

SOUTH AFRICA / JUDGMENT

# Mobile Telephone Networks (Pty) Ltd v Afrihost (Pty) Ltd (019075) [2015] ZACT 10; [2016] 1 CPLR 184 (CT) (12 January 2015)

[2015] ZACT 10

COURT  
Competition Tribunal

BEFORE  
Norman Manoim, Andiswa Ndoni, Imraan Valodia

CASE / FILE NUMBER  
019075

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## COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: 019075

In the matter between:

MOBILE TELEPHONE NETWORKS (PTY) LTD.....Primary acquiring firm

And

AFRIHOST (PTY) LTD.....Primary target firm

Panel: Norman Manoim (Presiding Member)

: Andiswa Ndoni (Tribunal Member)

: Prof Imraan Valodia (Tribunal Member)

Heard on: 05 November 2014

Order Issued on: 05 November 2014

Reasons Issued on: 12 January 2015

Reasons for Decision

Approval

[1] On 5 November 2014 the Competition Tribunal (“Tribunal”) unconditionally approved the acquisition by Mobile Telephone Networks (Pty) Ltd (“MTN”) of Afrihost (Pty) Ltd (“Afrihost”).

[2] The reasons for unconditionally approving the transaction follow hereunder.

## Background

[3] We will first briefly explain the merging parties' respective positions in the mobile telecommunications value chain and their pre-merger relationship.

[4] In South Africa there exist just a handful of mobile network operators ("MNOs") of which MTN is the second largest. MTN is a vertically integrated entity involved in operating mobile networks (at the upstream level) and the provision of a broad range of mobile communication services to end-users (at the downstream level).

[5] By contrast, Afrihost is an internet service provider ("ISP") whose activities include data hosting services and ancillary services, retail asymmetrical digital subscriber line ("ADSL") internet access services, and mobile internet access services.

[6] In relation to the provision of network services, both MTN and Afrihost provide access to end users. However, MTN provides internet

connectivity through its own internet protocol ("IP") network, whereas Afrihost does not own an IP network and merely resells the internet connectivity it purchases from MTN.

[7] The provision of network services is done so on top of an established telecommunications infrastructure. In general there are two types of telecommunication infrastructures on offer. Firstly, there are access connections which connect end customers or business sites to the core networks. Secondly, there are transmission services or links which are used to build the core networks of network providers, consisting mainly of leased lines and microwave links.

[8] In order to provide internet access services, the ISP's providing such access require a number of different types of access links to the website content. Such connectivity includes international and national connectivity, as well as local access links. In connecting to international websites, an ISP that operates an IP network has to obtain the content from the relevant website to come back to its IP network. To do this, the ISP may have an international link to the relevant website directly or alternatively have a link to another network that connects directly or indirectly to the relevant website. In practice however, ISP's normally buy capacity to link to overseas peering points, such as LINK, where a number of networks interchange content, as well as to one or more networks that directly or indirectly connect to the relevant website.

[9] In terms of connecting to local South African websites, an ISP also has to obtain the local content back to its network. In the case of fixed connectivity and in order to eventually deliver the content to the customer, ISP's utilize Telkom's infrastructure. This infrastructure consists of two main portions of links. The first are circuits offered by Telkom which connect an ISP's Point of Presence ("PoP") to a Telkom exchange. This access provided by Telkom is generally known as Internet Protocol Connect ("IPC") bandwidth. Teikom effectively owns all the IPC bandwidth in the country and this connectivity is charged by

Telkom as a Rate/Mbps. The second consists of copper lines that link the Telkom exchange to a customer's premises, the so called last mile'.<sup>1</sup>

- [10] Similarly, internet connectivity can be provided over wireless technology. The main distinction between mobile versus fixed internet relates to the access portion of the connectivity. Whereas mobile internet is provided over radio access network infrastructure, fixed internet, as the name suggests, relies on fixed connectivity cables for its access.

#### Parties to the Transaction

##### Primary acquiring firm

- [11] The primary acquiring firm is MTN, which is a provider of both fixed and mobile voice and data services; mobile messaging services; mobile handsets; certain value added services; and subscription services at both wholesale and retail level.
- [12] MTN is wholly owned by Mobile Telephone Networks Holdings (Pty) Ltd ("MTN Holdings") which is, in turn, a wholly owned subsidiary of the MTN Group Ltd. The MTN Group Ltd is listed on the Johannesburg Securities Exchange Limited ("JSE") and is not controlled, directly or indirectly, by any entity<sup>2</sup>

##### Primary target firm

- [13] The primary target firm is Afrihost which is an ISP that predominantly operates at the retail level only. Afrihost is not controlled by any single firm; its shareholders are its current management or their respective family trust. <sup>3</sup> A recently established firm whose management are still largely its founders it has shown considerable entrepreneurial zeal having expanded their market share rapidly in their particular retail niche.

#### Proposed Transaction and Rationale

- [14] In terms of the proposed transaction, MTN is purchasing from the present management, in the aggregate (50%) plus one (1) share of the entire issued share capital of Afrihost. However, post-merger, the management shareholders will have certain minority protections which mean that Afrihost is not solely controlled by MTN in all respects but the subject of joint control.<sup>4</sup>
- [15] The transaction allows MTN entry to a segment of the retail market where it lacks a presence whilst allowing the sellers to realise some of their investment and to grow the business with the assistance of a major shareholder.

#### Relevant Market

- [16] As mentioned above, there are two forms of internet access relevant to this transaction which can be sold to customers. MTN is active in the wholesale provision of both fixed and mobile data connectivity, whereas Afrihost does not own an IP network and currently only resells MTN's fixed and mobile data.

[17] An investigation into the merging parties' business activities revealed that both MTN and Afrihost offer services relating to mobile data, fixed (ADSL) data services and hosting services as well as ancillary services. Thus, there are horizontal overlaps arising from the merger in relation to the provision of (1) hosting services and

(2) ADSL and (3) mobile data services at a retail level. There is a further vertical relationship identified in that Afrihost also resells MTN's ADSL and mobile data services.

[18] The Commission, in its analysis, assessed the merger in the national markets for the following:

- i. Data hosting services and ancillary services;
- ii. Wholesale ADSL data services;
- iii. Wholesale mobile data services;
- iv. Retail ADSL data services, with potential sub-markets separately comprising large corporates and residential and SMME customers; and
- v. Retail mobile data services, with potential sub-markets separately comprising large corporates and residential and SMME customers.

## Competition

## Analysis

### Horizontal assessment

[19] According to the Commission's analysis, the merged entity is unlikely to exercise market power in the markets for the provision of hosting services and ADSL and mobile data services at a retail level. In relation to hosting services, the merged entity will have a combined market share of less than 6% and will continue to be constrained by several other large information communication technology ("ICT") companies such as Internet Solutions, BCX, Telkom, Gijima, Neotel, Vodacom Business, Vox, MWEB, and Hetzner etc.

[20] In relation to retail ADSL, the Commission found that the merged entity is unlikely to exercise market power, due to it having a combined market share of less than 6%. The Commission further found that the merged entity will be largely constrained by Telkom, the market leader in respect of ADSL data; virtually all other service providers are predominantly dependent upon Telkom for the leased lines and the 'last mile' connectivity which are required in the provision of ADSL data. Furthermore, there are also several other players such as MWEB, Internet Solutions, Vox Telecom, and Cybersmart amongst numerous others who provide ADSL data in the retail markets.

[21] The Commission has also concluded that the market for retail ADSL can be further segmented into two customer segments namely the small to medium enterprises (“SMME”) and residential segments, as well as large corporates. The Commission drew this distinction based on the different service requirements

that are typical in servicing these different customers.<sup>5</sup> MTN predominantly focuses on servicing large corporate customers, whereas Afrihost focuses on servicing the SMME and residential segment. The Commission thus finds that MTN and Afrihost are not direct competitors in the retail ADSL market.

[22] In respect of mobile data, MTN is a large player in the market with a market share exceeding 29%, Afrihost is by contrast a small player at the retail level with less than 1% market share. Thus the Commission finds that the market share accretion is so small and is therefore deemed to be insignificant. Further the merged entity will continue to be constrained by Vodacom, Cell C and Telkom Mobile. Accordingly, the Commission concludes that it is unlikely that this transaction raises significant horizontal concerns.

#### Vertical assessment

[23] As mentioned above, there is a vertical relationship between the merging parties in that Afrihost resells MTN’s ADSL and mobile data services. Concerns were raised in this regard arising from third parties in relation to the potential exclusionary conduct emanating from this vertical relationship. The Commission, in its assessment, identified various ways in which exclusionary conduct by vertically integrated firms in telecommunications markets can be perpetuated. The Commission accordingly assessed the following theories of harm that may arise from the proposed transaction:

- i) Unilateral effects;
- ii) Potential exclusionary effects that could arise through margin squeeze strategies; and
- iii) Conglomerate effects that can arise from portfolio effects of a vertically integrated firm expanding in several downstream (retail) markets.

#### Margin squeeze

[24] The Commission, in its assessment, chose to focus on margin squeeze as a potential theory of harm with which the exclusion of rivals can be exercised, given that MTN is a large and vertically integrated firm that is expanding its downstream operations through this merger.<sup>6</sup>

[25] ISP’s, such as Cybersmart and Internet Solutions, argued that Afrihost is currently charging below-cost prices which have the effect of excluding downstream rivals. In terms of the vertical relationship in ADSL data, the Commission concludes that MTN does not have sufficient market power in the wholesale market to foreclose downstream resellers. At the wholesale level, MTN is significantly constrained by other large and reputable ADSL wholesalers such as Telkom, MWEB, Internet Solutions, Vox Telecom, Cybersmart and

several other ADSL providers. Accordingly, the Commission concludes that the merged entity will not have the ability to foreclose rivals. In addition the incentives to do so also appear to be minimal.

- [26] In relation to mobile data, MTN is the largest mobile wholesale provider. This is so because MTN was the first MNO to introduce the wholesale mobile product. In spite of this, the Commission finds that its (MTN's) ability to exercise market power in the wholesale mobile data market appears ambiguous, particularly given the presence of Vodacom which has the ability to constrain MTN, given that it is the larger MNO, with a larger network. The ability to successfully exclude downstream rivals through a margin squeeze strategy is premised on MTN being able to exercise market power in the wholesale market. To the extent that MTN is indeed able to exercise market power in the wholesale mobile data market, it appears that the effects of such exclusion will only apply to the large corporate customer segment, being the segment MTN focuses on. Afrihost is however not active in the large corporate segment, thus the Commission finds that there to be no incentives for foreclosure in this segment.
- [27] Importantly, MTN is already vertically integrated and as such is already in a position to engage in this conduct pre-merger. In terms of the other segment comprising SMME and residential customers, the Commission finds that, unlike in the larger corporate segment which generally operates on relatively long term contracts and typically purchase mobile data as part of a suit of converged services, SMME and residential customers easily and routinely switch between mobile data providers. In this segment customers do not enter into long term contracts but rather enter into month-to-month contracts which allows for easy switching.
- [28] In conclusion, the Commission finds that the occurrence of below-cost ADSL and mobile data pricing in some instances appears to be an outcome of competition in the sector, due to the prevalence of large vertically integrated firms that operate at both the wholesale and retail levels. The Commission accordingly concludes that the below cost pricing concerns raised by third parties do not arise as a result of the merger nor are they thereby exacerbated by it.
- [29] The Tribunal raised further questions around the margin squeeze issue at the hearing. The following further facts became apparent. Although MTN's market share is presently very large, its most effective competitor Vodacom only entered the market recently in 2013 and hence the market shares going forward are likely to change in favour of Vodacom. Secondly, Cell C is well-placed to expand in this market. MTN also argued that it has no incentive to engage in a margin squeeze strategy post-merger as Afrihost represents only 3% of mobile data revenue.<sup>7</sup> Finally MTN submitted that it treats all parties in an equal manner according to its rate card. We set this out below during an exchange between the Tribunal and the legal representative for MTN:

*“CHAIRPERSON: So in other words what you’re saying is that if there was a complaint to the Commission post this merger about a margin squeeze from Internet Solutions let’s say the Commission would easily be able to investigate this because they would say to Internet Solutions what is your data volume and we go back to MTN and say well what you’re getting you’re in this region of the rate card there’s no margin squeeze here, the difference between your price and Afrihost is explained by the difference in volume as per the rate card.*

MS BURGER-SMIDT: Chair that is indeed the submission by MTN and the view of MTN that the rate card is implemented in an absolutely non-discriminatory way and fashion.

CHAIRPERSON: Does MTN apply to its own retail division the same way?

MS BURGER-SMIDT: Indeed.<sup>8</sup>

### Bundling

[30] The Commission also considered bundling as a strategy which may result in the exclusion of rivals. Firstly it concluded that bundling was unlikely to be an effective exclusionary strategy as rivals could easily replicate the bundle. Further, that bundled solutions may in fact be likely to result in pro-competitive gains, particularly for corporate clients.

[31] In light of the above, and on the evidence presented, we concur with the Commission’s competition assessment, i.e. that the proposed transaction is unlikely to substantially prevent or lessen competition in the hosting and the wholesale and retail ADSL and mobile data markets.

### Conclusion

[32] In conclusion we do not consider the proposed transaction to likely result in a substantial prevention or lessening of competition in the relevant markets. In addition, no public interest issues arise from the proposed transactions.

[33] For the reasons set out above, we approve the proposed transaction unconditionally.

12 January 2015

DATE

MR NORMAN MANOIM

Ms Andiswa Ndoni and Prof Imraan Valodia concurring

Tribunal Researcher: Derrick Bowles

For the target firm: Jocelyn Katz of Edward Nathan Sonnenbergs

For the acquiring firm: Ahmore Burger-Smidt of Werksmans Attorneys

For the Commission: Grashum Mutizwa

1The Telkom cost component is the single biggest cost component of providing ADSL data services making up roughly 80-85% of the total

cost.

2MTN Group Limited's shares are widely dispersed with just a single entity holding more than 6% in MTN, namely the Government Employees Pension Fund C/O Public Investment Corporation that holds roughly 14%.

3The shareholders are the PM, GV, BA and GP share trusts, Dlpionamiz and F Payne.

4See transcript of hearing page 27.

5For instance large corporate clients typically require complex service level agreements when engaging with providers.

6Margin squeeze amounts to a reduction by a dominant operator of the margin between wholesale and retail prices so as to make entry into such a market difficult or to encourage the exit of a dominant firms rivals.

7See transcript page 29.

8See transcript pages 29-30.

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