commission also notes that the proposed merger significantly dilutes the BEE shareholding of Neotel. This is against the spirit of the purpose of the Act, especially in relation to the element on the promotion of greater spread of ownership relating to increasing the ownership stakes of historically disadvantaged persons.
- [31] Accordingly, it is the Commission's view that the proposed merger raises public interest concerns, when all the above public interest elements, particularly if the effect on a particular industrial sector is taken into account.

REMEDIES

- [32] Given the above concerns, the Commission invited the parties to submit remedies that could address the concerns arising from the proposed merger. After some engagements, the parties eventually proffered remedies which seek to allay the concerns. Initially, the main remedy proposed related to deferring the use of the spectrum currently licenced to Neotel by 12 months. However, following further engagements, the period was amended to 2 years.
- [33] It is the Commission's view that since the main concerns arising from the merger arise from spectrum concentration, the concerns may be remedied. Such a remedy may include the non-use of Neotel's spectrum by Vodacom until such a time when spectrum equalisation occurs in the industry. However, the 12 month deferment period initially offered by the parties is

inadequate as it does not address the competition concerns identified relating to spectrum. None of the third parties engaged consider such a 12 month deferment period as adequate.

- [34] However, it is the Commission's view that a deferment period of 2 years will likely alleviate the concerns relating to spectrum. The concerns arising in this merger and/or any potential remedy imposed is a spectrum policy issue relating to spectrum allocations. The spectrum issue can therefore be addressed through a policy process. It is the Commission's view that such a process may be concluded within 2 years as there are indications from the relevant departments that plans are underway to introduce and implement a spectrum policy in the country. Therefore, a 2 year spectrum deferment period addresses the harm arising.
- [35] In respect of the monitoring provision, the Commission is agreeable to the principles of appointing an independent third party, at Vodacom's cost, to monitor the implementation of any spectrum deferment remedy.
- [36] The parties have also made commitments to invest R10 billion over 5 years in relation to fixed line infrastructure. It is the Commission's view that such investments are important and significant, particularly if existing investment levels of both Vodacom and Neotel towards fixed infrastructure are taken into account. These investments are likely to provide a stronger competition to the incumbent operator Telkom. Therefore, these proposals on fixed investments are a positive and also alleviate the public interest concerns arising from the merger.
- [37] The Commission is agreeable in principle to all other conditions tendered relating to employment and BEE dilution effect. All the Conditions discussed above were also agreed upon by the merging parties.

CONCLUSION/RECOMMENDATION

- [38] Taken as a whole, the Commission recommends that the proposed merger be approved subject to conditions attached hereto as Annexure A.

B. ANALYSIS

1 DESCRIPTION OF THE MERGING PARTIES

1.1 Vodacom

- [1] The primary acquiring firm is Vodacom Proprietary Limited ("Vodacom"), a private company incorporated in accordance with the company laws of the Republic of South Africa.
- [2] Vodacom is controlled by Vodacom Group Limited a public company listed on the Johannesburg Securities Exchange Limited. The shareholders of the ordinary issued share capital of Vodacom are:
- | | | |
|-----|--|--------|
| 2.1 | Vodacom Group | 93.75% |
| 2.2 | Lisinfo 209 Investment Proprietary Limited | 1.97% |
| 2.3 | Main Street 661 Proprietary Limited | 0.84% |
| 2.4 | YeboYethu Limited | 3.44% |
- [3] Vodafone Investments (SA) Proprietary Limited ("VISA") holds 65% of the issued share capital of Vodacom Group, while the balance (35%) is held publicly. VISA is ultimately controlled by the Vodafone Group plc ("Vodafone"), a company having its principal place of business at Vodafone House, West Berkshire, England. Vodacom submits that Vodafone is a listed entity and is not controlled by any shareholder.
- [4] Vodacom Group controls various firms either directly or indirectly and the business activities of these firms have been assessed where necessary.

1.2 Neotel

- [5] The primary target firm is Neotel Proprietary Limited ("Neotel"), a private company incorporated in accordance with the company laws of the Republic of South Africa.
- [6] The shareholders of Neotel are:
- | | | | |
|-----|---|-----------|-----|
| 6.1 | Sepco Communications Proprietary Limited | ("Sepco") | 51% |
| 6.2 | VSNL SNOSPV Pte Limited ("VSNL") | | 30% |
| 6.3 | Nexus Connection (SA) Proprietary Limited | ("Nexus") | 19% |
- [7] The shareholders of Sepco are:
- VSNL 73.17%

- CommuniTel Telecommunications Proprietary Limited 20.60%
 - Tata Africa Holdings Proprietary Limited 6.23%
- [8] VSNL is a wholly-owned subsidiary of Tata Communications Limited ("TCL"), which has its principal place of business at 35 Tai Seng Street, TCX Building, Singapore.
- [9] Neotel is therefore ultimately controlled by TCL and forms part of the Tata Group, being a global enterprise headquartered in India.

2 DESCRIPTION AND RATIONALE OF THE TRANSACTION

2.1 Description

- [10] The parties to the proposed transaction are Vodacom, Neotel, Nexus, Sepco and VSNL. Vodacom intends to acquire the entire issued share capital of Neotel from its current shareholders and the claims against Neotel held by Nexus on loan account and any other shareholder loan funding claims provided by the sellers to Neotel.

- [11] The total cash consideration is equivalent to an enterprise value of R7 billion, [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

2.2 Rationale

2.2.1 Vodacom

- [13] Vodacom submits that its rationale for entering into the proposed merger is as follows:
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

There will be a wider choice of services in a more competitive environment."

2.2.2 Neotel

[14] Neotel submits that its rationale for entering into the proposed merger is as follows:

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

2.2.3 Commission's view of merging parties' rationale

[REDACTED] The Commission finds that part of Vodacom's primary interest in acquiring Neotel relates to access to the latter's spectrum allocation in order to accelerate the roll-out of a mobile long term evolution (LTE) network. [REDACTED]

[REDACTED]

- [17] It is widely documented that MNOs worldwide are seeking increasing amounts of spectrum to use in their networks as all operators continue to face significant data growth demand. South Africa is no exception. The proposed merger will give Vodacom access to the most sought-after radio frequency spectrum that Neotel has in the 800MHz spectrum, which is currently mainly used by broadcasters and is expected to be fully available to mobile network operators after the migration to digital process. Neotel currently uses this spectrum for its CDMA network. A telecommunications expert, Mr Duncan McLeod argues that the digital dividend is well suited to building robust urban broadband coverage using 4G/LTE technologies and extending those services into rural areas. Vodacom's decision to pursue Neotel is in large part built on the fact that it is not being granted access to new spectrum. It is the only operator with access to the 800MHz band, which forms part of the digital dividend. Vodacom will want to repurpose that spectrum for 4G broadband.⁷
- [18] Similarly, Mr Shameel Joosub, Vodacom's CEO, has publicly acknowledged the importance of access to additional spectrum which can be achievable through the acquisition of Neotel's spectrum.⁸ According to Mr Joosub, part of this is about finding innovative ways to get around regulatory challenges with issuing new spectrum to MNOs which has caused mobile operators to choke.⁹ More recently, he has also added that *"We need the opportunity to grow data but we need to put up the requisite tools first and government has to give us the tools, spectrum"*.¹⁰
- [19] Mr Joosub further states that *"Your ability to switch on LTE on a wider basis can be achieved overnight and help to meet some of those broadband targets... To be able to do that we need spectrum. The acquisition of Neotel, besides giving us fibre, capability and a customer base,*

⁷ See Business Times; The pros and cons of a Vodacom-Neotel deal; 18 January 2015.

⁸ See Business Day; Vodacom takes R2bn hit on rate cut; 19 May 2015 and Business Day; Focus on fibre optic cable network for Vodacom; 18 September 2014.

⁹ See Engineering News 'ICASA defends spectrum allocation position' dated 11 June 2014.

¹⁰ See Business Day; Vodacom takes R2bn hit on rate cut; 19 May 2015.

also has spectrum ¹¹ This suggests that additional spectrum provides immediate advantages in network and service rollout.

[20] Vodacom's interest in Neotel's spectrum has also been highlighted by various media and industry players. Industry experts have noted that Vodacom's need for access to additional spectrum has been a driving force in implementing the merger.¹² For example, Bloomberg reported in May 2013 that Vodacom was interested in buying Neotel for its spectrum access.¹³

[21] Access to more spectrum reduces the cost of network rollout which is more expensive than acquiring additional spectrum. In the instant transaction, Vodacom is seeking to gain access to Neotel's spectrum and this will mean lower network rollout costs relative to the alternative of adding additional base stations. In fact, access to Neotel's spectrum is a significant component of this transaction. [REDACTED]

[REDACTED]

[REDACTED]

3 JURISDICTION

[23] The implementation of the proposed merger requires the approval of the South African Competition Authorities and of the Independent Communications Authority of South Africa (ICASA).

[24] The Commission has jurisdiction to evaluate the proposed transaction as it constitutes a merger as defined in section 12(1) of the Competition Act No.89 of 1998, as amended (the Act), as it

¹¹ See Business Day; Focus on fibre optic cable network for Vodacom; 18 September 2014.

¹² See Business Times; Spectrum share holds key to mobile growth; 09 March 2014.

¹³ Business Report, The Star; Vodacom plans pounce on Neotel; 30 September 2013.

[REDACTED]

relates to the acquisition of control over the business of another firm. The transaction is a large merger as defined in section 11(5)(c) of the Act because the turnover/or asset value of the merging parties are above the higher thresholds as required in terms of section 11(1)(a) of the Act.

- [25] Neotel also filed an application in terms of section 13(1) of the Electronic Communications Act No. 36 of 2005, as amended (the ECA) with ICASA. This application is made so that control of the individual electronic communications network service (IECNS) and individual electronic communication services (IECS) licences issued to Neotel can be transferred to Vodacom. Neotel also filed an application in terms of section 31(2A) of the ECA with ICASA for the change and transfer of control of Neotel's radio frequency spectrum licenses to Vodacom.
- [26] The Commission and ICASA's engagements took place in terms of the Memorandum of Agreement as published in the Government Gazette number 23857, Volume 1747 of 2002 9 (the MOA). The relevant provisions of the MOA are:
- 26.1 The Commission and ICASA are to make independent determinations of the applications filed with them on the basis of the criteria and mandates of their respective legislation. In arriving at these determinations the Commission and ICASA may consult with each other.¹⁷
- 26.2 The Commission and ICASA may participate in each other's proceedings and may advise or receive advice from each other.¹⁸
- [27] ICASA received written submissions from a number of interested parties who are opposed to the acquisition and change of control of Neotel's licenses. Public hearings were held by ICASA on 15 and 16 January 2015 where the merging parties and other interested parties made oral representations.
- [28] ICASA approved the merger subject to conditions on 15 June 2015. The conditions largely relate to ownership of historically disadvantaged individuals.

¹⁷ See clause 2.2 of the MOA.

¹⁸ Ibid, clause 2.6.

4 CONFIDENTIALITY

- [29] The merging parties have claimed confidentiality over certain information submitted and this is set out in the CC7 Forms. The Commission also received confidentiality claims by third parties in respect of information submitted to the Commission.
- [30] These confidentiality claims were interrogated and where necessary the Commission requested the party to waive its claim of confidentiality as it did not meet the relevant threshold for confidentiality as set out in section 1(v) of the Act.

5 INVESTIGATION AND PROCEDURES

- [31] The proposed transaction was filed with the Commission on 18 July 2014 and on 15 occasions, the Commission extended the duration of the investigation in terms of section 14(1)(a) of the Act. The extensions were necessitated by numerous engagements that were required between the merging parties, the Commission and other stakeholders. Although the parties raised reservations on a number of the extensions requested, none of the requested extensions were formally opposed.
- [32] The Commission continuously liaised with the legal representatives of the merging parties and also carried out a site inspection of Vodacom's data centre facilities on 26 November 2014. Below is a brief overview of the different market participants and interested parties/stakeholders interviewed by the Commission.

5.1 Submissions from third parties

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]



[REDACTED]

[REDACTED]

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[REDACTED]

[REDACTED]

6 ACTIVITIES OF THE MERGING PARTIES

6.1 Vodacom

[42] Vodacom is an MNO which prides itself as having over 61 million customers in South Africa on many different devices connected to a world-class network that is serviced through various distribution and service partners. Vodacom's core services offerings include mobile voice, messaging and data, which are all available on either contract or prepaid basis. The products and services keep its customers connected in various media such as call, SMS, email, tweets or status update, including sending money.¹⁹

[43] Vodacom also provides retail fixed line services to business customers, whilst offering fixed leased lines on a wholesale basis to third parties.²⁰ It offers the following services:

- Vodacom Broadband Connect Fibre (BBC Fibre) which provides high speed Internet access from 3Mbps – 100 Mbps over future proof fibre connectivity which previously was only within the reach of large enterprise.

¹⁹ www.vodacom.co.za

²⁰ See Vodacom Annual Integrated Report, 2014

- Broadband Connect LTE (commonly known as 4G) offers a faster and more efficient data network for small and medium businesses with speed that is up to three times faster than 3G.²¹ Provides reduced network delay for business activities such as video conferencing.
- Broadband Connect Wireless provides high-speed Internet access from 2Mbps up to 40Mbps (uncapped) and 10GB to 50GB (capped). Broadband Connect Wireless offers high-speed broadband connectivity to Vodacom's business-grade Internet offerings, unified communications and hosted applications such as Office 365 and IP Talk without the need for copper cables.
- VoIP uses the latest IP technology to provide high quality voice transmission services managed and designed for all businesses and large corporates.²²

[44] Vodacom operates in five countries namely South Africa, Democratic Republic of Congo, Lesotho, Mozambique and Tanzania. According to Vodacom, its footprint in sub-Saharan Africa is strengthened by its subsidiary Vodacom Business Africa, which is Africa's largest provider of satellite and terrestrial network infrastructure and interconnection services for African and International telecommunications companies.

6.2 Neotel

[45] Neotel is a fixed line telecommunications network provider and provides fixed leased lines on a wholesale basis to third parties as well as retail fixed line services to business customers. Some of the business solutions Neotel offers to enterprise customers are similar to that being offered by Vodacom. [REDACTED]

[42] Neotel provides wholesale voice interconnections to customers possessing an ECN or ECNS license in accordance with regulatory requirements. It offers these services to MNOs, Fixed Line Operators and ISPs. There are 3 methods of interconnection provided by Neotel include the following:

- Internet POIL (Point Of Interconnect Local) – Interconnection through the internet

²¹ The Vodacom Broadband Connect LTE operates at an average speed of 9Mbps and connects multiple devices for instant downloads, file sharing and collaboration across the office faster than the average ADSL or 3G connection.

²² Ibid.

²³ [REDACTED]

- Local POIL – Interconnection by means of a physical circuit between the two parties
- Service Connect POIL – Interconnection in a data centre either belonging to Neotel or a third party.

[43] Neotel offers large corporates a consultative approach offering solutions supported through a range of Service Level Agreements (SLA) depending upon the specific requirements of each customer. The services offered span over VPN, Internet, Broadband, Data services, Enterprise voice, Data Centre and Hosted solutions, Audio and Video conferencing and Satellite services.²⁴

6.3 Relationship between the parties/ products (horizontal/vertical)

[46] It is useful to provide a definition of the key terms used by the Commission in its recommendation before turning to describe the relationship between the merging parties and identifying markets. These key terms are set out below:

46.1 Fixed leased lines – there are different types of fixed leased lines depending on the portion of the network over which they are provided such as international, national, metropolitan and last mile. There are also different types of technology that can be used to provide fixed leased lines including fibre, copper, microwave and satellite depending on the type of fixed leased line that is required. In the context of this merger, unless explicitly otherwise indicated, reference to wholesale fixed lease lines refers to access to the fixed fibre network at a wholesale level.

46.2 Fixed wireless – Neotel offers a fixed wireless service to consumers, SMEs and corporate enterprise business. These services are provided over a fibre network where the last mile is wireless. This service offering is generally provided over a fixed radius where the last mile utilises CDMA in the 800MHz band, WiMAX in the 3500MHz band, and LTE in the 1800MHz band. This also means that the fixed wireless services can only be accessed within a given radius where there is network coverage.

46.3 RAN – this is the Radio Access Network. It is used to transmit and receive signals from mobile terminals (handsets) at the particular network operator's specified spectrum. The RAN is made up of masts, radio equipment, cabinets, base station controllers and radio

²⁴ www.neotel.co.za

network controllers. In this recommendation, the Commission refers to RAN sites to describe RAN of MNO or of Neotel.

46.4 Retail fixed line services – these are fixed line services offered to business customers. These services consist of MNS, VANS, and hosting services.

46.5 Retail mobile services – this refers to mobile data, voice and sms services offered to end consumers.

46.6 Wholesale mobile services - these are voice and data packages sold in bulk by network operators to ISPs.

6.3.1 Horizontal

[47] The proposed merger presents several horizontal overlaps. First, Vodacom and Neotel compete against each other for the provision of wholesale fixed lease lines. Second, the merging parties offer a range of different retail fixed line services to business customers. These services include internet access, voice, hosting, VPN and managed services. Third, the merging parties both have RAN sites that are used to provide their wireless services and this infrastructure also presents an overlap. Fourth, the different service offerings of Vodacom and Neotel are made available via retail outlets. The different retail stores of the merging parties also presents a horizontal overlap. However, this overlap is negligible and unlikely to substantially prevent or lessen competition. This aspect of the proposed merger is not assessed in this recommendation.

[48] There is also a further overlap in that the implementation of the proposed merger will result in the aggregation of spectrum in the hands of Vodacom. Neotel currently uses the spectrum to provide LTE services over a fixed line network, whereas Vodacom will use the spectrum to accelerate the roll-out its mobile LTE network. The Commission's assessment focuses on the likely effect of this spectrum aggregation in the retail market for the provision of mobile services.

6.3.2 Vertical

[49] The proposed merger has several vertical dimensions. First, Vodacom and Neotel are in a vertical relationship in that Neotel provides access to its wholesale fixed leased lines on a wholesale basis. Post-merger, the fibre network of Neotel may be used by Vodacom to offer retail fixed line services to business customers, while Vodacom will also use the Neotel fibre

network to transmit mobile traffic over its own mobile network. Second, the implementation of the proposed merger may also raise conglomerate effects as it can be argued that the mobile products of Vodacom and fixed line products of Neotel are complementary.

[50] There are also other vertical relationships between the merging parties. In this regard, Vodacom provides voice termination services to Neotel and rental space for Neotel's network equipment on the national long distance ("NLD") fibre network. These vertical relationships are unlikely to have any effect on competition and will not be assessed by the Commission.

[51] Given the activities of the merging parties and the markets in which their activities overlap, the next section assess the markets affected by the merger, first by discussing the background and structure of the Information and Communications Technology ("ICT") sector. Thereafter, the relevant markets are defined.

7 RELEVANT MARKETS

7.1 Case precedent

[52] The Commission considered the market definitions of previous mergers assessed by the South African and international Competition Authorities.²⁵ In doing so, the Commission evaluated to what extent market dynamics are similar between the different jurisdictions and what impact technological developments have had.

[53] Vodacom offers fixed and mobile telecommunication services, while Neotel only offers fixed line telecommunication services. Both the fixed line and mobile telecommunication markets consist of (upstream) infrastructure or network and (downstream) service markets. For instance, in the Telkom / BCX merger²⁶ the Tribunal defined an infrastructure market, which comprised an access or last mile segment, backhaul and trunk segments which provides long distance connectivity between local exchanges.²⁷ In the same merger the Tribunal identified a

²⁵ Local case precedent considered by the Commission include Telkom / BCX (51/LM/Jun06), MTN / Verizon South Africa (Pty) Ltd (81/LM/Jul08), MTN / Afrihost (Pty) Ltd (019075), Main Street 1270 (Pty) Ltd / Dimension Data (Pty) Ltd and others and Dimension Data (Pty) Ltd / Mweb Connect (Pty) Ltd (019653), Altech Autopage Cellular (Pty) Ltd / Nashua Mobile (Pty) Ltd (019166), Vodacom and Nashua Mobile (019034), MTN and Nashua Mobile (019018)

²⁶ Case No. 51/LM/Jun06

²⁷ Ibid, para 97

downstream market for the provision of managed network services ("MNS") and information technology services ("ITS").²⁸

[54] MNS are provided over an infrastructure network which connects the various offices (or business sites) of organisations. MNS therefore include VPNs, internet access, hosting services, VoIP, security backup, firewall intrusion and other services. The Tribunal indicated that the ITS market involves the provision of planning, managing and supporting software and hardware required to meet the computing demands of large corporates. Some of the ITS services rendered by firms include application management, information systems outsourcing, network and desktop outsourcing services, hosted application management and hosted infrastructure services. In more recent fixed line telecommunication mergers evaluated by the Commission and Competition Tribunal the competitive effects in potential markets that include hosting and cloud services, voice, VPN and managed security services and wholesale and retail internet services were assessed.²⁹

[55] For mobile telecommunication services the Commission recently considered mergers in the retail market for the provision of pre-and post-paid mobile telecommunication products.³⁰

7.2 Introduction to market definition

[56] There are four specific market developments that are important in the context of the proposed merger.

[57] The first is convergence which was described by the Tribunal in the 2007 Telkom / BCX merger as follows.³¹

"...This trend towards convergence of voice and data services, broadcasting and telecommunications, and fixed and mobile services – with a single integrated receiver and number that allows the subscriber to move seamlessly between networks – paves the way for a new complex and integrated value chain of services bundling opportunities which has supplanted the classically linear value chain. It is anticipated that in future all services will

²⁸ Ibid, para 130 - 180

²⁹ MTN / Afrihost (019075), Main Street 1270 (Pty) Ltd / Dimension Data (Pty) Ltd and others and Dimension Data (Pty) Ltd / Mweb Connect (Pty) Ltd (019653). These mergers did not raise any competition concerns.

³⁰ Altech Autopage Cellular (Pty) Ltd / Nashua Mobile (Pty) Ltd (019166), Vodacom and Nashua Mobile (019034), MTN and Nashua Mobile (019018)

³¹ Telkom SA Limited and Business Connexion Group Limited, Case No:51/LM/Jun06, para 19

originate from infrastructure that may be composed of multiple and distinct networks that seamlessly integrate to create a modern information backbone known as Next generation Networks, NGNs. NGNs allow for lower-cost IP-based services to be transmitted over single platforms. These developments require than any value-chain analysis of operators, services or ICT companies by dynamic, flexible and open-ended."

[58] There are three different types of convergence:

58.1 Service convergence – allows a firm to offer multiple services over a single network

58.2 Network convergence – allows multiple networks to connect to each other

58.3 Corporate convergence – results from mergers and acquisitions and allows firms to offer multiple services or address new markets.³²

[59] A fundamental methodological challenge for defining markets in the ICT and telecommunications sector arises from rapid change and bundling both of which are associated with convergence.³³ Rapid change or constantly changing markets means that reliance on past market definitions should be conducted cautiously. This complicates the analysis because there are few past transactions that can be relied on to provide guidance. In these markets, the hypothetical monopolist thought experiment and interviews with industry participants is still useful in determining the potential for substitutability.

[60] It is important to recognise that since markets on the demand-side are defined in terms of supply of services, the technological change cannot in itself lead to changes in demand-side market definition. Rather it must be changes in the supply of services which affects demand-side substitutability.³⁴ The implications of the technological aspect of convergence for supply-side substitutability are interesting to note because it may result in widening of markets.³⁵ Supply-side substitutability can be used to expand a market definition (that would otherwise be narrower based on demand-side substitutability) in a case where a firm that is currently supplying services that are not demand-side substitutes, but has the production capacity in

³² World Bank 2010. Convergence in Information and Communication Technology: Strategic and Regulatory Considerations. Accessed from http://siteresources.worldbank.org/EXTINFORMATIONANDCOMMUNICATIONANDTECHNOLOGIES/Resources/Convergence_in_ICT.pdf on 20 January 2015.

³³ Market definition in the media sector – economic issues – report by Europe Economics for the European Commission, DG Competition (November 2002), page 10.

³⁴ Ibid pages 61-63

³⁵ Ibid.

place to quickly shift to supplying services that compete in the relevant market. However, caution is required to ensure that all aspects required to enter a market and introduce a competitive constraint are considered, rather than stopping with the observation that, due to convergence, the switch in production is technologically feasible.³⁶

- [61] Convergence allows firms to provide bundled services (e.g. VOIP and data). In the presence of such bundling, market definition is therefore complicated because bundles may compete with other bundles but also against unbundled supply (where consumers purchase individual products and services and construct their own bundles).³⁷ This means that there may be many permutations of markets for bundles and individual products that would need to be assessed. It also means that there may be several relevant markets that can be identified within any one particular case. An important task for market definition is to account for the possibility of there being multiple relevant markets for a particular service and ensuring that the markets in which competition is assessed are those relevant to the competition question under consideration (i.e. competition is not assessed in an irrelevant market).³⁸

- [62] [REDACTED]
- [REDACTED] The use of data centres for hosting and cloud based solutions is founded in the outsourcing of IT processes to service providers, which is driven by firms' requirement to focus on their core business. As a result, businesses are trying to move away from a capital expenditure to operating expenditure model by reducing their cost of ownership.⁴⁰ Service providers can offer simple based co-location (infrastructure hosting) services or advanced cloud services through application hosting.⁴¹ In this regard, the data centre provider's VPN will also play a central role as it will allow the end-user customer to communicate via the use of the data centre.

[REDACTED] The third development related to convergence and the use of cloud based solutions is the growth of data usage. The demand for data will continue to grow as different services are

³⁶ Ibid.

³⁷ Ibid, page 36.

³⁸ Ibid.

⁴⁰ Frost & Sullivan, Managed Services Market in South Africa – mapping opportunities in the data centre and cloud markets (January 2012), slide 5

⁴¹ Ibid, slide 87

offered over an IP-platform. As an example, consumers are steadily increasing their usage of smartphones or tablets to access the internet or to download and share videos, music, etc.⁴² MNOs require access to additional spectrum to meet the increase in data demand ■

■ Finally, the South African ICT market is consolidating with a spate of merger notifications with even more expected in future.⁴⁴ There have also been several mergers in the ICT sector in Europe since 2010 which involved mobile operators and mobile and fixed line operators. Some of these acquisitions include mergers between *T-Mobile/Orange*, *TDC/YouSee*, *3G Hutchison Austria/Orange* and *Hutchison 3G/Telefonica*. ■
■
■

[65] The international acquisitions by Vodafone and the proposed transaction have similarities in that the target firms are (i) all primarily fixed line operators (with fibre assets), (ii) have enterprise businesses which allows Vodafone to provide a converged fixed and mobile service offering and (iii) allows Vodafone to grow its mobile data business via the use of the fibre networks. The only noticeable difference between these mergers and the proposed transaction is that Neotel is primarily being acquired due to the high demand spectrum it holds. This spectrum will enable Vodacom to accelerate the roll-out of its LTE-network and provide a higher quality mobile data service. Moreover, the fibre network of Neotel can also be used to transmit the increased volume of data usage.

[66] The proposed merger concerns a range of fixed and mobile network elements and services, which can be divided into wholesale and retail markets. The wholesale market in this

⁴² See also Section 11.1.1 below.

■
■
⁴⁴ MTN and Nashua Mobile Proprietary Limited (Case No.:019018), Vodacom and the Vodacom subscriber base of Nashua Mobile Proprietary Limited (Case No.:019034), Altech Autopage Cellular Proprietary Limited and Nashua Mobile Proprietary Limited (Case No.:019166), MTN and Afrihost Proprietary Limited (Case No.:019075), Dimension Data Proprietary Limited and MWeb Connect Proprietary Limited (Case No.:019653, Main Street Proprietary Limited and Dimension Data Proprietary Limited and others, Telkom and Business Connexion Group Limited (Case No.:019356), MTN and certain of the radio access network assets of Telkom (Case No.:18895). The CEO of MTN indicated that they may look to further acquisitions <http://www.techcentral.co.za/mtn-actively-eyeing-it-acquisitions/52139/> (accessed on 31 October 2014), ■
■
■

transaction primarily deals with access to infrastructure. In general, telecommunication services can be provided over either fixed or mobile technologies. The larger mobile operators in South Africa, Vodacom and MTN have entered the fixed line services market mainly for business customers. In addition, Telkom has entered the mobile services market.

[REDACTED]

[REDACTED]

[68] There are a number of factors that need to be considered when entering a fixed and mobile market. The discussion below will first address whether a fixed line operator can easily start providing mobile services. Thereafter, the Commission will address whether a mobile operator can easily start providing fixed line services.

[69] For a fixed line operator to enter the mobile services market, spectrum is required. Spectrum is a scarce resource and it is not easily accessible. ICASA has indicated to the Commission that the 1800MHz and 2100MHz spectrum is fully allocated. There is currently uncertainty over the prospects of spectrum availability in the very near term, either through the licensing of 2600MHz spectrum or through the digital migration of broadcasting services – Digital Terrestrial Television (DTT). The DTT has since overrun its initial targeted timelines and it is not clear when this will be achieved. In addition, a radio frequency (RFS) licence needs to be obtained from ICASA before an operator can use spectrum. These factors significantly limit the ease with which a fixed line operator can start offering mobile services.

[70] For a mobile operator to enter the fixed line services market, the mobile operator would need to have access to fixed leased lines for last mile services in particular. A mobile operator cannot start offering fixed line services on a mobile network. The mobile operator would need to invest in building an extensive fibre network. [REDACTED]

[REDACTED] There are significant barriers including capital costs and regulatory approvals in building a fibre network.⁴⁶ The capital costs

⁴⁶ A customer who requires mobile telephony services is unlikely to switch to a fixed telephone because the customer would only be able to use the telephone at a fixed location. However, a customer requiring fixed line services could potentially use mobile services. This is because the use of a mobile telephone is not limited to a fixed location. It is important to note that although, mobile telephones could potentially be used in place of fixed line, the quality of service between fixed and mobile networks may not be the same.

[REDACTED]

for investing in last mile services are even greater as this requires penetration through pavements and buildings. The fact that mobile operators are offering fixed line services by leasing fibre from third parties indicates that it is not possible to offer fixed line services on a mobile network and that it is costly and timely to build one's own fibre network. A mobile operator would need to make significant investments in a fibre network before being able to provide fixed line services. Even if the mobile operator decides to lease the fibre from third parties, the point remains that they are unable to offer fixed line services on a mobile network. The mobile operator would need to incur significant additional costs in obtaining the fibre network either by building a fibre network or leasing the fibre from third parties.

- [71] The Commission concludes that fixed connectivity and mobile connectivity markets are separate and this market definition is in line with international case precedents where the European Commission ("EC") identified separate markets for mobile and fixed line services.⁴⁹ The EC noted that through technological advancements similar services can be offered over both fixed and mobile networks, but that a key differentiating factor is that fixed services do not offer mobility.

- [73] The wholesale or upstream market for fixed line services comprises the physical infrastructure (fixed leased lines) which is primarily provided by the merging parties over fibre optic cables.⁵² In this regard, it is possible to identify different segments of fixed leased lines depending on the type of connectivity that is offered i.e., access (last mile), metropolitan, national long distance and international connectivity.

⁴⁹ See for instance Telia / Sonera (COMP/M.2803), Vodafone / Cable & Wireless (COMP/M.6584, Hutchinson 3G Austria / Orange (COMP/M.6497).

⁵² Neotel also offers fixed line services using wireless technology.

- [74] In the mobile segment, the upstream infrastructure can be broken down into the core and RAN. The RAN can be further disaggregated into spectrum, passive infrastructure and active infrastructure.⁵³
- [75] It is also important to note that internet access can be provided on a wholesale and retail basis. As both of the merging parties provide internet services on a wholesale and retail basis, the Commission identifies a wholesale and retail market for the provision of internet access.⁵⁴
- [76] As mentioned above, the merging parties offer various products or services in the fixed line market. The exact market delineation of the services is considered in the following sections.

7.3 Mobile infrastructure market

7.3.1 Merging parties' view

- [77] The merging parties did not identify a market for mobile infrastructure.

7.3.2 Commission's view

- [78] Mobile and fixed wireless networks are built to include RAN assets (base or radio stations). This infrastructure comprises active and passive elements. The passive elements can include the cabinets, electricity, air-conditioning and masts, while the active elements include antennas, node and radio network controllers. These radio stations are connected to the core network of a MNO by way of fibre optic cables or microwave links.
- [79] It is common practice for MNOs to share the passive site infrastructure and MNOs may lease from another (or other independent provider) ground space on its radio sites and space on its masts.⁵⁵
- [80] Although Neotel is not a MNO, it does have RAN assets from which it provides CDMA, Wimax and/or LTE services over a fixed wireless network. As such, there is a horizontal overlap between the merging parties as both own RAN sites.

⁵³ See GSMA – Mobile Infrastructure sharing, 2010 and Commission recommendation In Telkom / MTN (2014Apr0165).

⁵⁴ This market definition is also in line with the assessment carried out in MTN / Afrihost (019075).

⁵⁵ See para 8.a.1 of Vodacom submission dated 22 September 2014.

7.4 Fixed line infrastructure market – fixed leased lines

[81] In the fixed leased line market, Telkom and Neotel provide connectivity to downstream OLOs, while at the same time competing with these firms for the provision of retail fixed line services.⁵⁶ Vodacom is also a provider of retail fixed line services to business customers and therefore competes with Neotel and Telkom at a downstream level. Other firms that compete with the merging parties are not vertically integrated or have very small fibre networks. As a result, these competitors are dependent on other firms to provide them with wholesale fixed leased line services in order to compete and deliver retail fixed line services to business customers.

[82] The past few years has also seen other fixed leased line providers such as DFA enter the market and provide fibre connectivity to MNOs and OLOs. These new entrants have generally targeted 'high use' routes or metropolitan areas.

[83] In Table 1 below we provide an overview of firms that contest in the different markets referred to above.

Table 1: Market participants in fixed and mobile telecommunication market

Wholesale fixed lease lines	Retail fixed line services
Vodacom	Vodacom
Neotel	Neotel
Telkom Wholesale	Telkom Business
MTN	MTN
DFA	IS
BBi	T-Systems
Infraco	BT
Liquid Telecom	BCX
Municipalities	Gijima
	Vox
	Teraco
	Others

Source: Submissions received from market participants

[84] The proposed transaction therefore straddles fixed and mobile markets. The assessment of market structure, market shares and competitive dynamics of each market follow below. The next section provides a background on Neotel as an operator in the telecommunications and ICT sector.

⁵⁶ Neotel has had very little success in providing connectivity and related services to household customers.

7.5 Neotel as South Africa's SNO

[85] Telkom was granted an exclusive license until 2002 to provide public switched telecommunication services and install, provide, maintain and operate public switched telecommunication networks. This effectively meant that Telkom was a monopolist for the provision of all fixed line services in South Africa and international telecommunication services.

[86] In 2001, the South African government promulgated the Telecommunications Amendment Act No.64 of 2001 which provided for the licensing of a SNO in the fixed line telecommunications market as a competitor to Telkom. The licensing of the SNO was protracted and began in 2002 and ended on 9 December 2005 with Neotel being awarded the same rights as Telkom.

[87]

[REDACTED]

[88] In addition to providing wholesale fixed leased lines and broadband internet services, Neotel also provides retail fixed line services. A breakdown of Neotel's revenue contribution and customer list suggests that it has been more successful in targeting enterprise businesses when compared to small office/home office ("SOHO") customers.

7.5.1 Merging Parties' View

[89] The merging parties define this market as the market for wholesale leased line services. According to the merging parties, wholesale leased lines allow communication providers to connect their own networks to end user sites in order to provide business connectivity services.⁵⁸

[90] The EC has previously considered whether to subdivide the wholesale leased lines market between terminating segments versus trunk segments. In its recommendation on market definition in the electronic communications sector, the EC considered a separate market for

⁵⁸ See Frontier Economics Report, para 3.15

terminating segments for leased lines.⁵⁹ The merging parties submit that it is not necessary for the purpose of this transaction to consider whether to subdivide the wholesale leased lines market between terminating segments (last mile) and trunk segments (metro and national fibre), as suggested by the EC.⁶⁰ However, the merging parties' competitive assessment considered the likely effects on the national, metropolitan and international fibre segments.

7.5.2 Commission's View

[91] The merging parties are network operators who own a significant part of the physical infrastructure (fibre) related to the telecommunications network they provide. These networks are made up of switches and transmission mediums. [REDACTED]

[REDACTED] It is also important to note that MNOs also use fibre to transmit signals (traffic) through their network.

[92] Fibre is currently the most commonly used form of fixed-line infrastructure through which services are rendered to enterprise customers and large businesses. The merging parties both provide fibre on a wholesale basis to other ISPs or OLOs and also use their own or third parties' fibre networks to render services to their customers.

[93] The Commission understands that different types of leased lines (international, national, metropolitan, last mile) can be used by a customer depending on the portion of the network over which it is being used, the network design in the area concerned and the specific requirements of the customers. This influences the type of technology that can be used (i.e., fibre, microwave or copper). [REDACTED]

⁵⁹ See Commission Recommendation of 17 December 2007 on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services (2007/879/EC), OJ L 344, 28.12.2007, p. 65.

⁶⁰ See European Commission decisions in *Telefonica/Hansenet Telekommunikation* (M.5730) and *Deutsche Telekom/GTS* (COMP/M7109)

[94] Fibre can either be dark or lit and this determines the type of service that is provided by the service provider. Dark fibre refers to the physical fibre that is laid in the ground and over which no services are provided. The dark fibre therefore needs to be lit using equipment at both ends of the fibre which then allows for the transmission of signals and value added services. The customer will purchase dark or lit (managed fibre) fibre depending on its requirements. All fibre is fundamentally the same with the capacity that is put through the fibre being the main distinguishing factor.⁶⁴ Differences between the fixed leased line providers are therefore the type of service (speed, etc.) and service level agreement that are provided.

[95] It is common-cause that access to fibre is an essential input for all ISPs and OLOs in order to render downstream services to customers. These downstream services would include VPN, voice, internet access, videoconferencing, managed security services, hosted infrastructure and hosted application management. ■

[96] The upstream market for wholesale leased lines can be segmented into international, national, metropolitan and last-mile.⁶⁶ The merging parties are active in each segment of this market.

Last Mile

[97] The first component is the access layer or last mile which comprises the link between the end users' premises and the service provider's network or local exchange. As mentioned above, the

⁶⁴ Fibre capacity is determined by the termination equipment installed in the fibre and can be upgraded depending on the requirement of the customer and depending on technological advancements.

use of alternative access technologies to fibre is limited due to capacity and reliability constraints. ■

Metropolitan

[98] The next layer is metropolitan connectivity where fibre links connect the access layer to larger switches and aggregation points in the network (mainly in cities). Again, the use of other technologies is limited due to capacity and reliability constraints.

National

[99] National (also referred to as “backbone” or “long haul”) connectivity comprises of high capacity fibre transmission links between cities and towns and/or service providers’ points of presence (“POPs”) across the country. ■

International

[100] The last layer is the international connectivity which comprises five submarine-laid fibre optic cables that connect South Africa to the rest of the world. These cables include SEACOM, WACS, SAT-3, SAFE and EASSY.⁶⁹ EASSY, SEACOM and SAFE are connected at Mthunzini along the Kwa-Zulu Natal coast while WACS, SAT-3, SAFE are connected along the west coast of the country. The merging parties have a participating share in each of the international cables except the SEACOM cable.■

[101] The Commission will assess the competitive impact of the proposed merger on each of the wholesale fibre segments identified above.

⁶⁹ <http://mybroadband.co.za/news/internet/98178-this-is-what-south-africas-internet-actually-looks-like.html>

7.6 Downstream (retail) market for the provision of mobile services

7.6.1 Merging parties' views

[102] The merging parties are of the view that the proposed merger does not present a horizontal overlap for the provision of mobile services as Neotel does not offer any services in this market.⁷¹

7.6.2 Commission's view

[103] Neotel does not provide any mobile telecommunication services. Neotel does, however, have assets and offer services which could potentially constrain MNOs in the retail market or provide MNOs with a competitive advantage. It is therefore necessary to consider the impact of the proposed merger on the retail market despite Neotel not being a MNO.

[104] MNOs, resellers and other service providers compete to provide end users with mobile telephony services to their customers. These services include mobile voice, mobile data, mobile messaging services and value added services. MNOs typically channel their products to the retail market through own managed retail outlets or franchisees and agents.

[105] Nashua Mobile recently disposed of its mobile subscriber base. In assessing these mergers, the Tribunal considered the potential competition effects on the pre- and post-paid market subscriber segments.⁷² It may also be possible to segment the mobile market either according to the different type of network technology (2G, 3G or LTE networks) or by the specific type of customer (corporate or private). This was also considered by the EC in the 2013 merger between Vodafone / Kabel Deutschland where the EC did not conclude on a precise market definition as the merger did not raise any competition concerns under any possible market definition.⁷³

[106] The Commission does not find it necessary to conclude on the exact delineation of the mobile services market. The impact of the proposed merger is likely to be observed across the (i) pre-paid and post-paid market segments, (ii) different types of network technologies, but especially the provision of LTE services and (iii) different customer types (corporate or private).

⁷¹ Ibid, para 3.3 – 3.4

⁷² Case numbers 019166, 019018 and 019034

⁷³ COMP/M.6990, page 38 and 39

[107] In order to render mobile services, MNOs require access to spectrum. Vodacom will have access to Neotel's high demand spectrum. Vodacom intends to use the spectrum of Neotel to accelerate the roll-out of its LTE network.

[108] [REDACTED]
[REDACTED] The Commission will therefore assess to what extent the fixed-wireless offering of Neotel is likely to constrain MNOs.

[109] Neotel currently uses its high demand spectrum to provide fixed-wireless LTE services, but which could potentially be used to compete with MNOs. The Commission will therefore consider to what extent the implementation of the proposed merger will result in the removal of an effective competitor for the provision of mobile network services in the retail market.

7.7 Downstream market for the provision of retail fixed line services

7.7.1 Merging parties' view

[110] The merging parties identify a single market for the provision of fixed line services to business customers. This includes the following products: transmission, voice, internet access, VPN and hosting and cloud services.⁷⁵ Some of these products comprise of different services. For instance, Neotel offers basic voice services and managed PBX, hosted contact centres and conferencing facilities as part of its voice product.■

[111] The merging parties are of the view that the different services within the business connectivity market do not form separate markets but should instead be considered as complementary products that customers purchase as part of a bundle.■ The merging parties therefore identified a relevant market for business connectivity services.

7.7.2 Commission's view

[112] Business customers require network services in order to communicate, transmit data and share information between their respective offices and their suppliers or customers. None of the downstream services can be offered without access to fixed line infrastructure which the

⁷⁵ Frontier report (July, 2014). Page 22, paragraph 3.8
[REDACTED]
[REDACTED]

Commission has defined as an upstream market. It is the view of the Commission that the transmission product offering identified by the merging parties as a downstream service offering is better described as an upstream input to the various downstream products offered by the merging parties.

[113] For large organisations, communication takes place over a privately owned or outsourced wide area network ("WAN") which transmits data across different geographic locations using leased telecommunication lines; i.e. linking all the different branches. When a network is outsourced to a service provider, it is referred to as a virtual private network ("VPN"). Network services also include VANS such as internet access and voice as well as hosting services.

Customers can be segmented according to the scale and complexity of their demand for fixed line services.⁷⁸ Consumers, for instance, would generally require a simple ADSL connection and would not require large volumes of data and voice on a monthly basis when compared to enterprise businesses. Enterprise customers would be serviced through a VPN offering with a range of VANS. This can again be contrasted with SMEs who generally only have a few branches and require simple solutions. Service providers use different criteria to segment their customers

[115] Vodacom and Neotel offer fixed line services to SMEs and enterprise customers.

⁷⁸ This approach is also in line with the Commission's recommendation in the MTN / Afrihost merger which was approved by the Tribunal.

see para 4.86 and Figure 22 of Frontier Report

[REDACTED] The Commission is therefore of the view that the competitive effects of the proposed transaction are more likely to be found in the enterprise segment. [REDACTED]

[116] The unique services demanded by high demand enterprise customers place different requirements on service providers relative to low demand residential customers. [REDACTED]

[REDACTED] For example, enterprise customers generally require VPN services and more sophisticated forms of connectivity relative to residential customers who require simpler connections.

[117] It is generally accepted that enterprise customers require network services in the form of VPN's, VANS and hosting services. Network services can be offered separately by different service providers or as part of a bundle from a single service provider. A description of these services is provided below.

9.5.2.1 VPN (Managed network services)

[118] As explained above, a VPN is an outsourced service where a private network is created to link all the branches of an organisation and also ensures a secure means by which data can be accessed within the organisation's network. A VPN is a managed service because it is designed, built, operated and managed by the third party service provider.

9.5.2.2 VANS

[119] VANS are services that are rendered on top of a basic VPN or WAN, once the network is established. These services facilitate specific functions within the organisation. VANS complement VPNs and include services such as voice, internet access, videoconferencing, hosting services, etc [REDACTED]

There is a separate market for basic VPN and VANS; firstly because VPN and VANS are not substitutable services and secondly due to the fact that being a supplier of core VPN services is a necessary but not a sufficient condition to be a competitor in the VANS market. The ability to compete in the VANS market is dependent upon the skills and expertise of the firm rather than its core connectivity options.

[120] Voice and internet access are discussed below, while hosting services will be discussed as a separate market.

9.5.2.2.1 Voice

[121] In the *Reunert / ECN Telecommunications*⁸⁸ merger a market for the provision of fixed line voice services was identified and this included voice services offered over different technologies including traditional voice, VoIP and least cost routing. Vodacom offers voice services using VoIP, while Neotel uses traditional voice technology. As mentioned above, the merging parties also offer value added services to their core voice service offering.

9.5.2.2.2 Internet Access

[122] In the recent merger between *MTN / Afrihost*⁸⁹ the Commission carried out a detailed analysis of the fixed line internet market.⁹⁰ The Commission is of the view that internet access should be segmented in terms of wholesale and retail offering.

[123] Service providers who own or operate their own network are considered to be first tier internet service providers and have access to national and international peering and/or transit links. First tier internet service providers then on-sell internet connectivity to second tier internet service providers who operate in the retail market. It is not uncommon for first tier internet service providers to operate along the value chain and also be present in the retail segment of the market. Firms operating at the wholesale level therefore provide internet connectivity to ISPs operating at the retail level where the product is sold and where billing, support and other value added services are provided.

⁸⁸ Reunert Limited and ECN Telecommunication Proprietary Limited, Case No.: 25/LM/Apr11

⁸⁹ Tribunal Case No.: 019075

⁹⁰ See para 6.2.2 of Commission's recommendation

[124] Vodacom and Neotel operate at the wholesale and retail level and the internet access provided to enterprise customers can be considered to be the retail offering.

9.5.2.3 Hosting services

[125] Hosting services can be divided into two categories, namely hosted infrastructure services ("HIS") and hosted application management ("HAM"). The merging parties offer both services, albeit not to the same extent.

[126] HIS can generally be described as the outsourcing of equipment by a customer to a service provider's data centre. There are different types of infrastructure hosting services namely, colocation and managed server hosting. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] Basic packaged applications are standardised applications while customised packaged applications involve software customised and integrated into an enterprise's business processes to achieve a specific scope of work such as processing the enterprise's sales data.⁹³

[127] HIS involves the off-site hosting of an organisation's datacentre. Large capital investment is required in order to build data centres and this poses a huge barrier to entry. Enterprises that own their own data centres can outsource the management thereof to a specialised ITS company. [REDACTED]

[REDACTED] Therefore a separate market for the provision of hosting services exists.

Do MNS, VANS and Hosting constitute one market?

Demand-side substitutability

[REDACTED]

[REDACTED]

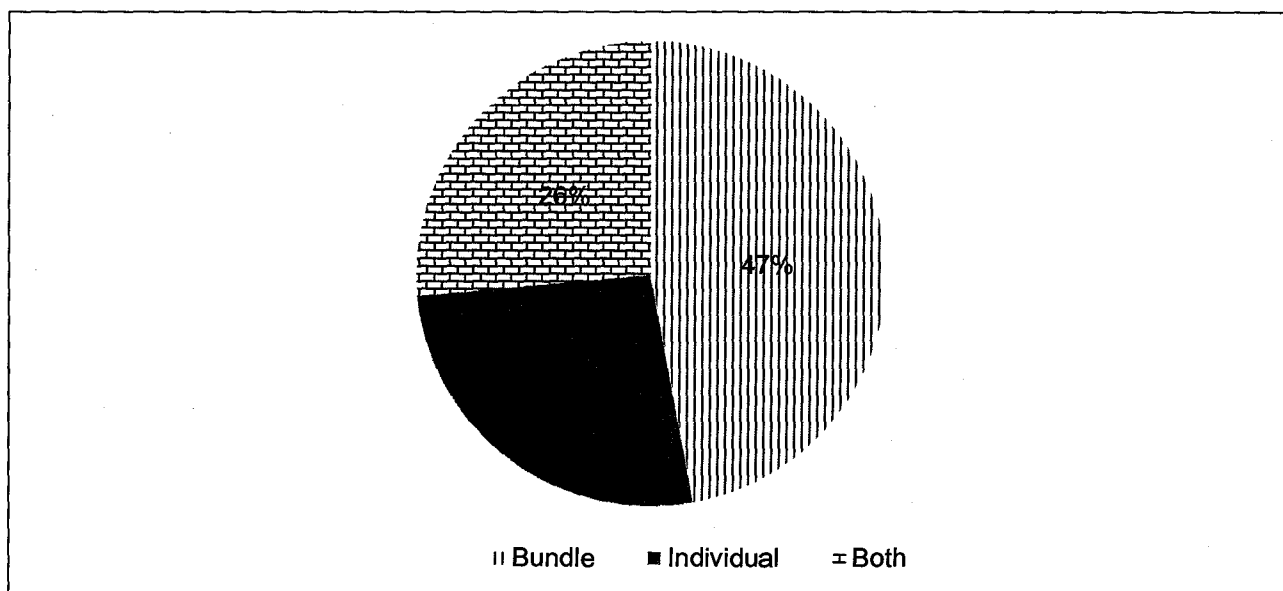
⁹³ Krigsman, M. (2011) Introducing Packaged Solutions. Page 2.
<http://www.sdn.sap.com/irj/scn/go/portal/prtroot/docs/library/uuid/70488c82-e5e2-2e10-37a2-ca5acfd7679a?QuickLink=index> (accessed 9 December 2014)

[REDACTED]

[128] The Commission sent out questionnaires to customers in which it sought to understand how they purchased their retail fixed line services. Customers that require an end solution can attain it by purchasing it as a complete bundle, or by purchasing individual components which are aggregated by the customer or a third party-service provider. Evidence from the Commission's investigation suggests that preferences are mixed.

[129] The Commission asked enterprise customers whether they purchase their products and services on a bundled basis or an individual basis.⁹⁵ Furthermore, these customers were asked whether they preferred to purchase end-to-end solutions.⁹⁶ 47% of the 34 received responses indicated that they purchase their products and services as a bundle, 26% on an individual basis, and 26% purchase both on an individual and bundled basis – see Figure 1. Furthermore, 44% of the customer responses (total of 34) indicated that they preferred end-to-end solutions, 38% indicated that they did not prefer end-to-end solutions and 18% did not provide a clear answer as to their preference.

Figure 1: ICT services and products purchased as a bundle or on an individual basis

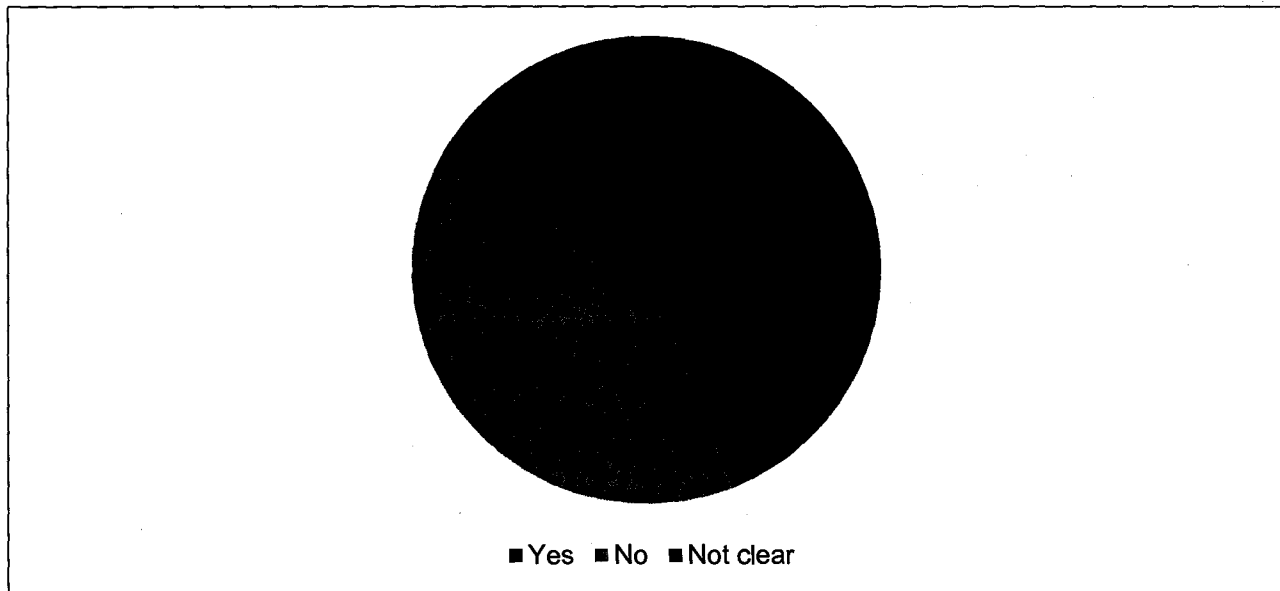


Source: Commission construction based on submissions from enterprise customers

⁹⁵ Original question: "Does your company purchase the products/services ... as a bundle from the same service provider, or are these products/services acquired on an individual basis?"

⁹⁶ Original question: "Does your company prefer to be able to procure end-to-end ICT solutions from service providers? That is, does your company prefer to procure connectivity and all the other value added ICT services ... from one supplier?"

Figure 2: Enterprise customer's preference for end-to-end solutions



Source: Commission construction based on submissions from enterprise customers

[130] The reasons driving this divergence in purchasing behaviour and preferences are varied because customers will purchase enterprise services based on their specific needs. From a customer's perspective, MNS and VANS are separate services which cannot be substituted. Customers will purchase enterprise services based on their specific needs. Customers [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED] Other customers indicated that they purchase some services as a bundle and others individually. [REDACTED]

[REDACTED]
[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]

[131] Thus from a demand side perspective, customers can either buy bundles, individual products or a combination of both.

Supply-side substitutability

Do MNS and VANS constitute one market?

[132] The Commission will first consider whether a supplier of MNS can quickly shift to supply VANS. Then the Commission will assess whether the reverse is possible, that is, whether a supplier of VANS can easily start providing MNS services.

[133] In order to supply MNS services, access to a network is necessary. VANS are services that are offered as a value add above basic MNS services. With the right skills and expertise, a supplier of MNS can quickly shift to supplying VANS as they already have the network in place. In order to start supplying VANS, a MNS supplier would not need to incur significant additional costs.

[REDACTED]

Do MNS, VANS and Hosting constitute one market?

[134] The Commission's investigation revealed that in order to provide hosting services, access to a data centre is required. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] Despite this additional cost involved in providing hosting services, the Commission's investigation revealed that most of the market players that are active in MNS and VANS also provide hosting services either through their own data centres or by using third party data centres. [REDACTED]

[REDACTED]

[135] It is clear from supplier behaviour that there is mixed bundling where products or services are supplied both as bundles and individual products or services. Based on the evidence and the theory presented, three sets of market definitions can possibly be identified:

135.1 A market where mixed bundles are sold – in which case individual products can constrain the purchase of bundles.

135.2 A market where bundles are sold – in which case individual products do not constrain the pricing of bundles.

135.3 Separate markets for individual products – in which case the products are identified as complements fulfilling different needs.

7.8 Geographic market

7.8.1 Upstream market for mobile infrastructure

7.8.1.1 Merging parties' view

[136] The merging parties did not identify an upstream market for mobile infrastructure and as such did not provide a geographic market definition.

7.8.1.2 Commission's view

[137] As mentioned above, MNOs can provide each other access to their radio sites and sharing arrangements and leasing prices are set at a national level, which suggests that a national market should be identified. There are, however, also local dynamics to this market as certain areas are more densely populated with radio sites to meet demand and there are different regulatory provisions for erecting new sites in different municipal regions.

[138] Ultimately, the Commission does not conclude on the exact scope of the geographic market as the proposed merger does not raise any concerns whether a national or regional geographic market is identified.

7.8.2 Upstream market for fixed line infrastructure – fixed leased lines

[139] The Commission finds that the market for wholesale leased lines is national in scope in that leased lines are supplied across South Africa. However, there are regional or local competitive dynamics as Vodacom and Neotel primarily offer access to their fibre networks in metropolitan areas. It is also important to note that both Vodacom and Neotel have an interest in the undersea cables that provide international connectivity.

[140] The Commission will therefore assess the impact of the proposed merger on an international, national and regional/local basis where necessary.

7.8.3 Downstream market for retail mobile services

[141] The Commission finds that retail mobile services are provided by MNOs on a national basis and that the relevant geographic market is national in scope.

7.8.4 Downstream market for retail fixed line services

[142] These services are provided on a national basis by the merging parties and their competitors. Where service provision is limited by infrastructure owned or access to infrastructure, the geographic market can be restricted to a local, metropolitan or regional geographic market.

7.9 Conclusion on the relevant markets

[143] The Commission therefore defines the following markets:

143.1A national market for the upstream supply of fixed leased lines

143.2A national market for the upstream supply of mobile infrastructure

143.3A national market for the downstream supply of bundles and individual services for retail fixed line services

143.4A national market for the downstream supply of bundles for retail fixed line services

143.5A national market for the downstream supply of MNS

143.6A national market for the downstream supply of VANS

143.7A national market for the downstream supply of hosting services

143.8A national market for the downstream retail supply of mobile services (voice, data, sms).

8 VIEWS OF THIRD PARTIES

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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9 COMPETITION ASSESSMENT

9.1 Assessment of likely competition effects in mobile services

9.1.1 Theories of Harm

[157] Mobile operators compete on several dimensions including network based competition (e.g., coverage, quality of signal, capacity, speed, and technology) and/or service based competition at the retail level.

[158] Mergers may result in anticompetitive effects through unilateral and coordinated effects. Unilateral effects may arise where the merged entity is able to exercise market power, for example, by profitably raising prices or reducing output or quality or variety (or changing any other competitive parameter) as a result of reduced competitive constraints post-merger.¹²² In the proposed merger, anticompetitive effects may occur as follows:

[159] First, part of Vodacom's rationale for entering into this merger is access to Neotel's spectrum in order to accelerate the roll-out of Vodacom's LTE network and enhance its retail mobile

[REDACTED]

[REDACTED]

[REDACTED]

¹²² The ICN Merger Guidelines Workbook, April 2006: Pg .39

offerings. Access to additional spectrum through the acquisition of Neotel could provide Vodacom with a competitive advantage over its rivals in terms of network services and in the retail mobile services market which may in turn result in higher prices to consumers. In particular, advantages in spectrum holdings by an MNO over its rivals will provide it with an advantage at the retail level in relation to service rollout, speed, and capacity. If rivals with lower spectrum holdings are unable to match the offerings derived from the merged entity's spectrum advantages (high speed services and capacity) and the resulting retail service offerings, consumers may be faced with reduced choice, higher prices, reduced quality and investment relative to the pre-merger scenario.

[160] The ability of rivals to match the merged entity depends on factors such as the availability of spectrum and/or the ability to increase the number of sites. It is important to note that spectrum is an essential input and is a scarce resource controlled by the state and most of the bands dedicated for use by mobile operators are currently fully allocated and the only way to obtain access to additional bandwidth within those bands would be through obtaining access to spectrum currently allocated to other operators who may be under-utilising it. This is not a straightforward process as it has both commercial and regulatory implications. Adding new sites is likely to increase costs significantly (especially in the case of building greenfield sites and relatively less so in the case of leasing sites from rivals provided access is obtained speedily and on reasonable terms) and may be constrained by a number of other factors such as obtaining requisite approvals. Spectrum constraints and higher costs are also likely to adversely impact on the ability of rivals to innovate. The likely anticompetitive effects are likely to be exacerbated where first mover advantages are durable and persist in the market such that a leading firm entrenches its position. It is important to note that these various elements are mutually reinforcing in terms of effects on competition.

[161] The European Regulators Group ("ERG") notes that "a limitation on the amount of spectrum available and the number of players who have access to spectrum may also create market power in the electronic communications market". The ERG however noted that market power in upstream spectrum usage rights does not necessarily imply market power in downstream markets. The ERG notes that if one or a small number of market players holds a large share of the spectrum, competitors may not be able to provide the same type of service in terms of, inter alia, the quality of service level or price. The ERG states that a monopoly-like situation in some frequency bands could lead to a similar competitive structure in the downstream markets.

[162] Second, there is a consolidation of RAN sites, an important component of a MNO's ability to roll out its network and provide retail mobile services. In this case, the key question is one of extent of accretion of share of RAN sites supplied to rival MNOs that the merged entity will enjoy post-merger and whether this accords any market power to the merged entity. MNOs and OLOs share passive elements of RAN sites and the both Vodacom and Neotel have RAN sites that are shared with other operators such that there could be a competition risk arising from potential foreclosure from access to shared sites. There are significant barriers in constructing new sites and the accretion in the number of sites could provide the merged entity with market power and an ability and incentive to foreclose rivals from accessing the merged entity's RAN sites leading to anticompetitive effects.

[163] Finally, the implementation of the proposed merger could result in the removal of Neotel as an effective competitor or a potential competitor in the provision of mobile services. Neotel has the necessary spectrum allocation in order to provide retail mobile services and currently provides LTE services to enterprise customers over a fixed-wireless network. This requires an assessment of the current competitive constraint exercised by Neotel or potential future competitive constraints that Neotel could, absent the merger, impose in mobile services.

9.1.2 Unilateral effects

9.1.2.1 Spectrum advantages and likely effects in the mobile services markets

9.1.2.1.1 Merging parties' views

[164] [REDACTED]
[REDACTED]
[REDACTED] The merging parties also argue that there is no horizontal overlap in the mobile market and as such the implementation of the proposed merger will not result in a substantial prevention or lessening of competition. The submissions of the merging parties are described in the following paragraphs.

[165] First, Vodacom submits that it is capacity constrained to offer LTE services and is further constrained from re-farming more spectrum as this would have a negative impact on its 2G network. In this respect, [REDACTED]

[REDACTED]

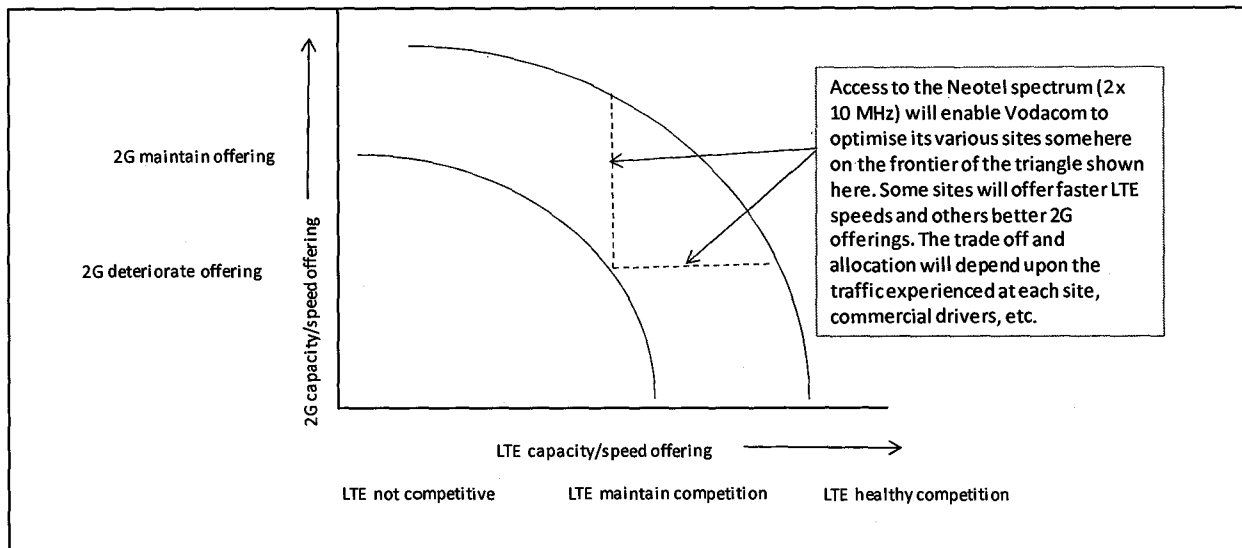
[REDACTED]

[REDACTED]

[REDACTED]

[166] Vodacom submits that the conceptual effect of the incremental Neotel spectrum for Vodacom will be to shift the frontier that defines the trade-off between 2G and LTE service quality as illustrated in Figure 3 below.

Figure 3: Illustration of the impact of Neotel's spectrum on Vodacom's mobile network



Source: Vodacom

[REDACTED]

[REDACTED]

[REDACTED]

[168] [REDACTED] It would also not be able to compensate for the lack of spectrum by building more RAN sites as it is too expensive and time consuming.

[REDACTED]

[REDACTED]

[REDACTED]

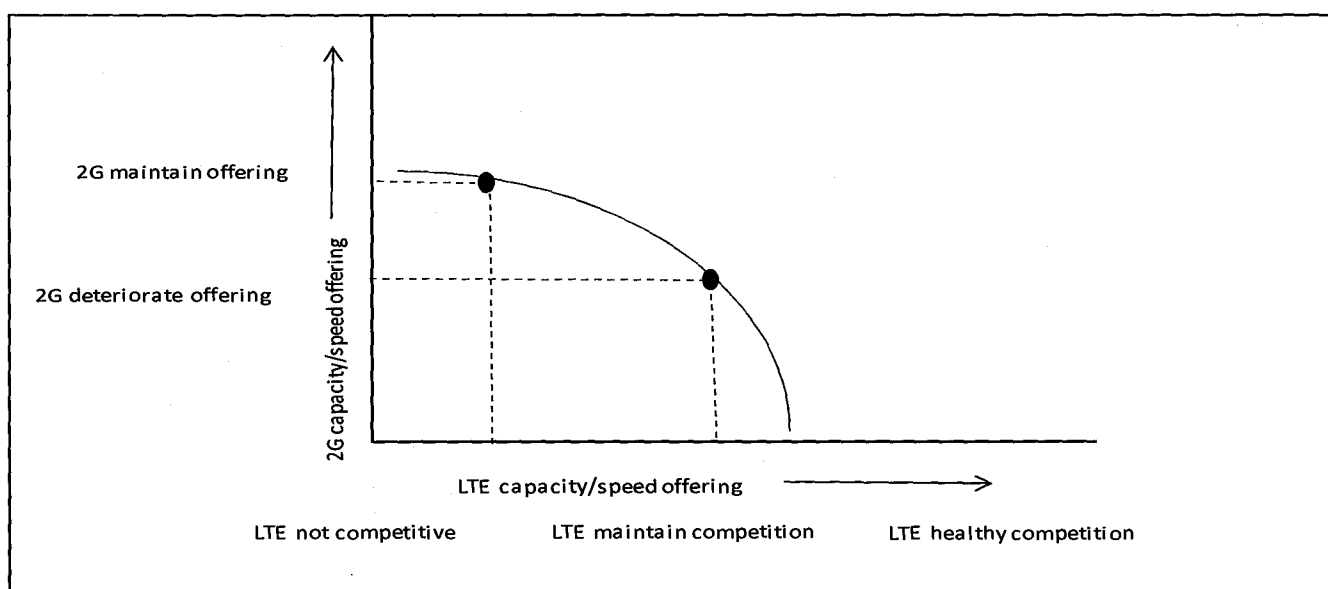
[REDACTED]

For these reasons the merging parties argue that the implementation of the proposed transaction will allow Vodacom to effectively compete against MTN and Telkom Mobile and have pro-competitive effects.

[170]

[171] The capacity constraint of Vodacom is also illustrated in Figure 4 below.

Figure 4: Illustration of Vodacom's network constraint to offer LTE services



Source: Vodacom

[172] Figure 4 shows that as Vodacom increases the capacity or speed offering of LTE services (horizontal axis) the quality of the 2G network deteriorates (vertical axis). Similarly, an increase in 2G quality would compromise the quality of the LTE network.

9.1.2.1.2 Commission's views

9.1.2.1.2.1 Review of spectrum properties and current allocations

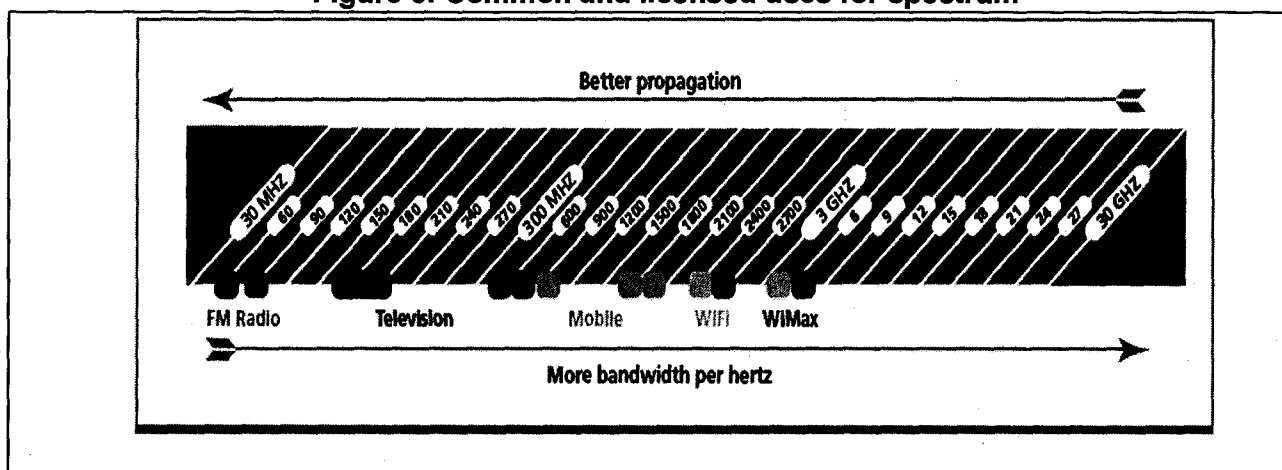
[173] Vodacom and Neotel have each been licensed to spectrum by ICASA in bands that apply to mobile operators. The spectrum holdings by Vodacom and Neotel are set out in Table 2 and it is clear that the implementation of the merger will result in the aggregation of spectrum in the hands of Vodacom. Neotel does not compete in the mobile market, but the 800MHz and 1800MHz spectrum that has been licensed to it is particularly suited for the roll-out of a mobile LTE network.

[174] It is common cause that the concentration of spectrum in the hands of a particular network operator is likely to provide it with advantages over its rivals and may result in market power leading to a substantial prevention or lessening of competition. In this respect, regulators and competition authorities have considered the allocation and/or aggregation of spectrum carefully and in some instances have ordered a divestiture of spectrum or imposed spectrum caps as a

means of limiting the advantages that accrue to firms.¹³¹ Therefore, the aggregation of spectrum and the resulting likely effects on competition are important considerations for South African Authorities.

[175] Generally, lower frequency spectrum travels much further than higher frequency and has better penetration properties in relation to physical obstacles such as buildings before it attenuates. However, higher frequency spectrum has greater data carrying capacity than lower frequency spectrum. Different spectrum frequencies have different network implications in terms of network configuration requirements (e.g., number of sites to be rolled out). Figure 5 provides a simple overview of the different frequency ranges that are used for communication and the type of communication services that are used in each frequency band.

Figure 5: Common and licensed uses for spectrum



Source: *Spectrum for Development – by Steven Song in APC Issue Papers –Series 2011 (September 2011).*

[176] The use and allocation of spectrum is coordinated according to an international plan agreed to by members of the International Telecommunication Unions' Radio Communication Group, of which South Africa is a member. Government agencies (such as ICASA) therefore play a central role in licensing spectrum. The licensing of spectrum requires the allocation of particular frequencies for particular services and to ensure that these signals do not interfere with each

¹³¹ See for instance the European Regulators Group Report on spectrum competition, June 2009; see the Office of Communication (OFCOM) consultation paper on assessment of future mobile competition and proposals for the award of 800MHz and 2.6GHz spectrum and related issues; see the Federal Communications Commission (FCC) statement on the auctioning of spectrum <http://online.wsj.com/articles/fcc-proposes-banning-joint-bids-by-wireless-companies-at-spectrum-auction>; T-Mobile/Orange COMP/M.5650 where the European Commission ordered the joint venture between the parties to divest 1800MHz spectrum as it would have an adverse impact on competition;

other.¹³² ICASA licenses spectrum to the different MNOs in order to render mobile services (e.g., voice, messaging and data services). The current allocations to MNOs in South Africa are reflected and discussed in the analysis that follows below.

¹³² Section 30(1) of the ACA requires ICASA to control, plan, administer and manage the use of licensing of RFS in the public interest.

Table 2: Current spectrum holdings by MNOs and OLOs across all mobile spectrum bands

Frequency Band		Frequency Band Size	User	Application	Channel Bandwidth applicable (duplex)	Comment
900 MHz [GSM-900]	No spare capacity	880 MHz - 960 MHz	Cell - C	Mobile FDD	11 MHz duplex	Fully utilised
			MTN	Mobile FDD	11 MHz duplex	Fully utilised
			Vodacom	Mobile FDD	11 MHz duplex	Fully utilised
800MHz (CDMA 2000)		827.77MHz - 832.695MHz paired with 872.775MHz - 877.695MHz	Neotel	Nomadic FDD	4.92MHz duplex	Fully utilised and coordinated with Analog UHF TV broadcasting
Frequency Band		Frequency Band Size	User	Application	Channel Bandwidth applicable (duplex)	Comment
1.7/1.8 GHz (GSM-1800)	No Spare capacity.	1710 - 1880 MHz (2 x75 MHz)	Vodacom	Mobile FDD	12 MHz duplex	Fully utilised
			Neotel	Fixed FDD	12 MHz duplex	Fully utilised
			MTN	Mobile FDD	12 MHz duplex	Fully utilised
			Telkom	Mobile FDD	12 MHz duplex	Fully utilised
			Cell C	Mobile FDD	12 MHz duplex	Fully utilised
			WBS	Fixed FDD	12 MHz duplex	Fully utilised
			WBS ***	Fixed TDD	10 MHz TDD block	Centre gap partly utilised
Frequency Band		Frequency Band Size	User	Application	Channel Bandwidth applicable (duplex)	Comment
1.9/2.1 GHz (3G - mobile)	No spare capacity	1920 - 1980 MHz // 2110 - 2170 MHz (FDD)	Vodacom	Mobile FDD	15 MHz duplex	National
			MTN	Mobile FDD	15 MHz duplex	National
			Telkom	Mobile FDD	15 MHz duplex	National
			Cell C	Mobile FDD	15 MHz duplex	National
		2010 - 2025 MHz (TDD)	Vodacom	Mobile TDD	5 MHz TDD	National
			MTN	Mobile TDD	10 MHz TDD	National
2.3-2.5 GHz ***	*** Parts of this band is also used for ISM, WiFi & Short Range Devices which are spectrum licence exempt. 2.3 - 2.4 GHz identified as IMT band		Telkom	IMT TDD	60 MHz block	National (2300 - 2360 MHz)
3.5 GHz	Yes, 2x 28 MHz available (pending high demand spectrum licensing policies being in place)	3400 - 3600 MHz	3400 - 3600 MHz	Neotel	FWA FDD	28 MHz duplex
				Telkom	FWA FDD	28 MHz duplex

Source: Extract from ICASA's Spectrum Usage and Availability Schedule – Q1 2014

[177]

[REDACTED]

[REDACTED] The Commission finds that Vodacom's use of Neotel's 1800MHz spectrum is likely to substantially prevent or lessen competition and it is therefore not necessary to consider the added benefits of Neotel's 800MHz spectrum. However, it is important to reiterate that the 800MHz spectrum has excellent propagation abilities which are extremely useful for LTE deployment and that any anti-competitive effect is likely to be exacerbated by use of this spectrum. There is also an additional hidden benefit of securing the 800MHz spectrum through this transaction as Vodacom should be able to make use of this spectrum once the DTT migration is completed, whereas other MNOs would have to participate in an ICASA allocation process to secure spectrum.¹³⁴

[178] It is common-cause that Vodacom will have double the amount of spectrum in the 1800MHz spectrum band to its closest rival. Vodacom and Neotel's spectrum is not contiguous and Vodacom submits that it will not enjoy the immediate benefits that are associated with contiguous spectrum.¹³⁵ [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] It appears that this technology will become available in future which will provide Vodacom with additional capacity to offer greater speeds relative to other MNOs.

[179]

[REDACTED] While this may theoretically be possible, it is unclear if and when such investments could be realised. The building of additional RAN sites is complex, costly and time consuming. MNOs can, however, equip more of its existing RAN sites with LTE equipment to deploy LTE services. In this respect, MTN indicated that it expects to activate 4,500 sites with LTE services over the next 3 years, while Telkom expects to activate 2,895

¹³⁴ Nothing prevents Vodacom from participating in the ICASA process and it is possible that Vodacom would be able to secure additional spectrum in the 800MHz band.

¹³⁵ These benefits include cheaper spectrum equipment and coordination.

[REDACTED]

[REDACTED]

[REDACTED]

RAN sites. Vodacom has a detailed investment program to upgrade RAN sites and indicated that it expects to equip a total of 5,291 sites with LTE equipment over the next 3 years. It is therefore unclear what advantage, if any, competitors of Vodacom would be able to gain over the next 3 years by activating more LTE RAN sites.

[180] [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] Neotel's 3500MHz has not been included in the Commission's assessment as it appears spectrum in this band currently has limited use for LTE services. [REDACTED] The ability of Vodacom to use this spectrum band in future will provide Vodacom with an additional competitive advantage over its rivals.

[181] The post-merger spectrum holdings of the different MNOs relevant to the proposed merger are set out in Tables 3 to 4.

Table 3: MNO market shares based on FDD spectrum holdings in individual bands of overlap

Firm	Application	Channel Bandwidth applicable (duplex)	Comment	Bandwidth
Cell - C	Mobile FDD	11 MHz duplex	Fully utilised	[REDACTED]
MTN	Mobile FDD	11 MHz duplex	Fully utilised	[REDACTED]
Vodacom	Mobile FDD	11 MHz duplex	Fully utilised	[REDACTED]
Telkom	Mobile FDD			[REDACTED]
Neotel	Nomadic FDD	4.92MHz duplex	Fully utilised and coordinated with Analogue UHF TV broadcasting	[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

User	Application	Channel Bandwidth applicable (duplex)	Comment	Bandwidth	Share of 1800MHz bandwidth
Vodacom	Mobile FDD	12 MHz duplex	Fully utilised		
Neotel	Fixed FDD	12 MHz duplex	Fully utilised		
Merged entity					
MTN	Mobile FDD	12 MHz duplex	Fully utilised		
Telkom	Mobile FDD	12 MHz duplex	Fully utilised		
Cell C	Mobile FDD	12 MHz duplex	Fully utilised		
Total Bandwidth Available					

Source: Commission construction based on extract from ICASA's Spectrum Usage and Availability Schedule – Q1 2014

Table 4: MNO market shares based on FDD spectrum holdings used by mobile operators

Firm	Total FDD Bandwidth	Share of total FDD bandwidth (900MHz+1800MHz + 2100MHz)
Vodacom		
Neotel		
Merged entity		
MTN		
Telkom		
Cell C		
Total		

Source: Commission construction based on extract from ICASA's Spectrum Usage and Availability Schedule – Q1 2014

[182] From the market share estimates above, it is clear that Vodacom will have a sizeable advantage over other MNOs in terms of spectrum bandwidth. Vodacom will have double 1800MHz bandwidth to its closest competitor, namely MTN. Vodacom will, post-merger have 40% share of FDD spectrum bandwidth in the 1800MHz band currently being used by mobile operators. The other operators will post-merger have 20% each of spectrum used by mobile operators.

In these estimates, 1800MHz FDD spectrum held by WBS is excluded since it is currently not being used for mobile services. Vodacom will also be the only MNO with 800MHz spectrum which is valuable given its propagation characteristics. The Commission notes that this spectrum is not yet available for use by mobile operators due to delays in digital migration, but should this process be

completed, Vodacom may have a lead time advantage over rivals. The same applies to 3500MHz spectrum which is licensed to Neotel.

[REDACTED]

[184] The Commission's market share estimates of share of bandwidth exclude TDD spectrum holdings. The Commission is of the view that TDD spectrum is currently predominantly used for last mile access as a replacement for last mile for fixed line services as well as for microwave connections. Although recent devices are capable of picking up the signal from TDD spectrum, coverage area is much smaller compared to FDD spectrum and as such the strength of the competitive constraint is still relatively weak. In addition, whether this becomes a significant consideration depends on the actions of device manufacturers and is not entirely in the influence of mobile operators. In addition, some of the TDD spectrum such as Telkom's 1900MHz spectrum is currently designated for a different use (such as extended DECT type applications) and as such is not readily available for use in providing mobile services. In the 2300MHz band in which Telkom is allocated 60MHz of IMT TDD, ICASA's spectrum allocation information notes that part of the band is also used for ISM, Wi-Fi and Short Range Devices which are spectrum license exempt. Short range devices include power meters and other remote instrumentation, RFID applications, radio-controlled models, fire, security and social alarms, vehicle radars, wireless microphones and earphones, traffic signs and signals (including control signals), remote garage door openers and car keys, barcode readers, motion detection, and many others.

[REDACTED]

[185] The EC found¹⁴⁴ (and South African MNOs agree¹⁴⁵) that in the context of mobile broadband three dimensions of the spectrum holdings of a MNO is important. First, the aggregate amount of spectrum available is the main determinant for capacity, which has a direct incidence on the number of calls that can be served simultaneously, and, in the case of data transmission, on the bandwidth that the user can access for download/upload. Second, the frequency band, since different frequency bands present different propagation characteristics i.e., the lower frequency spectrum (800MHz) is generally preferable to higher frequency spectrum (i.e., 2600MHz) as lower frequency signals travel further and penetrate buildings more effectively. Lastly, contiguous spectrum allows for cheaper spectrum coordination and equipment.

[186] In the section that follows below, the Commission assesses the likely effects of the proposed acquisition of additional spectrum by Vodacom on retail mobile services given the history, structure and salient features of the SA mobile markets.

9.1.2.2 Assessment of history of SA mobile markets, market structure and likely effects in retail mobile services

[187] At the outset it is important to begin by reviewing the history of the SA mobile markets in terms of licensing and market structure with particular focus on how the latter has evolved. Vodacom and MTN were licenced to provide national cellular telephony services in September 1993, pursuant to an invitation issued by the then Postmaster-General in terms of the Radio Act 1952 and the Post Office Act 1958.

[188] In 1996, both Vodacom and MTN were issued a formal telecommunication services licence in terms of the Telecommunications Act¹⁴⁶. Cell C was licensed in June 2001 and commenced operations in November 2001, eight (8) years after Vodacom and MTN had been operating in the market. Telkom Mobile was created as a business unit within the Telkom group in 2010 and also provides retail mobile services.

¹⁴⁴ T-Mobile / Orange, COMP/M.5650, page 21

[REDACTED]

¹⁴⁶ This feature was amended in 1996 with the introduction of the Telecommunications Act 103 of 1996, which enabled the two mobile operators to connect their networks directly to one another in order to transmit calls across the networks.

[189] South Africa has also seen the entry of Mobile Virtual Network Operators ("MVNO") such as Virgin Mobile, Red Bull Mobile, Hello Mobile and the anticipated entry of Mr Price (MRP Mobile) and MVN-X. MVNOs are mobile service operators that typically do not own any infrastructure and do not have licensed spectrum. These operators are therefore totally reliant on MNOs for access to their mobile networks and are currently running on the basis of agreements with Cell C which also relies on Vodacom for coverage in areas where they have not built coverage.

[190] It is accepted that MNOs in South Africa are experiencing significant growth in the use of mobile data, which MTN described as a "data tsunami".¹⁴⁷ [REDACTED]

[REDACTED] The merging parties accept that all MNOs in South Africa are spectrum constrained and will struggle over the medium term to meet rapidly growing demand for mobile data and that Vodacom and MTN have been forced by spectrum limitations to re-farm their 1800MHz spectrum to try and offer LTE services.¹⁴⁹ [REDACTED]

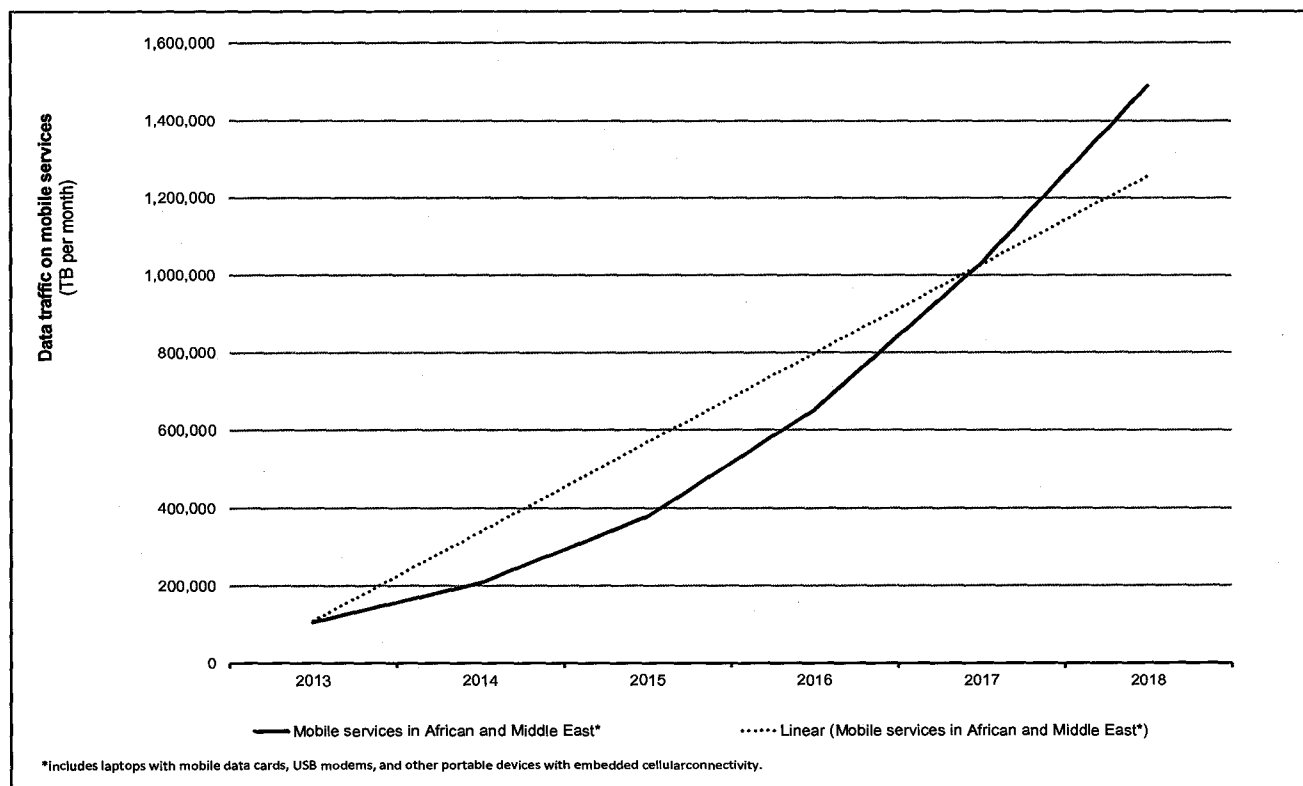
[REDACTED] Therefore, the mobile data services are of significant importance to all MNOs including Vodacom.

[191] [REDACTED] Growth in data demand is not peculiar to Vodacom as it also applies to its rivals including MTN. The Commission therefore finds that the ability of MNOs to provide LTE services will shape the competitive landscape for mobile services in South Africa in future as mobile users increase their use of data-hungry devices such as smartphones and tablets and as voice services are commoditised. [REDACTED]

¹⁴⁷ <http://www.techcentral.co.za/govt-delays-hurting-operators-mtn/51451/> accessed on 13 November 2014

¹⁴⁹ Frontier Report, para. 4.42 and 4.43, p.39.

Figure 6: Mobile data traffic forecast for Africa and Middle East



Source: Cisco VNI Global Data Traffic Forecast

[193] The implementation of the proposed merger does not result in an accretion of market shares in the retail mobile market as Neotel does not have a mobile offering of any substance.¹⁵⁵ However, the impact (or effect) of spectrum accretion to Vodacom must be assessed in the context of the likely effect on retail mobile services market positions of the relevant MNOs and the likely competition outcomes post-merger. This is due to the fact that any additional spectrum is likely to provide the MNO with an opportunity to attain greater network speed, capacity and quality and consequently increase its product offering at the retail level and by implication strengthen its market share position and if rivals are unable to effectively respond to such

¹⁵⁵ Neotel offers a fixed-wireless LTE network and offers limited mobile data. Neotel is not considered to be a significant competitor in the retail mobile market. The Commission's assessment of Neotel's mobile offering as set out in Section 11.2.

offerings, consumers could be faced with reduced choice, higher prices, and reduced incentives to invest.

[194] It is common cause between the Commission and the merging parties that the additional spectrum that will become available to Vodacom allows it to increase the speed and capacity of its mobile network. In this case, additional spectrum will enable Vodacom to increase the coverage, speed and quality across all its services without having to either compromise the quality of its other services (e.g., 2G network) or undertake more costly investments such as building new sites which rivals would have to do to match the new offering. Vodacom's (capacity) advantage will likely attract more customers to its network as other MNOs would not be able to offer LTE services of a similar standard. This is likely to entrench the market share position of Vodacom and provide it with market power. The Commission estimated market share the following market shares based on revenue, subscribers and RAN sites are set out in Tables 5 to 8.

Table 5: MNO market shares in mobile voice (revenue) for the years 2010 – 2013

MNO	2010	2011	2012	2013
Vodacom				
MTN				
Cell C				
Telkom Mobile				
TOTAL				

Source: Commission calculations based on revenue figures provided by MNOs

Table 6: MNO market shares in mobile data (revenue) for the years 2010 – 2013

MNO	2010	2011	2012	2013
Vodacom				
MTN				
Cell C				
Telkom Mobile				
TOTAL				

Source: Commission calculations based on revenue figures provided by MNOs

Table 7: MNO market shares based on number of active subscribers for the years 2010 – 2013

MNO	2010	2011	2012	2013
Vodacom				
MTN				
Cell C				
Telkom Mobile				
TOTAL				

Source: Commission calculations based on subscriber numbers provided by MNOs

Table 8: MNOs RAN sites using 2G, 3G and LTE technology

MNO	Number of sites compatible with 2G technology	Number of sites compatible with 3G technology	Number of sites compatible with LTE technology	Number of sites with fibre capacity backhaul
Vodacom				
MTN				
Cell C				
Telkom				
Neotel				

[195] Table 5 shows that the market share figures for mobile voice (based on revenue) have remained relatively consistent over the past 4 years with Vodacom and MTN being the market leaders, and Cell C a distant third and with Telkom Mobile being a very small competitor. In particular, over the period 2010, the two largest operators, who were first to enter the South African mobile market accounted for more than 86% of the revenue with Cell C, the third entrant accounting for between 10% and 14% of the share despite entering the market in 2001.

[196] Vodacom is also the market leader in terms of mobile data with MTN in second place. Telkom Mobile and Cell C are very small when compared to the market leaders. There is, however, a notable difference between the market positions of Telkom Mobile in the provision of mobile voice services relative to the provision of mobile data services.

It is important to note here that the market share estimates above include revenue generated from Telkom's TDD based services as the information could not be separated into FDD based and TDD based components. As such, this information likely overstates the share of Telkom Mobile in FDD-based retail mobile services. Despite being the third largest competitor (based on both TDD and FDD offerings), Telkom Mobile is almost seven times smaller than the second largest provider of mobile data services and at least eight times smaller than Vodacom, the leading provider of mobile data services.

¹⁵⁶ Neotel uses CDMA technology

[197] Cell C has a limited network and it is dependent on Vodacom to a significant extent in order to provide national coverage. The Commission understands that the roaming agreement between Vodacom and Cell C only allowed Cell C to roam on Vodacom's 2G network and not 3G or 4G until recently. This limits Cell C's ability to compete with Vodacom as effectively the roaming charges set by Vodacom become some minimum price that Cell C would have to charge its subscribers. It is also notable that Telkom Mobile does not have a full national network comprised of investments in RAN sites and currently utilises the services of MTN through a roaming agreement and its network size is no match for Vodacom and MTN's national networks in terms of coverage. Similarly, the roaming charges set by MTN become an important element of pricing to Telkom Mobile customers. This could partly explain why the smaller networks that entered the market years after Vodacom and MTN had established themselves have not been able to make significant inroads in the provision of mobile services. Although there are a few MVNOs operating in South Africa such as Virgin Mobile, Red Bull Mobile and Hello Mobile, these MVNOs roam on Cell C's network which in turn relies on Vodacom to obtain full national coverage. [REDACTED]

[REDACTED] MVNOs in South Africa have not played a significant competitive role to discipline the incumbents and appear to only target niche markets. MTN remains the closest competitor best placed to challenge Vodacom, but could be placed at a competitive disadvantage due to differentials in spectrum holdings at the same time facing capacity constraints.

[198] The market shares based on the total number of active subscribers (voice and data combined) reflected in Table 7 reflect that Vodacom is the clear market leader followed by MTN. Notably, Cell C's share of active subscribers contrasts significantly to its share of data revenue and to some extent voice revenue. The share of active subscribers is higher than revenue shares suggesting that some of Cell C's subscribers may be more price sensitive as the acquisition of those subscribers have not translated into similar revenue shares.

[199] The competitive strength of MNOs can also be considered with reference to the number of RAN sites used to provide mobile telecommunication services. [REDACTED]
[REDACTED]

¹⁵⁷ <http://mybroadband.co.za/news/cellular/125562-red-bull-mobile-shutting-down-in-south-africa.html>: accessed on 8 May 2015 at 0818hrs.

[REDACTED] Table 8 shows that Vodacom has a significant advantage over its rivals in terms of radio sites and network coverage for each type of technology being used to provide mobile services. [REDACTED]
[REDACTED]
[REDACTED]

[200] Table 8 also shows that Neotel has some RAN sites that are equipped with LTE technology. These and other RAN sites can potentially be used by Vodacom to offer LTE services and is likely to provide Vodacom with additional RAN sites capacity for the provision of retail mobile services. The Commission understands from the merging parties that Vodacom has more LTE ready sites and one of the limiting factors is spectrum availability. The acquisition of Neotel's spectrum is thus likely to have an immediate impact on Vodacom's ability to provide LTE services in that this additional spectrum could allow the merged entity to increase LTE coverage (and consequently speed, capacity, and network quality) relative to its competitors.

[201] Access to Neotel's spectrum will provide Vodacom with additional ability to provide LTE services without the need to re-farm spectrum at the expense of other services. It is of course also possible to increase the capacity and geographic reach of a mobile network by building more RAN sites, but there are costs and related challenges that may make this option unattractive. The ability of a MNO to build more RAN sites is complicated by the availability of appropriate building sites (geographic locations), regulatory approvals and capital expenditure. The building of more RAN sites to achieve a similar increase of network capacity and geographic reach is therefore more costly and time consuming. Access to additional spectrum presents a MNO with a lower cost alternative compared to building new sites. For instance,
[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED] Vodacom is of the view that it is not economically viable to build RAN sites instead of obtaining additional spectrum as it would be too expensive

and because of issues such as building approvals and municipal policy restrictions which would make it impractical. So, for rivals such as MTN (with a need to add new sites), Cell C and Telkom (with a smaller independent network coverage) to match Vodacom's advantages absent access to additional spectrum, they may have to incur substantial costs associated with building or installing new sites meaning that the second largest operator is likely to be at a cost disadvantage relative to the leading MNO - Vodacom.

[202] It is also important to note here that the order of the share of each firm in the market is also correlated to the time of entry. The two largest operators entered the markets in 1996 while Cell C and Telkom Mobile entered much later. It is clear from these market shares that first mover advantages have proved to be durable and persistent. Quite clearly, the MNO with a share closest to Vodacom is MTN and it is, pre-merger, the firm best placed to discipline Vodacom in terms of coverage, speed, and capacity as a network package.

[203] The South African mobile services markets also appear to demonstrate low rates of consumer switching with the incumbents who have enjoyed first mover advantages appearing to capture the consumers that are less likely to switch. The first-mover advantages that are likely to accrue to Vodacom also relate to marketing opportunities related to retail services (e.g., LTE service coverage, network speeds etc.) which will enable Vodacom to gain and retain customers relative to rivals. In addition, mobile markets exhibit network effects which favour the larger incumbents and provide scope for first-mover advantages to be exploited. This means that smaller rivals have remained largely subscale and service consumers that are more likely to switch. Although smaller mobile networks potentially have more bandwidth per user relative to larger networks, this does not automatically translate into a competitive advantage due to considerations such as first-mover advantages, lower rates of switching, nature of subscribers on network and network effects amongst other factors. In fact if this was the case, Telkom Mobile and Cell C would have made much greater inroads in eroding the shares of both Vodacom and MTN, but this has not been the case. The market share analysis above provides direct evidence on this.

[204] Vodacom is South Africa's largest MNO by revenue, subscriber numbers and number of RAN sites. It is generally accepted that additional spectrum can provide a MNO with significant competitive advantages over its rivals, particularly its closest rival by share - MTN. The implementation of the proposed merger is therefore likely to have a significant impact on future competition in the mobile market as it provides a leading MNO with additional spectrum which

will be used to intensify the deployment of its LTE-network. In the long-term, consumers are likely to be faced with higher prices and reduced choice as Vodacom will unlikely have any incentives to pass on cost-savings to consumers given that it will unlikely face strong competitive constraints. In addition, the increase in data demand (due to the emergence of smart devices) represents a shift in the demand curve as opposed to movement along the demand curve and as such, Vodacom is unlikely to have an incentive to lower prices. Advantages that accrue in the provision of data services are also likely to translate into advantages in the provision of other services such as voice services thereby further entrenching Vodacom's position in the market. Up until the more aggressive regulation of mobile termination rates by ICASA in recent years, South African consumers have endured amongst the highest prices in the world for access to mobile services. Even with the reductions in mobile termination rates, the incumbent MNOs have been reluctant to reduce prices, but for the aggression of Cell C. The South African mobile market structure and outcomes have not in the past served consumers and the proposed transaction is likely to perpetuate this.

[205] The merging parties have argued that Vodacom requires access to additional spectrum to remain competitive. The Commission considered whether Vodacom requires Neotel's 1800MHz spectrum in order to compete with other MNOs and then turn to consider the likely impact of the merger is on the mobile market.

Does Vodacom require Neotel's spectrum to compete with other MNOs?

[206] The Commission's assessment of Vodacom's arguments begins by emphasising that the proposed merger has effects that extend beyond LTE services and includes services such as voice and data offered over technologies such as 2G and 3G. Access to additional spectrum is likely to have a positive impact on Vodacom's voice and other data offerings first by reducing the need to re-farm spectrum from other services (e.g., 2G) which deteriorates the quality of the 2G offering and secondly by reducing the relative network load per service. In fact, when subscribers decide to join a network, they are not subscribing to an LTE service, but rather make a decision based on the services offered by a network inclusive of voice, data and SMS. In particular, a subscriber with an LTE enabled device is not joining a network on the basis of using only the LTE service. Devices are produced with capabilities to handle different technologies depending on the device's generation and networks are configured to switch devices between technologies depending on signal availability and strength. In addition, the decision of subscribers to join a network also takes into account network coverage across the

country. So any attempts to focus only on LTE services risks understating the full competitive impact of the acquisition of additional spectrum by Vodacom.

[207] Vodacom submits that Cell C cannot currently be considered a competitive threat to Vodacom for the provision of LTE services. The Commission disagrees with Vodacom's view that the implementation of this merger is required to make Vodacom a credible competitor to Telkom Mobile. The Commission's preceding analysis demonstrates that Telkom Mobile is currently at least eight times smaller than Vodacom in terms of revenue shares for data and approximately twenty-five times smaller than Vodacom in terms of voice shares by revenue. Similarly, Telkom Mobile is at least six times smaller than MTN in terms of data revenue shares and at least eighteen times smaller in terms of voice revenue shares. As such, attempts to argue that additional spectrum allows Vodacom to remain a credible competitor to Telkom Mobile are likely to be misleading. Vodacom's analysis shows that Telkom has significantly more spectrum (60 MHz in 2300MHz spectrum band) that can be used for LTE services. [REDACTED]

[REDACTED]

[REDACTED]

The Commission notes and re-emphasises that despite having 2300MHz spectrum and LTE sites, Telkom Mobile remains multiple times smaller than Vodacom and MTN meaning that there are other important factors (as discussed above) to be considered to avoid overstating the significance and competitive threats imposed on the incumbents by Telkom Mobile.

[208] In addition, the Commission finds that Vodacom's analysis does not fully account for other factors which suggest that Vodacom does not require Neotel's spectrum to rival Telkom Mobile for the provision of LTE services. First, Telkom Mobile's LTE services are offered over the 2300MHz spectrum band (a dongle service) and as such it does not enjoy the same coverage as Vodacom. This competitive disadvantage is compounded by Telkom Mobile having approximately [REDACTED] LTE RAN sites less than Vodacom. Second, Telkom Mobile only has [REDACTED] subscriber devices which are LTE capable compared to Vodacom's [REDACTED] subscriber devices. This suggests that Telkom Mobile is only able to provide LTE services to a small group of customers compared to Vodacom. In fact, if Telkom Mobile had these claimed advantages it

would have made significant inroads in eroding Vodacom's share. [REDACTED]

[209] The Commission is therefore of the view that Vodacom's current LTE offering is superior to that of Telkom Mobile. As indicated above, the closest competitor in terms of market share to Vodacom has for long been MTN with other MNOs accounting for less than 10% of data revenues. It is therefore necessary to consider whether Vodacom requires Neotel's spectrum to compete with MTN.

[210] Vodacom submitted an analysis of the LTE network capability of its own network and MTN's whereby it compared the spectrum allocation in the 1800MHz spectrum band, LTE subscribers and LTE RAN site count.¹⁶⁴ [REDACTED]

[211] The Commission replicated Vodacom's analysis correcting for the number of LTE sites which MTN currently has.¹⁶⁶ The Commission finds that Vodacom can offer an average speed of [REDACTED], while MTN can offer [REDACTED]. It therefore appears that the difference is accounted for by differences in the number of LTE sites. [REDACTED]

[REDACTED] In fact, in its marketing offerings for S6 devices, Vodacom states that it is "... SA's best network with the fastest mobile internet".¹⁶⁸ [REDACTED]

¹⁶⁸ <http://www.vodacom.co.za/vodacom/shopping/samsungs6?icmp=Internal/Home/R1/S6Launch>: accessed 30 April 2015 at 10.28am.

In addition, despite claiming to be at a competitive disadvantage to its rivals, Vodacom continues to run promotions which can be expected to increase network load. Tables 9 and 10 below provide more evidence of Vodacom's network speed relative to its rivals as conducted by MyBroadband.

Table 9: Network speed tests according to MyBroadband

Rank	ISP	Service	Download Speed	Upload Speed
1	Vodacom	Vodacom LTE	31.77 Mbps	6.68 Mbps
2	MTN	MTN LTE	18.54 Mbps	3.94 Mbps
3	8ta	8ta LTE	10.1 Mbps	2.32 Mbps
4	Cell C	Cell C LTE	4.88 Mbps	1.11 Mbps
5	Vodacom	Vodacom 3G	4.8 Mbps	1.29 Mbps
6	8ta	8ta 3G	3.41 Mbps	0.94 Mbps
7	MTN	MTN 3G	3.22 Mbps	0.86 Mbps
8	Cell C	Cell C 3G	2.1 Mbps	0.75 Mbps
9	Neotel CDMA	Neotel CDMA	0.71 Mbps	0.27 Mbps
10	iBurst Wireless	iBurst Wireless	0.48 Mbps	0.17 Mbps

Source: MyBroadband (http://speedtest.mybroadband.co.za/stats/connection/wireless_mobile): accessed on 7 May 2015

Table 10: MyBroadband speed tests for Vodacom Mobile and Telkom Mobile & Telkom Fixed LTE services

Vodacom Mobile				
Rank	ISP	Service	Download Speed	Upload Speed
1	Vodacom Mobile	Vodacom mobile	29 Mbps	3.08 Mbps
2	Vodacom Mobile	Vodacom mobile	20.74 Mbps	10.62 Mbps
3	Vodacom Mobile	Vodacom mobile	20.61 Mbps	12.26 Mbps
4	Vodacom Mobile	Vodacom mobile	2.71 Mbps	4.41 Mbps
5	Vodacom Mobile	Vodacom mobile	2.59 Mbps	2.3 Mbps
Telkom Mobile				
Rank	ISP	Service	Download Speed	Upload Speed
1	Telkom Mobile	Telkom mobile	7.41 Mbps	1.37 Mbps
2	Telkom Mobile	Telkom mobile	6.72 Mbps	1.68 Mbps
3	Telkom Mobile	Telkom mobile	2.13 Mbps	1.61 Mbps

that Vodacom is credited with the fastest mobile network in South Africa by OOKLA despite having the largest LTE customer base – see page 4 and 5 of Vodacom CEO Report to Board Of Directors

4	Telkom Mobile	Telkom mobile	0.83 Mbps	0.12 Mbps
Telkom Fixed LTE				
Rank	ISP	Service	Download Speed	Upload Speed
1	Telkom Mobile	Telkom fixed LTE	8.58 Mbps	3.95 Mbps
2	Telkom Mobile	Telkom fixed LTE	8.17 Mbps	4.01 Mbps
3	Telkom Mobile	Telkom fixed LTE	7.77 Mbps	0.72 Mbps
4	Telkom Mobile	Telkom fixed LTE	7.7 Mbps	3.96 Mbps
5	Telkom Mobile	Telkom fixed LTE	7.68 Mbps	5.36 Mbps
6	Telkom Mobile	Telkom fixed LTE	7.41 Mbps	5.32 Mbps

Source: MyBroadband Speed Test; Available: <http://speedtest.mybroadband.co.za/> (accessed: 08 May 2015)

[212] With these network speed test results in mind, it is clear that additional spectrum will provide Vodacom with additional capacity and speed advantages as it will be able to accommodate an increase in traffic on its network without compromising the quality of services. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]. The Commission requested MTN to provide information relating to these two parameters and found the following.

[REDACTED] As such, the calculations by Vodacom are based on information that understates MTN's network load. It is also important to note here that even if MTN had a better ability to re-farm spectrum for LTE services, re-farming spectrum means that the quality of other

services deteriorates to some extent. As such, access to additional spectrum is a much better option than relying on spectrum re-farming to rollout services. [REDACTED]

[215] The merging parties also undertook an experiment based on a Mother's Day promotion in which Vodacom offered subscribers 1GB of data for free. In this experiment the merging parties appear to be attempting to simulate what is likely to happen on the Vodacom network should data demand increase as expected. The merging parties conclude that an increase in demand of 58% reduces throughput and also spectrum re-farming deteriorates quality of service. This experiment and the resulting conclusions are not assessed relative to similar experiments on a rival network such as MTN to see if the effects are would differ. The Commission notes that it is common cause that both MTN and Vodacom are likely to face similar challenges in terms of reduction in throughput and quality of service due to increased network load. In any event MTN is seeking to increase its capacity to deal with increased data demand by entering into an arrangement with Telkom. The Commission finds that Vodacom's leading and durable market position in both voice and data services suggests that it is not at a competitive disadvantage relative to its rivals. If it were, one would expect Vodacom to be experiencing significant market share loss to its rivals.

[216] Considering this evidence, the Commission concludes that Vodacom does not require Neotel's spectrum in order to remain competitive against its rivals across all retail mobile services including LTE services. On the basis of current market conditions, the evidence suggests that Vodacom is currently able to do so without Neotel's spectrum in the 1800MHz band.

9.1.2.2.1 Competitors views on the likely impact of the proposed merger

[217]

The concerns of the MNOs can be summarised as follows:

217.1 First, Vodacom would be able to launch a national LTE network in advance of its competitors. This will provide Vodacom with a lasting advantage and entrench its dominant position as competitors will find it difficult to compete. ■ MNOs submit that Vodacom already has the largest legacy base of subscribers and the first mover advantage will allow it to sign up new subscribers to the LTE-service. These customers of Vodacom will become incontestable and the revenue base to support the necessary improvements required to become effective competitors will be less attractive with the result that MNOs will exert a weak competitive constraint on Vodacom. ■ These customers will also provide Vodacom with superior economies of scale and will limit the ability of other MNOs to compete against Vodacom. ■

■ Second, access to Neotel's spectrum will provide Vodacom with a capacity and operational cost advantage. This will allow Vodacom to offer LTE services in (i) high demand areas where MNOs are capacity constrained and (ii) over a greater geographic area, without the investment in RAN sites. Without additional spectrum competitors of

Vodacom would need to invest in radio sites, which is costly and may take several years ■

217.3 ■

■ However, MNOs submit that any benefit to consumers will be short lived and that consumers will be harmed in the long-term as other MNOs are not able to effectively compete against Vodacom. ■

9.1.2.3 Upstream market for mobile infrastructure – RAN sites

9.1.2.3.1 Merging parties' view

[218] The merging parties did not define an upstream market for mobile infrastructure and as such did not carry out a horizontal competitive analysis in this respect.

■
■
■
■
■
■

9.1.2.3.2 Commission's view

[220] Vodacom and Neotel use radio sites for the deployment of mobile and fixed-wireless services respectively. The Commission therefore calculated the estimated market shares of the merging parties with reference to the number of RAN sites of each MNO – see Table 11 below.

Table 11: Market shares based on the number of radio sites across South Africa

■
■
■
■
■
■
■

Infrastructure Operator	Number of radio sites		Estimated market share	
Vodacom				
Neotel				
Merged Entity				
TOTAL				

[221] [REDACTED]

[REDACTED] The RAN sites of Neotel can provide Vodacom with a competitive advantage in the retail mobile market as RAN sites can alleviate capacity constraints on the network of the MNO or it can provide further coverage. However, the implementation of the proposed merger is unlikely to raise any horizontal or vertical competition concerns due to the insignificant number of radio sites owned by Neotel.

[222] Some of the RAN sites of Neotel [REDACTED] are equipped with LTE-technology and the Commission therefore also considered whether Vodacom would gain market power as a result of acquiring Neotel's LTE-equipped radio sites. [REDACTED]

[REDACTED] implementation of the proposed merger is therefore also unlikely to raise any competition concerns in this respect. The Commission has however considered this competitive advantage under spectrum aggregation as the RAN sites of Neotel will also facilitate the accelerated deployment of Vodacom's LTE network.

9.1.3 Input foreclosure – access to Neotel's RAN sites

9.1.3.1 Merging parties' view

[223] The merging parties do not provide a vertical assessment of the transaction.

9.1.3.2 Commission's view

[224] Currently in South Africa, there is a significant amount of physical infrastructure sharing among the MNOs. The sharing of physical infrastructure occurs either by way of a one-for-one sharing agreement or on a rental basis. The one-for-one sharing is common between larger MNOs with

a vast number of sites across the country. [REDACTED]

[REDACTED] Smaller MNOs have a limited number of sites and thus depend on access to sites and site infrastructure of the larger MNOs to deploy their RAN equipment in order to achieve a wider geographic coverage.

[225] It is important to note that the transaction may not result in the outright refusal to supply access to sites and site infrastructure due to the ECA which requires ECNS licence holders to grant access to electronic communications facilities unless the request for access is unreasonable¹⁸⁵. However, the merging parties could achieve foreclosure through other means such as an increase in the price of access post-merger as the ECA does not make a provision for the price of access.

[226] [REDACTED] This is a very small share compared to that of MNOs. [REDACTED]

[REDACTED] The Commission is of the view that this may affect co-location agreements of other MNOs that are currently utilising these sites. However, given that these sites consist of a very small number of the total sites, it is unlikely that rival MNOs are significantly dependent on Neotel's sites and site infrastructure. The Commission cannot conclude that the merging parties have the ability to foreclose rivals from access to Neotel's sites and site infrastructure.

[227] [REDACTED] The Commission has not received any information to suggest that Vodacom would attempt to deny access or alter the terms and conditions of access to Neotel's sites and site infrastructure post-merger. Currently, Vodacom is the largest provider of sites and site infrastructure and rival MNOs co-locate on Vodacom's sites. The Commission has not received information that indicates that Vodacom is currently denying rivals access to its own sites or that they would deny or alter the terms of access to

¹⁸⁵ See Chapter 8 of the Electronics Communications Act 36 of 2005. According to the ECA, a request for access is reasonable if it is technically and financially feasible and it will promote the efficient use of electronic communication networks and services.

rivals for Neotel's sites post-merger. In any event, Neotel's sites represent a very small proportion of the total sites in the market and as such any attempts to foreclose rivals by denying them access to these sites is unlikely to be successful.

9.1.4 Barriers to entry for the mobile market

9.1.4.1 Merging parties' view

[228] The merging parties did not carry out a competitive analysis for the mobile market.

9.1.4.2 Commission's view

[229] It is generally accepted that entry into a market by new firms may prevent or counteract any attempt by the merged entity or their competitors to profit from the potential loss in competition brought about by the merger. ■ The Commission finds that there are significant barriers to enter and expand in the mobile telecommunication market.

[230] The licensing process in terms of the ECA to acquire a license to provide mobile services can be considered to be an absolute barrier. There are also several structural barriers to entry and expansion that are discussed below in no particular order.

[231] First, the entrant or existing MNO would need to invest in RAN sites and ancillary equipment in order to provide customers with sufficient coverage. It is unlikely that the new entrant would be able to attract customers to its mobile network in the event that it would only offer coverage in a metropolitan area or province. In order to provide greater (national) coverage significant capital investments in RAN sites would have to be made, alternatively, the entrant would be required to roam on an incumbent's network.

[232] The building of RAN sites requires of the MNO to carry out environmental impact studies, which may be complicated by the requirements of different municipalities, local authorities and provinces. ■

■ This restricts the number of sites that can be built in a particular area. The actual building of the RAN sites is also expensive and the costs to

¹⁸⁸ ICN Merger Guideline, April 2006, page 53

provide sufficient coverage can be prohibitive. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] It is possible for a MNO to roam on the mobile network of a competitor.¹⁹³ Roaming on a competitor's network has certain inherent disadvantages. For instance, telephone calls can be "dropped" as the call is transferred from one mobile network to the other, while roaming costs would also have to be paid by the one MNO to the other.

[233] Second, a MNO would require access to spectrum in order to provide a voice and/or mobile data service. The rapid development of the mobile telecommunication market requires of an entrant to provide voice services and LTE-technology in order to compete with incumbent operators who offer both services. Moreover, voice revenues are in decline which will put further pressure on the entrant to deliver LTE services in competition with incumbents who have already commenced deploying their LTE networks.

[234] It is also clear that incumbent MNOs require spectrum in order to alleviate their capacity constraints and deliver LTE technology. It is common-cause that spectrum is a finite resource and that ICASA cannot allocate any additional spectrum in the 1800MHz and 2100MHz spectrum bands. Incumbents and new entrants would therefore have to compete for the allocation of new spectrum. The allocation process selected by ICASA to allocate spectrum may be contested and be drawn out – direct evidence in this regard is the objections to ICASA's attempt in 2011 to distribute spectrum and MNOs comments to ICASA's enquiry into the general state of competition in the ICT sector. Moreover, it is not clear when the digital dividend process will be completed and/or when ICASA will release spectrum in the 2600MHz frequency band. For the same reasons, expansion by existing MNOs to compete with Vodacom is not likely to take place timeously.

[REDACTED]

¹⁹³ For instance, Cell C roams on the mobile network of Vodacom where it cannot provide coverage on its own network.

[235] The significant capital expenditure in order to operate a mobile network gives rise to a further entry barrier in that economies of scale are necessary. The ability of a new entrant to achieve the necessary economies of scale is complicated in that a portion of the more lucrative mobile market (post-paid customers) is captured in long term agreements and that incumbents have strategic advantages. These strategic advantages include expenditure on advertising, existing retail, sales and distribution networks and the ability to offer special discounts or lower prices on voice and data packages or even on handsets and other mobile devices.

[236] The South African mobile telecommunications market is characterised by relatively low switching patterns. This is evidenced by the relatively small number of subscribers¹⁹⁴ who have switched networks since number portability came into being. This has occurred despite the fact that porting fees have been declining over time¹⁹⁵. It is reported that on average, 25 884 cell phone numbers¹⁹⁶ are ported every month. The lack of switching can further help to explain the lack of competition between the mobile networks. The Commission is of the view that competitiveness in the mobile market will further deteriorate if Vodacom is to acquire Neotel's spectrum. This is because Neotel's spectrum will give Vodacom an added first mover advantage (and therefore increase barriers to entry and expansion) in the LTE market as the industry continues to experience high speed data demand.

9.1.5 Conclusion on likely effects in mobile services markets

[237] The Commission finds that the acquisition of additional spectrum by Vodacom is likely to provide it with network and service advantages that its rivals will not be in a position to match. In the long-term, this is likely to adversely affect competition in retail mobile markets resulting in consumers being faced with reduced choice of mobile service providers, higher prices due to reduced competitive constraints and choice. This is further aggravated by the existence of network effects, lower switching, first mover advantages which have proved to be durable and have persisted for a sustained period of time. In the short-term, the first-mover advantage to Vodacom would be in the form of network (coverage, speed and quality), network rollout costs

¹⁹⁴ According to a Techfinancials article of 15 December 2014, approximately 2.6 million subscribers have ported their cell phone numbers between November 2006 and end November 2014. See <http://www.techfinancials.co.za/index.php/company-news/1459-an-axe-hovers-over-neotel-s-stake-in-the-npc?showall=1> [Accessed 8 January 2015]

¹⁹⁵ See <http://www.number-portability.co.za/news.php> [Accessed 5 May 2015]

¹⁹⁶ See <http://www.techfinancials.co.za/index.php/company-news/1459-an-axe-hovers-over-neotel-s-stake-in-the-npc?showall=1> [Accessed 8 January 2015]

and service (voice and data services) rollout as well as marketing opportunities relative to rivals. The advantages will extend beyond high speed data services such as LTE, but will include voice and other data services (e.g., 3G).

[238] The Commission concludes that barriers to entry and expansion are very high and that it is unlikely that new entry will take place post-merger. The implementation of the proposed merger could also raise the level of entry barriers as new entrants would have to consider whether they are able to compete against an incumbent operator who has access to more spectrum than any of the other MNO and enjoys incumbency advantages. Scale economies are also an important factor and combined with network effects are likely to reduce the incentive for new entry.

[239] The Commission is therefore of the view that the acquisition of additional spectrum is likely to entrench Vodacom's market position in a market where outcomes have not traditionally served consumers well. Past competitive behaviour of Vodacom suggests less incentive to offer lower prices unless forced by either regulatory intervention or increased levels of competition. As such, the Commission is of the view that the acquisition of additional spectrum through the proposed merger is likely to substantially prevent or lessen competition in retail mobile markets.

[240] Although Neotel has LTE sites which Vodacom could potentially use for the rollout of its LTE network, the Commission is of the view that the accretion is small, on its own, to warrant concerns of horizontal unilateral effects and in terms of potential foreclosure of rivals from access to sites. [REDACTED]

[REDACTED]

9.2 Assessment of likely competition effects in fixed line services

9.2.1 Forms of Competition

[241] The proposed merger results in horizontal overlaps at two levels of the value chain. First, at the upstream infrastructure level where fixed leased line providers such as Vodacom, Neotel and Telkom compete against each other to provide MNOs and OLOs with access to fixed leased lines increasingly in the form of fibre. Fibre is used by the merging parties and OLOs to provide retail fixed line services to enterprise customers in the form of MNS (including VPNs, internet, voice and hosting). At the upstream level, providers compete in terms of coverage, capacity,

[REDACTED]

speed, price, quality which can be in the form of service level agreements. At the downstream level, there is differentiated competition along different dimensions such as price, network uptime, skills etc.

[242] The proposed merger also has a vertical dimension to it as MNOs and OLOs make use of the fixed leased line services of Vodacom and Neotel to provide retail fixed line services in competition with the merging parties.

9.2.2 Theories of Harm

9.2.2.1 Horizontal effects

[243] The merging parties own fibre infrastructure that is used to provide international, national, metropolitan and last mile access - fixed leased lines. The Commission assesses whether the proposed transaction is likely to result in unilateral effects or whether the proposed merger could result in a chilling of competition. A chilling of competition in the fixed leased lines markets could also have vertical effects as this could undermine the ability of ISPs and OLOs to compete effectively since fixed leased lines are an essential input in the provision of downstream retail fixed line services. In so doing, the Commission assesses whether Neotel, despite its pre-merger size, can be regarded as an effective competitive constraint in the supply of fixed leased lines and whether the proposed merger is likely to alter the incentives of Neotel in supplying fixed leased lines in such a way that levels of competition in this market are adversely affected to the detriment of competition in the downstream markets. Neotel's presence in the wholesale fixed leased lines market has provided third parties an alternative wholesale fixed leased line provider imposing a competitive constraint on Telkom resulting in reductions in Telkom's prices.

[244] In addition, the merging parties compete against each other for the provision of retail fixed line services. Post-merger, Vodacom will integrate its enterprise Division into Neotel's. The merged entity will have own and have access to a larger fibre infrastructure network (comprised of both Vodacom's and Neotel's fibre) in order to provide different retail fixed line services. Vodacom and Neotel also offer internet access on a wholesale basis. The Commission will therefore also assess whether the implementation of the proposed merger will have any effect on the wholesale market for internet access.

9.2.2.2 Vertical effects

[245] A vertical merger may give rise to anticompetitive effects if it enables the merged firm to restrict a rival's ability to compete either by foreclosing it from an upstream or downstream market or by raising its costs in a way that allows the merged firm to exercise market power.¹⁹⁸ This can occur by way of input foreclosure or customer foreclosure.

[246] In the current transaction, input foreclosure is unlikely to occur through an outright refusal to supply but rather by way of price discrimination, margin squeeze or exclusive dealing. The following inputs may be affected:

246.1 First, Neotel has a metropolitan fibre footprint and offers fixed leased line services to other MNOs, ISPs and OLOs. Vodacom also has a fibre footprint and recently begun providing fixed leased line access to third parties. Vodacom is also likely to use the fibre network of Neotel in its mobile and fixed line service offerings. In this regard, it is important to assess whether the merged entity is likely to have the ability and incentive to foreclose downstream customers for the provision of fixed leased line services.

246.2 In the event that the merger affects Neotel's ability and incentives to invest in fixed leased lines network coverage, this could adversely impact on downstream rivals' ability to compete by affecting their ability to cost-effectively and competitively access wholesale fixed leased lines. This assessment is undertaken in the context of the horizontal effects assessment, but it is noted that there could be vertical effects arising since the merged entity is also vertically integrated into downstream services.

246.3 Second, customer foreclosure may take place where Vodacom currently sources wholesale fixed leased lines from other infrastructure providers such as DFA. [REDACTED]

246.4 Third, the proposed merger may also result in portfolio or conglomerate effects. The merged entity will be in a position to offer bundled retail fixed line services and to bundle retail fixed line services with mobile services. The Commission will therefore assess to what extent Vodacom's access to a greater fibre network will enable it to bundle retail

¹⁹⁸ Ibid, Pg. 73

fixed line services, while Vodacom's leading position in the mobile market combined with Neotel's fixed leased line infrastructure could potentially lead to a converged service bundle that rivals in the mobile and fixed market will be unable to match.

9.2.3 Assessment of the likely horizontal effects in the fixed line services

9.2.3.1 Upstream market for wholesale fixed leased lines

9.2.3.1.1 Merging parties' view

[247] The merging parties are of the view that the proposed merger will not materially affect competition for the provision of fixed leased line services in any of the geographic areas where their fixed lines overlap. This is because Vodacom's presence in this market is negligible and the market is dominated by Telkom. The merging parties also submit that Vodacom operates in those geographic areas where there is competition from other fixed leased line providers and that wholesale services have become a commodity product due to fierce competition and the ability of fixed leased line providers to easily add capacity on a specific route.¹⁹⁹

[248] [REDACTED]
[REDACTED] while Telkom's market share is between 60% - 80%. [REDACTED] Therefore, the proposed merger is not expected to materially impact on competition in the wholesale fixed leased lines market in South Africa.²⁰¹ In their submissions, the merging parties considered the following market segments: international (subsea cable), national and metropolitan fibre. These submissions are summarised below.

9.2.3.1.1.1 International (subsea cable)

[249] The merging parties submit that despite having participating shares on all five subsea cable systems with the exception of SEACOM where Neotel has an irrevocable right of use relating to capacity on the cable, the proposed merger is unlikely to have any material effect on third party access to international connections. [REDACTED]
[REDACTED]

²⁰⁰ Ibid, para 4.117 on Pg. 72.

²⁰¹ Ibid para 4.118 on Pg. 72.

9.2.3.1.1.2 National network

[250] The merging parties have fibre networks (fixed leased lines) on three (potentially four) of the twenty-one main national routes across South Africa. The three routes on which the merging parties' fibre networks overlap are the Gauteng and Durban (NLD1) route and Gauteng and Cape Town via Bloemfontein (NLD 2, 3 and 4) route. Another potential overlap is between Gauteng and Polokwane.²⁰⁵ The merging parties submit that there are several other competitors on each of the fibre routes where both Vodacom and Neotel have capacity including FibreCo, Telkom, BBI and MTN. Telkom has an extensive network, providing multiple connectivity solutions between urban centres with many operators relying on it for national connectivity retail services.²⁰⁶ According to the merging parties, most customers consider wholesale fixed leased line services as commoditised meaning that competition is price-based. [REDACTED]

9.2.3.1.1.3 Metropolitan network

[251] The merging parties submit that the proposed merger is unlikely to adversely affect competition at the metropolitan segment because Vodacom has limited fibre network. Instead Vodacom leases capacity from third parties such as [REDACTED]. The merging parties argue that the merged entity will continue to face competition from several other fixed leased line providers [REDACTED] in the metropolitan areas where their respective fibre networks overlap.

9.2.3.1.2 Commission's view

[252] The Commission's assessment of the likely competitive effects of the proposed merger in the fixed leased line markets by considering the shares of fixed leased line network coverage based

[REDACTED]
[REDACTED]
[REDACTED]

²⁰⁵ Ibid, para 4.121 on Pg. 74.

²⁰⁶ Ibid, para 4.124 on Pg. 75-76.

[REDACTED]
[REDACTED]

on actual distance of infrastructure of a network. These shares are estimated for each of national and metropolitan (including last mile) segments. The Commission has focused its estimates only on providers who provide access to third parties and not those exclusively used by an operator for its own use. The Commission's assessment also focuses on the competitive role of Neotel as a provider of access to third parties and whether the proposed merger is likely to weaken or enhance this role given the relative levels of concentration in the market, entry barriers and alternatives available post-merger. In doing so, the Commission also focuses on other dimensions of competition apart from coverage and price.

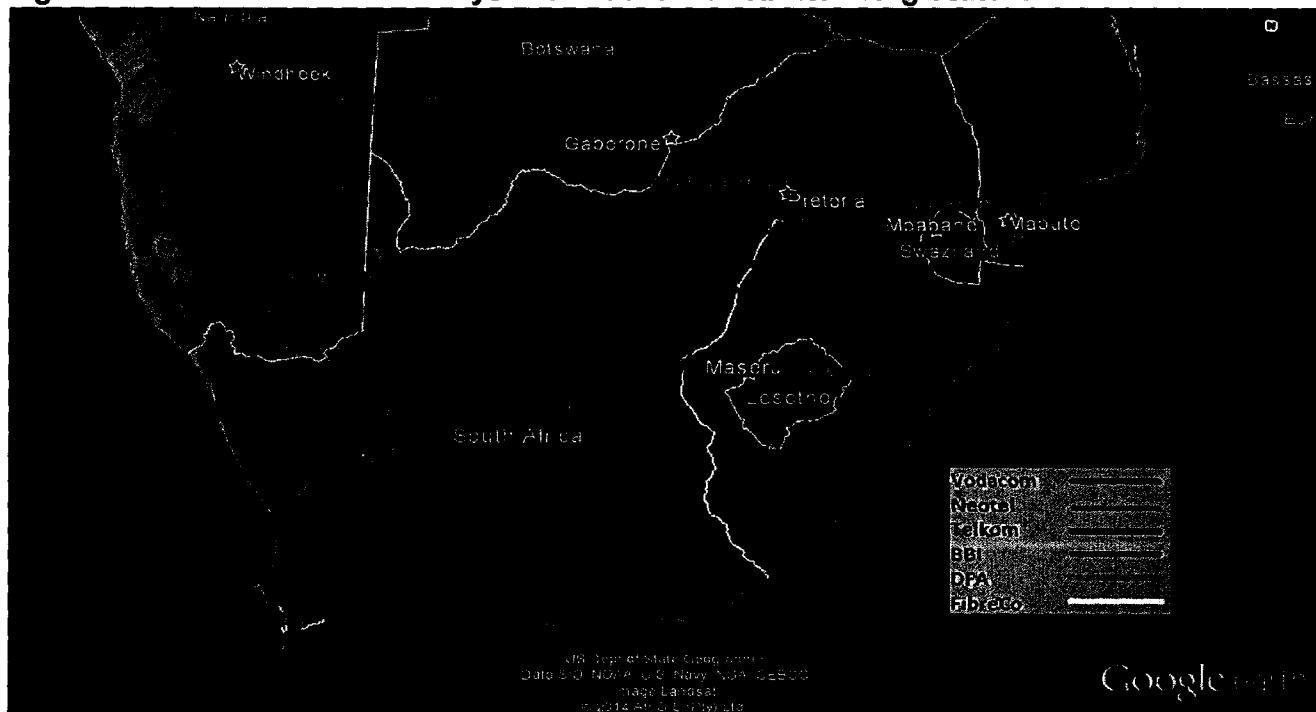
[253] The Commission is of the view that there are unlikely to be competition concerns arising in relation to international fixed leased line connectivity and as such no further analysis is undertaken on this.

9.2.3.1.2.1 National fixed leased lines network

[254] The merging parties' fibre networks overlap as both are members of the NLD joint venture with MTN. Each of the consortium members owns their own respective fibre in the duct and the consortium members therefore shared the costs for the trenching and construction of this fibre network. Neotel made use of BBI's national network prior to the construction of the NLD.

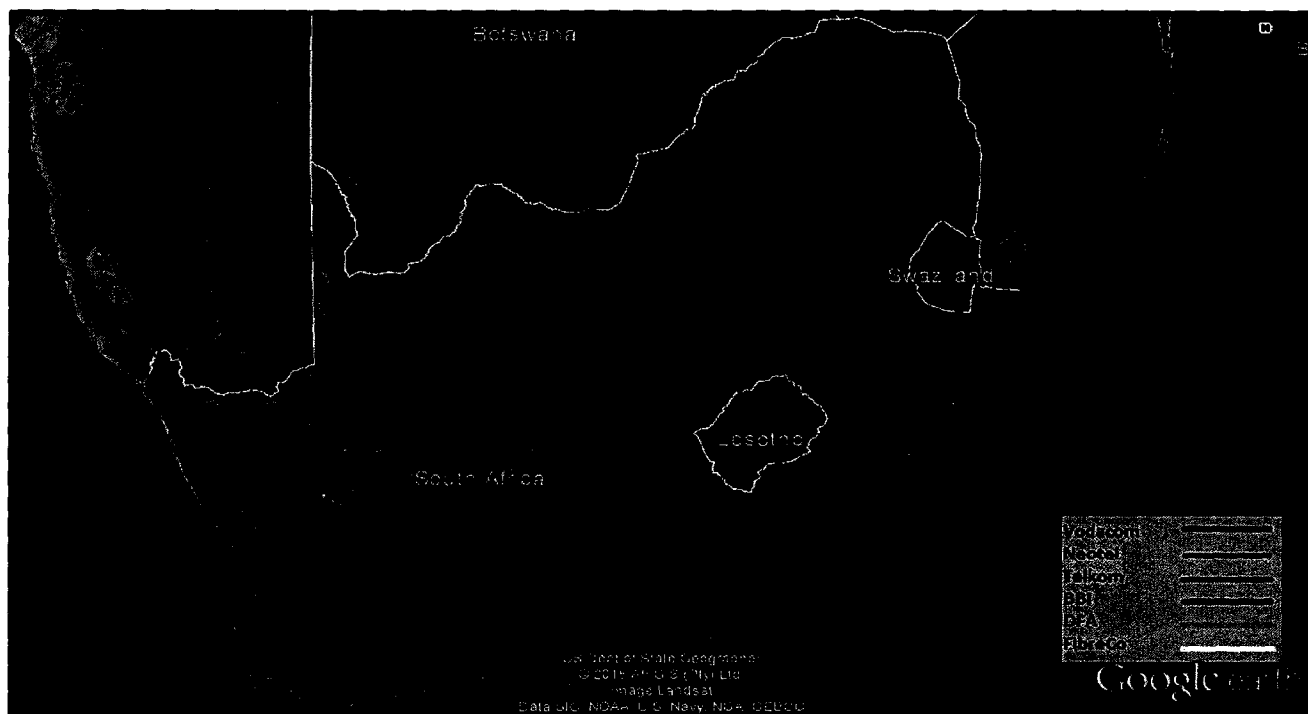
[255] Figures 7 to 9 show the geographical distribution of the South African national fibre network as owned by different fixed leased line infrastructure providers.

Figure 7: National fibre network system of South Africa excluding Telkom



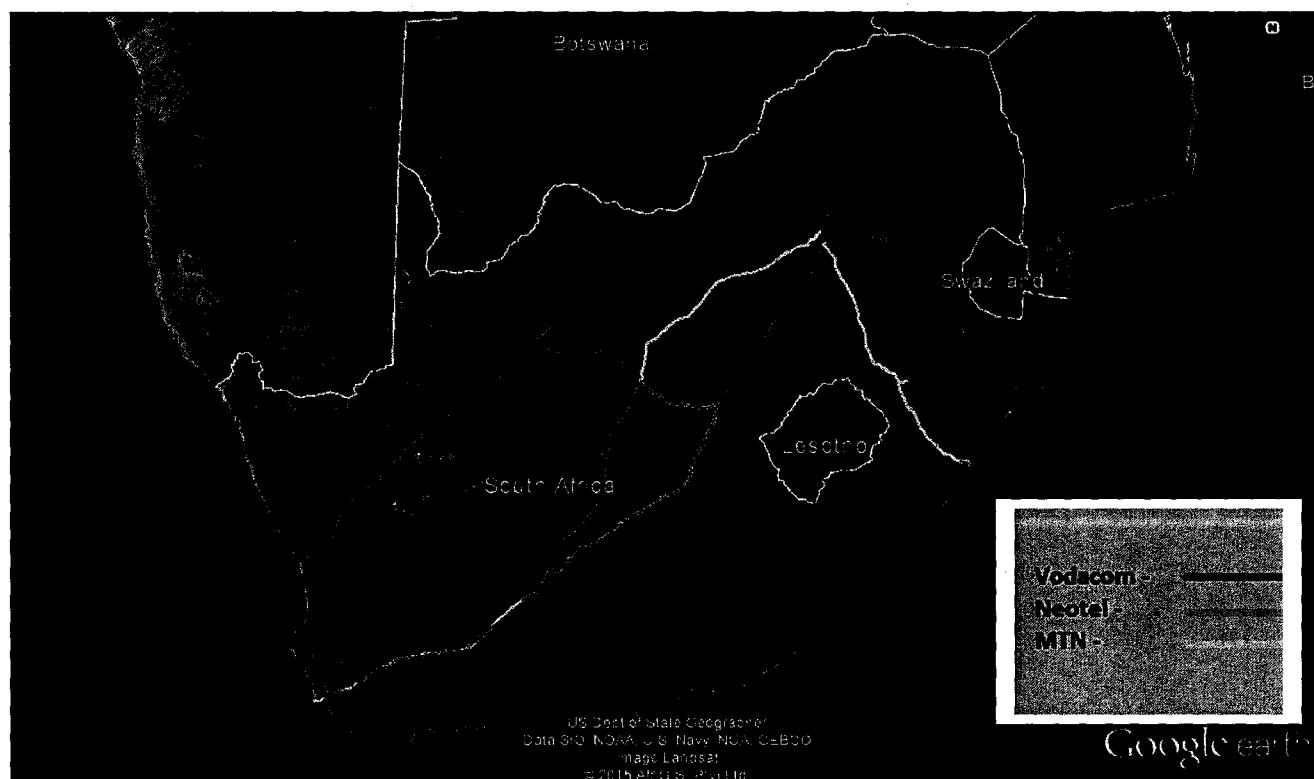
Source: Commission's construction based on submissions of the merging parties and competitors

Figure 8: Telkom's national fibre network infrastructure



Source: Commission's construction based on Telkom submission

Figure 9: MTN, Vodacom and Neotel's NLD fibre



Source: Commission's construction based on MTN, Vodacom and Neotel's submission

[256] The fibre networks of Vodacom and Neotel overlap for the Johannesburg - Cape Town (via Bloemfontein) and Johannesburg - Durban Route. The above figures do not show Liquid Telecom's fibre route from Pretoria to the Beitbridge border post.

[257] [REDACTED] has informed the Commission that the current NLD [REDACTED] [REDACTED] The affected routes include NLD 5-8 from Cape Town to Durban and NLD 7-8 from Ladysmith to Polokwane to Pretoria.²⁰⁹

[REDACTED]

[REDACTED]

[REDACTED]

[259] In August 2014 agreement was reached at a Co-Build Steering Committee meeting to de-scope the Co-Build Agreement by not proceeding with NLD 5 - 8. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] This suggests that, post-merger, coordination on investments in network build-up will take place between Vodacom and Neotel and depending on decisions taken by the merged entity, could have an adverse effect on rivalry in the national fixed leased line segment. In other words, instead of investing in building a national fixed leased line network, the merged entity may well opt to lease from other providers meaning that future alternatives are reduced.

[260] Table 12 shows the Commission's market share calculations based on the distance of each operators national fibre network. The market shares are based on the actual route distance (also known as civil route distance) and not the length of the fibre. Civil route distance is less than fibre length because the length of the fibre would include reserve coils which are used for maintenance purposes.

Table 12: Market shares based on distance of national fibre networks owned by wholesale leased line operators – 2014

Infrastructure provider	Distance of network (km)	Market share
Vodacom	[REDACTED]	[REDACTED]
Neotel	[REDACTED]	[REDACTED]
Merged Entity		
Fibre Co	[REDACTED]	[REDACTED]
BBI	[REDACTED]	[REDACTED]
Liquid Telecom	[REDACTED]	[REDACTED]

²¹⁰ See Para 14 on Pg. 8 of Vodacom's letter to the Commission; 13 March 2015

²¹¹ See Para 14 on Pg. 8 of Vodacom's letter to the Commission; 13 March 2015

²¹² See Para 14 on Pg. 8 of Vodacom's letter to the Commission; 13 March 2015

DFA			
Telkom			
MTN			
TOTAL			

Source: Commission calculations based on submissions of merging parties and competitors

has the largest national fibre network of all operators with as the second largest competitor with a market share of the third largest provider of national fixed leased lines with a share of approximately The

The merged entity's

overlaps with the merged entity It is, however, important to note that although there are other firms, their shares are currently small. In addition,

The Commission, however, notes that several of these market participants are indicate that they are considering expanding their fibre networks.

The Commission disagrees with the merging parties that fixed leased line services are commoditised and as such competition is price based. The Commission is of the view that there are other important considerations other price and these include: (1) the technology which must be compatible with customer requirements e.g., Metro Ethernet Forum Standards; (2) service levels must be acceptable with regard to availability, latency, round trip delay, time to repair,

and time to respond; (3) access to dedicated bandwidth not shared with other customers; and (4) coverage.²¹⁹ As such, switching to other providers especially the smaller providers with smaller network coverage may not be as easy as in purely commodity markets. Failure to meet these customer requirements means that the potential alternative supplier may not be seen as a viable alternative. [REDACTED]

[REDACTED] The Commission also interviewed several downstream fixed line service providers in order to determine whether the merged entity's competitors are reliable and credible. [REDACTED]

[265] Based on this evidence the Commission concludes that the proposed merger is unlikely to raise any horizontal competition concerns in respect of the national market for fixed leased line services and this aspect of the proposed merger will not be assessed in any further detail.

9.2.3.1.2.2 Metropolitan

[266] Similar to national fixed leased line services, the Commission's analysis begins with estimating market shares for different providers of metropolitan and last mile services based on actual distance. The Commission's analysis is not undertaken on a street-to-street basis (route level), but rather at the broad metropolitan and last mile level where the merging parties' have deployed fibre networks.

[REDACTED]

Table 13: Market shares based on distance of metropolitan fibre networks owned by wholesale leased line operators – 2014

Infrastructure provider	Distance of network (km)	Market share
Vodacom		
Neotel		
Merged Entity		
FibreCo		
Liquid Telecom		
DFA		
Telkom		
MTN		
TOTAL		

Source: Commission calculations based on submissions of merging parties and competitors

[267] Table 13 shows that Vodacom owns a relatively small fibre network when compared to that of other operators such as [REDACTED]. Other players such as [REDACTED] have very limited metropolitan fibre network coverage. There are also other smaller operators who own metropolitan fibre networks including [REDACTED]. These are excluded due to size.

[268] The Commission also considered the extent of the merging parties' fibre network overlap in respect of all the major metropolitan areas. [REDACTED]

[REDACTED] Vodacom has a greater fibre network in the [REDACTED] area where its fibre coverage is [REDACTED]. This is, however, relatively small when compared to [REDACTED]

[REDACTED]

[270] The same conclusions can be drawn from the merging parties' fibre networks in the Johannesburg and Pretoria metropolitan areas. In Johannesburg, the merged entity will have a combined fibre network of [REDACTED]

[REDACTED]

[271] Evidence collected by the Commission shows that the merged entity will continue to face competition from Telkom and DFA in each of the major metropolitan areas where the merging parties' fibre networks overlap. These areas include Johannesburg, Pretoria, Durban and Cape Town. It is also important to note that [REDACTED] and does not compete in any of the further downstream markets.

[272] There are also smaller metropolitan areas where Vodacom and Neotel have fibre networks but in the majority of these areas there is competition from [REDACTED]
[REDACTED]
[REDACTED] have their own self-built fibre infrastructure in these towns.

[273] The Commission also interviewed MNOs and OLOs in order to determine whether they consider the competitors of the merging parties as reliable and credible and found that alternative include [REDACTED] Although there are potential alternatives such as

[REDACTED]

[REDACTED]

[REDACTED] As discussed above, the Commission has received submissions from fixed leased line providers that they intend to expand and upgrade their existing fibre network.

[REDACTED] The Commission notes that despite the likes of [REDACTED] being potential alternatives to Neotel, the offerings are varied and this could limit the scope for switching between alternatives especially if the end customers are not prepared to accept similar or related terms. For instance, [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] On the other hand [REDACTED] has 12 month minimum term of service which is applicable to all its services. A customer can terminate its contract within sixty calendar days and is required to pay a termination charge which is calculated as a percentage of monthly revenue, taking into account the contracted length of the term, as well as the remaining period of the service being terminated.²³⁸ [REDACTED]

[REDACTED]

[REDACTED] Termination terms for most [REDACTED] services typically require a written 30 days' notice and a cancellation charge for any discontinuation prior to the relevant contract period expiring. [REDACTED]

[REDACTED]

[REDACTED]

[275] The Commission's noted that the merger may alter Neotel's incentives to invest in fixed leased line network as Vodacom appears to be primarily focused on investing in building its own network to focus primarily on enterprise customers. In particular, the merging parties argue that the merger will create a merged entity capable [REDACTED]

[REDACTED]
[REDACTED] Vodacom's investment plans are summarised below.

[276] Vodacom submit that the transaction [REDACTED]

[REDACTED] allowing them to compete more effectively in [REDACTED]
[REDACTED]
[REDACTED]

[REDACTED] According to Vodacom, this investment will allow the merged entity to pose a significant challenge to Telkom and provide customers, such as banks and retail businesses, with a competitive and viable alternative. This added constraint that will be placed on Telkom will benefit the consumer through improved choice and better service offerings.

[277] Vodacom has submitted [REDACTED] which shows their plans to

[REDACTED] in upgrading Neotel's current network and systems.

The Commission notes that these levels of investment are not very significant compared to how much Vodacom invests in its mobile network. [REDACTED]
[REDACTED]

[REDACTED] It therefore becomes important to determine to what extent Vodacom intends to continue making fibre available to third parties and whether this will be in the same fashion as Neotel currently does.

[REDACTED]
[REDACTED]
[REDACTED] Given these expansion plans, it is clear that Vodacom has more incentive to make use of Neotel's fibre footprint for their own commercial expansion and less incentive to roll-out fibre for the benefit of third parties. [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

[279] Vodacom's motive behind fibre roll-out may then have a negative impact on ISPs and other third parties and on wholesale access to fibre in general. Neotel provides wholesale fixed leased line services to MNOs and OLOs.

[280] The Commission is of the view that Vodacom is likely to alter focus of its investments primarily towards enterprise and end-customers and this may impact on Neotel's ability to continue to invest in wholesale fixed leased lines, thus potentially chilling competition in the upstream market for wholesale provision of leased lines. However, evidence provided to the Commission suggests that other providers have plans to increase their fixed leased line footprint and are likely to continue to offer alternatives to the merged entity. As such, the merger is unlikely to raise competition concerns in the provision of fixed leased lines at a metropolitan level. This is not to diminish the role of Neotel as a competitive provider of fixed leased line services pre-merger.

[281] As explained above, the last mile access refers to the fibre connection between the POPs on the metropolitan network and the access elements and customer premises equipment. [REDACTED]

[282] In considering these market shares it is important to note that [REDACTED] was not able to distinguish between fibre provided to residential customers and fibre provided to business customers. However, [REDACTED]

Table 15: Market shares based on distance of last mile fibre networks owned by wholesale leased line operators – 2014

Infrastructure provider	Distance of network (km)			Market share	
Vodacom					
Neotel					
Merged Entity					
TOTAL					

Source: Commission calculations based on submissions of merging parties and competitors

[283] Table 15 shows that the last-mile fibre networks of [REDACTED]
[REDACTED] The implementation of the merger will effectively result in Vodacom entering the market instead of Neotel and is unlikely to raise any horizontal competition concerns.

[285] The significant cost of providing last-mile access to business customers suggests that it is unlikely that last-mile fibre infrastructure would be duplicated. To explain further, it is unlikely that [REDACTED] would build a second fibre line to a customer's premises if Neotel had already built last mile access to that specific customer's premises. Therefore, once an infrastructure provider has built the last-mile, it is unlikely that further competition would take place at a wholesale level and competition is more likely to take place at a retail level for fixed line services. To take the above example further, the business customer could decide not to procure retail fixed line services (i.e., internet) from Neotel and switch to IS even though Neotel is the owner of the last-mile.

[286] The Commission finds that the implementation of the proposed merger is unlikely to raise any competition concerns for the provision of last-mile fibre.

[REDACTED]
[REDACTED]
[REDACTED]

in the enterprise or VPN segment of the market. For instance, [REDACTED] primarily focus on providing services to SME customers and were therefore excluded from the Commission's calculation [REDACTED]

[REDACTED] The Commission therefore finds that the competitive constraint of [REDACTED] is limited. Similarly, [REDACTED]

[REDACTED] For this reason, the Commission also finds that the competitive constraint of [REDACTED] is limited. [REDACTED]

[291] The Commission also estimated market shares of the merging parties and their competitors based on the number of customer sites that are connected to their respective VPN networks. Competitors with a large number of customer sites are stronger competitors as their networks are able to connect to more third parties and lower the cost of services rendered over the VPN network as economies of scale are important in the provision of VPN services. As a result, their networks are likely to be more attractive for potential customers and as such these competitors would exercise a stronger competitive constraint.

Table 17: Market shares for the provision of VPN and managed network services to enterprise customers based on the number of customer sites (2014)

Firm	Number of customer sites			Market share (%)	
Vodacom					
Neotel					
Merged entity					
Telkom					
IS					

[REDACTED]

Firm	Number of customer sites				Market share (%)	

Source: Commission calculations based on revenue figures provided by merging parties and competitors

[292] [REDACTED] lead the market for the provision of VPN and managed network services on the basis of the number of customer sites attached to the VPN network and account for [REDACTED] of the market based on the number of customer sites. The merged entity and other competitors are significantly smaller than [REDACTED] and it is unlikely that the merged entity would be able to unilaterally increase the price for the provision of MNS.

[293] The Commission finds that the implementation of the proposed merger is unlikely to raise a concern in the VPN market. The merged entity is unlikely to be in a position to exercise market power as it would be constrained from doing so by other competitors including IS and Telkom. Moreover, this market is characterised by customers issuing tenders or request for proposal which ensures that competitive bidding and competition takes place. Finally, no competitors or customers indicated that the proposed merger would raise a concern in the VPN market.

9.2.3.2.1.2 VANS

[294] The Commission's market share estimates in respect of VANS are set out in Table 18 below. These estimates for VANS include a wide range of different services that include internet access, VoIP, video conferencing, content filtering, disaster and recovery services, firewall protection, emails service, anti-virus, managed security services and remote access services.

Table 18: Market shares for the provision of VANS for the period 2011 to 2013

Firm	2011		2012		2013	
	Revenue (R)	Market share	Revenue (R)	Market share	Revenue (R)	Market share
Vodacom	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Neotel	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Merged Entity						
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Source: Commission calculations based on revenue figures provided by the merging parties and competitors

[295] Table 18 shows that the implementation of the proposed merger is unlikely to raise any concerns in the VANS market as the merged entity has a combined market share of [REDACTED]. The merged entity is also likely to continue to face competition from the likes of [REDACTED] and other smaller competitors.

Table 19: Market shares for the provision of internet services to enterprise customers for the period 2011 to 2013

Source: Commission calculations based on revenue figures provided by merging parties and competitors

[297] The merged entity will have a combined market share of approximately [REDACTED]. Competitors such as [REDACTED] all have a greater market share position than the merged entity.²⁵⁴ It is therefore unlikely that the proposed merger will result in any unilateral effects.

[298] As mentioned above, there is also a horizontal overlap where Vodacom and Neotel provide wholesale internet services. The Commission also finds that it is unlikely that the proposed merger will raise a concern in this respect as there are several other firms that compete at a wholesale level including MTN, Telkom, IS and Mweb.

[299] It is unlikely that the implementation of the proposed merger will raise any competition concerns in the VANS market. The market shares of the merging parties are relatively low and the merged entity will continue to face competition from other VANS providers including Telkom, IS, MTN and other smaller operators.

9.2.3.2.1.3 Hosting services

[300] The market shares for hosting services are provided in Table 20. This includes revenue derived from HIS, HAM and other cloud based services.

Table 20: Market shares for the provision of hosting services to enterprise customers for the period 2011 to 2013

Competitor	2011		2012		2013	
	Revenue	Market share	Revenue	Market share	Revenue	Market share
Vodacom	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Neotel	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Merged entity	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Source: Commission calculations based on revenue figures provided by merging parties and competitors

* Teraco provides open-access hosting services to third parties and does not itself provide any of the value-added service such as HAM.

[301] The merged entity will have a combined market share of [REDACTED] and is likely to continue to face competition from [REDACTED] and others. The Commission's market share calculations show that the implementation of the merger is unlikely to raise any competition concerns.

[302] [REDACTED] The Commission therefore assessed the structure of the data centre hosting market (co-location) by considering the data centres owned by the merging parties and competitors. The Commission calculated market shares based on the total floor space which is useable, floor space that is rented to third parties on a commercial basis and available floor space for third party rental.

[303] These figures are informative as it shows the current size of the competitors and their ability to expand and compete in future as demand for hosting services are likely to grow. It is important to note that these figures include all data centres owned by competitors, irrespective of their location. The Commission's findings are presented in Table 21 below.

Table 21: Market shares for the provision of hosting (co-location) services based on data centre capability (m²)

Firm	Total Floor space (m ²)	Market share (%)	Rented on commercial basis to third parties (m ²)	Market share (%)	Space available for third parties (m ²)	Market share (%)
Vodacom						
Neotel						
Merged entity						

[REDACTED]

Source: Commission calculations based on revenue figures provided by merging parties and competitors

[304] The merged entity is unlikely to have any market power for the provision of hosting co-location services where [REDACTED] and others is likely to exert a competitive constraint.

[REDACTED] This added capacity is also likely to

[REDACTED] This added capacity is also likely to undermine any exercise of market power by the merged entity.

[305] The Commission did not estimate market shares of the merging parties for the provision of HAM services as the merging parties submit that Neotel is primarily a provider of co-location and managed services.²⁵⁸ The merging parties did, however, calculate their own estimated market shares based on their own revenue figures and the total size of the market as estimated by IDC (research consultancy firm). [REDACTED]

9.2.3.2.2 Conclusion: Retail fixed line services

[306] The Commission finds that Vodacom and Neotel are competitors in the VPN, VANS and hosting market. However, the Commission's market share and concentration analysis shows that the implementation of the proposed merger is unlikely to raise any unilateral effects for the provision of VPN, VANS and hosting services. The merged entity will have a relatively strong market position for the provision of VPN services but is likely to be constrained from exercising market power by other competitors such as Telkom and IS who both have more customer sites connected to their respective VPN. Moreover, there are also other smaller competitors in the market that includes MTN. It is also important to note that the Commission's assessment of the

²⁵⁷ Business Day, 25 March 2015

VPN market appears to be supported by market share calculations of an independent research consultancy firm [REDACTED] which estimates that the merged entity would have a combined market share of [REDACTED] based on 2012 data. In the VANS and hosting market the merged entity has a much smaller share of the market [REDACTED]

[307] The Commission is of the view that the merger is unlikely to raise any unilateral competition concerns in any of the fixed line markets where horizontal overlaps arise.

[308] The Commission considers vertical issues arising in the fixed lines markets below.

9.2.4 Vertical Assessment

[309] Neotel provides MNOs and OLOs wholesale access to its fibre network (fixed leased line services) for use as an input in their downstream activities. The Commission will assess whether the proposed merger raises any potential for anticompetitive foreclosure.

[310] The Commission will also assess customer foreclosure as Vodacom currently procures fibre from other fixed leased line providers such as DFA. The merged entity could therefore implement a strategy to internalise all wholesale fixed leased lines procurement to Neotel.

[311] Finally, OLOs and MNOs are currently granted access to Neotel's RAN sites, which is used to provide retail mobile services or retail fixed line services. The Commission will therefore also consider whether the implementation of the proposed merger may raise input foreclosure concerns.

9.2.4.1 Input Foreclosure for wholesale fixed lease lines

9.2.4.1.1 Merging parties' view

[312] The merging parties submit that the implementation of the proposed merger will not provide Vodacom with the ability or incentive to engage in a foreclosure strategy. The merging parties argue that there are a large number of strong competitors for the supply of fixed leased line services and that there are no capacity constraints for the supply of this service.²⁵⁹

[REDACTED] The merging parties argue that the implementation of the merger does not create a "novel vertical integration" as [REDACTED] and there is no suggestion that

It is further submitted that vertical foreclosure requires unilateral market power in both upstream and downstream markets and evidence suggests this is not the case.²⁶¹ The merging parties estimate that the merged entity will have a market share of approximately [REDACTED]

[314] The merging parties go on to submit that in terms of Vodacom retaining Neotel's fibre infrastructure for its own exclusive use, for this hypothesis to be conceptually profitable Vodacom must be able to replace all foregone Neotel wholesale revenues (wholesale fixed lease lines) with a combination of cost savings on leased lines from third parties and/or the profits that would have been derived from higher pricing in the retail market. This is unlikely since there is no prospect for foreclosure in the retail market for the provision of fixed line services.²⁶³

[315] Finally, Vodacom submits that it intends to continue to provide, in the same or similar form, fixed leased line services to Neotel's current clients. Further, Neotel indicated during ICASA public hearings that Neotel offered and is still prepared to offer all of the OLOs long term fibre supply agreements in order to address any concerns that the implementation of the proposed merger may result in input foreclosure.²⁶⁴

9.2.4.1.2 Commission's view

[316] Vertical foreclosure concerns are typically assessed by considering whether the merged entity has the ability and incentive to foreclose its downstream rivals from access to inputs. In the event that the merged entity has both the ability and incentive to foreclose rivals, consideration is then made as to the likely effects of foreclosure on competition. In the instance case, the market shares (at national, metropolitan and last mile segments of fixed leased lines) suggest that the merged entity is unlikely to have the ability to foreclose rivals. The Commission finds that the merged entity does not have the ability to foreclose Cell C as a rival in mobile markets from access to fixed leased line services since it currently sources only [REDACTED] of its fibre links

²⁶³ Ibid, para 28 on Pg.6.

²⁶⁴ Comments made by Mr. Budlender during the ICASA hearings on 16 January 2015.

from Neotel, while [REDACTED] is procured from Telkom and [REDACTED] from DFA. As such, it is unlikely that the proposed merger is likely to result in the traditional anticompetitive foreclosure.

[317] The concerns that have been raised however are somewhat novel and require a more nuanced approach than the traditional foreclosure assessment. In sum, the concerns raised by several OLOs and [REDACTED]

[REDACTED] In other words, Vodacom could, post-merger, offload its mobile traffic onto the Neotel fibre network thereby reducing Neotel's incentives to take up the traffic of OLOs and MNOs and consequently reducing Neotel's incentives to aggressively compete with other fixed leased line providers.

[318] This approach requires an assessment of Neotel's role as a competitor in the provision of fixed leased lines which has been considered above. It also requires an understanding of the incentives of the merged entity to engage in the claimed mobile traffic offload strategy and the consequential impact on the alternatives available to OLOs and MNOs should Neotel become a reluctant competitor. The alternatives that are likely to be available to OLOs and other MNOs have been discussed above. The focus in this section is on incentives to foreclose should Neotel become a reluctant competitor in the markets for provision of fixed leased lines.

[319] First, should Vodacom engage in the mobile traffic offload as argued, it would have to divert traffic from its current fixed leased line providers such as [REDACTED]. The Commission understands that [REDACTED]

[REDACTED] At the same time, they will incur revenue losses on the contracts that Neotel could possibly have with OLOs and MNOs due to the alleged reluctance to deal.

[320] Second, it is not apparent that on the current routes that Neotel has installed its fixed leased lines, it has capacity constraints which would mean that should Vodacom offload its mobile traffic onto the Neotel network, rivals would be foreclosed from access to the Neotel network. To the extent that Neotel has additional capacity or could create additional capacity (which

would lower its per unit costs), then it is unlikely that foreclosure from access to Neotel's network would be profitable for the merged entity as it would likely simply be foregoing revenue it could possibly generate without incurring significant costs.

[321] The Commission is therefore of the view that the merger is unlikely to result in incentives to foreclose rivals via a mobile traffic offload strategy.

9.2.4.2 Customer foreclosure for retail fixed line services

9.2.4.2.1 Merging parties' view

The merging parties submit that Vodacom lacks the necessary ability and incentive to foreclose rival fixed leased line providers. The merging parties first submit that there is no ability to foreclose as [REDACTED] and that there is no market segments in which the merged entity [REDACTED]

[323] The merging parties also argue that Vodacom lacks the incentive to engage in a customer foreclosure strategy post-merger as Vodacom currently leases from third party providers in areas where neither Vodacom nor Neotel are present. Also, in areas where fibre is leased from third parties alongside fibre owned by the merging parties there is no incentive to no longer lease infrastructure from a rival [REDACTED]

[324] The merging parties further submit that Vodacom is a small buyer of fixed leased line services relative to the entire [REDACTED]

██████████ The merging parties argue that it is implausible given Vodacom's small share of the retail fixed line services market that the loss of business from Vodacom would jeopardise the commercial survival of suppliers other than Neotel. Such commercial arrangements are

governed by term contracts that explicitly recognise the desirability of a reasonable period of commitment from the user to avoid the problem of stranded assets. [REDACTED]
[REDACTED]

[325] Finally, the merging parties argue that a strategy by Vodacom to internalise demand for wholesale fixed lease lines would not make economic sense. In support of this view that merging parties argue that [REDACTED]
[REDACTED]

[REDACTED] The ability to internalize demand is also restricted by the existence of multi-year [REDACTED] contractual commitments to other leased line operators such as [REDACTED]. In instances where there are overlaps between Neotel's fibre network and other fibre operators from which Vodacom currently leases, a switch to Neotel's fibre would not occur without great cost. [REDACTED]
[REDACTED]
[REDACTED]

[REDACTED] In the event that Vodacom would both remove the provision of Neotel's fibre to third parties and also internalise Vodacom's demand [REDACTED]
[REDACTED]

9.2.4.2.2 Commission's view

[326] In this assessment, the Commission considers the merged entity's ability, and incentive to foreclose fixed leased line providers such as DFA from access to Vodacom as a customer.

9.2.4.3 Ability to foreclose

[REDACTED] The Commission received written submission from all of the fixed lease line providers. [REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED] Vodacom may therefore decide to internalise its procurement of fixed lease line services which may have a significant impact on the commercial viability of [REDACTED]. Representatives of Vodacom confirmed that Vodacom would look to rationalise their procurement of wholesale fixed lease lines post-merger [REDACTED]
[REDACTED]

[328] [REDACTED] considered it unlikely that Vodacom would cancel the lease agreements that it has with [REDACTED] with regards to the fibre linking its radio access network sites [REDACTED]
[REDACTED]

[REDACTED] subsequently indicated that it does not wish to raise a concern and do not intend to participate at the Tribunal proceedings and will abide by the Commission and Tribunal's assessment of the proposed merger.²⁷⁸

[329] The Commission is of the view that Vodacom could potentially foreclose [REDACTED] from access to a significant customer. Whether this is likely to take place is assessed under incentives.

9.2.4.4 Incentive to foreclose

[330] [REDACTED] indicated that even though Vodacom could terminate contracts related to its enterprise customers in favour of Neotel, it was unlikely that contracts relating to fixed leased lines connected to Vodacom's radio access network would be terminated in favour of Neotel as the merged entity would have to duplicate the building of the fibre links to the RAN sites, which is costly and characterised by high fixed costs. In addition, Vodacom would have to pay termination fees to [REDACTED] in terms of the contractual agreements.

[331] Vodacom is likely to continue to procure from [REDACTED] areas where neither Neotel nor Vodacom have any fixed leased lines. This view was confirmed [REDACTED] for the supply of fixed

leased lines.²⁷⁹ [REDACTED] also confirmed that it is also possible for Vodacom to use any of [REDACTED]
[REDACTED] A fibre link can be implemented from an
enterprise customer's premise to [REDACTED]
[REDACTED] It appears from Vodacom's projected investment plans and submissions
that there is likely to be continued use of third party fixed leased line providers.

[332] Despite this, Vodacom has indicated its interest in rationalising procurement of fixed leased lines post-merger meaning that there could be incentives to not deal with, at the least, some upstream suppliers. These rationalisations may likely affect common routes between Neotel and rival service providers.

9.2.4.5 Effect on competition

[333] Currently Vodacom accounts for approximately [REDACTED] [REDACTED] cautioned that the loss of Vodacom as an anchor tenant on its fibre network may restrict [REDACTED] [REDACTED] The Commission however, finds that there are factors that are likely to limit the extent to which Vodacom can engage in full customer foreclosure on Neotel. First, the presence of long term agreements [REDACTED] [REDACTED] If Vodacom was to terminate all leases with [REDACTED] it would have to settle the [REDACTED] [REDACTED]. If Vodacom was to only cancel links to Vodacom's core network, the settlement would be [REDACTED]

[334] Second, [REDACTED] indicated that it is unlikely that Vodacom will terminate all [REDACTED] [REDACTED] as Neotel does not have fibre links on certain routes (i.e., RAN sites). Finally, [REDACTED] on long-term contracts for it to be economically

viable to roll-out fibre on a specific route.²⁸⁵ [REDACTED]

[REDACTED] it can provide enough fibre pairs depending on the customer specification. Fibre pairs can vary from [REDACTED] There are other MNOs and OLOs who would be able to enter into agreements [REDACTED] that it has already seen customers switching [REDACTED] subsequent to the proposed merger being announced.²⁸⁷

[335] The Commission finds that it is unlikely that Vodacom has [REDACTED] [REDACTED], particularly in relation to its mobile network. As such, the Commission is of the view that [REDACTED] in the short-to-medium term. The Commission is therefore of the view that the proposed merger is unlikely to substantially lessen competition [REDACTED]

9.2.4.6 Coordination for retail fixed line services

[336] The Commission's assessment of coordinated effects is based on the horizontal and vertical nature of the proposed merger. The Commission therefore assessed to what extent the horizontal overlap that exists between the retail fixed line activities of the merging parties could facilitate coordination. Second, the Commission considers to what extent the vertical integration between the merging parties may facilitate coordination between market participants in the fixed lease line market and retail fixed line services market.

9.2.4.6.1 Horizontal forms of coordination

[337] The Commission finds that the proposed transaction unlikely to facilitate coordination among the merged entity and its competitors as there are several market characteristics which suggest that it would be difficult for firms to identify terms of coordination and then to monitor and punish deviation. First, the Commission's concentration level (HHI) calculations show that the implementation of the proposed merger is unlikely to significantly increase the concentration levels in any market which suggests that the implementation of the proposed merger is unlikely to facilitate coordination. Second, the market share position of the merged entity and its

competitors are not symmetrical. This suggests that the merged entity and its competitors are unlikely to be incentivised to coordinate their competitive behaviour. Third, customer's purchasing decisions may also disrupt or undermine any attempt at coordination. Generally, customers procure retail fixed line products by way of tender or request for proposal where several firms are selected by the customer to provide quotations or submit bids. It also appears that some customers procure individual products, while others prefer to procure a bundle of products or services thereby making it difficult to reach terms of agreement, monitor deviation in a timely manner and punish deviators.

[338] The Commission therefore finds that the implementation of the proposed merger is unlikely to facilitate coordination based on the horizontal overlap in the retail market for fixed line services.

9.2.4.6.2 Vertical forms of coordination

[339] The primary concern is that the implementation of the proposed merger could facilitate the exchange of price sensitive information amongst competitors. However, the Commission also finds that consolidation as a result of the vertical integration brought about by the proposed merger is unlikely to facilitate coordination.

It appears to be common practice for MNOs and OLOs to procure fixed lease line services from different service providers. This practice takes place as the fibre networks of the different fixed lease line providers differ as they do not necessarily cover the same geographic areas.

Neotel also procures fixed leased line services from other providers in order to supplement its own network. In this regard, Neotel leases fixed leased line services

[341] These relationships exist pre-merger and the implementation of the proposed merger is unlikely to change these relationships to such a degree that coordination would be made easier. The evidence shows that the supply agreements between these firms are at arms-length, that is, the agreements do not entitle each contracting party to commercially sensitive information of the other party. In this regard, Vodacom would not gain access to rivals costing or pricing information due to its acquisition of Neotel. The only information that Vodacom is likely to gain an understanding of the demand of its rivals for fixed leased line services. It is unlikely that this type of information could facilitate coordination.

9.2.5 Conglomerate Effects

9.2.5.1 Merging parties' view

The merging parties submit that there are no foreclosure concerns arising from the merging parties' ability to offer fixed/mobile bundles [REDACTED]

_____ The merging parties indicate that this trend of bundles accounting for a small percentage of customers' purchases is unlikely to change even though some growth in the sale of fixed-mobile bundles is expected over the next few years. In addition, the merging parties submit that they would not gain any competitive advantage in the retail markets for fixed line or mobile services by either foreclosing fixed line rivals to access Vodacom's mobile offering or by foreclosing rival mobile providers to access Neotel's fixed offering.²⁹⁰ Further, Vodacom states that any consumer benefits that can be delivered by bundling fixed and mobile products will be strongly competed for – _____

9.2.5.2 Commission's view

[343] Conglomerate mergers involve companies that are active in closely related markets (e.g. mergers involving suppliers of complementary products or products that belong to the same product range and is generally purchased by the same set of customers).²⁹² The combination of products in related markets may provide the merging parties with the ability and incentive to leverage a strong market position from one market to another by means of tying or bundling or other exclusionary practices. Conglomerate mergers may also create market power especially where customers have a preference for bundles which rivals of the merged entity will not be able to match.

[344] Enterprise customers generally require a VPN (which requires the necessary access to fixed leased line services). VANS such as VoIP, internet access, video conferencing and hosting

²⁹² EC Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings; (2008/C 265/07); para 3; 2008

services are complementary products provided over the VPN. The ability to compete in the provision of these retail fixed line services hinges heavily on whether they possess the necessary network infrastructure or access to fixed leased line services.²⁹³

The responses received from enterprise customers of the merging parties suggest that mobile and retail fixed line services are complementary.²⁹⁴ For instance, [REDACTED]

[346] The Commission's assessment of conglomerate effects considers two types of possible bundled offerings that can be offered by the merged entity. The first is a bundle involving fixed lines services comprising of retail fixed line services and possibly including fixed leased lines (connectivity). The second bundle includes retail mobile services and fixed line services comprising of retail services and possibly connectivity. The specific bundles can have various combinations of the different retail fixed line services and retail mobile services depending on customer requirements. For instance, customers may choose to procure a bundle of products that would provide them with an end-to-end solution. This bundle would include connectivity and the different retail fixed line services and can also include retail mobile services.²⁹⁷ A customer may also choose to create their own bundle of services either because they want multiple sources of supply or because a service provider is unable to deliver a complete bundle of products.

[illegible]

[347] In considering the bundling strategy of Vodacom it is also important to note that the bundling of fixed and mobile services in future will be driven by the increased role of convergence as the Commission's assessment is therefore not solely based on whether fixed and mobile services are complementary.

[348] It is important to note at the outset that Vodacom operates across all the services that Neotel operates in at the fixed line services level and the real question from a bundling perspective is whether the merger accords Vodacom with an enhanced position that it accrues market power which it would otherwise not have absent the merger. Alternatively, whether the merged entity enjoys a position of market power in any of the fixed line services which could be leveraged onto the other services. This requires either Vodacom to have a pre-merger position of market power or Neotel to have a pre-merger position of market power that the merged entity will then leverage. In the preceding analysis of the merging parties' positions in retail fixed line services and fixed leased lines shows that the merged entity is unlikely to enjoy a position of market power in any of the relevant markets. As such, there is unlikely to be anti-competitive bundling based on leverage. In addition, given the presence of rivals across different markets, it is unlikely that a bundling strategy involving retail fixed line services and possibly fixed leased lines would create market power which would not exist absent the merger. In addition, some of the merged entity's rivals such as [REDACTED] are present across all the markets and as such can potentially replicate the merged entity's bundles.

[349] The Commission's assessment of the likely competitive effects of bundling will therefore focus on the merged entity's possible bundles comprised of fixed and mobile services. Vodacom is the largest provider of mobile services and could potentially leverage this position into fixed lines services by engaging in a bundling strategy. This appears to be at the heart of the concerns raised by [REDACTED] is concerned that the proposed merger will prevent it from competing in providing mobile services to enterprise customers since it would not be able to rival the converged (bundled) offering of Vodacom.²⁹⁸ [REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]

[352] [REDACTED] are currently able to offer a bundle of products as they offer retail fixed line and mobile services. The Commission's market share analysis shows that in each downstream market for retail fixed line services, [REDACTED] are able to rival the merged entity for the provision of retail fixed line services. This suggests that [REDACTED] would be able to rival Vodacom's bundled offering. This view is supported by enterprise customers who indicated that [REDACTED] would be able to offer a similar bundle to Vodacom post-merger.³⁰⁶

[353] ISPs can procure mobile services from other MNOs including Telkom, MTN and Cell C and offer bundles. [REDACTED]

[REDACTED] The Commission is of the view that all MNOs provide coverage to all the major metropolitan and surrounding areas where the majority of enterprise businesses are located.³⁰⁸ It is also necessary to consider to what extent enterprise customers procure fixed and mobile services as a bundle. Bundles of fixed and mobile voice services currently comprise approximately [REDACTED] For [REDACTED] fixed and mobile bundles comprise [REDACTED] to enterprise customers in 2013 and 2014 respectively. These figures suggest that the customers accounting for most revenue do not currently exhibit a strong preference for fixed/mobile bundles.

[354] The responses received from customer interviews indicate that enterprise customers procure fixed and mobile services on an individual basis and would also prefer to do so in future.³⁰⁹ Reasons for procuring fixed and mobile services on an individual basis include (i) operational and procurement risks in buying all services from one provider, (ii) avoid being locked into long term agreements, (iii) avoid the supplier being able to cross subsidise income and (iv) being able to compare the different products or services on a "like for like" basis.

[REDACTED] There are, however, some enterprise customers who indicated that they currently procure a bundle of products that would include fixed and mobile services, while others indicated they would consider procuring a bundle of products in future although they currently procure these

³⁰⁸ The Commission accepts that certain enterprise customers such as mines may have operations at remote destinations where the coverage of some of the MNOs may be limited.

services separately.³¹⁰ These enterprise customers indicated that they can realise cost savings (by way of discount) and prefer to deal with one service provider as a “one-stop shop.” As an example [REDACTED] indicated that [REDACTED]
[REDACTED]
[REDACTED]

9.2.6 Barriers to entry in the fixed line market

9.2.6.1 Merging parties view

[356] The merging parties submit that the main barrier to entry in the infrastructure market is the capital cost, as there is typically a significant upfront cost that has a long payback period (of a minimum of 5 years). This cost varies depending on whether it is national, metropolitan or access fibre. The cost is also dependant on the model of investment (self-built, co-build, purchased or leased).

[357] Other barriers include access to important technologies and specific skills and expertise as there is a small pool of expertise from which to draw in building telecoms networks. According to the merging parties, there are, however, several suppliers that can be contracted to build these networks, which mitigates this impediment. Economies of scale are another barrier but the merging parties submit that scale can be achieved through a collaborative approach to build by operators. This has been done in several instances already on national fibre connectivity in South Africa.

9.2.6.2 Commission's view

[358] The barriers to entry in relation to the fibre infrastructure market are high. According to [REDACTED], the total fibre optic network turn-key solution is very expensive and requires a large source of funding. Hence, only the high dense (high demand) areas are feasible. This restricts the ability [REDACTED] into the smaller metropolitans and rural areas. However, there are significant restrictions to access technologies. [REDACTED] also submits that it is very expensive to build, operate and maintain the fixed infrastructure. These costs include network

[REDACTED]
[REDACTED]

equipment, trenching and operation centres.³¹² In addition, regulatory approvals (way leave approvals) are the greatest restriction from an infrastructure rollout point of view. [REDACTED] experiences significant delays and affects the ability to rollout the network infrastructure in a timely manner. In some circumstances, [REDACTED] to build in certain areas.³¹³

[359] Similar, [REDACTED] submits that regulatory approvals remain a challenge, especially when deploying linear infrastructure that traverse a number of provinces across the country. There is not yet a single approvals process for securing the rights to develop infrastructure that includes the environmental, water, and way leaves. It is further submitted that whereas the process to obtain environmental approvals are well documented and fairly well regulated, the process of securing water use licenses differ from region to region with no defined process. This has led to numerous delays in the past and remains a risk to any linear terrestrial projects. Similarly, metropolitans and provinces impose different requirements when approving way leaves along their roads and highways, which in some instances become prohibitively restrictive.³¹⁴

[360] In addition, economies of scale represent a massive barrier to entry for new and/or prospective entrants, especially in light of the high capital costs.³¹⁵ This barrier can be deduced through promotion of open access networks such as [REDACTED]

[361] The main requirements to enter the retail provision of fixed line services include economies of scale and skills. [REDACTED] submits that for managed services especially where geographical reach is required, economies of scale are a prerequisite for success. [REDACTED]

[REDACTED] Other barriers for providing services include data centre space/facilities to host such services and the capital required for equipment at the client site to enable such services.³¹⁹

9.2.7 Conclusion on fixed line markets

[362] The Commission is of the view that Vodacom is likely to alter focus of its investments primarily towards enterprise and end-customers and this may impact on Neotel's ability to continue to invest in wholesale fixed leased lines, thus potentially chilling competition in the upstream market for wholesale provision of leased lines. However, evidence provided to the Commission suggests that other providers have plans to increase their fixed leased line footprint and are likely to continue to offer alternatives to the merged entity. As such, the merger is unlikely to raise competition concerns in the provision of fixed leased lines at a metropolitan level.

[363] In relation to MNS, VANS and hosting markets, the Commission finds that the merger is unlikely to raise unilateral or coordinated effects in those downstream markets. This is mainly because of the relative post-merger position of the merged entity in these downstream markets.

[364] In relation to the vertical analysis, the Commission considered potential foreclosure via a mobile traffic offload strategy by Vodacom. Firstly, the Commission finds that should Vodacom engage in the mobile traffic offload as argued by third parties, it would have to divert traffic from its current fixed leased line providers [REDACTED]. [REDACTED]

[REDACTED] At the same time, they will incur revenue losses on the contracts that Neotel could possibly have with OLOs and MNOs due to the alleged reluctance to deal.

[365] Second, to the extent that Neotel has additional capacity or could create additional capacity (which would lower its per unit costs), then it is unlikely that foreclosure from access to Neotel's network would be profitable for the merged entity as it would likely simply be foregoing revenue it could possibly generate without incurring significant costs. Therefore there appears to be no incentives to engage in such a foreclosure strategy.

[366] The Commission also finds that the merged entity is unlikely to engage in anticompetitive customer foreclosure even if the ability and incentive may exist to foreclose suppliers such as DFA. This is primarily because there are significant financial penalties as well as costs associated with having to replicate the current DFA network that Vodacom uses.

[367] In respect of potential bundling, the Commission found that it is unlikely that Vodacom would be able to foreclose OLOs by providing bundles of fixed and mobile services. This is primarily due to the merged entity's market positions in the retail fixed line services market and the ability of some of its major competitors to replicate the bundles.

10 THE RELEVANT COUNTERFACTUAL

10.1 Merging parties' view

[368] The merging parties have submitted the following arguments in relation to the relevant counterfactuals relating to both mobile and fixed telephony.

368.1 *Relevant counterfactual for mobile services*

368.1.1 [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

368.1.1.1 The regulatory procedure in terms of the ECA is unclear in so far as it relates to spectrum trading;

368.1.1.2 It is unclear whether Neotel's shareholders would sell the spectrum assets independently of the Neotel business;

368.1.1.3 It is unclear whether any other holder of spectrum is prepared to sell spectrum assets;

368.1.1.4 The benefits of acquiring Neotel's spectrum cannot be duplicated with a roaming agreement with Neotel as Neotel does not have sufficient developed RAN sites to deploy a mobile LTE network nationally or the [REDACTED]; and

368.1.1.5 Vodacom is unlikely to be able to enter into roaming agreements with MTN and Telkom as they have completed their own roaming agreement.

368.1.2 Vodacom therefore submits that absent the merger it would have to continue re-farming and using a limited amount of spectrum (5MHz of 1800MHz) for LTE purposes and would not be able to compete against MTN and Telkom. Alternatively, it could re-farm a greater amount of spectrum (10MHz of 1800MHz), but this would have severe consequences for the performance of its 2G network and this could raise the costs of 2G usage to its customers.

[REDACTED]
[REDACTED]

[REDACTED]

368.2 Relevant counterfactual for fixed lines services

368.2.1 In the fixed line services, the regulatory reforms are unlikely to remove the barriers to competition that the merging parties individually face meaning that they are both likely to remain small.

10.2 Commission's view

[369] The Commission is of the view that any assessment of the relevant counterfactual should be informed by a consideration of various factors influencing possible market outcomes absent the merger, in both mobile and fixed. In doing so, it is important to separate what is regulatory in nature and what are competitive outcomes based on behaviour of firms in the market.

[370] At the outset, the Commission notes that the merging parties' views on the relevant counterfactual are closely correlated to the arguments they have proffered as motivation for the merger. For instance, the merging parties' arguments on the relevant counterfactual on spectrum are premised on an underlying assumption or argument that Vodacom is at a competitive disadvantage relative to rivals and even go to the extent of speculating on the possible outcome of the review of the proposed merger between MTN and Telkom. This transaction is still under consideration by the Commission and a decision has not yet been made. The Commission's investigation reveals that Vodacom is currently not at a competitive disadvantage relative to its rivals in terms of spectrum allocation, network coverage, speed and capacity. The Commission notes that the same arguments raised by the merging parties equally affect their rivals in relation to spectrum. In fact, Vodacom enjoys a leading market position in voice and data services and this position has persisted for a sustained period of time.

[371] The Commission considered the merging parties' arguments on the relevant counterfactual relating to spectrum and concludes the following:

371.1 The Commission does not agree with the merging parties' argument that because regulations are considered unclear, there is no alternative way to access spectrum of other operators other than through ways such as the proposed merger. The Commission

³²¹ See ENS letter dated 28 November 2014, para 37 to 41

understands that access to spectrum can be obtained through a regulatory process based on the ECA and regulations. These enabling laws allow licensees to apply for the transfer of spectrum license or sharing of spectrum, subject to approval by ICASA. For example, Section 31 (2A)³²² of the ECA states that –

“A radio frequency spectrum licence may not be assigned, ceded or in any way transferred, and the control of radio frequency spectrum licence may not be assigned, ceded or in any way transferred, to any other person without the prior written permission of the Authority.”

It is the Commission's view that this amendment to the ECA which occurred in 2014 paves the way for ICASA to grant approval for the assigning, ceding or transferring [own emphasis] of radio frequency spectrum. The Radio Frequency Spectrum Regulations³²³ (Spectrum Regulations) prescribed in terms of the ECA, deal with, among other things, procedures for amending and transferring a radio frequency spectrum licence. More importantly, the regulations also allow for spectrum sharing. In particular, clause 16 of the Spectrum Regulations of 2011 stipulates the following:

- (1) Radio Spectrum Sharing is where two or more licensees have been granted Radio Frequency Spectrum Licences for all or part of the same frequency assignment.*
- (2) The Authority may require a licensee to share an assigned frequency with other licensees.*
- (3) Two or more persons may apply to the Authority for Radio Frequency Spectrum Licences for spectrum assignments on a shared basis.*
- (4) All radio frequency spectrum sharing agreements are subject to approval by the Authority.*

The 2011 Spectrum Regulations have recently been updated and amended in March 2015. However, the spectrum sharing provisions above remain as is, save that an accompanying form ('Form D of Annexure A') has been now been added to the regulations (now clause 18) to permit for the direct application of spectrum sharing.³²⁴ It is

³²² Section 2A was effected through the Electronic Communications Amendment Act, No 1 of 2014.

³²³ Radio Frequency Spectrum Regulations, 2011, Government Gazette No. 34172 (Notice 184 of 2011).

³²⁴ See clause 18(3) of Radio Frequency Spectrum Regulations 2015.

therefore the Commission's view that there are enabling laws which are not unclear as suggested by the merging parties. The available regulations allow for both the transfer of spectrum license as well as spectrum sharing. To the extent that the 2011 Spectrum Regulations were ambiguous at the time of the merging parties consummating the proposed transaction, the Spectrum Regulations have since been recently updated in March 2015 and appear to have addressed any ambiguities.

371.2 The Commission is also of the view that the willingness or unwillingness of TATA to sell spectrum separately from Neotel's other assets is not a relevant or significant counterfactual consideration.

371.3 The Commission also understands that the merging parties are not seeking to transfer Neotel's spectrum licence to Vodacom, but rather that Neotel will continue to exist as a separate entity with its own spectrum license. Vodacom will then have options of accessing this spectrum through commercial arrangements that could include roaming and spectrum sharing. This argument of the merging parties presupposes that in the counterfactual, Neotel will have to rollout news sites and cannot lease space on existing sites, including those owned by Vodacom.

371.4 The Commission is of the view that an issue such as underutilisation of spectrum by some operators is an issue within the regulatory ambit of ICASA and as such should be addressed through regulatory processes.

[372] The Commission also finds that the release of high-demand spectrum by ICASA has been an on-going process since 2006. The latest attempt by ICASA to release 800MHz and 2600MHz spectrum was challenged in 2011 by operators after ICASA used an invitation to apply and the process was subsequently deferred. The main objection by the industry was that there was no clear policy direction at the time.³²⁵ ICASA notes that the licensing process "*sought to, amongst other things, achieve the following policy objectives:*

1. *Facilitate the introduction of new national and rural providers of electronic communications, including broadband;*

³²⁵ What is happening in ICT in South Africa: A Supply-and demand-side analysis of the ICT sector, Gillwald, Moyo and Stork (2013), page 33 - 34; see also ICASA media release at [https://www.icasa.org.za/AboutUs/ICASANews/tabid/630/post/Comments On Mergers And Acquisitions/Default.aspx](https://www.icasa.org.za/AboutUs/ICASANews/tabid/630/post/Comments%20On%20Mergers%20And%20Acquisitions/Default.aspx) accessed on 14 November 2014

2. *Ensure that participating licensees contribute to broad-based black economic empowerment."*

[373] The switch from terrestrial television services to digital technology ('digital dividend') was originally planned to take place during 2015. However, several delays have taken place and it is not clear when the digital dividend will be completed. This is an important process as it would free up high demand spectrum (700MHz & 800MHz) which can be allocated to MNOs to roll-out their LTE networks.³²⁶ [REDACTED]

[REDACTED] It is, however, notable that this policy challenge affects all operators equally.

[374] The Commission is not in a position to determine when high-demand spectrum is likely to be made available by ICASA or whether high demand spectrum could be traded among MNOs or MNOs and OLOs. [REDACTED]

[REDACTED] Regardless, the relevant counterfactual is a scenario where pre-merger competition is likely to continue on the basis of equitable spectrum holdings between Vodacom, MTN and Cell C compared to Vodacom having additional spectrum.

[375] It is possible to argue that the relevant counterfactual is a scenario where Neotel will emerge as a competitor to Vodacom in the LTE mobile market. The Commission is of the view, however, that Neotel's assignment in the 1800MHz frequency band was not intended and is not currently being used to offer mobile services.³²⁹ Absent this merger, the Commission has no reason to believe that Neotel would exercise a competitive constraint to Vodacom in the LTE mobile market.

[376] The Commission's relevant counterfactual relating to fixed line services is the pre-merger scenario in which both Vodacom and Neotel are relatively smaller providers of fixed leased line services compared to Telkom. It is however, notable that both Vodacom and Neotel have plans to keep expanding their own fibre networks and have incentives to do so.

10.3 Conclusion on relevant counterfactual

[377] The Commission is of the view that the rationale for the transaction is an 'innovative way' to get around regulatory challenges associated with issuing of new spectrum. The Commission concludes that most of the arguments raised by the merging parties supporting their view on the counterfactual are of a regulatory nature and can thus be addressed via a regulatory process. The Commission finds that Vodacom is not at a competitive disadvantage relative to its rivals and that the challenge with spectrum equally applies to its rivals and as such, in the counterfactual other operators face similar challenges.

[378] These regulatory challenges should be weighed against the medium-to-long term adverse competition effects arising from the merger. In this regard, the risk of harm to competition is greater than the short term challenges that can be resolved through regulatory processes.

11 EFFICIENCIES OR OTHER PRO-COMPETITIVE GAIN

11.1 Merging parties' views

[379] The merging parties have argued that the merger will result in pro-competitive effects in both the fixed line and mobile telecoms. [REDACTED]

[REDACTED] The Commission will nonetheless address these pro-competitive claims made by the merging parties. In the fixed market the merging parties argue that the merger will create a greater competitive challenge to Telkom and in the mobile market; the merger will alleviate the LTE spectrum constraints on Vodacom and therefore enable Vodacom to roll out its LTE/LTE-Advanced mobile data service.³³¹ Each of these pro-competitive claims is discussed in detail below.

11.1.1 Efficiency gains in the fixed line market

[380] The merging parties have submitted that absent this transaction, Telkom's position in the fixed line market will remain unchanged as the parties are unable to materially challenge Telkom's position due to their lack of last mile infrastructure. The merging parties argue that there are

[REDACTED]

three specific areas of synergy between Vodacom and Neotel that will have the most significant impact on the merged entity's competitive strength against Telkom. These are discussed below:

11.1.1.1 Superior network with greater ability and incentive to invest

[381] The merging parties submit that they would have access to a more extensive fixed network across South Africa and access to this network would place Vodacom closer to the premises of enterprise customers. Vodacom estimates that it would be able to service [REDACTED] that would, post-merger, [REDACTED] of the merged firm's own fibre network. Currently, Vodacom can only reach those customers by leasing fibre from third parties. For Neotel, access to Vodacom's fibre base station network would also increase its reach nationally due [REDACTED] This would place more customers closer to the merged entity's fibre and therefore reduce the cost of extending fibre to the customers' premises.

[382] Vodacom further submits that the merger would enable them to compete against Telkom with regards to Fibre to the Home (FTTH) and Fibre to the Business (FTTB) as they would have access to Neotel's network, experience and capability in the fixed line business. Furthermore, over and above the merging parties' current investment plans, Vodacom submits that they anticipate the transaction could unlock the potential for up to approximately [REDACTED] This incremental investment would comprise:

Table 22: Vodacom's anticipated investment over the next five years

Type of Investment	Investment over 5 years, Rbn
[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]

Source: Vodacom's supplementary submission to the Commission dated 06 March 2015

[383] The merging parties submit that the merger would eliminate Neotel's capital constraints which limit its ability to expand its network. The merger would allow Neotel to recapitalise its debt and it will provide Neotel with Vodacom's greater financial resources. Vodacom submits that an additional [REDACTED] Absent

the merger, the merging parties claim they are materially unable to challenge Telkom's position because they lack the last mile coverage to serve all the customers that Telkom can serve. The merging parties submit that it is very costly to invest in last mile coverage and the lack of LLU regulation makes it difficult to effectively compete in this space. Neotel estimates that for it to increase its population coverage [REDACTED]

[384] The merging parties acknowledge that although the merger would provide them with greater reach and lower cost, it would in no way eliminate the gap to Telkom. However, the merging parties argue that by narrowing the gap to Telkom, the merger increases the probability that the merged firm can persuade a dissatisfied customer to choose an alternative provider. This in turn increases the incentive on the merged firm to make further investments in rolling out additional infrastructure since the investment would have a higher chance of commercial success. The merging parties argue that entrants will want to secure the contract first with customers before making the last mile investment and are therefore unable to offer the service immediately and this places them at a disadvantage compared to Telkom.

11.1.1.2 Complementary product sets will give the merged entity a stronger portfolio offer

[385] According to the merging parties a combination of the Neotel and Vodacom product sets will result in an enhanced offering to a range of enterprise customers. This complementarity is across the range of enterprise offerings including transmission services, voice services, internet access services, VPN and managed network services and hosting cloud and other application services.

11.1.1.3 More effective installation, support and distribution

[386] The merging parties submit that the merger will allow them to acquire new customers by having an effective sales and distribution network; sufficient expertise, capacity and coverage to carry out the installation work timeously and have the resources and coverage to be able to provide effective support services to customers. Vodacom has a significant distribution network due to its mobile business and this network is key to serving small and medium sized enterprise customers. Neotel does not have a distribution network on the same scale as Vodacom. In addition Neotel has the technical workforce with expertise in the fixed market which Vodacom

[REDACTED]

does not have due to its small size in the fixed market. The merging parties submit that [REDACTED] both are slower than Telkom.³³⁵ A combination of the two businesses' support services will result in faster turnaround times and the ability to service a greater geographic reach.

11.1.2 Efficiency gains in the mobile market

[387] The merging parties claim that Vodacom is significantly constrained in its ability to compete with MTN and Telkom in the provision of mobile data services. This is because it lacks the spectrum to meet the increasing demand for LTE data services in South Africa. The merging parties submit that Vodacom is more constrained compared to MTN even though the two firms have a similar spectrum allocation because Vodacom has a large legacy 2G customer base. The higher loading on Vodacom's 2G network means that it operates much closer to capacity than MTN, Telkom or Cell C on its 900 MHz and 1 800MHz spectrum. The merging parties submit that this limits Vodacom's scope to re-farm spectrum to other uses without degrading the 2G network performance. According to the merging parties this constraint is likely to worsen in the future when demand for data grows.³³⁶ [REDACTED]

[REDACTED] However, the expense and policy restrictions limit the ease with which new sites can be built. Therefore, access to Neotel's 1 800MHz spectrum will make Vodacom a third credible competitor for LTE. The merging parties submit that with Neotel's spectrum, Vodacom would be able to obtain [REDACTED]

[REDACTED] Vodacom submits that the use of Neotel's spectrum brings unambiguous pro-competitive effects in the retail mobile market. By alleviating the spectrum capacity constraint, Vodacom will be able to profitably lower prices and increase sales. The transaction will create [REDACTED] [REDACTED] which will result in better services and [REDACTED] to the

benefit of consumers.³⁴⁰ Furthermore, Vodacom submitted that approving the merger will spur other operators to make the necessary investments in order to expand their LTE networks. [REDACTED]

[REDACTED]

[REDACTED]

11.2 Commission's views

[389] In the merger between **Trident Steel (Proprietary) Limited and Dorbyl Limited**³⁴², (Trident/Dorbyl), the Tribunal laid out the principles against which merger efficiencies should be considered and a method for balancing these against potential anti-competitive effects. This section provides a discussion of this test.

11.2.1 Types of efficiencies that should be considered

[390] In the **Tongaat-Hulett Group Ltd and Transvaal Suiker Bpk & Others**³⁴³ merger, the Tribunal suggested that the types of efficiencies that should be considered would be those that, for example, evidences new products or processes that will flow from the merger of the two companies, or that identifies new markets that will be penetrated as a consequence of the merger, markets that neither firm on their own would have been capable of entering, or that significantly enhances the intensity with which productive capacity is utilised. However, these were not given to be an exhaustive list.

[391] In Trident/Dorbyl, the Tribunal described three types of possible efficiencies arising from a merger. The first two of these, dynamic and production efficiencies are seen as 'real' efficiencies, whereas the third, pecuniary efficiencies are not.³⁴⁴ The Tribunal gave several examples of the types of efficiencies falling into this category, namely plant efficiencies, distribution, procurement or capital cost economies, research and development. They cited Areeda et al (1995)³⁴⁵ who find plant efficiencies most compelling and are more sceptical of the other types. In the Trident/Dorbyl merger, there was shown to be some potential cost-reducing

³⁴⁰ See Vodacom's submission dated 6 March 2015.

³⁴¹ Ibid.

³⁴² Case No: 89/LM/Oct00

³⁴³ Case No: 83/LM/Jul00

³⁴⁴ According to the Tribunal, dynamic efficiencies are those associated with innovation which improves product or service quality. It was also noted that although these efficiencies are seen as the most beneficial, they are also the hardest to quantify in practice. Production efficiencies are described as those which allow firms to produce more or better quality output with same amount of input.

³⁴⁵ Areeda, Hovenkamp, Solow ANTITRUST LAW Vol IIA, (1995) pg 975

'specialisation' between the two companies' plants which were seen as 'plant efficiency'. The second type fell under a category called 'supply efficiencies' and arose from the fact that the joint firm would be large enough to order correctly sized pieces of steel (which they could not get previously) which would drastically reduce the amount of scrap metal they produced.

[392] The third category, pecuniary efficiencies, was described as 'e.g. tax savings or lower input costs resulting from improved bargaining power with suppliers'. Of their overall approach to efficiencies, the Tribunal suggested the following:

"When we talk of real economies we would, without proposing an exhaustive list, include dynamic efficiencies, production efficiencies ranging from plant economies of scope and scale to research and development efficiencies that might not be achieved short of merger. Pecuniary efficiencies would not constitute real economies nor would those that result in a mere redistribution of income from the customers, suppliers or employees to the merged entity. Without categorically rejecting them we would be more sceptical than the Canadian courts in accepting certain efficiencies such as administrative efficiencies since these can be established in most mergers."

[393] A final important point noted by the Tribunal in the Trident/Dorbyl decision is that not all cost savings should be considered, only efficiencies that are 'significant or enduring'.

11.2.2 Total welfare or consumer welfare standard

[394] On the subject of whether efficiencies must be passed on to consumers or not (i.e. whether efficiencies should be considered against a consumer welfare or total welfare standard), the Tribunal concluded the following: *"where efficiencies constitute "real" efficiencies and there is evidence to verify them of a quantitative or qualitative nature, evidence that the efficiencies will benefit consumers, is less compelling"*. In other words, it is not necessary to show pass-through to consumers if the efficiency gains are shown to be "real" and of a reasonable order of magnitude. On the other hand if the efficiencies put forward achieve only *"less compelling economies"*, the Tribunal ruled that firms must then show that there are some benefits to consumers. These *"need to be more than trivial, but neither is it necessary that they are wholly passed on"*³⁴⁶.

³⁴⁶ As argued by Kerr (2008), we are of the opinion that the Tribunal's "less-compelling economies" do not refer to pecuniary efficiencies as suggested by Ngobese and Chung (2008), as these were rejected out of hand in the

11.2.3 Merger-specific efficiencies

[395] Efficiencies are measured against 'what could be achieved absent the merger'. The principle of merger-specificity of efficiencies is set out in the Act, which states that efficiencies should only be considered if they 'would not likely be obtained if the merger is prevented. The Tribunal elaborated on this, stating that: *"If the efficiencies could come about through some other legal arrangement or organisational form that is not a merger, or if one of the firms could achieve a claimed efficiency on its own, the efficiency defence fails"*.

[396] The Canadian Merger Guidelines in its categorisation of efficiency gains excludes those claimed efficiency gains that:

"would be likely to be attained if the order that would be required to remedy the anti-competitive effect of the merger were made".

"the efficiencies contemplated could not have been achieved without the merger".

[397] This is also consistent with the EC, which states that:

*"efficiencies are relevant to competitive assessment when they are a direct consequence of the notified merger and cannot be achieved to a similar extent by less anticompetitive alternatives"*³⁴⁷.

[398] The US agencies also apply a similar test:

*"the Agencies will not deem efficiencies to be merger specific if they could be attained by practical alternatives that might mitigate competitive concerns, such as divestiture or licensing. If a merger affects not whether but only when an efficiency would be achieved, only the timing advantage is a merger specific efficiency"*³⁴⁸.

Trident/Dorbyl decision and the question of pass-through or not was never considered. Rather we believe they are other dynamic or production efficiencies which are "less compelling".

³⁴⁷ European Commission, Horizontal Merger Guidelines, para 85.

³⁴⁸ US Horizontal Merger Guidelines, Section 10.

11.2.3.1 Balancing efficiencies against anti-competitive effects

[399] In the Trident/Dorbyl merger the Tribunal noted that there are two possible approaches to weighing efficiencies against anti-competitive effects. The first, which the Tribunal described as a “formulaic” approach, was suggested by Williamson (1968), and explicitly calculates the trade-offs associated with the merger. Both efficiencies and potential deadweight loss resulting from the reduced competition are calculated and compared. This, however, is much harder to achieve, since in practice the two effects are extremely difficult to quantify. The alternative method was termed the “discretionary” approach, which is what the Tribunal used to weigh the possible effects of the Trident/Dorbyl merger.³⁴⁹ The above discussion suggests that in an analysis of merger efficiencies, we should consider whether the efficiencies cited by the merging parties are:

- 399.1 Real;
- 399.2 Compelling or substantial;
- 399.3 Verifiable (how likely are they to occur?);
- 399.4 Merger-specific (and could not otherwise be achieved); and
- 399.5 Going to be passed on to consumers (this is only required if the efficiencies are not sufficiently compelling).

[400] Using the above test, the Commission will assess and apply the above test to each of the claimed pro-competitive gains.

11.2.4 Telkom’s position in the fixed line market

[401] The merging parties argue that Telkom’s position will remain unchanged absent this transaction. However, the entrance of Neotel in the fixed line infrastructure market has provided some competition to Telkom. [REDACTED]

[REDACTED]

[REDACTED]

³⁴⁹ In this merger, the Tribunal did not require a lot of quantitative evidence and did not attempt to calculate the likely price increase due to the merger, except to consider that it could not increase above the import parity price (IPP) which was estimated by one stakeholder to be about 20% higher than the pre-merger price. This effectively put an upper bound on the potential price increase and the efficiencies arising from the merger were found to be both real and compelling. Thus the merger was approved despite the fact that it would leave only one firm in the market.

[REDACTED]

[REDACTED] This shows that absent this deal, Telkom has been facing some competition in the fixed line infrastructure market.

11.2.5 Superior network with greater ability and incentive to invest

[402] The merging parties' argument on this point is that Vodacom does not have an extensive fibre network of its own and access to Neotel's fibre would place Vodacom closer to enterprise customers and therefore make them more attractive as a service provider to enterprise customers. In addition, the merging parties argue that once Vodacom has access to Neotel's fibre they would have the incentive to invest in further infrastructure (last mile) as the likelihood of success will be higher. Specifically, Vodacom submits that it would invest in approximately [REDACTED] and that Vodacom is unable to carry out this investment [REDACTED]. However, the Commission is of the view that there are a number of alternatives available to Vodacom absent this transaction and these alternatives have to be compared to the acquisition of Neotel's fibre network.

[403] Firstly, Vodacom currently has its own fibre network which it has been expanding. In fact, Vodacom submitted that over [REDACTED]
[REDACTED]
[REDACTED] It is not clear to the Commission why Vodacom cannot obtain the necessary technical and commercial capabilities to invest in fixed infrastructure given its size in the mobile market as well the fact that Vodacom is already in the fixed infrastructure market.

[REDACTED] Secondly, Vodacom leases fibre from third parties. Vodacom submitted that it leases metropolitan and last mile fibre from [REDACTED]. Vodacom also submitted that they rely on [REDACTED]. In addition, Vodacom also leases national, metropolitan and last mile fibre from [REDACTED]
[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

Table 23: Vodacom's use of Dark Fibre Africa's fibre network³⁵⁸

Metropolitan leases		Total distance leased	
Last mile access leases		Total distance leased	

[405] It is not clear to the Commission how this deal would enable Vodacom to better serve enterprise customers and provide a competitive constraint to Telkom as Vodacom is already expanding its own network and it leases fibre from third parties including Neotel. If the merging parties rely on this argument as an efficiency defence then the merging parties would have to submit a detailed comparison of the savings that would result from this transaction against the costs involved in expanding Vodacom's own network or leasing fibre from third parties including Neotel.

[406] At present, Vodacom uses VSAT to serve enterprise customers before investing in the infrastructure. This means that Vodacom can win a customer by offering VSAT and then build the infrastructure once they have secured the customer. This eliminates the "immediacy" of service problem that the merging parties refer to. [REDACTED]

[REDACTED]

[407] The merging parties also argue that Neotel is financially constrained and this limits its ability to invest in significant network expansion. However, this does not mean that Neotel cannot expand its network at all. [REDACTED]

[REDACTED]

[REDACTED] For national fibre, Neotel submitted that they will continue to invest in [REDACTED]. For metropolitan and last mile connectivity, Neotel submitted that they will continue to [REDACTED]

[REDACTED] In addition, [REDACTED] Generally, Neotel expands [REDACTED]

[REDACTED] This suggests that although Neotel is financially constrained, they are able to expand their network to some degree. Although Neotel may not be able to expand its network significantly, Neotel has been expanding its network even for last mile coverage. [REDACTED]

[REDACTED] Furthermore, similar to Vodacom, Neotel can also use satellite connectivity for last mile to capture new clients while building the infrastructure.

[408] It is not clear to the Commission that the efficiency benefit of an expanded network is only achievable via this transaction. The Commission is of the view that there are other alternatives and in fact the merging parties are already implementing these options to achieve the same efficiency benefit of an expanded network.

11.2.6 Distribution

[REDACTED] The merging parties have argued that Vodacom's mobile distribution network will be beneficial in acquiring new customers in the fixed line business. However, the merging parties mainly serve enterprise customers in the fixed line business and these customers are served via direct sales. [REDACTED]

[REDACTED]

[REDACTED] This shows that Vodacom does not currently extensively utilise its retail stores to service their enterprise customers. [REDACTED]

[REDACTED]

[REDACTED]

[410] The merging parties also submit that Vodacom does not have the technical workforce required for the fixed line business as Neotel does. It is not clear to the Commission why Vodacom cannot train their staff with the necessary skills and expertise. Vodacom is a very large firm and the largest mobile network operator in South Africa. Vodacom can train their staff with the required skills absent this transaction.

[411] The Commission is of the view that Vodacom's mobile distribution network will not benefit Neotel's fixed line business significantly as Neotel mainly focuses on large enterprise customers who are serviced by direct sales. The Commission is also of the view that the efficiency gains that Vodacom would benefit from Neotel's technical workforce can be achieved without the transaction as Vodacom can train its staff with the necessary skills.

11.2.7 Product complementarity

[REDACTED] The merging parties argue that the merger will allow them to offer a stronger portfolio of enterprise services. The merging parties' argument is that they offer complementary services within the various service offerings to enterprise customers and as such they are not direct competitors. However, the offerings of the merging parties are similar and as such it is not clear how much more value will be added to the enterprise customer by combining similar offerings of the merging parties. Simply because the service offerings are not identical does not mean that the merging parties are not competing in their bundle of offerings to enterprise customers [REDACTED]

[REDACTED]

[REDACTED]

11.2.8 Mobile market

[413] The merging parties submit that the merger will provide Vodacom with access to Neotel's spectrum and this will make Vodacom a credible LTE competitor. Vodacom estimates that the use of Neotel spectrum would provide the equivalent to around [REDACTED]

[REDACTED]

[REDACTED]

However, the merging parties have not provided an estimate of the savings that they would make from acquiring Neotel's spectrum as opposed to building RAN sites.

[414] The Commission is of the view that access to this additional spectrum will give Vodacom significant advantages which rivals will not be able to match. The effect of this advantage is that Vodacom would not be under competitive pressure to reduce prices, and as such the benefits that Vodacom would gain from additional spectrum will not be passed on to end consumers through lower prices. As a result of this spectrum concentration, Vodacom will be able to gain a significant competitive and time advantage, thereby offering a superior network and services that cannot be matched by rivals. The anti-competitiveness of this is in the sense that Vodacom will be able to offer mobile telephony products and services (more directly LTE services, but also indirectly other services such as 3G due to reduced network load on the technology) at prices which are unlikely to be constrained by their rivals in the form of comparable mobile networks that can be built through additional spectrum. Vodacom in particular will not be obtaining the resultant position through competition on the merits (such as lower prices, better service and/or innovation) but rather simply through having access to additional scarce resources (spectrum) which rivals would not have.

11.3 Conclusion on efficiency arguments

[415] The Commission is of the view that the likely benefits that Vodacom would obtain from the additional spectrum do not outweigh the harm that would result as a result of access to the additional spectrum. In addition, Vodacom is unlikely to pass on to consumers the benefit it will gain from additional spectrum. This is because rivals will not be able to match Vodacom and as such Vodacom will not face any competitive constraints from rivals in the mobile market.

[416] The merger will enhance Vodacom's already dominant position in the mobile market. Whilst Vodacom submits that the merger will make other MNOs invest in LTE rollout, however, without spectrum, other MNOs will be constrained. Neotel's spectrum will give Vodacom an advantage over other rivals and as such Vodacom will have no incentive to provide services at lower prices.

12 PUBLIC INTEREST ANALYSIS

[417] The development of South Africa's ICT sector and the regulatory changes thereto has been well documented in other cases that have served before the Competition Tribunal and will not be reiterated in this recommendation.³⁶⁹

[418] The Commission first provides a brief overview of South Africa's broadband policy and objectives and thereafter provides a brief overview of South Africa's telecommunication market structure. Finally, the Commission will describe the inception of Neotel as South Africa's Second National Operator (SNO).

12.1 South Africa's Broadband Policy: 'South Africa Connect'³⁷⁰

[419] The importance of a competitive ICT sector is highlighted in South Africa's Broadband Policy (South Africa Connect) which notes that a lack of quality bandwidth required by public institutions, business and citizens has impacted negatively on the country's development.³⁷¹ It further notes that research suggests that a rise in broadband penetration is linked with economic growth, new jobs, educational opportunities, enhanced public service delivery and rural development.³⁷² South Africa Connect explains that the slow deployment of fixed broadband services and high costs have resulted in mobile broadband becoming the main form of broadband access. As a result, the demand for spectrum by mobile operators has increased, while it has not been allocated spectrum as a result of policy and regulatory bottlenecks.³⁷³

[420] Given this context, the proposed transaction may have a significant impact not only on South Africa's ICT sector, but also on the economy as a whole. This is due to the fact that the proposed transaction involves South Africa's SNO who provides connectivity to ISPs and VANS and fixed broadband services. It also involves South Africa's largest mobile operator who may gain access to Neotel's high demand spectrum, while the DOC, DTSP and ICASA are not yet in a position to allocate spectrum to Vodacom and other market participants.

³⁶⁹ See Competition Commission and Telkom SOC Limited 55/CR/Jul09, 73/CR/Oct09, 78/Cr/Nov09, Telkom SA Limited and Business Connexion Group Limited, 51/LM/Jun06.

³⁷⁰ South Africa Connect: Creating Opportunities, Ensuring Inclusion South Africa's Broadband Policy, 6 December 2013, Government Gazette No.37119

³⁷¹ Ibid, page 18

³⁷² Ibid, page 17

³⁷³ Ibid, page 19

[421] The South African ICT sector is consolidating and several mergers have been filed with the competition authorities. It may therefore be necessary to ask what effect this sector consolidation will have on competition (in a broader sense) and the South African economy as the ICT sector can play a pivotal role in social and economic development.³⁷⁴ Ultimately, this is a question that would have to be answered on a case by case basis, while at the same time being acutely aware of overall trends and the service offerings of firms as a result of these mergers.³⁷⁵ One should therefore be careful to conclude that consolidation will *per se* result in less competition and be aware that some of the concerns in the ICT market should rather be addressed by way of effective regulation than by merger enforcement.

[422] It is also important to be aware that there is a global trend towards consolidation in the ICT sector.³⁷⁶ It appears that maturing markets (decline of traditional voice based revenues) and convergence is driving acquisitions between fixed, mobile, IT, satellite and cable firms. Broadly, the merged firms are looking to replace declining revenues with new service offerings and hope to realise efficiencies through vertical integration or "*triple-play*"³⁷⁷ and "*quad-play*"³⁷⁸ service offerings. It also appears that the merging firms are of the view that these efficiencies and advantages can be released more quickly through acquisitions than by organic growth.³⁷⁹ This also seems to be the case for Vodacom where it intends to use the fixed line assets of Neotel to provide a broader range of services.

[423] In the preamble to the Act, it is recognized that the South African economy must be open to greater ownership by a greater number of South Africans and that an efficient, competitive economic environment, balancing the interests of workers, owners and consumers and focused on development, will benefit all South Africans. Section 2 of the Act also stipulates that the purpose of the Act is to promote and maintain competition in order to provide consumers with competitive prices and product choices.

³⁷⁴ Ibid.

³⁷⁵ Some of the mergers that have been approved by the Commission and Tribunal is likely to have a benign effect on competition – for instance the mergers where Vodacom and MTN acquired the subscriber base of Nashua Mobile

³⁷⁶ See Section 9.1.2

³⁷⁷ Refers to the ability to offer voice and data services over fixed and mobile networks

³⁷⁸ Refers to the ability to offer voice, data and entertainment (video) services over fixed and mobile networks.

³⁷⁹ See also <http://www.techcentral.co.za/industry-consolidation-gathers-pace/49206/> accessed on 14 January 2015.

[424] With this in mind, the competition authorities are obliged in terms of section 12A(1) and 12A(2) of the Act to consider both the impact that a proposed merger will have on competition in a relevant market and whether a proposed merger can or cannot be justified on public interest grounds. As the Commission has found that the implementation of the proposed merger is likely to substantially prevent or lessen competition, it is necessary to determine whether the proposed merger has sufficient public interest benefits that outweigh the likely lessening of competition.

[425] The Commission will first consider what impact the proposed merger will have on employment and then the likely impact on consumers.

12.2 Effect on employment

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[427] [REDACTED]

[REDACTED]

[REDACTED] In assessing the impact of the merger on employment each functional area and business unit of Vodacom considered their own employee numbers against the respective Neotel business unit numbers and made assumptions as to how many full time employees were needed to operate the business unit. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[428] Although [REDACTED] as a result of the proposed merger,³⁸² the Commission cannot find that the proposed merger raises sufficient employment benefits to conclude that the merger should be approved on that public interest benefit.

[REDACTED]

[REDACTED]

[REDACTED]

12.3 Effect on particular industrial sector

[429] The Commission also considered the impact of the proposed merger on a particular industrial sector. It is the Commission's view that the implementation of the proposed merger is likely to have a significant effect on the structure of the South African mobile industry and will shape future competitive dynamics to a material extent.

[430] Ultimately the shape and market structure of the industry may be significantly altered by the proposed merger, possibly erecting a 'single tower' market structure that cannot be significantly matched by rivals. Such an outcome is not in the public interest, particularly given the macro goals of providing more broadband access to the economy. The importance of fostering and maintaining long run competition in the mobile industry is important in attaining this macro objective.

[431] A potential future industry characterised by a large dominant firm may trample on some of the government macro policies particularly those relating to the provision of affordable broadband to citizens and businesses. For instance, in 2010, the then DOC published a Broadband Policy for South Africa³⁸³, the objective of which is stated as:

"To facilitate the provisioning of affordable, accessible, universal access to Broadband infrastructure to citizens, business, communities and the three spheres of government, and to stimulate the usage of Broadband services – in order to promote economic development and growth and act as an enabler for further social benefits".

[432] A market structure dominated by a single firm is unlikely to provide low cost and affordable broadband to the three spheres of government in the long term, particularly when compared against the current structure of four independent competitors. Whilst the proposed merger may also be in line with the objectives of improving the quality of mobile service to customers, through LTE services, the overall objective of providing such on affordable terms is significantly undermined by the re-shaping of the structure of the market that occurs by virtue of the proposed merger. This is particularly important when viewed in the context of the general high prices for mobile experienced in the country against other comparable countries.

³⁸³ Government Gazette No. 33377, 13 July 2010, pp7.

[433] South African mobile operators have generally not served consumers well particularly in terms of offering lower mobile prices when compared to at least other Africa countries. In spite of the significant profits earned by the larger operators Vodacom and MTN, there is generally no history of pass through in the mobile industry. The lower prices that have been observed, particularly in relation to mobile voice have been at the initiation of the smaller operators, particularly Cell C.

[434] [REDACTED]
[REDACTED]
[REDACTED] Whilst there is nothing wrong with dividend declaration by companies, such past conduct of the incumbents, including Vodacom, in the likely resultant market structure is demonstrative that it is unlikely that lower prices and affordable broadband to end customers will be achieved, at least at the same rate that similar low prices would be achieved if there is significant constraining influence from rivals.

[435] For instance, in a research by the Research ICT Africa, South Africa fares lowly against comparable countries in relation to the prices of mobile data, a 1GB mobile data basket price comparison as demonstrated in Figure 10 below.

Figure 10: Index of 1GB mobile data comparison

Table 1: 1GB baskets price				
Operator name	Q2 2014 1GB baskets			
	USD	Rank	USD PPP	Rank
MTN Cameroon	2.1	1	3.8	1
Yu Kenya	4.6	2	7.9	2
Tigo Telecom Senegal	5.2	3	9.0	3
Zantel	6.2	4	14.7	5
MTN Ghana	6.3	5	18.4	11
Movitel	6.4	6	11.9	4
TTCL Mobile	7.7	7	18.4	10
Orange Kenya	8.7	8	14.9	6
Orange Tunisia	8.9	9	20.4	14
Orange Mali	9.1	10	19.4	13
Tigo Tanzania	9.3	11	22.1	17
Vodacom Tanzania	9.3	12	22.1	18
Airtel Ghana	9.4	13	27.6	28
Vodafone Ghana	9.4	14	27.6	29
Glo Mobile Benin	10.4	15	19.9	13
Airtel Burkina Faso	10.4	16	22.1	15
Telmob (Onatel)	10.4	17	22.1	16
Smile Tanzania	10.8	18	25.8	26
Airtel Tanzania	10.9	19	25.9	27
Smile Nigeria	11.1	20	18.3	9
Moov Cote d'Ivoire	11.4	21	17.0	8
Safaricom	11.6	22	19.8	12
MTN Rwanda	11.9	23	24.7	22
Moov Benin	12.5	24	23.8	20
Vodacom Mozambique	12.8	25	23.9	21
Orange Uganda	13.7	26	31.0	36
Airtel Kenya	13.9	27	23.8	19
CellC	14.1	28	24.8	23
MTN Botswana	14.1	29	24.8	24
MTN Uganda	14.6	31	33.2	37
Smile Uganda	14.6	32	33.2	38
Airtel Rwanda	14.9	33	30.9	34
Mcel	16.0	34	29.8	30
Airtel Uganda	17.6	36	39.9	43
Airtel Nigeria	18.6	37	30.5	32
Glo Mobile Nigeria	18.6	38	30.5	33
Ethio	20.6	39	51.2	47
MTN Cote d'Ivoire	20.8	40	31.0	35
Orange Cameroon	20.9	41	38.4	40
MTN Nigeria	21.7	42	35.6	39
Mascom	21.8	43	48.4	46
Etisalat Nigeria	24.8	44	40.7	44
Glo Mobile Ghana	25.1	45	73.7	49
MTC	25.9	46	39.2	41
TN Mobile	25.9	47	39.2	42
YooMee Cote d'Ivoire	31.2	48	46.5	45
Tigo Rwanda	31.3	49	64.9	48
Orange Botswana	69.2	50	153.6	50
beMobile	86.5	51	192.0	51
MTN Benin	122.8	52	234.3	52

Vodacom/Ne

Source: Research ICT Africa, RIA Broadband Brief Policy No 6 Broadband 2014

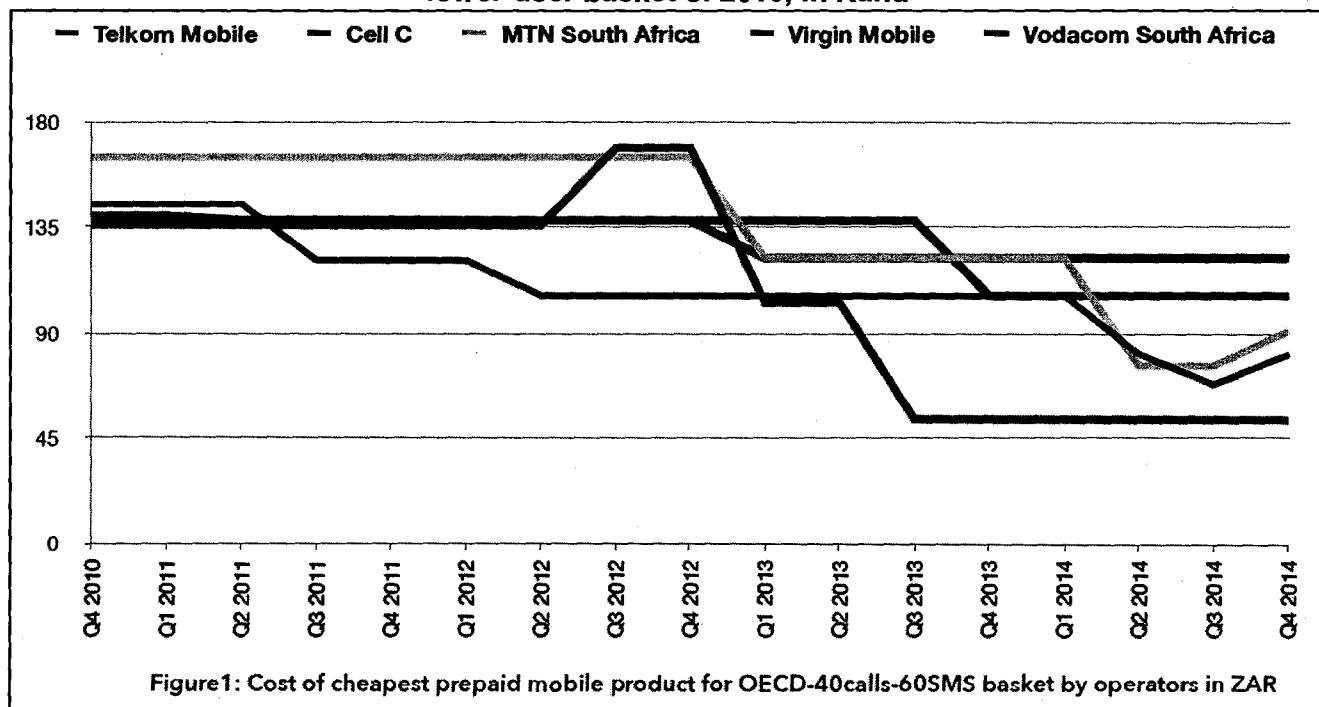
[437] As can be observed from the above Figure 10, South Africa mobile data prices are significantly higher than other comparable countries, with Cell C offering the cheapest basket in the country but sitting at number 28 for all the companies considered in the index. The reshaping of the industry that arises from the proposed merger is unlikely to drive lower broadband prices, particularly if Vodacom ends up becoming a larger dominant firm that cannot be significantly constrained by other rivals.

[438] The Commission notes that MNOs and other operators increasingly focus on the provision of data services in response to customer's increase in demand. Whilst the focus and future of the industry is likely to shift towards mobile data against mobile voice as detailed earlier in the report, the advantages that accrue from additional spectrum are also likely to spill-over to other services such as mobile voice. This is because with more and additional spectrum to utilise for LTE services, there will be more spectrum available for 3G, 2G and voice services as well for Vodacom. This issue has to be viewed in the context of all of Vodacom's first mover LTE advantages and the resultant 'network effects' that will arise from Vodacom having an LTE network that cannot be matched by rivals. Thus, the public interest effects of the merger that arise from the reshaping of the industry should not be limited to mobile data only, but should also consider the likely spill-over effects to other services such as voice.

[439] On this score, the Commission also considered how South Africa fares against other countries on mobile voice prices. South Africa does not fare well against other comparable countries on voice prices either, hence, customers have not be served very by MNOs in this industry. It is likely the effects will be worse if there is lesser competition in the industry by virtue of one firm acquiring an even larger dominant position through offering a mobile network that cannot be rivalled to a significant extent. For instance, the Organisation for Economic Co-operation ('OECD') compared South Africa with other African countries in terms of the OECD 2010 lower-user prepaid mobile basket and its findings are presented in Figure 11 below.³⁸⁵

[1] ³⁸⁵ In order to overcome comparative price complexities the OECD developed a "price benchmarking baskets" methodology. This methodology is based on 40 calls in a month and distribution of calls across time and off-net and on-net. Although the basket volumes and destination distribution in the original OECD basket also include voicemail, RIA has removed voicemail from the basket and redistributed throughout the amount of on-net and off-net calls because voicemail is free of charge with the majority African operators.

Figure 11: Cheapest prepaid mobile product by operator in South Africa, based on OECD lower-user basket of 2010, in Rand



Source: Research ICT Africa Report - Based on RIA Pricing Transparency Index: Prepaid Mobile data (2013)

[440] Figure 11 shows that it is the smaller operators, particularly Cell C that has led price reduction on mobile voice. Vodacom remains the one with the highest prices, at least up to Q4 in 2014. Research ICT Africa notes that the price cuts by the smaller operators put pressure on Vodacom and MTN as they were losing market share.³⁸⁶ This points to the importance of maintaining constraining influence from other rival operators, which however the proposed merger will undermine.

The role of strong competitive constraints from rivals cannot therefore be overemphasised in disciplining larger operators.

[441] It is unlikely that Vodacom will have any incentives to reduce the price of LTE services given that it is unlikely to be constrained by other MNOs and considering its documented strategy that it aims to replace declining voice revenues with mobile data revenues. As shown above, historic competitive behaviour of Vodacom suggests that it would not lower prices for mobile data absent price regulation and/or absent fierce price competition from other MNOs.

[442] In all, the proposed merger negatively impacts on the structure of the mobile industry in South Africa by creating a larger and dominant firm that is unlikely to be significantly constrained by rivals. The past competitive behaviour of Vodacom shows that end-customers have not had pass-through benefits in the form of lower prices and the reduction of mobile prices were brought about by increased, *albeit* limited, competition from smaller rivals and new entrants and the reduction of mobile termination rates. It is unlikely that Vodacom would have the incentive to lower the price of mobile services when it is unconstrained and aiming to replace declining voice revenues with data revenues. The inability of MNOs to compete with Vodacom that arises as a result of the proposed merger is not in the public interest to achieve affordable mobile and broadband prices in the long term.

[443] If anything, any improved LTE benefits from the merger are likely to accrue to a small proportion of consumers with the majority likely to be negatively impacted by a lack of price reductions and lesser competitive choices.

Conclusion on impact on particular industrial sector

[444] The Research ICT Africa study concludes by noting that South Africa remains one of the most expensive mobile countries against select African countries. Despite the quality of some operators in South Africa remaining amongst the best of the 12 countries on the African Broadband Value for Money Index, the inability by regulatory authorities to assign the 2.6GHz bands for LTE is impacting negatively on the quality of mobile data networks in the country. With mobile broadband being the primary form of access for most South Africa, it is imperative that the DTPS issues directives for the regulator to assign high demand spectrum to operators.³⁸⁸

[445] Therefore, the spectrum shortage problems cited by leading operators in the country which are driving some of the transactions in the industry may very well be short term problems which

³⁸⁸ See Research ICT Africa, RIA Broadband Brief Policy No 6 Broadband 2014

may eventually be corrected through regulatory processes. There are indications from the relevant departments, DTPS and DoC, that spectrum challenges may be addressed in the coming few years.

12.4 Impact on firms controlled or owned by historically disadvantaged persons

[446] As mentioned earlier in the introduction to public interest, section 2 of the Act addressing the purpose of the Act seeks to promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons. This section appears to set out the broad objectives that the Act seeks to achieve. The Commission therefore considered the proposed merger in this context. In terms of section 12A(3) (c), the Act requires a consideration of the proposed merger on the ability of small businesses or firms controlled or owned by historically disadvantaged persons to become competitive.

[447]

The Commission considered whether the proposed merger would materially dilute the BEE shareholding in Neotel, against the principle of section 2. Vodacom's BEE shareholding is around 5%. Thus, the merger significantly dilutes the BEE shareholding. For instance, one of the concerns raised in the proposed merger during the ICASA public hearing process is that the implementation of the proposed merger will result in the reduction of ownership of HDPs in Neotel. It also appears that this concern was raised in the context of certain ICASA licensing requirements.³⁹⁰

[448] For example, one of the requirements of the Regulation 12 of the ICASA Licensing Processes and Procedures Regulations 2010 (as amended) relating to Restrictions on transfers and renewal of an individual license state that:

"The Authority may refuse to renew or transfer a licence if the Licensee has not complied with one or more of the following ...(c) where the transferee's ownership and control by historically disadvantaged persons is less than 30%"

³⁹⁰

Third parties were of the view that there is a legal requirement that individual licenses or transferees (who acquire control of an individual license) must have a particular level of HDP ownership.

[449] Therefore, the merger is not be in the spirit of promoting greater spread of ownership as contemplated in section 2 of the Act.

[450] Further, the Commission considered the impact of the merger on the ability of businesses previously owned or controlled by historically disadvantaged persons to become competitive. On this score, it is noteworthy that Neotel is a level 3 broad based black economic empowerment (B-BBEE) contributor whereas Vodacom is a level 2 contributor.³⁹¹ There is therefore a B-BBEE dilution effect that arise from the merger which is not in line with section 12A(3) (c) of the Act.

[451] In all, there is a negative impact arising from the merger, particularly in relation to the BEE shareholding dilution which is against the spirit of one of the purposes of the Act.

12.5 Conclusion on public interest

[452] The proposed merger is likely to reshape the structure of the mobile industry, by erecting a larger and dominant firm that is unlikely to be significantly constrained by rivals. South Africa generally experiences higher mobile services prices than most comparable countries in Africa. More access to broadband services, in line with government policy, is unlikely to be achievable in such a market structure as broadband access is dependent on mobile prices reducing. The proposed merger places Vodacom in a position which will likely entrench its position, further reducing the likelihood of mobile prices coming down, at least to the same extent that prices would decline in a competitive environment.

[453] Although the merger may improve LTE service provision by Vodacom, this benefit is likely to accrue only to a small proportion of end consumers, with the majority likely to be negatively impacted by a lack of price reductions and lesser competitive choices. More so, the past competitive behaviour of Vodacom shows that end-customers have not enjoyed pass-through benefits in the form of lower prices. The reduction in mobile prices observed before have been a culmination, *albeit* limited, of competition from smaller rivals or new entrants and the reduction of mobile termination rates through regulation.

³⁹¹http://vodacom.onlinereport.co.za/vodacom_ir_2014/wp-content/themes/vodacom/downloads/ELC4780_Vodacom%20SA_BEE%20Certificate_Final.pdf

Lastly, the spectrum problems cited by incumbent leading MNOs may be short term problems which may eventually be addressed through the appropriate regulatory forum. [REDACTED]

[455] The Commission also notes that the proposed merger significantly dilutes the BEE shareholding of Neotel. This is against the spirit of the purpose of the Act, especially in relation to the element on the promotion of greater spread of ownership relating to increasing the ownership stakes of historically disadvantaged persons.

[456] Accordingly, it is the Commission's view that the proposed merger raises public interest concerns, particularly when the effect on a particular industrial sector is taken into account.

13 REMEDIES

[457] Given the concerns arising from the merger, the Commission invited the merging parties to submit remedies that could alleviate the concerns arising. [REDACTED]

13.1 Merging parties' views

[458] In light of the concerns arising from the merger relating to spectrum concentration and public interest, the merging parties suggested the following:

SPECTRUM CONDITION

[459] Vodacom shall not directly or indirectly use Neotel's Spectrum for the purpose of offering wholesale or retail mobile services to any of its customers for a period of 2 (two) years from the Approval Date or until 31 December 2017, whichever is earlier.

INVESTMENT CONDITION

[460] Within a period of Vodacom's 5 (five) financial years following the Approval Date, Vodacom shall commit R10 billion investment in fixed network, data and connectivity infrastructure, which shall include all capital investments and long-term commitments, additions and upgrades in transmission, national long distance fibre, backhaul, connectivity and in the development of value adding services. At least 50% of the committed investment amount shall specifically comprise investments in all fixed network elements required to enhance services to homes and enterprises in South Africa, including home and enterprise connectivity and the development of value adding services.

BEE CONDITION

[461] Vodacom shall, within a period of 2 (two) years following the Approval Date, ensure that the value of shares in its share capital held by BEE shareholders shall increase by an amount of at least R1.4 billion, being the value attributable to Neotel in terms of the Merger multiplied by 19% (being the current BEE shareholders' direct shareholding in Neotel)

EMPLOYMENT CONDITIONS

[462] Vodacom shall not retrench any employees within the Merging Parties as a result of the Merger. Retrenchments do not include –

- 462.1 voluntary separation arrangements
- 462.2 voluntary early retirement packages
- 462.3 unreasonable refusals to be redeployed in accordance with the provisions of the Labour Relations Act
- 462.4 resignation or retirements in the normal course
- 462.5 retrenchments lawfully effected for operational requirements unrelated to the proposed transaction.

13.2 Third party views on the proposed remedies

[463] The Commission engaged third parties in order to obtain their views on the proposed remedies. Initially, the parties had proposed a 12 month deferment period on spectrum. However following

further engagements with the parties, the parties accepted a longer 2 year deferment period. However, the views below from third parties were based on the original 12 month deferment period as had been proposed.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

³⁹⁵ See letters from ICASA dated 28 May 2015 and 25 June 2015.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

³⁹⁶ See letter from Graham Mackinnon Cell C dated 23 June 2015.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

13.3 Commission's views

[472] The Commission engaged the parties on several occasions to discuss the adequacy of the proposed conditions. It has to be noted that the parties do not agree with the theory of harm identified by the Commission but for purposes of taking the investigation forward, agreed to proffer remedies as discussed above.

[473] The Commission also engaged several affected stakeholders such as ICASA, DTPS and other MNOs in order to test the adequacy and probity of the remedies proposed by the merging parties. As observed, the views submitted by third parties are based on the original proposal of 12 months, which however was amended to 2 years as described earlier.

[474] At the outset, it is important to understand the context and scope with which remedies are imposed and the framework with which remedies can achieve the intended outcomes. According to the ICN Merger Working Group: Analytical Framework Subgroup, remedies should only be applied to address the identified competitive detriments expected to arise from a merger transaction. In the absence of remedies, competitive detriments resulting from a merger could only be addressed by prohibiting the transaction in its entirety. The key contribution of remedies is to enable a modified outcome to merger transactions which restores or maintains the competition whilst permitting the realisation of relevant merger benefits, thus achieving a better outcome than straightforward prohibit or permit decision.³⁹⁸

[475] With this framework in mind, it is important to note that the major competitive concern arising from the merger is that Vodacom will access additional spectrum from Neotel which will confer significant first mover advantages which are likely to be inherently durable. It is also unlikely that Vodacom will be significantly constrained by rival MNOs in the country as they are also constrained. Therefore, any remedy should seek to address the durable first mover advantages. In the absence of any direct remedy to achieve this, competition may similarly be maintained if other MNOs also obtain similar additional spectrum.

[476] ICASA submits that spectrum is a scarce and limited resource. Currently, it is only the 2600MHz band which could potentially be licensed to MNOs. Other bands which are suitable for mobile such as 1800MHz and 2100MHz are fully utilised. The other potential 700MHz and 800MHz

³⁹⁸ See ICN Merger Working Group: Analytical Framework Subgroup – Merger Remedies Review Project – June 2005.

bands could be available in future; however, this is dependent on the DTT process which at this stage is unclear when it will be finalised. [REDACTED]

[REDACTED] The DTPS and DoC Annual Strategy Plans reflect that plans are underway to formulate and implement a policy on spectrum within the coming few years.

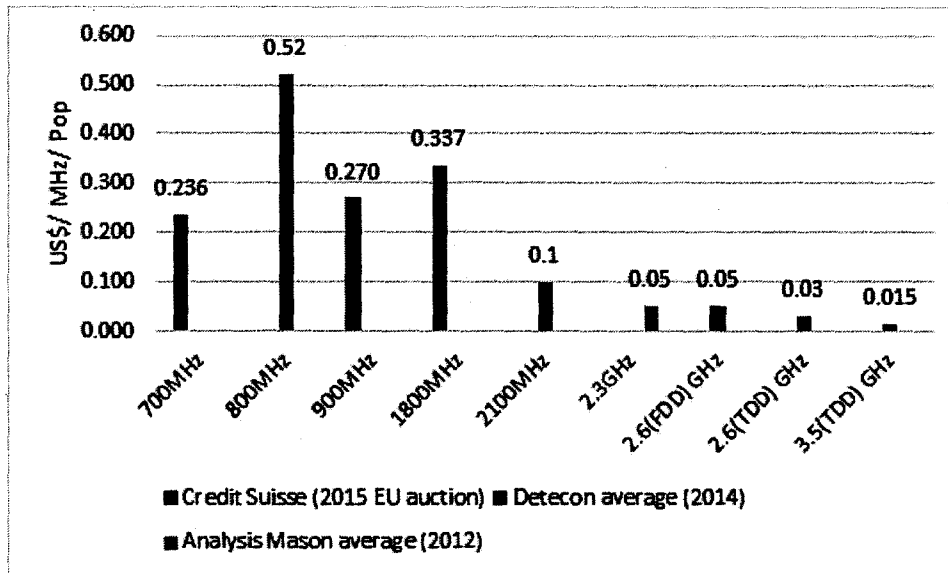
[477] In light of this, the 12 month deferment period as suggested by the merging parties does not address the durable first mover advantages which will accrue to Vodacom should it acquire additional spectrum when other rivals are unlikely to obtain similar additional spectrum. As long as other rivals do not obtain additional spectrum, the competitive harm will not be addressed even if Vodacom does not utilise the spectrum for 12 months.

[478] In addition, the 12 month deferment does not prevent Vodacom from rolling out its infrastructure that will be used once it has access to the spectrum. Vodacom still acquires the head start in terms of rolling out infrastructure as it will be assured of the type (bands) of spectrum they will use on the newly rolled out infrastructure. On the other hand, rival MNOs have no guarantee of which type of spectrum they will obtain and when such spectrum will be available. Accordingly, they cannot roll out their infrastructure the same way Vodacom could. Therefore, the advantages remain even in the presence of the 12 month deferment period.

[479] A 2 year period may address the concerns relating to the <1GHz spectrum provided such a period coincides with the alignment of spectrum allocations through the DTT process. However, even this will only partly address the concerns. This is because the DTT process is unlikely to equalise spectrum allocations in other >1GHz bands. For instance, Vodacom will acquire the 1800MHz bands which is fully utilised. On the hand, it is only the 2600MHz which may potentially become available for allocation to other MNOs. The usefulness of these spectrum bands in rolling out LTE is different. For example, the 1800MHz band which Vodacom will acquire from Neotel is considered prime property due to the fact that it is globally harmonised for IMT usage. In recent EU spectrum auctions, the 1800MHz band attracted the highest bidding from bands available. Figure 12 below highlights this.

Figure 12: Economic value of IMT spectrum bands⁴⁰⁰





[480] Therefore, whilst a 2 year deferment period may allow for the alignment of spectrum to occur, it may not ultimately equalise in all the bands.

[481] The Commission however notes that ultimately, the concerns arising in this merger and any remedy imposed is a policy issue relating to spectrum allocations. There are indications that the relevant government departments are embarking on processes to introduce and implement policies on spectrum. In this regard, the spectrum concerns arising in this instance can therefore be addressed through a policy process. It is also the Commission's view that such a process may be concluded within 2 years. Therefore, a 2 year deferment period addresses the harm arising.

[482] In relation to the proposals on investments in fixed infrastructure [REDACTED] In the remedies proposed, Vodacom has proffered to invest R10 billion in relation to fixed line infrastructure over a shorter period of 5 years. This is significant and will likely materially introduce stronger competition to Telkom, the leader in the fixed infrastructure markets. These proposals on fixed investments alleviate the public interest issues arising from the merger.

[483] The views of other stakeholders in relation to the spectrum concerns are discussed below.

Conclusion on remedies

[484] Taken as a whole, it is the Commission's view that the 12 month deferment period offered is inadequate as it does not address the competition concerns identified relating to spectrum. None of the third parties engaged consider such a deferment adequate.

[485] However, a deferment period of 2 years or a period when new spectrum can be allocated to other MNOs, whichever comes first, may alleviate the concerns relating to spectrum. The concerns arising in this merger and any remedy imposed is a Policy issue relating to spectrum allocations. The spectrum issue can therefore be addressed through a policy process and it is the Commission view that such a process may be concluded within 2 years. Therefore, a 2 year deferment period may address the harm arising.

[486] In respect of the monitoring provision, the Commission is agreeable to the principles of appointing an independent third party, at Vodacom's cost, to monitor the implementation of any spectrum deferment remedy.

[487] The parties have made commitments to invest significant amounts in relation to fixed line infrastructure. It is the Commission's view that such investments are important and will provide a stronger competitor to the incumbent operator Telkom. [REDACTED]

[REDACTED] However, in the proposed condition Vodacom has committed to investing R10 billion over a shorter period of 5 years. Such investments are material and will alleviate the public interest issues arising from the merger.

[488] The Commission is agreeable in principle to all other conditions tendered relating to employment. In respect of the BEE dilution, the Commission notes that ICASA has approved the proposed merger subject to conditions on BEE. Therefore the Commission will defer to the Conditions which ICASA will impose as such BEE requirements as prescribed under the ECA.

[489] The rest of the Conditions are attached hereto as Annexure A. the merging parties have agreed to the proposed condition in its entirety.

14 CONCLUSION

[490] The Commission finds that the proposed transaction is likely to substantially lessen or prevent competition in the mobile services markets. This is mainly as a result of the spectrum

concentration effects that accrue to Vodacom and undermine competition in the mobile markets.

[491] The merger is also likely to have a significant impact on the structure of the South African mobile markets and future competitive dynamics. Although the parties have submitted that the merger will improve LTE service to end customers, the benefit is likely to accrue only to a small portion of the end customers.

[492] Given the above concerns arising in the mobile markets, the Commission invited the parties to submit remedies that could alleviate the concerns arising from the proposed merger. The main remedy proposed relates to deferring the use of the spectrum currently licenced to Neotel by 12 months.

[493] In all, a deferment period of 2 years is likely to alleviate the concerns relating to spectrum. The concerns arising in this merger and any remedy imposed is a spectrum policy issue relating to spectrum allocations. The spectrum issue can therefore be addressed through a policy process and it is the Commission view that such a process may be concluded within 2 years. Therefore, a 2 year deferment period may address the harm arising.

[494] In all, the Commission recommends that the proposed merger be approved subject to conditions attached hereto as Annexure A.

Report prepared by:

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Legal Services

HARDIN RATSHISUSU

Divisional Manager: Mergers and Acquisitions

Competition Commission, South Africa

Annexure for database purposes

Ultimate Acquiring Firm		Vodacom Group Limited	
Legal Representative (Firm)		Edward Nathan Sonnenbergs and Bowman Gilfillan	
Contact person		Lee Mendelsohn	
Telephone no:		011 269 7600	
Name of analyst:		Relebohile Thabane	
Name of coordinator:		Relebohile Thabane	
Purchase price:		R7 billion	
SIC code (target or overlapping markets):		619 – Other telecommunications services	
Sector description acquiring group:		Mobile Telecommunications	
Sector description target firm:		Mobile Telecommunication	
Threshold Analysis (Q 6,7 and 8)	Annual turnover preceding financial year	Asset value preceding financial year	
Primary acquiring firm (Total of all firms)	A R [REDACTED]	B R [REDACTED]	
Primary target firm (Total of all firms)	C R [REDACTED]	D R [REDACTED]	
Combined*	A+C R [REDACTED]	A+D R [REDACTED]	B+D R [REDACTED]

14.1.1.1.1.1 Public interest Issues		
Effect on employment (Specify number)	Jobs lost	Yes
	Jobs saved	Yes
	Jobs created	No
Trade union participation/ CC5(1) filed	Yes	
	Name of Trade Union	Media Workers Association of South Africa Communication Workers Union ("CWU") and South African Communications Union ("SACU").
Impact on small business/firm of HDP	No	
Foreign direct investment	No	
International competitiveness	No	
Arguments used	By the Commission	By the parties
SMME's	No	No
International competitiveness	No	No
Impact on particular industry	Yes	Yes
Black economic empowerment	No	No
Failing firm	No	No
Efficiency defense	No	Yes
Type of transaction		
Horizontal, vertical, conglomerate, combination (specify)		Horizontal vertical and conglomerate
Management buy-out		No
International transaction		No



Rule 28 application	No
Other jurisdictions notified	Decision
Participation of regulators, government departments, consumer organizations, industry organizations, professional associations and research institutions	Nature of participation, e.g. intervener, stakeholder, etc.
ICASA	Stakeholder
ISPA	Stakeholder
WAPA	Stakeholder

Annexure A

Case No: 2014Jul0382

In the large merger between:

Vodacom Proprietary Limited

Primary Acquiring Firm

and

Neotel Proprietary Limited

Primary Target Firm

CONDITIONS

1. DEFINITIONS

In this document and the annexures hereto the following expressions bear the meanings assigned to them below and related expressions bear corresponding meanings –

- 1.1. **“Act”** means the Competition Act, No. 89 of 1998 (as amended)
- 1.2. **“Approval Date”** means the date on which the Merger is approved by the Competition Tribunal
- 1.3. **“BEE”** means Black Economic Empowerment
- 1.4. **“Competition Commission”** means the Competition Commission of South Africa, a statutory body established in terms of section 19 of the Act
- 1.5. **“Competition Tribunal”** means the Competition Tribunal of South Africa, a statutory body established in terms of section 26 of the Act
- 1.6. **“Conditions”** mean, collectively, the Spectrum Condition, Investment Condition, BEE Condition and the Employment Condition as set out in this document
- 1.7. **“ECA”** mean Electronic Communications Act No. 36 of 2005,(as amended)
- 1.8. **“Employment Condition”** means the condition set out in paragraph 3.4 below

3.4. EMPLOYMENT CONDITIONS

- 3.4.1. Vodacom shall not retrench any employees within the Merging Parties as a result of the Merger. Retrenchments do not include –
- 3.4.1.1. voluntary separation arrangements
 - 3.4.1.2. voluntary early retirement packages
 - 3.4.1.3. unreasonable refusals to be redeployed in accordance with the provisions of the Labour Relations Act
 - 3.4.1.4. resignation or retirements in the normal course
 - 3.4.1.5. retrenchments lawfully effected for operational requirements unrelated to the proposed transaction.

3.5. MONITORING

- 3.5.1. In order to monitor Vodacom's compliance with the condition set out in clause 3.1
- 3.5.1.1. Vodacom and the Commission, together with ICASA, shall work together to agree on efficient and effective means of monitoring such compliance. This shall include but not be limited to the appointment by the Commission, after consultation with ICASA and Vodacom, of an independent entity to attend to the administrative function of such monitoring;
 - 3.5.1.2. Vodacom shall bear the reasonable costs of the independent entity so appointed, and shall pay the appointed entity directly; and
 - 3.5.1.3. The independent entity shall prepare a bi-annual report on Vodacom's compliance, which shall be made available to the Commission, ICASA and Vodacom, every 6 (six) months after the Approval Date for the duration of the condition in clause 3.1.

- 3.5.2. Vodacom shall on an annual basis, following its financial year end, submit a report on its compliance with the Investment Condition. The report shall be submitted not more than 3 (three) months of its financial year end and must be accompanied by an audit certificate by an independent auditor confirming the total amount invested for that year, the areas of investment and the level of investment per area.
- 3.5.3. Vodacom shall circulate the Employment Conditions to all employees of Vodacom and shall procure that Neotel circulate same to all employees of Neotel within 10 business days of the Approval Date. Vodacom shall submit an affidavit by a senior official confirming compliance with this condition. The affidavit shall be submitted within 5 (five) business days of the circulation and also contain a copy of the notice sent to its employees.

3.6. VARIATION

- 3.6.1. Should the merging parties wish to amend the Conditions, Vodacom shall be entitled, upon good cause, to make a proposal to the Competition Commission to consent to the waiver, relaxation, modification and/or substitution of one or more of the Conditions, which consent shall not be unreasonably withheld. "Good cause" shall mean any circumstances that could not reasonably have been foreseen by Vodacom at the time of the Competition Tribunal's approval of the Merger.
- 3.6.2. In the event of the Competition Commission and Vodacom agreeing upon the waiver, relaxation, modification or substitution of any aspect of the Conditions, the Competition Commission and Vodacom shall make application to the Competition Tribunal for confirmation by it of such waiver, relaxation, modification or substitution of any one or more of the Conditions.
- 3.6.3. In the event of the Competition Commission withholding its consent to a waiver, relaxation, modification and/or substitution of any one or more of the Conditions, Vodacom shall be entitled to apply to the Competition Tribunal for an order waiving, relaxing, modifying or substituting of any one or more of the Conditions. The Competition Commission shall be entitled to oppose such application.

- 1.9. **"ICASA"** means the Independent Communications Authority of South Africa, the regulator for the South African communications, broadcasting and postal services sector established by the Independent Communications Authority of South Africa Act No. 13 of 2000 (as amended)
- 1.10. **"JSE"** means the Johannesburg Securities Exchange Limited, a limited liability public company duly incorporated in the Republic of South Africa and licenced to operate as an exchange
- 1.11. **"Labour Relations Act"** means the Labour Relations Act, No. 66 of 1995 (as amended)
- 1.12. **"Merger"** means the acquisition by Vodacom of the entire issued share capital of Neotel, in terms of section 114 of the Companies Act No 71 of 2008 (as amended)
- 1.13. **"Merging Parties"** means, collectively, Vodacom and Neotel
- 1.14. **"Neotel"** means Neotel Proprietary Limited, a private company incorporated in accordance with the company laws of the Republic of South Africa
- 1.15. **"Neotel's Spectrum"** means Neotel's 850 MHz, 1800 MHz and 3.5GHz spectrum
- 1.16. **"Vodacom"** means Vodacom Proprietary Limited, a private company incorporated in accordance with the company laws of the Republic of South Africa. Vodacom is controlled by Vodacom Group Limited ("Vodacom Group"), a public company listed on the JSE.

2. RECORDAL

The Commission's investigation of the proposed merger found that there are competition concerns arising from the merger relating to spectrum concentration accruing to Vodacom. As a result of the proposed merger, Vodacom will access additional spectrum from Neotel which will confer significant first mover advantages to Vodacom. Such advantages are likely to be inherently durable. It is also unlikely that Vodacom will be significantly constrained by rival mobile network operators (MNOs) in the country as they are also constrained. In addition, the proposed merger raises public interest concerns, particularly if the effect on an industrial sector is taken into account.

In order to address these concerns, the Commission and the merging parties have agreed on a set of remedies which seek to address these concerns.

The Commission recommends the approval of the acquisition by Vodacom of the entire issued share capital of Neotel, as well as all of Neotel's shareholders' loan claims against Neotel on the basis of the Conditions that follow below.

3. CONDITIONS TO THE APPROVAL OF THE MERGER

3.1. SPECTRUM CONDITION

Vodacom shall not directly or indirectly use Neotel's Spectrum for the purpose of offering wholesale or retail mobile services to any of its customers for a period of 2 (two) years from the Approval Date or until 31 December 2017, whichever is earlier.

3.2. INVESTMENT CONDITION

Within a period of Vodacom's 5 (five) financial years following the Approval Date, Vodacom shall commit R10 billion investment in fixed network, data and connectivity infrastructure, which shall include all capital investments and long-term commitments, additions and upgrades in transmission, national long distance fibre, backhaul, connectivity and in the development of value adding services. At least 50% of the committed investment amount shall specifically comprise investments in all fixed network elements required to enhance services to homes and enterprises in South Africa, including home and enterprise connectivity and the development of value adding services.

3.3. BEE CONDITION

- 3.3.1. Vodacom shall, within a period of 2 (two) years following the Approval Date, ensure that the value of shares in its share capital held by BEE shareholders shall increase by an amount of at least R1.4 billion, being the value attributable to Neotel in terms of the Merger multiplied by 19% (being the current BEE shareholders' direct shareholding in Neotel)
- 3.3.2. Nothing in 3.3.1 precludes ICASA from imposing any conditions on BEE obligations on the merging parties in terms of the ECA.
- 3.3.3. Should the value of the BEE obligations imposed by ICASA in terms of the ECA exceed the value set out in 3.3.1 above, then the obligations imposed by ICASA will apply.

