REVIEW OF IMPLEMENTATION OF THE INTERCONNECTION DETERMINATION NO.1 OF 2007

1. Introduction

The Commission conducted a Network Cost Study on retail and wholesale prices in the Telecommunications market in 2006/07. The overall objective of the study was to determine, through review of the available institutional, regulatory and financial information and through a costing exercise, the appropriate costs and prices of various telecommunications services. It covered mobile and fixed telecommunications services in the country and the interconnection envisaged therein. To achieve this, the study developed three models; the market models, cost models and price models. The results of the study are meant to provide the necessary regulatory tools in support of a competitive telecommunications environment that can ensure increased investment, returns and access to services in the long run.

One of the short-term regulatory requirements recommended to realign call termination was for the Commission to issue a Determination on Interconnection rates. Consequently, the Commission issued a Determination No.1 of 2007 on Cost based Interconnection Rates for Fixed and Mobile Telecommunication Networks in the Republic of Kenya (hereafter referred to as the Determination) to allow for the implementation of a cost-based pricing structure in Kenya.

2. Interconnection rates ruled in the determination

The Interconnection Determination became effective on the 1st day of March 2007 and is binding to all the fixed and mobile telecommunications network operators operating in the Republic of Kenya. The Determination superseded all the previous Rulings made by the Communications Commission of Kenya on mobile and fixed interconnection rates. The appropriate cost-based interconnection rates determined are as shown in Table 1.

Table 1:The Cost-based Interconnection rates with effect from 1st March 2007 in KES				
Real 2006 KES	*1st March 2007*	*1st January 2008*	*1st January 2009*	*1st January 2010*
Mobile Termination	6.28	5.27	4.42	*xxxxx*
Fixed Termination				
Local termination	*1.74*	*1.65*	*1.61*	1.67
Single tandem termination from tandem exchange	*3.23* *(KES3.50 in nominal terms)*	*3.03*	*2.90*	3.01
Double tandem termination from tandem exchange	*4.82* *(KES5.23 in nominal terms)*	*4.35*	*3.61*	3.76
Single tandem termination from local exchange*	5.48	4.98	4.89	5.08
Double tandem termination from local exchange*	6.27	5.71	5.59	5.81
Fixed Transit				
Transit local exchange to tandem (single tandem)	2.57	2.31	2.27	2.30
Transit local exchange to tandem (double tandem)	3.37	3.05	2.99	3.06
Tandem to tandem transit	1.08	0.98	0.96	1.01
Local to local transit (single tandem)	4.86	4.38	4.30	4.35
Local to local transit (double tandem)	5.66	5.12	5.02	5.10

*These rates were effective 1st July 2007

The implementation of the interconnection rates is based on a glide path and therefore requires operators to continuously enter into new Interconnection Agreements and submit the same to the Commission. Operators are however at liberty to negotiate lower interconnection rates subject to the capped rates provided in the Determination.

The first review was carried out in January 2008 before introduction of phase two of the interconnection rates on 1st March 2008. The review established that during the initial stages of implementation, there were challenges in drawing the agreements. However on the overall the Determination provided a framework that spurred growth and competition in the industry.

3. Current Implementation Status

The implementation of Phase two of the Determination No. 1 of 2007 commenced on 1st March 2008 and was not hindered by issues of interpretation and disputes as witnessed during the implementation of Phase one. The operators subsequently filed the Deeds of variation following new interconnection agreements as per the Determination. The mobile operators, Safaricom and Celtel, filed their Deed of variation with the Commission on 4th June 2008. Telkom Kenya and Safaricom filed their Deed of variation on 19th May 2008, Telkom Kenya and EM-Communications on 26th May 2008, Telkom Kenya and Celtel on 6th August 2008, and Telkom Kenya and Flashcom on 9th May 2008.

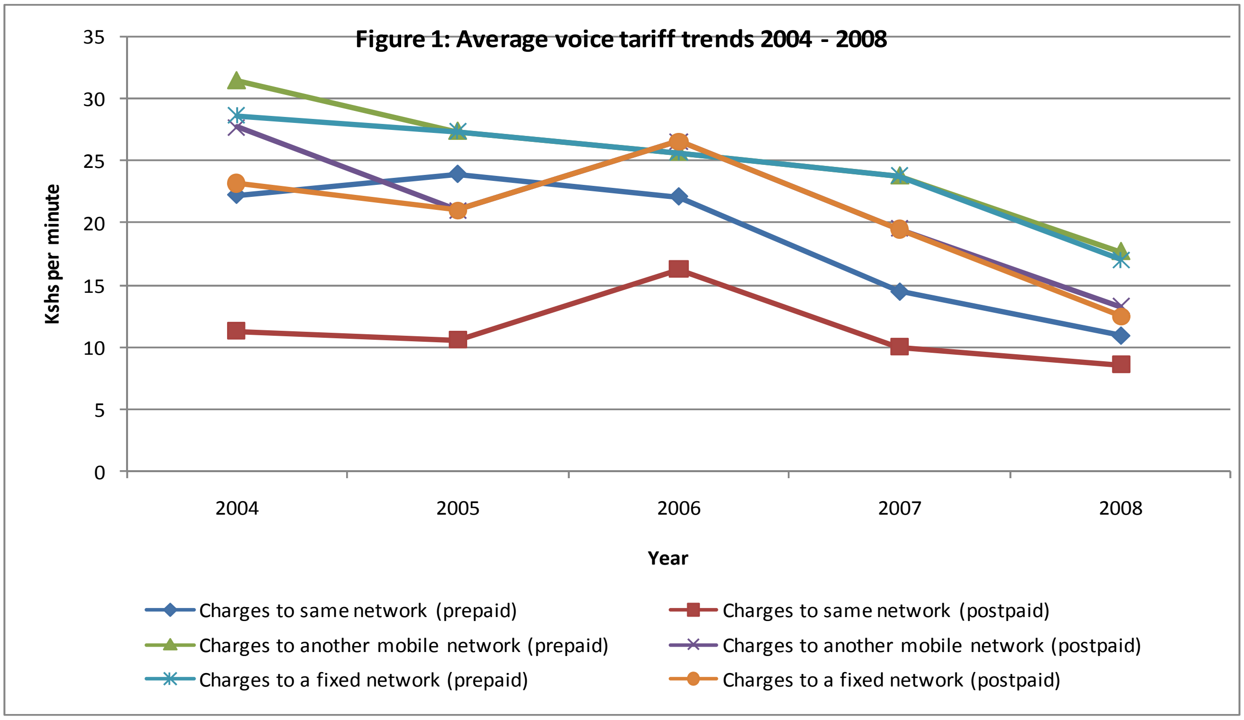
During the period of implementation of the second phase, two new mobile operators came on board (that is, Telkom Kenya "Orange" and Econet Wireless Kenya "YU"). The operators negotiated and signed agreements with the other operators on the basis of the rates in second phase. The interconnection agreements were subsequently filed with the Commission as required by the regulations before the new operators commenced offering their services.

4. Impact of the determination in the telecommunications sector

As a requirement of the Determination, the Commission has reviewed the status of implementation of the second phase based on information from the quarterly returns submitted by the operators. To establish the impact of the Interconnection Determination on the sector, we look at probable indicators that show the developments in the telecommunications market. These include tariffs of voice services, growth in subscriber numbers and network coverage.

Tariffs of voice services

The implementation of the Determination has continued to result in tariff reductions as experienced in Phase one of implementation. The tariff trend presented in Figure 1 shows a reduction in both postpaid and prepaid tariffs within the review period, with average tariff reductions ranging from 15% for postpaid calls to same network and 37% for postpaid calls to fixed networks. The average charges to fixed network (postpaid and prepaid) are lower than charges to another mobile network (postpaid and prepaid respectively), which may be due to lower changes by Telkom Kenya "Orange" to the fixed network compared to other mobile networks, thus resulting in lower average charges.



The trend shows that tariffs tend towards converging and given this trend, it is expected that in future, there will marginal difference between tariffs for on-net and off-net calls. However, an analysis of the average tariffs by operators in Chart 1 reveals a wide disparity as Safaricom limited continues to levy higher tariffs. The new entrants have the lowest calling rates in the market.

Chart 1: Average tariffs for Voice service by Operators in Kenya as at December 2008

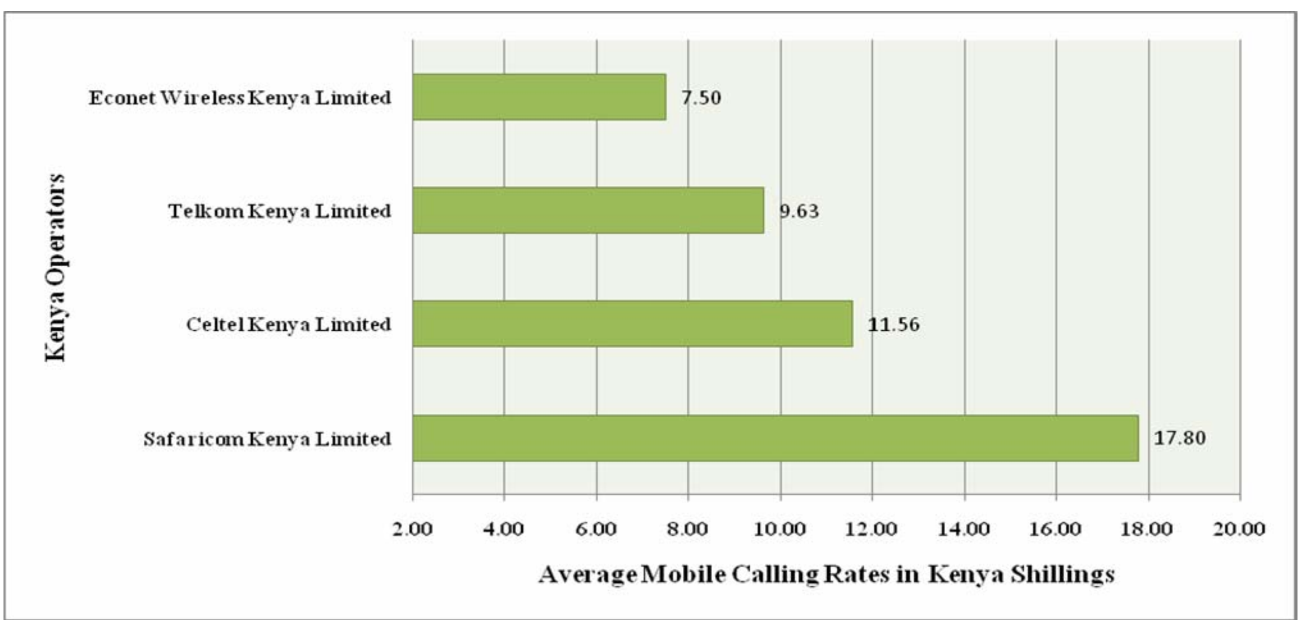
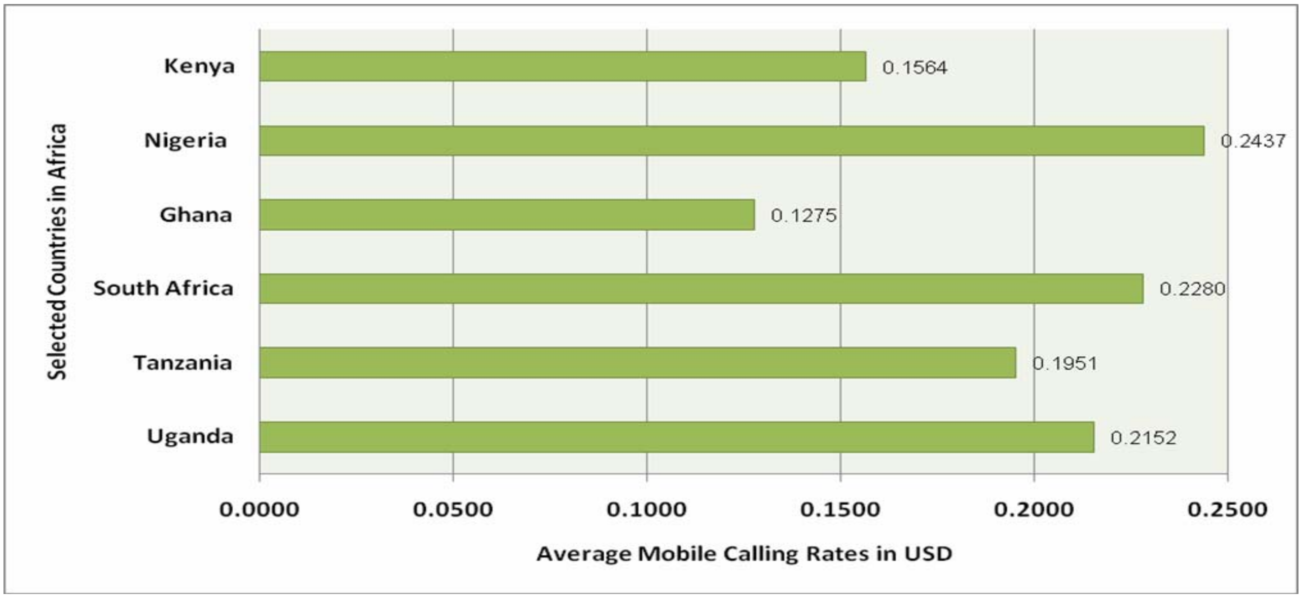


Chart 2 below shows that as at October 2008, Kenya was having the lowest tariffs within the East African region but this was much higher that the average cost in Ghana.

Chart 2: **Comparison of Mobile Tariff Rates in Selected Countries in Africa – October 2008**



With the resurgence of the Telkom Kenya and the launch of the Econet "YU" service it is expected that Kenya will become one of the most competitive mobile markets on the African continent. Competition among the four mobile operators have seen tariff rates decline tremendously. Despite the disparities that exist among the African countries, the average mobile charges per minute seem comparable. Among the selected countries, Nigeria has the highest cost at USD 0.2437, while Ghana has the lowest at USD0.1275. In East Africa, mobile charges in Kenya are the lowest (USD 0.1564) followed by Tanzania (USD 0.1951) while Uganda has the highest mobile charges (USD 0.2152).

During implementation of the second phase, the market experienced intensified wars on tariffs as operators introduced differentiated services and promotional offers. Some of the promotional offers did not comply with the Determination, resulting to complaints of anti-competitive behavior in the market. Whereas the current regulations section 96(1) clearly compels operators to file tariffs, it does not make provisions on how to deal with promotional offers therefore posing a challenge on the conclusion of the complaints.

Subscriber numbers and growth

During the review period, total subscribers increased by 35% from 11.9 million to 16.2 million. Figures (2), (3), and (4) show growth trends for postpaid and prepaid subscribers by operator. The total number of prepaid subscribers has continued to dominate the market and register increasing growth for all operators. However, there was declining trend on the number of postpaid subscribers under the Local Loop Operators (LLOs). This could be attributed to the increased competition and their limited mobility. The continued expansion of Telkom wireless services and increased growth in its subscribers has posed a major challenge to the growth of the LLOs. This has been compound by the entry of Telkom Orange (GSM) services into the market.

Figure 2: Active Postpaid Subscribers, January 2006 to December 2008

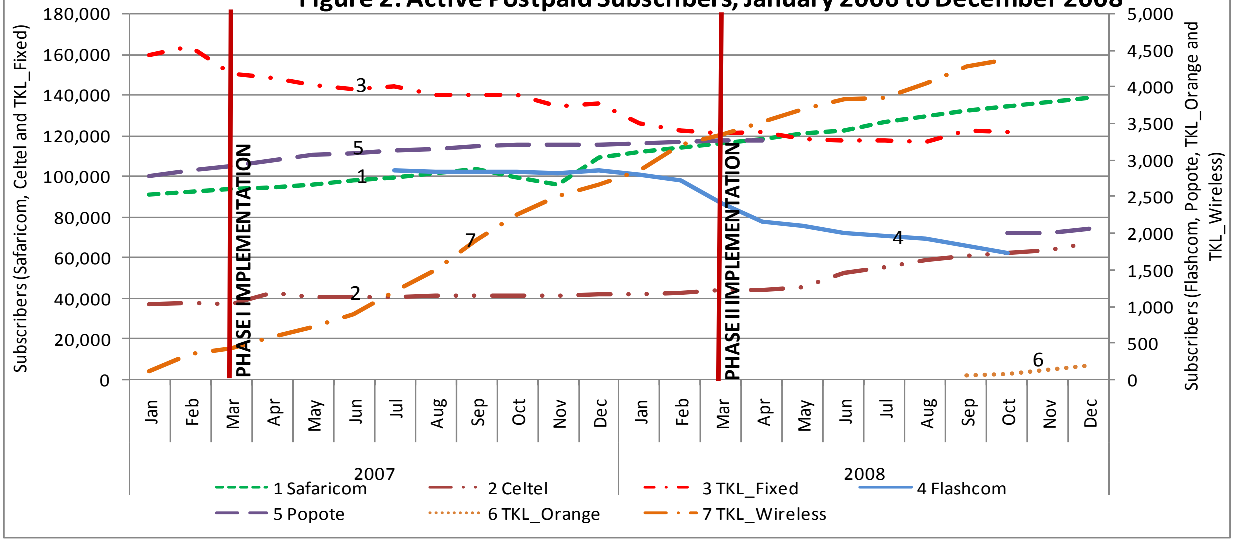


Figure 3: Active Prepaid Subscribers, January 2006 to December 2008

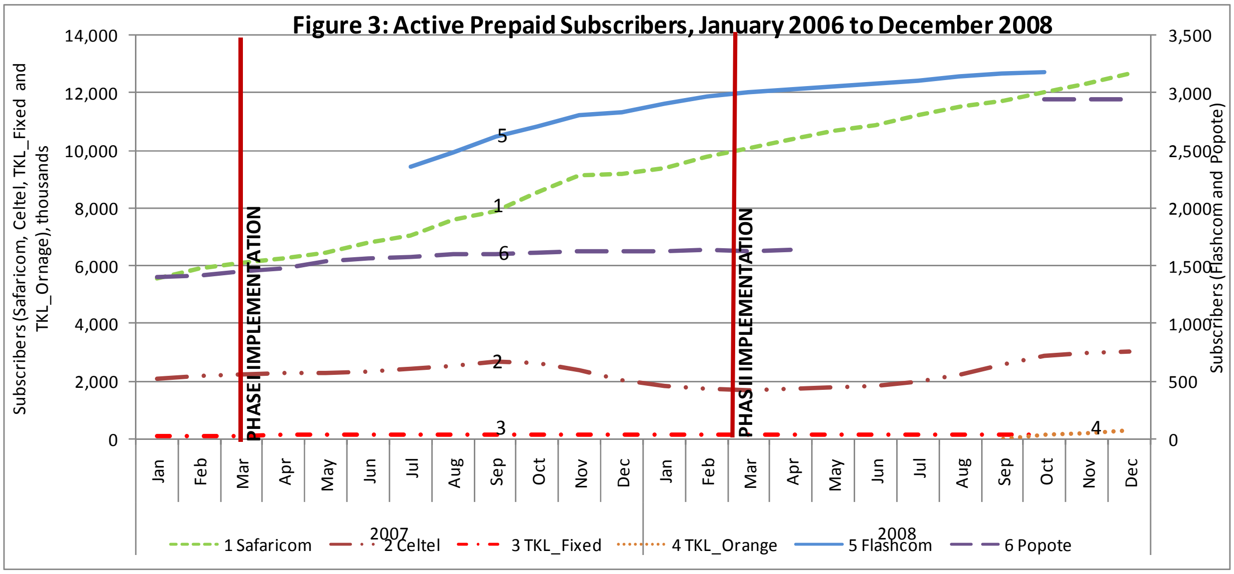
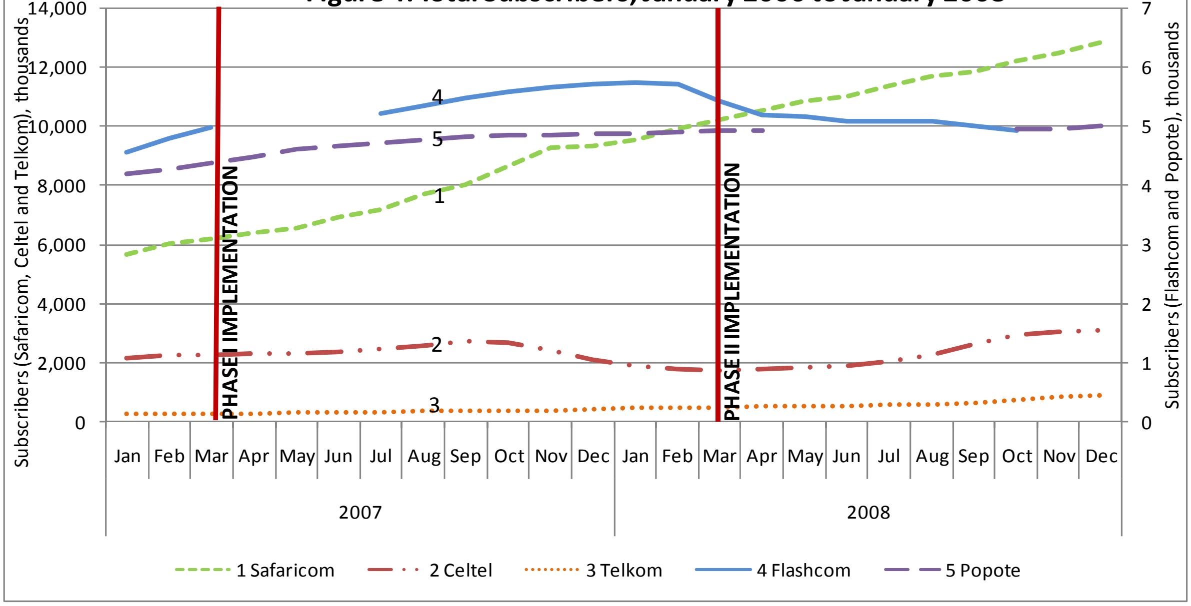


Figure 4: Total Subscribers, January 2006 to January 2008



The declining trend recorded by LLO is expected to reverse and a positive growth registered once the operators migrate to the Unified Licensing Framework that is technology neutral. An LLO that migrates to NFP tier 3 with be able to interconnect with other services providers and therefore allowing greater mobility of their customers.

While the growth in subscriber rates cannot be attributed solely to the implementation of the determination, the reduction in end-user tariffs resulting from low termination rates has enhanced affordability thus increased uptake by a population that was not previously served. A comparative analysis of the average tariffs charged by operators within the region reveals that the current cost of telecommunication services is competitive.

5.0 Implementation of Phase 3

The period March 2009- 10 marks the third and final phase of the implementation of the interconnection rates under the Determination No. 1 of 2007. As recommended in the final report of the Cost study, the interconnection rates are set to reduce by 16.1% from Kshs 5.27 to Kshs 4.42 for the mobile networks termination and 2.4% from Kshs 1.65 to Kshs 1.61 for the fixed networks local area termination. The reduction ensures that interconnection rates in Kenya are in line with the rates forecasted using the LRIC model for an optimal service provider in the market. The decline in interconnection rates is expected to increase access of network facilities between multiple operators and therefore lead to a reduction in the ultimate retail tariffs paid by customers. As was the case in phase one and two, it is estimated that there will be increased competition in the market resulting to further decline in tariff in both the post paid and prepaid categories of subscribers.

This phase is proposed to follow the benchmark rates as shown in the Table 2 below, and will become effective beginning 1st March 2009.

Table 2: The Cost-based Interconnection rates with effect from 1st March 2009 in KES	
Mobile Termination	4.42
Fixed Termination	
Local termination	1.61
Single tandem termination from tandem exchange	2.90
Double tandem termination from tandem exchange	3.61
Single tandem termination from local exchange*	4.89
Double tandem termination from local exchange*	5.59
Fixed Transit	
Transit local exchange to tandem (single tandem)	2.27
Transit local exchange to tandem (double tandem)	2.99
Tandem to tandem transit	0.96
Local to local transit (single tandem)	4.30
Local to local transit (double tandem)	5.02