

TELKOM SA LIMITED'S ("TELKOM'S") SUBMISSION ON THE AUTHORITY'S DRAFT LICENCE FEES REGULATION: NOTICE 1306 OF 2008 IN GOVERNMENT GAZETTE NO. 31543 OF 24 OCTOBER 2008

INTRODUCTION

Telkom appreciates the opportunity to submit its response to the draft general licence fees regulation ("the draft Regulation").

Telkom's submission consists of two sections and an appendix, as follows:

Section A: Telkom's general and specific comments on the draft Regulation

1. Executive summary
2. General comments
3. Specific comments

Section B: Considerations regarding international best practice for regulatory fees

Appendix: Supporting charts

Telkom would like to take part in any public hearings or oral presentations that the Authority may decide to hold in regard to this draft Regulation.

SECTION A: Telkom's general and specific comments on the draft Regulation

1. EXECUTIVE SUMMARY

The main points that Telkom will address in this submission are as follows:

1.1 Telkom submits that the draft Regulation would result in Telkom being placed in **a less favourable position** regarding its licence fees. A rough estimate based on 2007 figures shows that Telkom would have to pay around R 700 million more in licence fees, a 23-fold increase. This would in our view be contrary to Section 93(1) of the Electronic Communications Act ("the Act") that provides that licence conversion must take place on no less favourable terms than the existing licences, including radio frequency spectrum licences.

However, in the interest of contributing, in a constructive manner, to the establishment of a sound regulatory framework, Telkom will offer comments on the draft Regulation.

1.2 The licence fees that would be appropriated through the draft Regulation would be **unjustified and extremely high**. They by far exceed the cost to regulate the market – our estimates indicate that the expected licence fees will at R 3 billion be roughly ten times the budget of ICASA. They are also high relative to international best practice benchmarks which tend to be at 1% or less of gross revenues.

1.3 The draft Regulation discourages infrastructure investments and therefore runs counter to all best practice trends, in particular in fixed network regulation. According to our estimates based on 2007 figures, it would extract an additional R 1.7 billion from the industry. This will likely have a **negative socio-economic impact** on the ICT sector as well as South Africa

as a whole and leave the country further behind in the quality of its telecommunication infrastructure.

- 1.4 There are many areas of the draft Regulation where there is a **lack of clarity**, or which are open to different interpretations. These need to be resolved before any new framework is put in place.

2. GENERAL COMMENTS

2.1 Conversion must be implemented on no less favourable terms

Telkom's current licence fee, as contained in Condition 13.3 of its Public Switched Telecommunication Service ("PSTS") licence, is 0.1% of annual revenue generated from the provision of PSTS.

It is Telkom's submission that section 93(1) of the Act has confirmed the right that upon conversion of the licence the conversion will be done on "*no less favourable terms*". It is trite law that subordinate legislation, for example Regulations and Bylaws, cannot take away rights conferred by an Act of Parliament.

The case of *Van Heerden v Queens's Hotel (Pty) Ltd*, as quoted in Kellaway¹, provides that

"...*prima facie* subordinate legislation which purport, without express power to alter or to modify existing statutory rights is *ultra vires*".

Parliament may validly confer on a subordinate law making body power to alter or repeal a provision of an Act of parliament, but such power has to be expressly conferred.

Telkom's interpretation of the wording '*no less favourable terms*', having considered other provisions in the Act, is as follows:

that the Act sought to prohibit a situation arising where licensees are in a worse position post the conversion process. The status quo ought to remain in place subject to provisions of sections 93(4)(b), 93(8) and 93(11). Accordingly, there are specific instances in which pre-conversion is countenanced by the Act in this regard, but in the whole a licensee must be placed in no less favourable position as a result of the licence conversion process.

Throughout the conversion process, Telkom, together with other operators, has consistently maintained that the principle of no less favourable terms is paramount in the licence conversion process. However, the draft Regulation will place a significantly higher licence fee on Telkom resulting in a clearly less favourable position. Telkom estimates suggest that, based on 2007 revenues, its licence fees payable would rise from about R 30 million to more than R 727 million, implying an increase of 2,300%.

In accordance with section 93(4) of the Act, the Independent Communications Authority of South Africa ("the Authority") must use the following framework for converting existing licences:

¹ Kellaway EA Principles of Legal Interpretation 1995 at 382

- (a) Where an existing licence authorises the holder of such licence to both provide services and operate electronic communications facilities or networks, the Authority must issue to that licence holder–
- (i) a licence relating to the electronic communications services or broadcasting services, if applicable, that coincide with the services authorised in the existing licence;
 - (ii) **a separate licence relating to any radio frequency spectrum** authorised in the existing licence (own emphasis added); and
 - (iii) a separate licence relating to the electronic communications network services, consistent with the licence types set out in Chapter 3.

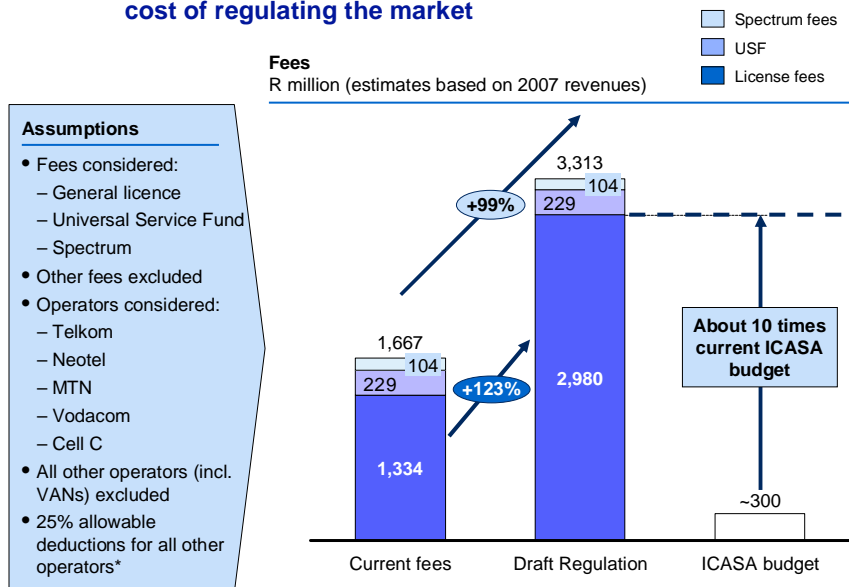
The conversion of the existing frequency spectrum licences forms a part of the whole conversion process, and is also, therefore, subject to 93(1). For this reason Telkom is of the view that spectrum fees should also not be changed in any way as part of the licence conversion process.

By saying the above, Telkom is not suggesting that the Authority may not review spectrum fees, but merely that any review of these should form part of a different process to that of licence conversion. The Authority is on record as stating its intention to review spectrum fees in the near future, and any changes to current spectrum fees must result from this public process.

2.2 Licence fees are extremely high and unjustified

It appears from the draft Regulation that the licence fees that will be collected from operators would be extremely high, with respect to both the cost of regulating the South African market as well as international best practice.

Exhibit 1: Fees collected under the draft Regulation by far exceed the cost of regulating the market



Source: Telkom; other South African operators' annual reports; ICASA

In markets that can be viewed as best practice, licence fees from operators are used to cover/recover the cost of regulating the market – not for additional taxes or surpluses to the Government. In the US, for example, the FCC (regulatory) budget is first determined, then the percentage of total revenues is determined to ensure that the FCC collects only as much as is needed to recover the cost of regulating the market.

In its "Licence Fee Framework" section, the draft Regulation states that "At minimum, the licence fees should cover the cost of regulating the market". However, if a general licensing fee of 3% of gross adjusted revenues were applied to all operators in South Africa, the licence fees collected from the largest operators would likely be in the are of R 3.0 billion, an increase of around 123% (estimates based on 2007 figures, see exhibit 1). This is significantly in excess of the cost to regulate the South African market, which can be estimated to be around R 250-R300 million (the Authority's Annual Report 2007 shows overall expenditures of R 180 million) and does not yet include other fees collected such as spectrum fees, administrative fees etc.

The draft Regulation does not give any indication as to what the additional fees would be used for. In the worst case, they would be withdrawn from the telecommunications sector and therefore negatively impact its development.

Based on our research of international best practice, a licence fee of **1% or less** is typically the percentage applied, and the base used can be either gross revenues, net revenues or total revenues. Alternatively, the fee is a fixed sum derived from the regulator's budget. In any of these cases the total amount appropriated is significantly less than 3% 'adjusted gross revenues' as proposed by the draft Regulation. In the US, for example, licence fees amount to around 0.1% of gross revenues. In the UK, this value is at less than 0.1%, and in Singapore at 1.0%. See exhibit 4 in the appendix for additional information.

In addition, there is no justification for applying the licence fee to revenues from activities that are not license-related.

2.3 Draft Regulation discourages investments leading to negative socio-economic impact

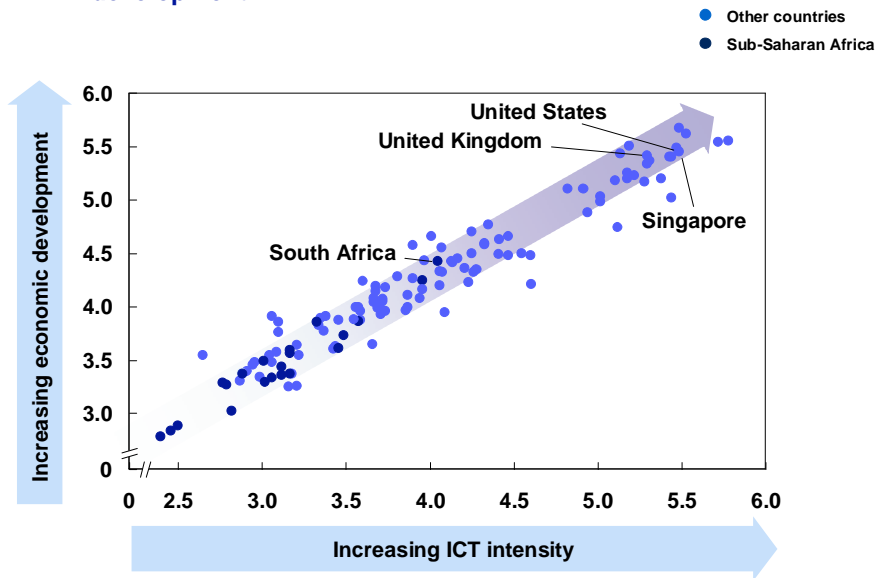
Telkom supports the Authority in its drive to improve ICT in South Africa. As we try as a nation to integrate more closely with the global economy, our performance increasingly depends on the competitiveness of firms in our economy. Becoming competitive means that we have to adopt long-term strategies to raise efficiency, boost skill levels, improve technology levels and move into more sophisticated products and services that imply higher value creation.

ICT investments are critical for all of these areas of growth – ICT is a key sector in its own right, but also an enabler for other sectors of our economy to achieve the efficiency and performance levels that we need to be globally competitive (multiplier effect). Exhibit 2 shows that there is a direct correlation between the ICT investments (represented by the World Economic Forum's Network Readiness Index) and the economic development of a country (represented by the Global Competitiveness Index).

While the draft Regulation states that "the licence fee should facilitate the establishment of an environment conducive to network investments", Telkom argues that the framework does exactly the opposite: it places undue burden on operators, especially those who invest in infrastructure. The multiplier effect of ICT investments also works in the reverse – any framework that provides an environment that is not conducive to investing in ICT will have a

double-negative effect on our economy. The proposed increase in licence fees amounts to a tax on licensees, which will extract an additional R 1.7 billion from the industry (estimates based on 2007 figures, see exhibit 1). This is likely to result in reduced investments and, consequently, other undesired effects such as job losses, higher prices and a further delay in deployment of much needed state-of-the-art infrastructure with a negative impact on other sectors of the economy.

Exhibit 2: There is a clear link between ICT investments and economic development



Source: World Economic Forum

The draft Regulation's effect is exacerbated by the fact that leasing charges are considered allowable deductions. This clearly places an additional burden on those licensees who want to invest and thus improve the ICT infrastructure and competitiveness of South Africa. In the case of Telkom, we estimate that the draft Regulation would increase Telkom's ECNS fees 31-fold and its ECS fees 22-fold. In contrast, regulation in the UK, which is usually seen as a best practice example, clearly states that "There will be no distinction between charges of a network operator and a service provider" (Ofcom: Statement of charging principles, 2005).

2.4 There is a need for clarification

As part of Telkom's submission, we would like to address a few areas where we feel the draft framework is up for interpretation and needs to be clarified.

It is not clear whether the **overall objective** for the new licensing framework is to

- recover the cost of regulating the market or
- maximise contributions to treasury or
- encourage the development and social contribution of the sector, e.g. by achieving healthy competition, low entry barriers for new entrants, lower prices to consumers, improved service levels and deployment of state-of-the-art technology

For a dual licensee, i.e., a holder of ECNS and ECS licences, it is not clear whether or not the **ECS licensee can deduct its cost of interconnect from its ECNS**, or whether the interconnect deduction applies to inter-licensee interconnects.

The framework states that the licence fees should be **offset against commitments to construct ECN and provide ECS in rural and underserved areas** but it is unclear from the method of calculation where and how these provisions have been incorporated into the framework:

- the framework states that, other than VAT and discounts granted to customers, the other deductions allowable for an ECNS licensee are facilities leasing charges and leased lines costs. However, for an operator like Telkom, that owns its own facilities (towers, cabinet space, etc.), and has invested significant capital in building out its network capacity (and therefore does not lease lines from any other operator), the framework does not provide an offset for such capital-intensive investments;
- the framework does not provide a mechanism for deductions for under-serviced area obligations.

Given that there are no clear definitions of some costs, and that not all operators will be in a position to separate different revenue and cost streams, the draft Regulation may result in different standards being applied in calculating licence fees payable.

3. SPECIFIC COMMENTS ON THE DRAFT REGULATION

Telkom hereby submits its specific comments on both the preamble to the draft Regulation, as well as on the draft Regulation itself. The actual text in the draft Regulation is repeated in highlighting, for the sake of convenience, followed by Telkom's comments, where relevant.

BACKGROUND

As part of the license conversion process undertaken in terms of section 93 of the ECA, the Authority conducted a workshop on 11 October 2007 wherein the Authority initiated discussions with and solicited opinions from industry players regarding the relevant principles to be considered in the formulation of license fees.

A comprehensive discussion yielded a set of principles which the Authority considered when revising/formulating the various fees. These "various fees" include:

- *The applicable fees itemised in schedule 1 of the draft licensing procedure regulations contained in Government Gazette number 30363 of 9 October;*

Government Gazette No. 30363 was published on 9 October 2007.

- *The variable annual license fee payable by the licensees; and*
- *The determination of a once-off fee payable by licensees when a new license is granted.*

In order to formulate a policy framework to guide the Authority, additional research was conducted and comprised an international benchmarking exercise as well as an analysis of the current licensing environment in South Africa.

The Authority has indicated that an international benchmarking exercise was done. Telkom is of the view that it is in the interest of the industry, particularly with due regard to transparency, that the Authority shares the findings of this international benchmarking and also indicates how this information was used in the formulation of the draft Regulation.

LICENCE FEE FRAMEWORK

The Authority thereafter adopted the following framework for the formulation of the licence fees regulations attached hereto:

According to the draft Regulation, the following framework was used in the formulation of the licence fees regulation. It is Telkom's view, however, that the draft Regulation does not adhere, or is not consistent with, the stated framework. We will expand on this below.

I. Licensees in possession of an individual licence should pay a larger portion of their revenues towards fees as compared to those in possession of Class licences, in view of the wider scope of operation permitted by their licence;

As already stated, Telkom is not in agreement with the percentages proposed, and we have stated our viewpoint that licence fees should only be used to cover/recover the cost of regulating the market, and not for additional taxes or surpluses to the Government. If licence fees are calculated as a percentage of the revenues or profits derived from the economic activities related to the licence (which would increase with a wider scope), the wider scope is automatically taken into account.

II. The duration of the licence should be recognised as a significant factor when determining the value of the licence;

In terms of Schedule 2 of the regulation, the payment of annual licence fees is not linked to the duration of licence but only to the different category of licences, i.e. Individual versus Class licences.

In accordance with the regulations regarding standard terms and conditions for individual licences, in Government Gazette No. 30530 of 30 November 2007, the term for an individual ECNS licence is 20 years, whereas the term for an individual ECS licence is 15 years.

With regard to class licences, and with reference to Government Gazette No. 30512 of 23 November 2007, the term for both ECNS and ECS licences is 10 years.

Telkom points out, once again, that the Authority has not seemed to take regard of the framework in establishing the licence fees indicated in the draft Regulation.

III. Licensees with revenue below a certain threshold, for example R1 000 000.00 per annum, should pay marginal annual licence fees as a measure to support start ups and SMME's;

This principle has not been incorporated into the regulation.

IV. At minimum, the licence fees need to cover the cost of regulating the market;

In accordance with section 15 of the Independent Communications Authority of South Africa Act of 2000 (Act No. 13 of 2000, as amended) ("the ICASA Act"), the Authority is financed from money appropriated by Parliament. The Independent Communications Authority of South Africa Amendment Act of 2006 (Act No. 3 of 2006) ("the ICASA Amendment Act") brought about the addition of clause 15(1A), in terms of which "the Authority may receive money determined in any other manner as may be agreed between the Minister and the Minister of Finance and approved by Cabinet".

It is not clear to Telkom how the proposed covering of costs of regulating the market will be realised in terms of the above provisions.

The Authority has not demonstrated whether the licence fees will indeed cover the cost of regulating the market, or not. In addition, it seems that the licence fees generated under the draft Regulation would, far exceed the cost of regulating the market.

V. The licence fee should be structured in a manner that promotes a competitive ICT sector, and should not constitute a barrier to market entry;

Telkom is of the view that the licence fees are excessive and do not promote a competitive ICT sector as the proposed licence fee structure will extract resources from the sector and discourage network roll-out and self-provisioning which is the foundation for infrastructure-based competition. In this regard, we refer to our General Comments.

VI. The licence fees should facilitate the establishment of an environment conducive to network investments;

Due to the structure of the licence fee regime and the allowable costs that ECNS licensees may deduct, the proposed licence fee structure will not promote network investments but create ECNS licensees that lease facilities from other ECNS licensees rather than self-provisioning and rolling out their own networks. This will not increase infrastructure-based competition but will rather promote 'virtual' ECNS licensees. In this regard, we refer to our General Comments.

VII. The administrative fee structure should be as simple as possible.

Telkom is in agreement with this principle.

VIII. The licence fees should be calculated in a transparent manner;

We do not believe that the licensing fee proposal would facilitate transparency. Firstly, it is not clear as to whether ECNS licensees that provide network infrastructure and facilities to their own ECS business would need to account for the same in their books of accounting. It should be noted that ECS licensees would not physically pay for the use of the network provided by its own ECNS business. Therefore, and assuming that the ECS business has to compensate its ECNS business, 'transfer charges' between these two business units would need to be reflected. The calculation and reflection thereof would however not be possible without regulatory accounts, i.e. COA/CAM.

Telkom believes that, if transfer charges must be shown and included, then ECS licensees should be able to deduct the lease of networks/facilities as input costs from their ECS revenues.

IX. The licence fees should be offset against commitments to construct ECN and provide ECS in rural and under-serviced areas.

Although this provision is welcomed, the practicalities thereof seem unclear and uncertain. Firstly, it is not clear why both ECNS and ECS licensee should be allowed this concession. An ECS licensee cannot construct ECN, and will be entirely dependent on an ECNS licensee to construct infrastructure before any ECS can be provided. Secondly, it is not clear how these 'commitments' would be calculated. Thirdly, Schedule 2 read with the definitions and section 5 which deals with 'Allowable deductions' does not allow for the commitments to be offset.

Previously licence fees were based on either Gross Revenue or Net Operational Income. Whilst Gross Profit is internationally the more common definition, and encourages cost savings and effectively rewards efficiency, the Authority proposes using adjusted Gross Revenue to allow for the necessary deductions in the different licence categories.

In Telkom's view the Authority's rationale for not following international best practice is neither fully understandable nor justified. It remains unclear while certain deductions are "necessary". A more substantial explanation would assist the industry in understanding the Authority's motivation and objectives in this regard.

ANNUAL LICENCE FEES:

The licence fee formula proposed in the attached regulation is based on a flat rate as a percentage of revenue.

The Authority's Operating expenses are projected to increase at a rate of 24 percent p.a. for the first five years. Thereafter, the rate of increase is reduced to 8 percent p.a. for the remaining five years (supported by historical figures and implementation of the Electronic Communications Act, in particular Chapter 10).

Telkom fully supports the need for the Authority to be adequately financed, and has repeatedly said so in many fora. However, in terms of the ICASA Act the Authority is financed from money appropriated by Parliament. Thus, it is not clear how the Authority is relating the licence fees payable by operators, which are paid directly into the National Revenue Fund and not to the Authority, to the cost of regulating the market. If, however, by such statement the Authority intended to provide some indirect rationale for increasing licence fees, Telkom notes that, under the heading of "ANNUAL LICENCE FEES" in the Background section of the draft Regulation, the Authority claims that "The Authority's Operating expenses are projected to increase at a rate of 24% p.a. for the first five years. Thereafter, the rate of increase is reduced to 8% p.a. for the remaining five years ..." Yet there is no indication of what other expenses of the Authority are intended to be covered by the annual licence fees, assuming that such process of recovery through licence fees were provided for in the relevant legislation, which Telkom strongly doubts.

1. DEFINITIONS

Terms used in these regulations have the same meaning as defined in the Electronic Communications Act, 2005 (Act 36 of 2005), unless the context indicates otherwise:

"Gross Revenue" means revenues generated from licensed activities, including but not limited to the following, where applicable:

- (a) Services provided**
- (b) Leasing of infrastructure**
- (c) Installations charges**
- (d) Call charges**
- (e) Late fees**
- (f) Hand sets**
- (g) Band width**
- (h) Income from Value Added Services**
- (i) Supplementary Services (j) Interconnection Fees**
- (k) Facilities leasing**

(l) Sale of Set Top Boxes

(m) Application Fees

Telkom believes that the definition could be simplified to only include revenues generated from licensed activity. Since the list is non-exclusive it does not really create more certainty. On the other hand, the meaning of many of the items/costs specified is not clear and could only result in confusion, disputes and the use of different interpretations by different licensees. For example, in Telkom's view, 'late fees' is not a "revenue" generated by a 'communication service', but is rather a financing charge (interest/penalty) and should be excluded. CPE is deregulated and is not provided in terms of ECS/ECNS, and this revenue should not be included.

To overcome all the above discrepancies, we propose that the definition of Gross Revenue be simplified, as follows:

"Gross Revenue" means revenues generated from licensed activities.

4. PAYMENT OF FEES

(1) Payments in respect of annual licence fees:

(a) are due quarterly based on the licensee's financial year;

Telkom cannot see the reason why licensees should pay licence fees on a quarterly basis. This only creates a regulatory cost that is unnecessary, especially in view of the fact that the Authority's financing is not dependent on the timing of licence fee payments.

(b) are due and payable within 45 calendar days from the end of the relevant quarter/period; and

Aside from the concern on quarterly payments, Telkom submits that having regard to the severe penalties associated with late payment of licence fees, the three-month period should be extended to four months. Not only will licensees have to first finalise sign-off on the audited financial statements, but then must split the revenues according to licence activity (i.e. ECS/ECNS) which also requires auditing. Currently Telkom finds it extremely difficult to finalise and audit licence fee payments within three months.

5. ALLOWABLE DEDUCTIONS

(1) In determining the Adjusted Gross Revenue, an ECS Licensee is allowed to deduct the following costs from the Gross Revenue generated from licensed activity, where applicable:

(a) Value Added Tax (VAT);

(b) discounts granted in relation to revenue generated from licensed activities; and

(c) interconnection charges.

(2) In determining the Adjusted Gross Revenue, an ECNS Licensee is allowed to deduct the following costs from the Gross Revenue generated from licensed activity, where applicable:

(a) Value Added Tax (VAT);

(b) discounts granted in relation to revenue generated from licensed activities;

(c) facilities leasing charges; and

(d) leased line costs.

Telkom is highly concerned by the concept of "allowable deductions" as set out in regulation 5. If Telkom correctly understands its meaning, it is the intention of the Authority that Adjusted Gross revenue is Gross revenue net, in the first instance, of VAT and discounts allowed (with which Telkom has no concerns) and net of certain charges (e.g. interconnection charges, facilities leasing charges, etc.) that the licensee pays to other licensees.

The latter is of great concern to Telkom in respect particularly of the ECNS licence. Such licence grants the right to build a network and to use it for the licensee's own purpose or to make it available to other licensees, as clearly stipulated in the definition of electronic communications network service in the Act. Telkom assumes that, having granted such licence the Authority, in pursuance of the earlier quoted objectives of the Act, would encourage ECNS licensees to build such networks.

However, the effect of regulation 5 is a reduction, through the allowable deductions (e.g. for leasing facilities), of the licence fees of ECNS licensees who do not build their network, but rather lease them. No similar favour is extended to those ECNS licensees who build, rather than lease, their networks, e.g. there is no deduction allowed for the capital (i.e. the cost thereof) invested in building the network. This approach clearly will discourage investments in the network.

Furthermore, where the same person has both an ECS and an ECNS licence, the costs incurred by the ECS for network services that it receives from the ECNS will not be billed to it but at best be shown as internal transfer charges. Telkom is of the view that, for fairness of treatment, ECS and ECNS licensees should be permitted to deduct any transfer charges or inter-licensee payments from the Adjusted Gross Revenue, it is not clear that this is addressed in regulation 5.

Telkom, however, recognises that allowing deductions for cost of investment in the network or for inter-licensees payments may cause problems of verification for the Authority where a COA/CAM is not enforced on a licensee. Yet not permitting these deductions would be patently unfair. This is a further reason why Telkom recommends that licence fees be based on a simpler and less controversial standard of economic activity, either the Gross Profit commonly used in other legislations or the Gross Revenue derived from licensed activities.

7. CONTRAVENTIONS AND PENALTIES

- (1) Where payment in respect of the annual licence fee is overdue by more than 21 days, a late payment penalty of 25 percent of the capital amount due is payable in addition to the overdue amount.**

The requirement to pay both a 25% penalty and interest amounts to the payment of a double penalty (or double interest). Telkom questions the permissibility and appropriateness of this requirement.

8. SHORT TITLE AND COMMENCEMENT

- (1) Subject to regulation 8(2) and (3), these regulations are effective from the date of publication thereof in the Government Gazette.**
- (2) Schedule 2 of these regulations will come into effect on 1 April 2009.**

(3) Notwithstanding the provisions of regulation 8(1), Licensees who, in terms of the existing licences and applicable regulations, had licence fees due and payable are required to pay such licence fees until 31 March 2009.

Telkom understands the above to mean that the new licence percentages will only apply to revenue generated from 1 April 2009, and would be payable only on 1 April 2010 for a licensee whose year-end closes on 31 March of each year.

SCHEDULE 2

ANNUAL LICENCE FEES

The Annual Licence Fees payable by Licensees in accordance with these regulations are to be calculated using the formula set out herein, read with the applicable percentages.

P_a = Payable Annual Licence Fee GR_a = Adjusted Gross Revenue AD = Allowable Deductions GR = Gross Revenue

P_p = applicable percentage in accordance with this schedule read with regulation 3(1).

$$P_a = P_p \times (GR_a)$$

where

$$GR_a = GR - AD$$

Individual Electronic Communications Network Services: 3 percent

Individual Electronic Communications Services: 3 percent

Individual Commercial Broadcasting Services 2.5 percent

Class Electronic Communications Network Services: 1.5 percent

Class Electronic Communications Services: 1.5 percent

Telkom submits that the Authority must, in the interests of transparency, inform the industry as to the basis on which the above percentages were obtained. In its section in the draft Regulation headed 'Background', the Authority mentions the fact that "additional research was conducted and comprised an international benchmarking exercise as well as an analysis of the current licensing environment in South Africa".

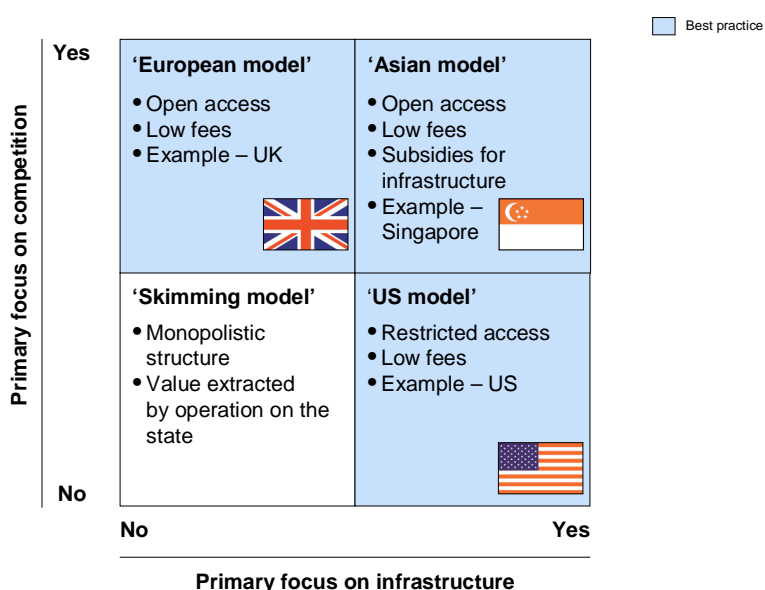
Telkom submits that the Authority should make these studies known publicly, in order that a greater understanding can be achieved as to why the indicated percentages were chosen, including the reason why individual commercial broadcasting licensees will pay less for their licences than communication service licensees. As laid out in different sections of this document, Telkom believes that these fees are markedly too high and not appropriate.

SECTION B: Considerations regarding international best practice for regulatory fees

Telkom acknowledges that there is a need to develop an overarching regulatory framework, including the regulation of licence and other fees. It therefore takes this opportunity to share some thoughts on international best practice and the resulting fee structure. However, as stated earlier, these considerations should be seen outside the context of the licence conversion process but as separate processes.

There are two main considerations that determine the structure of a regulatory framework: interest in competition and interest in the investment in infrastructure. Accordingly, there are four different "archetypical" models:

Exhibit 3: The regulatory intent determines the framework employed



Source: Telkom

- A "European model" that places the highest priority on competition (e.g. UK). In this model, far-reaching access to networks is granted to players to encourage market entry. At the same time, low fees are charged for players in order to let competition unfold freely.
- A "US model", where the primary focus is on infrastructure investments (e.g. US). Under these frameworks, access is restricted, so that there is high regulatory certainty regarding the recovery of infrastructure investments. This effect, in addition to low fees, leads to the deployment of infrastructure as the key competitive asset.
- The "Asian model" places equal importance on industry competition and high investments in infrastructure (e.g. Singapore). Here, access is granted, and in order to provide the required incentives for infrastructure deployment the state either provides incentives for investments or invests itself. Fees are kept low to encourage competition.
- Finally, there is a "Skimming model" with low competition and low investment. Under this framework, there is either excess profitability for monopolistic players or the state appropriates some of these monopoly rents by charging high fees. Whatever the case, the telecommunications industry will not develop its full potential.

The American and European model, which seem most appropriate in the South African context, both have a moderate fee structure that clearly differentiates between the purpose of different fees (see exhibit 5 in the appendix for details):

- There are *administrative fees*, which are meant to cover the cost of the regulator. These comprise mainly licence fees and are either calculated as a fixed amount or expressed as a percentage of profits or gross revenues. In the best practice examples surveyed, the level of licence fees is between less than 0.1 and 1.0% of gross revenues. If administrative fees exceed the actual costs of the regulator, they are in effect taxes to generate income for the Government.
- *Technical/efficiency fees* are levied to ensure that scarce resources are used and allocated efficiently. Examples are numbering and spectrum fees, which are normally established as a fixed amount per unit of resource or allocated through an auctioning process. Higher fees in this category lead to more efficient industry operations but there is a limit where the additional costs block the sector's development. Numbering fees are generally very low, while the level of spectrum fees varies considerably, depending on the size of a country's population and the expected revenues from spectrum use.
- Some countries levy *sector development fees* to create pools of funds to develop the ICT sector and promote its social benefits, e.g. through a Universal Service Fund or an R&D fund. The level of these fees tends to be in the area of 0.1 to 1.0 % of gross revenues. High sector development fees make more funds available for social projects in the ICT sector but the administration and effective allocation of these funds poses a great challenge. Telkom acknowledges that the Universal Service and Access Agency of South Africa (USAASA) is in the process of setting up the respective mechanisms for the Universal Service Fund.
- Taxes and royalties serve the goal of *income generation* for the government to spend outside the ICT sector. They are usually calculated as percentage of profits. It is important to keep in mind that even if they are not part of the specific regulatory framework for the ICT sector, they still place a burden on the industry. Clearly, too much value extraction from the industry leads to its decline and reduced investment activities.
- Finally, there are *non-monetary obligations* that constitute a cost to the operators and therefore have to be considered in this context. These can take the form of Universal Service Obligation, service standards, number portability and other provisions. While it is impossible to define benchmarks in this respect, it is considered best practice that asymmetrical burdens placed on players should be counterweighted by support in other areas.

In summary, translating these best practices to the South African context, we believe the following:

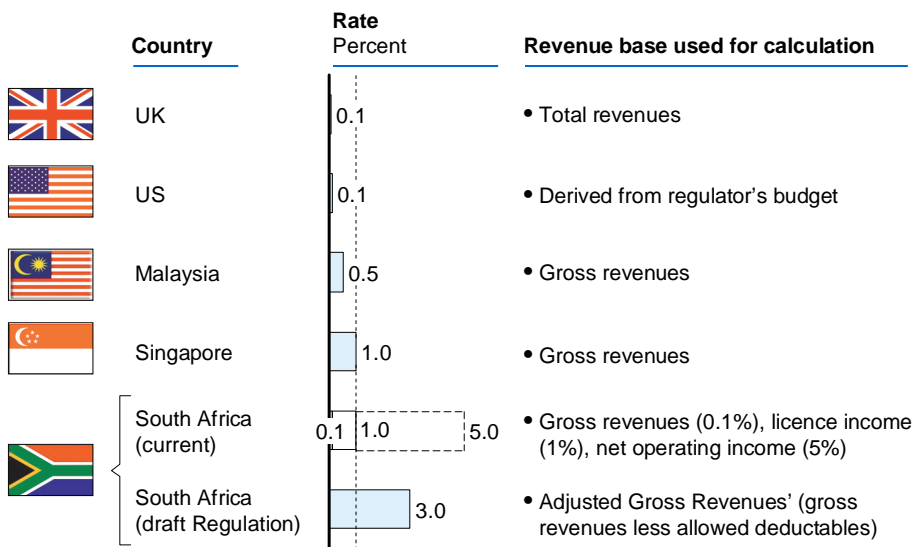
- It is important to consider the effect of the overall regulatory regime on the industry, including licence and other fees as well as taxes and non-monetary obligations.
- Fees that do not serve the purposes of recovering the regulator's costs, encouraging the efficient use of scarce resources or driving ICT development are in fact taxes on the industry.

- Given the paramount importance of ICT sector for economic development overall, excessive taxes will lead to negative socio-economic consequences beyond the ICT sector itself
- Investments in infrastructure are badly needed in South Africa's ICT sector, and any regulatory framework should encourage them.

Reaching this framework will be a process of several years, requiring public consultation at various stages – Telkom will welcome the opportunity to contribute to this process and help to reinforce the ICT sector's vitality and competitiveness in South Africa.

APPENDIX

Exhibit 4: Compared to best practice regulatory regimes, the licence fee in the draft Regulation is extremely high



Source: Regulatory authorities' websites

Exhibit 5: In best practice regulatory regimes, fees serve a particular purpose and are calculated by a corresponding method

Focus of draft Regulation

Type of fee	Purpose	Examples	Method of calculation	Level	Effect of elevated fee level
Administrative	<ul style="list-style-type: none"> Cover cost of the regulator 	<ul style="list-style-type: none"> General licence fees Other administrative fees* 	<ul style="list-style-type: none"> % of gross revenues/profits – or – Fixed sum 	<ul style="list-style-type: none"> <0.1-1.0% 	<ul style="list-style-type: none"> If above cost of regulator: effectively taxation
Technical/efficiency	<ul style="list-style-type: none"> Ensure efficient use and allocation of scarce resources 	<ul style="list-style-type: none"> Spectrum fees Numbering fees 	<ul style="list-style-type: none"> Fixed amount per unit – or – Auctioned 	<ul style="list-style-type: none"> Dependent on market size** 	<ul style="list-style-type: none"> More efficient use of resources (up to certain limit)
Sector development	<ul style="list-style-type: none"> Fund development of ICT sector 	<ul style="list-style-type: none"> Universal service fund R&D fund 	<ul style="list-style-type: none"> % of profits/gross revenues 	<ul style="list-style-type: none"> 0.1-1.0% 	<ul style="list-style-type: none"> More funds available but risk of distortion and allocation issues
State income generation	<ul style="list-style-type: none"> Generate state revenues 	<ul style="list-style-type: none"> Taxes Royalties 	<ul style="list-style-type: none"> % of profits/gross revenues 	<ul style="list-style-type: none"> <30% 	<ul style="list-style-type: none"> Extraction of funds from industry that hampers ICT development
Non-monetary	<ul style="list-style-type: none"> Prescribe certain industry behaviour 	<ul style="list-style-type: none"> USO Number portability Service level obligation 	<ul style="list-style-type: none"> — 	<ul style="list-style-type: none"> — 	<ul style="list-style-type: none"> —

* E.g., application fees, certification, equipment approval

** Population, penetration, ARPU

Source: Regulatory authorities' websites and publications; ITU; national tax authorities

END OF SUBMISSION