

# Telkom SA Ltd

## **Response to ICASA's Notice 314 of 2010**

**on**

## **DRAFT CALL TERMINATION REGULATIONS**

**Submission Date: 2 June 2010 extended to 18 June 2010**

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## 1 INTRODUCTION

Telkom SA Limited (“**Telkom**”) welcomes the opportunity afforded by the Independent Communications Authority of South Africa (“**the Authority**”) to submit its written response to the draft Call Termination Regulation (“**the Draft Regulations**”).

Telkom notes the Authority’s intention to hold public hearings on these regulations, and would welcome the opportunity to make an oral presentation in this regards.

Telkom’s response is structured as follows:

- Section 2 is the executive summary which outlines the message which Telkom wishes to deliver with this response
- Sections 3-6 outline Telkom’s legal reservations with respect to the processes
- In Section 7 Telkom puts forward economic considerations with respect to substantive parts of the regulation
- Section 8 concludes

## 2 EXECUTIVE SUMMARY

Though Telkom is generally supportive of regulatory intervention that is proportional, reasonable, rational and not arbitrary and which is consistent with the Authority's endeavours to attain the objects of the Electronic Communications Act, 2005 (Act No. 36 of 2005) ("the Act") and the Independent Communications Authority of South Africa Act, 2000 (Act No. 13 of 2000) ("the ICASA Act"), Telkom wishes to at the outset express its sincerest reservations regarding the manner in which the Authority purports to regulate the determination of wholesale termination charges in the Republic of South Africa ("the Republic"). In particular, Telkom is deeply concerned with both the *procedural* and *substantive* manner in which the Authority is purporting to regulate wholesale termination charges in the Republic.

Notwithstanding the expression of its reservations, Telkom shall endeavour, as far as possible, to propose to the Authority the most appropriate, reasonable, proportional and rational basis upon which the Authority ought to proceed to endeavour to regulate the determination of wholesale termination charges in the Republic.

### **The procedural approach adopted by the authority**

Telkom would like to note that this is the first market review which the Authority has attempted to undertake. However the immediate question arises as to "why this market"? It is not that undertaking this market review is unmerited per se, however there should be an administratively transparent rational on the order in which market reviews are undertaken. Telkom is of the view that the Act in fact did envisage this to occur. To this extent Telkom contends that the Act envisages that before any such market review is to be undertaken, that the Authority should put in place a framework across all market

reviews. Telkom does not see this as a luxury, however indeed a legal necessity in the interests of administrative justice<sup>1</sup>.

While Telkom recognises the need for these important regulations, Telkom contends that the Authority should first have set out a framework to provide all parties with clarity over the process that would be followed and the opportunities they would be afforded make constructive comment.

Thus briefly Telkom sees, presuming this is indeed the first market review, the implementation of cost based rates for all operators in three phases as follows:

1. A market review framework is put in place by passing the requisite regulations as per sections 67(4)(a),(b),(c),(d),(e) and (f) of the Act
2. In the regulations on s67(4)(c) the Authority sets out a sub framework with respect to the implementation of cost based rates. This may be for all termination rates, or per type of interconnection if different accounting treatments are merited
3. The Authority completes the market review on call termination culminating in the findings of said market review

### **Concerns over the substantive analysis undertaken by the Authority**

Within the narrow context of this review, the analysis undertaken by the Authority is in three parts:

1. Market definition
2. SMP assessment
3. Determination of remedies.

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<sup>1</sup> Telkom's view here mirrors a similar view we expressed with regards to the s31(3) regulations which precede ITA's for the issuing of spectrum where demand exceeds supply.

Telkom welcomes the improvements to the approach adopted by the Authority in relation to each of these aspects, and notes that many of Telkom's previous suggestions are incorporated within the supporting analysis. However Telkom remains concerned that the analysis by the Authority is inconsistent, self-contradictory, and lacks empirical rigour.

As an example of this the Authority has not clearly distinguished between retail and wholesale termination markets; and there is a risk that this could distort future decisions on remedies.

Similarly, while the Authority recognises that other operators such as those providing VoIP services also provide termination services, it does not make any attempt to conclude whether those services sit in the same markets as fixed termination, mobile termination, or some other market.

This is an important omission because the Authority also concludes that these operators hold SMP over their own termination. However without having clearly defined the relevant wholesale market for those operators, the Authority cannot now (and will not in the future) be in a position to judge whether their termination rates are excessive.

When considering remedies, the Authority bases its approach on a notion of 'established SMP'. The authority provides no definition of this approach and Telkom finds no basis for it in law (domestic or foreign).

The application of this concept of 'established and SMP' results in an inappropriate and unjustified inconstancy in the way that regulatory remedies are applied, particularly between Telkom and the VoIP operators.

As defined by its duties under the Act, the Authority should rather apply remedies proportionately between all operators. In this regard, Telkom consider i) separation of accounting and ii) cost based pricing to be the appropriate remedies; with (i) an necessary pre-requisite to (ii). However Telkom contends that such remedies should be

applied to all operators offering call termination services upon their networks. Telkom is of the firm view that there is no basis in law to exempt any operators from this requirement. To do so would amount not only to a regulatory endorsed economic cross subsidy of certain operators by others (with the effect of distorting the market) and would also represent a gross violation of administrative justice.

Practically Telkom is cognisant that currently only 3 operators submit COACAM's, however the regulation itself envisages that in the event of a dispute between operators would submit such costs to the Authority in resolution of such a dispute. Telkom is not advocating that each operator develop a full COACAM, however Telkom does envisage that the Authority would devise a further framework (colloquially called 'COACAM-lite) that would set out a simplified set of accounting standards whereby operators would submit information to the Authority and in conjunction with the Authority determine a cost.

With this information, the Authority would then be in a position to make an informed and legally defensible decision about the nature of remedies to be applied, and the level of cost-orientated prices.

In calculating the costs that operators of all nature incur, the Authority must build into the costs a means of recovering all universal service obligations imposed on such licensees. It is neither fair, nor administratively just for the Authority to impose obligations on operator, yet not provide explicit means for such costs to be recovered. With respect to Telkom's fixed termination rate, when USO costs are added, and in particular access line deficit, the actual termination rate increases from the current 29c. Accordingly there is no justification for a downwards glide path as mooted by the Authority. In the case of Telkom Mobile this means recognising the higher efficient costs that it will incur as a result of spectrum and other differences.

The regulations propose to implement a peak-off peak blended rate regime at wholesale, and by implication retail level. This proposal is not on the list of remedies as proposed in Chapter 10, and the Authority has overstepped their mandate in this regard by unduly interfering in the commercial activities of licences. Yet in the case of geographic numbered fixed services the Authority goes further in attempting to implement a blended local-long distance rate, which is again beyond the purview of the Authority.

### 3 GENERAL COMMENTS ON THE DRAFT REGULATIONS

Telkom wishes to convey its confusion to the Authority regarding the typographic manner in which the Authority has sought to present the Draft Regulations. In this regard, Telkom has experienced difficulties in appreciating the manner in which the Authority has intended that the Draft Regulations be read and construed. Here, Telkom notes that the Authority has *gazetted* a consolidated document which consists of two distinct portions. The first of these portions constitute a **Schedule** entitled *Call Termination Regulations Pursuant to Section 67(4) of the Electronic Communications Act No. 36 of 2005*. This portion further consists of an **Appendix A** entitled *Minimum content of a Reference Interconnect Offer (“RIO”)* and an **Appendix B** entitled *Format for Submission of Bi-Annual Market Reports*. The second of these portions consist of a document entitled *ICASA Wholesale Call Termination Market Review for the period 2010 – 2013: Explanatory Note for the draft Call Termination Regulations*.

Telkom is unclear as to whether or not the second portion of the consolidated document ought to be read as constituting the Draft Regulations and therefore proposed to be binding and enforceable in the same manner as subordinated legislative instruments are understood to be enforceable. In this regard, Telkom requests that the Authority provide further clarity concerning the legal status of the second portion of the consolidated document. Notwithstanding this uncertainty, Telkom has commented on the second portion of the consolidated document *as if* the document is intended to be read in conjunction with the first portion of the document. Telkom’s comments are contained in sufficient detail in the remainder of this written response.

Furthermore, and with regards to the first portion of the document, Telkom is unclear as to the reasons for the document to being referred to as a Schedule by the Authority. This is so, since the document has not been preceded by any other text to which it is intended to constitute a schedule. Telkom has understood the ordinary usage of schedules as

*supplementary constituents* of a primary text in relation to which the schedule is intended to be read in conjunction with. In this regard, Telkom requests the Authority to provide further clarification in relation to the intended classification and treatment of the Schedule. Notwithstanding this uncertainty, Telkom turns to provide specific comments regarding the Schedule and its constituent appendixes.

## 4 SPECIFIC COMMENTS ON THE DRAFT REGULATIONS

In this portion of Telkom's written response, specific comments shall be made in relation to the various propositions canvassed by the Authority in the Schedule and the appendixes. In this regard, and since Telkom has, in the absence of further clarity from the Authority construed the first and second portions of the consolidated document as not being mutually exclusive of each other, some of the specific comments made in relation to the first portion of the consolidated document have been elaborated upon further in the remainder of Telkom's written response. For the avoidance of duplicity, to the extent that there is further elaboration on the specific comments made by Telkom in relation to the first portion of the document, Telkom shall merely cross-reference such comments.

### 4.1 Definitions

#### 4.1.1 "DOWNSTREAM MARKETS"

Telkom is concerned with the Authority's definition of Downstream Markets and the subsequent absence of a definition for Upstream Markets. Further, Telkom has not construed the definitions professed by the Authority relating to *fixed call* termination, *mobile call* termination and *wholesale service* as being synonymous with Upstream Markets. It is trite that where the relevant product or service markets are characterised by *derived demand*, the existence of an Upstream Market is dependent upon the demand characteristics observed in the Downstream Market. Therefore, where demand for products or services is characterised by *derived demand*, it is inconceivable that a Downstream Market may exist in isolation and without there being an Upstream Market. The Authority's non-inclusion of a definition of an Upstream Market is suggestive of this, and to that extent Telkom is of the view that the exclusion of a definition of an Upstream Market in the Schedule is arbitrary and capricious, and irrational.

Indeed, the United Kingdom Office of Communications (“Ofcom”) has consistently recognised that the characteristics of rendering call termination services is that which is consistent with *derived demand*. Here, Ofcom has stated that:

*“Demand for termination is a derived demand in that it comes from a fixed or mobile originating network operator on behalf of a customer who has originated a call.”<sup>2</sup>*

Furthermore, in providing an analysis of the demand characteristics of call termination services, Valletti has described *derived demand* in the following manner:

*“...it is common and useful practice to think of a retail market for call origination, although it is clear that this market cannot exist in isolation without termination...the retail market for call origination is de facto extended to include termination as a necessary input for an originated call to be completed. Termination is an input that is not directly bought by the call originator, but is needed to satisfy the call originator’s needs. According to this view, there is a retail market for call origination, but not a retail market for termination, which is a derived demand instead. Call origination and call termination are in a vertical relationship where the provider of call origination takes as given the input price for call termination...”<sup>3</sup> (own emphasis)*

To this end, Telkom is of the view that the Authority ought to correctly and appropriately reflect the *derived demand* nature of call termination services in its definitions.

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<sup>2</sup> Paragraph 3.9 of the 2006 consultation entitled *Mobile call termination: Proposals for consultation*. The acceptance of the *derived demand* nature of call termination services has been carried forth in the 2007, 2009 and 2010 Ofcom consultations relating to call termination services.

<sup>3</sup> Valletti, Tommaso. 2006. Mobile call termination: a tale of two-sided markets, *Communications and Strategies*, 61(1), 61 – 77, at 63.

#### 4.1.2 “ESTABLISHED SMP LICENSEE”

Telkom considers the inclusion of a definition of *established SMP licensee* as invalid in law, unreasonable, irrational and capricious. In this regard, Telkom considers that there is no basis in law for the Authority to purport to delineate licensees in possession of SMP in accordance with a qualification relating to *established* or *non-established*. Indeed, Telkom can find no reference to this delineation in the Act as a basis upon which differentiated pro-competitive terms and conditions may be imposed upon licensees meeting the Authority’s arbitrarily derived threshold of *established* or *non-established*. To this end, Telkom proposed that since this delineation is incapable of being sustained in law, that it be deleted in its entirety.

#### 4.1.3 “MOBILE CALL TERMINATION”

Telkom considers it curious that the Authority, in its discussion of VoIP services at paragraph 1.9.5.5 of the Explanatory Note, inherently recognises VoIP services as being rendered through both wireline and wireless technologies, yet the Authority recognises VoIP services as only being capable of being rendered through their termination on wireline technologies in the Explanatory Note. In other words, the Authority ought to explicitly acknowledge, as it does in its discussion of the practicalities of licensees’ rendering VoIP services over wireless technologies, that VoIP services are capable of being terminated over wireless technologies such that the definition of *mobile call termination* ought to be inclusive of VoIP services.

Telkom notes that whereas the Authority has defined “fixed” and “mobile” call termination, no mention is made of “nomadic” call termination. There is no universal definition for nomadic calls however generally they are understood to be calls where the user may change his location between calls, as opposed to mobile which is both between

and during the course of a call. Nomadicity is a key value proposition of VoIP, although not all VoIP calls are nomadic.

Therefore, Telkom is of the view that it is critical that the Authority acknowledges this form of call, or provide clarity as to whether VoIP should instead be seen to always be either fixed or mobile.

#### 4.1.4 “RETAIL SERVICE”

Telkom consider that for purposes of ensuring consistent and reasonable interpretation and application of the Act and the regulations promulgated pursuant thereto, that the definition detailed in section 1 of the Act for “**retail**” be inserted as a substitute to the Authority’s definition of *retail service*.

## 4.2 Purpose of regulations

With regards to the Authority detailing the intended purpose of the regulations, Telkom notes that the Authority has merely paraphrased the recital of the provisions of sections 67(4)(a), (b), (c),(d), (e) and (f) of the Act. Furthermore, Telkom notes that sections 3, 4, 5 and 6 of the first portion of the consolidated document are intended to give treatment to sections 2(a), (b) and (c), respectively, while sections 7, 8, 9, 10 and 11 are intended to give treatment to section 2(d). In addition, section 12 is intended to give treatment to section

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(e), while curiously, the Authority has stated that the purpose of the regulations was also to give effect to section 2(f), it has nonetheless not purported to so in a corresponding section of the consolidated document.

Notwithstanding the Authority having stated the purpose of the regulations at section 2 of the document, it is Telkom’s considered view that the Authority has grossly misdirected

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itself in law in purporting to give effect to section 67(4) of the Act in the manner detailed in sections 2, 3, 4, 5, 6, 7, 8, 9, 10, 11 and 12 of the document. This is so for the reasons articulated at subsequent sections of Telkom's written response. Furthermore, and consistent with those views expressed by Telkom at subsequent sections of this written response, Telkom is of the emphatic view that the manner in which the Authority has purported to interpret, implement and administer Chapter 10 of the Act as proposed in the Draft Regulations falls far short of the Legislature's expectations as detailed in section 67 of the Act.

In this regard, and firstly, Telkom considers that it is insufficient, inappropriate and inconsistent with the clear, unambiguous and precise direction of section 67(4) of the Act for the Authority to purport to give effect to the requirements of section 67(4)(a) of the Act by making the assertions detailed at section 3 of the document regarding the definition of the relevant market. This is so, since the requirements of section 67(4)(a) of the Act ought to be read as directing the Authority to set out the methodology (by way of prescribing regulations in accordance with section 4 of the Act) to be used where the Authority intends to have recourse to such a methodology and its guiding principles when defining *specific* relevant markets. Telkom considers that it is insufficient for the Authority to discharge such a burden by merely making the statements detailed at section 3 of the document.

Secondly, and more importantly, it is insufficient and erroneous in law for the Authority to purport to give effect to the clear directions of section 67(4)(b) of the Act by merely paraphrasing *verbatim* the citation of sections 67(6)(a), (b)(i) and (ii) of the Act. This is so, since section 4(1)(a), (b) and (c) of the document amounts to a *verbatim* recital of sections 67(6)(a), (b)(i) and (ii) of the Act. Furthermore, and even more importantly, the requirements of section 67(4)(b) of the Act (as expressed by the Authority at section 2(b)

of the document) *direct* the Authority to set out the contemplated methodology, taking into account the provisions of section 67(6) of the Act.<sup>4</sup> In discharging this burden, Telkom is of the considered and emphatic view that the Authority may not merely and conveniently recite the very same provisions of the statute which it is required to give *elaborative* effect to and then purport to further rely upon such recitals in order to arrive at supposedly fact-centric determinations. This illogicality is reflected in section 5 of the document which states the following:

*“Pursuant to regulation 4 the Authority has determined that competition in the call termination markets is ineffective in the provision of both fixed and mobile voice services.”*

However, regulation 4 merely recites the provisions of sections 67(6)(a), (b)(i) and (ii) of the Act and does not in any measure or form sufficiently discharge the burden of setting out the required methodology mandated to be prescribed by the Authority in terms of section 67(4)(b) of the Act. Indeed, it would amount to a legislative absurdity that the Legislature would delegate powers to an administrative body in order for them to derive subordinate legislation as guided by the general application of primary legislation, such that such delegation ought to be understood as merely requiring that the administrative body recite *verbatim* the provisions of the primary legislation in order to discharge the obligation imposed by the Legislature through delegation. Telkom considers that such an absurdity could not have been the reasonable contemplation of the Legislature and that the steps taken by the Authority which reflect such an absurdity are clearly reflective of a gross misdirection in law by the Authority in its interpretation, application and administration of Chapter 10 of the Act. To this end, and as the Authority has purported to derive substantive determinations in the form of sections 6, 7, 8, 9, 10, 11 and 12, as

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<sup>4</sup> Through generally accepted principles of statutory interpretation, Telkom has construed the cross-reference to subsection (8) in section 67(4)(b) of the Act as referring to subsection (6) of the Act instead.

well as Appendix A and B of the document in accordance with such a misdirection in law, such substantive determinations are consequently unlawful, impermissible, void and unenforceable in law.

In particular, and in relation to the proposal of a RIO under Appendix A, Telkom considers that the Authority has misdirected itself in law when it purports to develop a RIO pursuant to a Chapter 10 process rather than, as clearly and unambiguously stated in the Act, pursuant to Chapter 7 of the Act. This is so, since section 67(7)(e)(ii) of the Act, which the Authority has implicitly relied upon in setting out its determination in section 8 entitled **PUBLICATION OF A REFERENCE INTERCONNECTION OFFER** may not be reasonably read as empowering the Authority to prescribe a RIO. Instead, section 67(7)(e)(ii) of the Act merely provides that such a RIO may be imposed by the Authority as an obligation for a licensee to comply with once the Authority has exercised its discretion in imposing pro-competitive terms and conditions upon such a licensee.

Here, section 67(7)(e)(ii) of the Act reads as follows:

*“(7) Pro-competitive terms and conditions may include but not limited to—*

*(e) an obligation to publish, in such a manner as the Authority may direct, the terms and conditions for—*

*(ii) the provision of electronic communications network services, electronic communications services or any other service offered by the licensee applicable to the relevant market or market segments at issue which may take the form of a reference offer.”*

Telkom is of the considered view that the provisions of section 67(7)(e)(ii) of the Act implicitly presupposes that the Authority has, pursuant to having promulgated the section 38 regulations, made provision for setting out the terms and conditions of such a RIO

such that, where the Authority deems it necessary to impose an obligation upon a licensee consistent with the section 67(c) regulations (which are intended to give effect to the operative manner of the section 67(7)(e)(ii) obligation), it may merely allude to such a RIO as being the appropriate remedy to impose. This is so, since section 38(2) of the Act amounts to the only legislative provision which explicitly empowers the Authority to prescribe regulations setting out the framework for the negotiation and conclusion of interconnection agreements, and provide powers to the Authority to specifically set out a RIO.

Here, section 38(2) of the Act reads as follows:

*“Interconnection regulations and interconnection agreement principles must provide for a framework which may include a reference interconnection offer containing model terms and conditions for interconnection.”* (own emphasis)

Therefore, it is clear that the Legislature had contemplated that the development of a RIO would be pursuant to the exercise by the Authority of the powers conferred in section 38(2) of the Act, and not, as suggested by the Authority, in accordance with section 67(7)(e)(ii) of the Act, which merely provides for the imposition of an obligation relating to a RIO. In this regard, the Authority has fundamentally misconstrued the scope for the exercise of its powers in relation to section 67(7)(e)(ii) of the Act. This misdirection in law renders section 8 and Appendix A of the Draft Regulations unlawful, void and unenforceable in law.

In passing, Telkom notes that on 9<sup>th</sup> April 2010, the Authority *gazetted* Regulations in terms of sections 4 and 38 read with section 3(3)(j) of the ICASA Act with respect to Interconnection Regulations in Government Gazette No. 33101 of 9<sup>th</sup> April 2010 (Government Notice No. R.282) (“the **Interconnection Regulations**”). Curiously, the Authority did not set out the terms and conditions for such RIOs as detailed in section 38(2) of the Act. Telkom is of the emphatic view that the Authority’s failure to

incorporate the terms and conditions of a RIO pursuant to section 38(2) of the Act within the Interconnection Regulations may not be corrected within the context of a section 67 process.

Telkom turns to provide further comments on the remainder of the consolidated document.

## **5 BACKGROUND TO THE ADMINISTRATIVE ENDEAVOURS AIMED AT REGULATING THE DETERMINATION OF WHOLESALE CALL TERMINATION CHARGES PURSUANT TO THE ACT**

### **5.1 Introduction**

The promulgation of the Act on 19<sup>th</sup> July 2006 introduced an elaborate and sophisticated statutory schema regarding the powers conferred upon the Authority by the Legislature to regulate for the persistence of durable market failure within the broader electronic communications market in the Republic. Here, the persistence of durable market failure ought to be understood as the existence of certain *structural* and *specific behaviour-inducing* factors which avail firms the (perverse) incentives to conduct themselves consistent with those incentives, such that the process of effective competition in relevant markets is significantly distorted or substantially retarded, thus resulting in durable market failure which is detrimental to *total welfare* and *consumer welfare*.

As distinct from the rate regime which existed under the Telecommunications Act, 1996 (Act No. 103 of 1996) (“the Repealed Act”), the provisions of Chapter 10 of the Act introduced two notable developments regarding the regulation for the persistence of durable market failure. Firstly, the Legislature conferred upon the Authority, in the form of section 67(4) of the Act, direct powers to derive subordinate legislation in the form of regulations. The conferment of these powers to the Authority were conditional and not of general application. That is to say, that in the exercise of these powers, the Authority was specifically constrained with regards to both the *procedural* and *substantive* matters which these envisaged regulations were to give treatment and set out. Inherent in the powers conferred upon the Authority was the requirement that the Authority set out an overarching *ex ante* regulatory framework which the Legislature had intended the Authority to rely upon in its endeavours to regulate for the persistence of durable market failure. Secondly, the manner in which the provisions of Chapter 10 of the Act had been

set out by the Legislature intrinsically required that the implementation and application of these provisions would have to be undertaken in a manner that took cognisance of the provisions of the Promotion of Administrative Justice Act, 2000 (Act No. 3 of 2000) (“the PAJA”).

## **5.2 The 2007 Discussion Document**

In purporting to implement and administer the provisions of Chapter 10 of the Act in the manner contemplated by the Legislature, on 29<sup>th</sup> January 2007 the Authority *gazetted* a discussion document entitled *Notice of Intention to Define Relevant Wholesale Call Termination Markets in Terms of Section 67(4) of the Electronic Communications Act 36 of 2005* pursuant to Government Gazette No. 29568 of 29<sup>th</sup> January 2007 (General Notice No. 78 of 2007) (“**the Discussion Document**”). Telkom understood the Authority’s *gazetting* of the Discussion Document as being in accordance with it undertaking an *inquiry* which was concerned with endeavouring to gain a heightened appreciation of the general manner in which wholesale termination charges were determinate by licensees. Here, the process of endeavouring to gain a heightened appreciation of the wholesale call termination services would be undertaken through an inquiry which sought to solicit broad and general information from licensees which rendered such services. The Authority solicited this broad and general information through posing specific questions. Indeed, these questions were detailed in Annexure A of the Discussion Document.

Crucially, and as stated by the Authority, the Discussion Document and its contemplated Findings ought to have been understood as amounting to an inquiry which was *exploratory* in nature. In this regard, the Authority unambiguously contextualised the *exploratory nature* of the Discussion Document and its contemplated Findings in the following manner:

“The findings and conclusions or recommendations made by the Authority following the inquiry will be published in a Government Gazette as provided for by section 4C of the ICASA Act.”<sup>5</sup> (own emphasis)

This is important to note at the outset since, firstly, the *proper context* of the inquiry and its subsequent findings ought to be appreciated in light of the statutory provisions which the Authority had sought to rely upon as the empowering provisions for undertaking the inquiry. Secondly, a distinction must be sustained between an *exploratory inquiry* undertaken pursuant to section 4B and 4C of the ICASA Act, and a *Chapter 10 inquiry*, which, by its very nature is not exploratory but *deterministic* and *extra-judicial*. Indeed, section 4B(1) of the ICASA Act empowers the Authority as follows:

“The Authority may conduct an inquiry into any matter with regard to—

- (a) *the achievement of the objects of this Act or the underlying statutes;*
- (b) *regulations and guidelines made in terms of this Act or the underlying statutes;*
- (c) *compliance by applicable persons with this Act and the underlying statutes;*
- (d) *compliance with the terms and conditions of any licence by the holder of such licence issued pursuant to the underlying statutes; and*
- (e) *the exercise and performance of its powers, functions and duties in terms of this Act or the underlying statutes.”*

This serves to emphasise the contemplated exploratory nature of such enquiries. Furthermore, the Authority has previously conducted similar *exploratory* enquiries through the reliance upon section 4B of the ICASA Act.

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<sup>5</sup> Page 5 of the Discussion Document

The *exploratory* nature of the Discussion Document is further evidenced by certain statements and assertions which the Authority proposes and advanced therein. Firstly, and in relation to discussions regarding the appropriate methodology which the Authority ought to employ in the definition of relevant product and geographic markets, the Authority states the following in the Discussion Document:

*“The approach which the Authority proposes to adopt in the delineation of the relevant markets is that which is consistent with that utilised by the Competition Commission of South Africa and the Competition Tribunal of South Africa (“the SA Competition Authorities”). (own emphasis)*

Secondly, the Authority proceeded to pose thirteen (13) questions which specifically requested interested parties to profess their respective views regarding the issues canvassed in the Discussion Document. This in itself demonstrates the Authority’s underlying intention in undertaking an *exploratory* inquiry into matters related to commercial arrangements of rendering wholesale call termination services by licensees. Indeed, it would appear from the manner in which the various questions are posed that the Authority sought to be in receipt of information from interested parties which would enable it to gain a heightened appreciation of such commercial arrangements with the view of determining the probable incidence where regulatory intervention would be appropriate, reasonable, proportional and capable of being objectively justified.

### **Summary**

In light of the above, Telkom is of the considered view that the purpose and proper context within which the Discussion Document is to be understood is that it essentially amounted to an *exploratory exercise* undertaken by the Authority in order to solicit views and informed perspectives from interested parties relating to the commercial arrangements pertaining to the rendering of wholesale call termination services. This is an important qualification of the inquiry since its purpose and context is intricately tied to

a document which the Authority *gazetted* on 9<sup>th</sup> November 2007 under Government Gazette No. 30449 of 9<sup>th</sup> November 2007 (General Notice No. 1627 of 2007) and entitled ***Publication of the Findings to Section 4C of the Independent Communications Authority of South Africa Act No. 13 of 2000, as Amended (“the ICASA Act”) of an Inquiry Conducted in Terms of Section 4B of the ICASA Act (“the Findings Document”)***.

We turn to consider the purpose and context within which the Findings Document is to be understood in relation to the Discussion Document and the Authority’s broader endeavour to regulate the determination of wholesale termination charges in the Republic.

### ***5.3 The 2007 Findings Document***

It is important to state at the outset that the Findings Document is incapable of being read in isolation and independently of the Discussion Document. Indeed, the very existence of the Findings Document is owed to the Authority having *gazetted* the Discussion Document and *being mandated by statute to gazette a Findings Document which serves as a culmination of an exploratory inquiry undertaken pursuant to section 4B of the ICASA Act* (own emphasis). This is so, since section 4C(6) of the ICASA Act, the provision which the Authority had relied upon as the legal basis upon which the Findings Document had been *gazetted*, reads as follows:

*“The Authority must, within 180 days from the date of conclusion of the inquiry—*

*(a) make a finding on the subject matter of the inquiry; and*

*(b) publish in the Gazette—*

*(i) a summary of its finding; and*

*(ii) the details of the place where and the time when the finding and the reasons for the finding can be obtained by the public.” (own emphasis)*

Further, Telkom is of the considered view that the Findings Document ought to be understood as being representative of the consolidated views of interested parties expressed within the context of an exploratory inquiry undertaken by the Authority pursuant to section 4B of the ICASA Act. Indeed, in *gazetting* the Findings Document, the Authority appears to have shared this view in stating the following:

*“This document follows a consultative process undertaken by the Independent Communications Authority of South Africa (“ICASA/Authority”) in terms of section 4B of the ICASA Act. It sets out the findings on the subject matter of the inquiry contained in Government Gazette No. 29568 published on 29 January 2007 in terms of section 4C(6)(a) of the Independent Communications Authority of South Africa Act No. 13 of 2000, as amended (“ICASA Act”). Pursuant to section 4C(6)(b)(i), the Authority is mandated to publish its findings in terms of a section 4B inquiry not more than 180 days after the conclusion of such an inquiry.”<sup>6</sup> (own emphasis)*

Furthermore, and consistent with the intended import of documents *gazetted* pursuant to section 4C(6) of the ICASA Act, the Authority categorically and unambiguously stated the purpose and context of the Findings Document and its interrelationship with the Discussion Document in the following manner:

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<sup>6</sup> Page 10 of the Findings Document

*“This Findings Document consolidates the responses and perspectives regarding the intricacies of the issues raised in the Discussion Document and the public hearings and proposes a progressive manner of dealing with the issues arising from such a process. Where appropriate, the Authority’s observations and preliminary conclusions will be detailed. Such preliminary conclusions and observations ought not to be interpreted as representative of conclusive determinations made by the Authority regarding any future substantive findings on the issues canvassed in the Discussion Document.”<sup>7</sup> (the Authority’s own emphasis)*

Telkom considers that the above statement made by the Authority serves to appropriately contextualise the legal status of the Discussion Document read in conjunction with the Findings Document. Further, Telkom is of the view that such contextualisation is consistent with a reasonable interpretation of the ICASA Act in relation to the purpose of a section 4B inquiry and the culmination of such a process being signalled through the *gazetting* of a Findings Document as mandated by section 4C(6) of the ICASA Act.

## **Summary**

In light of the above, Telkom is of the considered view that the purpose and proper context within which the Findings Document is to be understood is that it essentially amounted to a consolidation of the views and perspectives of interested parties who had expressed their views in relation to the questions posed by the Authority. Importantly, the Findings Document only concerned itself with reflecting those views expressed by interested parties relating to the identification of the salient aspects of rendering wholesale call termination services. This amounted to a limited aspect of the Discussion

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<sup>7</sup> Page 10 of the Findings Document

Document since the latter document also solicited responses from interested parties in relation to questions 11 to 13. These questions broadly related to the consideration of issues relating to the designation of licensees as possessing significant market power (“SMP”), the consideration of issues relating to the competitive functioning of the proposed market for rendering wholesale call termination services and the consideration of potential structural and behavioural constraints present in the functioning of the proposed market which *prima facie* rendered the proposed market as not being characterised by effective competition.

Furthermore, the Discussion Document proposed pro-competitive terms and conditions which the Authority preliminarily considered to be appropriate in alleviating the durable market failure observed in the rendering of wholesale call termination services. Crucially, the Findings Document is not reflective of the sentiments expressed by interested parties and their responses to those issues canvassed through questions 11 to 13 of the Discussion Document. Indeed, the Authority had stated the following:

*“As this process has been conducted as a section 4B inquiry in terms of the ICASA Act, the Authority only seeks to define the market. No pronouncement is made on the effectiveness of competition in this market. This pronouncement and any remedies that may flow from such a determination will be done by regulation in a process envisaged by section 67 of the Electronic Communications Act.”<sup>8</sup>*

(own emphasis)

A further important consideration of the Findings Document relates to the Authority’s explicit expression of its proposed approach towards the exercise of its powers in intervening in the commercial arrangements relating to the rendering of wholesale call terminations services. In doing so, the Authority effectively advanced its interpretation

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<sup>8</sup> Page 9 of the Findings Document

and understanding of the manner in which its powers were to be exercised as set out in section 67(4) of the Act. Here, the Authority stated that:

*“This Findings Document is also intended to provide clarity with regards to the manner in which the Authority has interpreted the exercise of its statutory powers and the pertinent enabling legislative provisions that the Authority relies upon. The Authority is of the view that by embarking upon an inquiry, through the publication of a Discussion Document and posing pertinent questions relevant to market dynamics serving to characterise the broader call termination market, it has met this obligation... [T]he Authority is cognisant that section 67(4) of the Act envisages regulations prescribing the following, the number and sequence, which will be determined in due course...”<sup>9</sup> (own emphasis)*

The Authority then proceeded to detail the nature and scope of the regulations which it contemplated as being necessary and mandated to be prescribed by section 67(4) of the Act. It is the Authority’s endeavours to prescribe these regulations that we turn to consider.

#### **5.4 The 2008 draft section 67(4) regulations**

In detailing its understanding of the powers conferred upon it by the Legislature in relation to the implementation of Chapter 10 of the Act, the Authority set out (in the Findings Document) the envisaged complexion of the regulations which it perceived as being necessary to prescribe *prior* to it intervening and making substantive determinations regarding any relevant product market. In this regard, the Authority stated the following:

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<sup>9</sup> Pages 10 – 11 of the Findings Document

***“Regulation(s) as envisaged by section 67(a) (sic) of the Act***

*Section 67(4)(a) regulations are intended to define and identify the retail and wholesale markets segments within which the Authority determines whether or not such markets are characterised by ineffective competition. The Authority will also detail the manner in which Significant Market Power (SMP) may be determined pursuant to section 67(4)(d) read together with section 67(5) of the Act.*

***Regulation(s) as envisaged by section 67(4)(b) of the Act***

*This regulation anticipates the detailing of the methodology which the Authority will use in determining whether or not a relevant market as defined pursuant to the regulation promulgated under section 67(4)(a) of the Act is characterised by ineffective competition. The factors to be considered in giving effect to the regulation are detailed in section 67(6)(b) of the Act. Within this regulation, the Authority will extrapolate on the substantive essence of the factors detailed in section 67(6)(b) of the Act.*

***Regulation(s) as envisaged by section 67(4)(c) of the Act***

*This regulation anticipates detailing the potential pro-competitive measures that the Authority, in exercising its discretion pursuant to section 67(4) of the Act, may impose where it is of the view that a relevant market is characterised by ineffective competition. The Authority is guided by factors detailed in section 67(7) of the Act.*

***Regulation(s) as envisaged by section 67(4)(e) and (f) of the Act***

*This regulation anticipates the Authority detailing both a schedule where the Authority will undertake periodic reviews of the relevant markets as defined, and*

*providing for procedures for the monitoring and investigation of anti-competitive behaviour in the relevant markets as defined.*” (own emphasis)

Pursuant to this expression of intent, on 6<sup>th</sup> March 2008 the Authority *gazetted* such draft regulations with the view of soliciting written representations from interested parties. These draft section 67(4) regulations were *gazetted* by the Authority under the following Government Gazettes:

- Section 67(4)(a) draft regulations *gazetted* pursuant to Government Gazette No. 30850 of 6<sup>th</sup> March 2008 (General Notice No. 335 of 2008);
- Section 67(4)(b) draft regulations *gazetted* pursuant to Government Gazette No. 30851 of 6<sup>th</sup> March 2008 (General Notice No. 336 of 2008);
- Section 67(4)(c) draft regulations *gazetted* pursuant to Government Gazette No. 30849 of 6<sup>th</sup> March 2008 (General Notice No. 334 of 2008);
- Section 67(4)(d) draft regulations *gazetted* pursuant to Government Gazette No. 30848 of 6<sup>th</sup> March 2008 (General Notice No. 333 of 2008);
- Section 67(4)(e) draft regulations *gazetted* pursuant to Government Gazette No. 30846 of 6<sup>th</sup> March 2008 (General Notice No. 331 of 2008), and
- Section 67(4)(f) draft regulations *gazetted* pursuant to Government Gazette No. 30847 of 6<sup>th</sup> March 2008 (General Notice No. 332 of 2008).

Over and above the Authority’s abridged elaboration on the envisaged scope of the section 67(4) regulations in the Findings Document, each draft section 67(4) regulation provided for further extrapolation on the intended purpose of such regulation.

Here, the Authority explicitly relied upon the provisions of section 67(4) of the Act as the basis upon which the regulations were to be understood. In this regard, and in relation to the draft section 67(4)(a) regulations, the Authority stated the following:

*“The prescriptive nature of section 67(4) requires the Authority to undertake an analysis of the particular relevant markets of market segments (“relevant markets”) and ascertain whether or such relevant markets are characterized by effective or ineffective competition and to determine which licensees possess significant market power (“SMP”)... [T]he Authority is of the view that the conceptual approach to the definition of the relevant market definition must be specified so as to provide the framework of the manner in which the Authority is to undertake the definition of the relevant market.”<sup>10</sup> (own emphasis)*

Further, the Authority stated the underlying purpose of its intention to prescribe the draft section 67(4)(b) regulations in the following manner:

*“The Independent Communications Authority of South Africa (“the Authority”) is required to promulgate regulations... [I]n particular, and with regards to the determination of whether or not relevant markets or market segments are characterised by effective competition, the Act requires the Authority to promulgate regulations which set out the methodology to be used to determine the effectiveness of competition in such markets or market segments.”<sup>11</sup> (own emphasis)*

With regards to the draft section 67(4)(c) regulations, the Authority also stated the intention for prescribing such regulations. Here, the Authority stated that:

*“The Independent Communications Authority of South Africa (“the Authority”) is required to promulgate regulations... [I]n particular, and with regards to the imposition of pro-competitive measures, section 67(4)(c) of the Act requires the*

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<sup>10</sup> Paragraphs 1.2 – 1.3 of the draft section 67(4)(a) regulations

<sup>11</sup> Paragraph 1.1 of the draft section 67(4)(b) regulations

*Authority to promulgate regulations which set out the pro-competitive measures which the Authority may impose in order to remedy the perceived market failure in the markets or market segments which are found to have ineffective competition, taking into account the provisions of subsection (7) of the Act.*<sup>12</sup>  
(own emphasis)

The same intention is expressed by the Authority with regards to setting out the operative framework within and pursuant to which substantive fact-specific determinations were to be made in accordance with the regulations envisaged in section 67(4)(d) of the Act. Here, the Authority stated that:

*“The Independent Communications Authority of South Africa (“the Authority”) is required to promulgate regulations... [I]n particular, and with regards to the declaration of licensees as possessing SMP, section 67(4)(d) of the Act requires the Authority to promulgate regulations which detail factors which the Authority must consider in declaring a licensee to be in possession of SMP, taking into consideration the factors detailed in section 67(5) of the Act.”*<sup>13</sup> (own emphasis)

With regards to the draft section 67(4)(e) regulations, the Authority signalled its intention in relation to the prescription of these regulations in the following manner:

*“The Independent Communications Authority of South Africa (“the Authority”) is required to promulgate regulations... [I]n particular, and with regards to undertaking periodic reviews of the relevant markets or market segments which have been determined by the Authority a being ineffectively competitive and the review of the pro-competitive measures which have been imposed by the Authority*

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<sup>12</sup> Paragraph 1.1 of the draft section 67(4)(c) regulations

<sup>13</sup> Paragraph 1.1 of the draft section 67(4)(d) regulations

*on a licensee in possession of SMP, the Act requires the Authority to promulgate regulations which set out the manner in which the Authority shall undertake such periodic reviews, taking into account the provisions of section 67(8) of the Act.”<sup>14</sup>*

(own emphasis)

Lastly, and with regards to the draft section 67(4)(f) regulations, the Authority expressed its intentions as follows:

*“The Authority views section 67(4)(f) as requiring the prescription of the administrative processes which the Authority must undertake when monitoring and investigating allegations of anti-competitive market conduct or behaviour in a relevant market or market segment.”<sup>15</sup>* (own emphasis)

All in all, the Authority expressed its intention and approach towards the implementation of Chapter 10 of the Act in manner described above. It is noteworthy that in expressing such an intention, the Authority clearly envisaged that the promulgation of the section 67(4) regulations would amount to the inception of an overarching *ex ante* regulatory framework which the Authority may, from time to time, invoke for purposes of seeking to intervene in relevant markets within which the alleviation of durable market failure through the imposition of pro-competitive terms and conditions would be attained. Furthermore, this overarching *ex ante* regulatory framework would serve as *constructive notice* for interested parties of the manner in which the Authority would purport to exercise its powers in accordance with the provisions of section 67(4) of the Act.

Crucially, and consistent with the express *directory* requirement of section 67(4) of the Act relating to the promulgation of regulations, the Authority would be required to

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<sup>14</sup> Paragraph 1.1 of the draft section 67(4)(e) regulations

<sup>15</sup> Paragraph 1.3 of the draft section 67(4)(f) regulations

consult with interested parties, through a *notice and comment* process regarding the manner in which it would, in future and once the overarching *ex ante* regulatory framework is in effect and in force, purport to exercise the powers conferred upon it in section 67(4) of the Act. More importantly, and consistent with the underlying essence of the Legislature's intention, such powers were to be derived through *delegation* and in the form of the regulations contemplated in section 67(4) of the Act. That is to say, that Chapter 10 of the Act is incapable of implementation and administration without the promulgation of the contemplated regulations clearly and expressly required in section 67(4) of the Act. Therefore, such powers were only capable of being exercised through specific delegation and not by recourse to the generality of the provisions of sections 67(4), (5), (6), (7) and (8) of the Act.

### Summary

The above account has sought to contextualise the historic developments regarding the Authority's endeavours, through the purported exercise of its powers, to regulate the determination of wholesale termination charges in the Republic. This account has sought to highlight the status of the Discussion Document and the Findings Document, as well as allude to the Authority's progressive approach towards its proposed implementation of Chapter 10 of the Act. Several points which ought to be born cognisance of are worth repeating here: firstly, the Discussion Document and Findings Document do not purport to make *factual determinations and substantive findings* since their very purpose was *exploratory* in nature and were compiled with recourse to *no empirical and quantitative data and information solicited from interested parties* (own emphasis). To the extent that any utility may be derived from both documents, they merely serve to cursorily reflect a *partially qualitative* perspective regarding the commercial arrangements of rendering wholesale call termination services. ***Therefore, to the extent that both documents are not premised upon any factual analyses and amount to a reflection of perspectives and anecdotal observations, they equally may not be relied upon for the formation of***

***factual determinations which are required to be made by the Authority in accordance and pursuant to specific powers derived through delegation*** (own emphasis).

Secondly, while the Authority had taken steps to endeavour to prescribe the overarching *ex ante* regulatory framework through the *gazetting* of the draft section 67(4) regulations, the reasons for the Authority's effective abandonment of such endeavours are not entirely clear to Telkom. Telkom had been generally supportive of the steps taken by the Authority in its implementation of Chapter 10 of the Act. In this regard, Telkom considered that the approach adopted by the Authority in the form of endeavouring to prescribe the contemplated section 67(4) regulations was broadly in accordance and consistent with the Legislature's intention as discerned from a plain construction of section 67 of the Act.

Having outlined the historic context of the developments regarding the Authority's endeavours to regulate the determination of wholesale termination charges in the Republic, we turn to consider the Authority's latest endeavours as detailed in the Draft Regulations. The following analysis shall firstly canvass general comments concerning the Draft Regulations. Secondly, the analysis shall draw attention to specific aspects of the Draft Regulations which Telkom views as particularly problematic and incapable of being lawfully sustained and enforceable.

## **6 SPECIFIC COMMENTS ON THE DRAFT REGULATIONS READ IN CONJUNCTION WITH THE ACCOMPANYING EXPLANATORY NOTE**

### **6.1 General comments**

Telkom notes the Authority's interpretation of the legislative requirements of the Act for defining the relevant market as detailed in paragraph 1.3 of the Explanatory Note. In this regard, the Authority states that:

*“The Act sets out the process that should be undertaken to conduct a market review. Under relevant parts of section 67(4) of the Act, the Authority must:*

*Define and identify the retail or wholesale markets or market segments in which it intends to impose pro-competitive measures in cases where such markets are found to have ineffective competition.*

*Section 67(6)(a) of the Electronic Communications Act (ECA) states the following:*

*When defining the relevant market or market segments the Authority must consider the non-transitory (structural, legal or regulatory) entry barriers to the applicable markets or market segments and the dynamic character and functioning of the subject markets or market segments.*

*These factors are explored in more detail below.”<sup>16</sup>*

Here, Telkom notes with heightened concern that the Authority has selectively cited the applicable statutory provision which it purports to rely upon in undertaking the process at hand. Furthermore, the Authority has misdirected itself in law with regards to the

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<sup>16</sup> Page 23 of the Explanatory Note.

interpretation and implementation of the empowering provisions which it purports to rely upon in undertaking the process at hand.

Firstly, and in purporting to state the applicable law which it relies upon, the Authority has selectively cited section 67(4)(a) of the Act. In doing so, the Authority has erroneously created the impression that the enabling provision of the Act empowers it to undertake the process at hand without any *conditions precedent* and without recourse to any *directory obligations* which are clearly articulated in the enabling provision. Here, by merely stating that the Act sets out the process that should be undertaken to conduct a market review, the Authority has not reflected the conditions precedent that are clearly stipulated in section 67(4) of the Act, and which are required to be fulfilled *prior* to undertaking such a market review process.

This impression has been further exacerbated by the selective citation of the enabling provision which the Authority purportedly relies upon in undertaking the process at hand. This is so, since while the Authority correctly alludes to the provisions of section 67(4)(a) of the Act, nonetheless these provisions are preceded by the *directory* nature of section 67(4) of the Act which serves to further establish the *conditions precedent* that *must* be satisfied *prior* to the Authority exercising its powers. In this regard, the complete citation of the enabling provision reads as follows:

*“The Authority must prescribe regulations defining the relevant markets and market segments, as applicable, that pro-competitive conditions may be imposed upon licensees having significant market power where the Authority determines such markets or market segments have ineffective competition. The regulations must, among other things—*

- (a) *define and identify the retail or wholesale markets or market segments in which it intends to impose pro-competitive measures in cases where such markets are found to have ineffective competition.”*

The *directory* nature of section 67(4) of the Act and the manner in which it imposes *conditions precedent* is clearly, unambiguously and precisely stated in the underlined portion of section 67(4) of the Act cited above. It is trite and established law that the Legislature's usage of the words "**must**" in statutory instruments connotes a *directory obligation* that is imposed upon a recipient of such a direction to conduct themselves in the manner directed within the subsequent portion of the statutory provision. In this regard, the subsequent portion of the statutory provision may not be interpreted exclusive of the *directory obligation* since the *directory obligation* serves to create *conditions precedent* which must be adhered to in order to render the interpretation and application of the statutory provision consistent with the Legislature's intention. Therefore, the Authority's selective citation of section 67(4) of the Act renders the interpretation and implementation of section 67(4)(a) of the Act inconsistent with the Legislature's intention and amounts to a fundamental misdirection in law in relation to the manner in which section 67(4) of the Act is to be interpreted and implemented.

Secondly, the Authority erroneously states that:

*"Under the relevant parts of Section 67(4) of the Act, the Authority must:*

*Define and identify the retail or wholesale markets or market segments..."*

Again, this amounts to an incorrect statement of the applicable law and renders the interpretation and application of the enabling provision as a misdirection in law and thus invalid. This is so, since the Authority has misconstrued the *directory nature* of section 67(4) of the Act and the context within which the *direction* ought to be interpreted. In this regard, section 67(4) of the Act does not, as suggested by the Authority at paragraph 1.3 of the Explanatory Note, *direct* the Authority to define and identify the retail or wholesale markets. Rather, section 67(4) of the Act *directs* the Authority to *prescribe regulations*, and not, as suggested by the Authority, to merely define and identify the retail or wholesale markets.

This point is important since it contextualises the scope and nature of the *obligatory direction* detailed in the language of section 67(4) of the Act and places a clear, unambiguous and precise obligation upon the Authority in the exercise of its powers. Therefore, Telkom is of the considered view that the misinterpretation of the nature, context and scope of section 67(4) of the Act as stated in paragraph 1.3 of the Explanatory Note renders the Authority's reliance upon it as stated there to amount to a fundamental misdirection in law. In this regard, the subsequent exercise of its powers pursuant to such misdirection is impermissible, void and unlawful and renders any determinations made pursuant to the misdirection in law unenforceable and void in law.

## **6.2 Defining the market for wholesale call termination**

It is important to state at the outset that the Authority has at paragraph 1.2 of the Explanatory Note incorrectly alluded to the Discussion Document and Findings Document as having constituted a "consultative process." In this regard, the Authority states that:

*"The definition of the wholesale call termination market follows on from the consultative process undertaken by the Independent Communications Authority of South Africa ("the Authority") in terms of section 4B of the ICASA Act. This prior consultation process is reflected in the:*

*Discussion Document on Wholesale Call Termination Market Definition (Government Gazette No. 29568 of 2007);*

*Findings Document on the Wholesale Call Termination Market Definition Process (Govt. Gazette 1627 of 2007)."*<sup>17</sup> (own emphasis)

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<sup>17</sup> Page 22 of the Explanatory Note

Telkom is of the considered view that the Authority has misconstrued and mischaracterised the Discussion Document and the Findings Document as amounting to a “consultative process.” Telkom has sought to provide the appropriate context within which both documents ought to be considered. Here, and as stated above, Telkom considers that the appropriate context to view these documents is that of them constituting elements of an *exploratory inquiry*. Indeed, the nature and orientation of the questions posed by the Authority in the Discussion Document were not *fact-specific* or requiring interested parties to render *positive empirical and quantitative* responses, but rather *normative and qualitative* responses. Furthermore, and as detailed above, the Authority explicitly and unambiguously stated that the essence of the Findings Document was reflective of:

*“...preliminary conclusions and observations ought not to be interpreted as representative of conclusive determinations made by the Authority regarding any future substantive findings on the issues canvassed in the Discussion Document.”*<sup>18</sup> (own emphasis)

To this end, Telkom views as curious the Authority’s resolute position in its *unqualified and substantial reliance* on the Findings Document, notwithstanding its admission and caution to interested persons not to interpret the Findings Document as being expressive of substantive factual determinations. Here, Telkom notes that the following paragraphs in the Explanatory Note specifically seek to rely upon the *preliminary conclusions and observations* of the Findings Document not arrived at through the consideration of *empirical and quantitative* factual analysis, but rather made within the context of an *exploratory inquiry*:

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<sup>18</sup> Page 3 of the Findings Document

paragraph 1.2.1.1;<sup>19</sup>

paragraph 1.2.1.2;<sup>20</sup>

paragraph 1.4.2;<sup>21</sup>

paragraph 1.4.3;<sup>22</sup>

paragraph 1.4.3.2;<sup>23</sup>

paragraph 1.5;<sup>24</sup>

paragraph 1.9;<sup>25</sup>

paragraph 1.9.2.2;<sup>26</sup>

paragraph 1.9.4.2;<sup>27</sup>

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<sup>19</sup> "However, the Authority does not consider that to date the licensing measures fundamentally change the definition of the market as outlined in the 2007 Findings document", at page 22 of the Explanatory Note.

<sup>20</sup> "However, the Authority does not consider that these measures fundamentally change the definition of the market as outlined in the 2007 Findings document", at page 23 of the Explanatory Note.

<sup>21</sup> "The Authority notes that the following sections draw heavily from the published findings that were released in 2007 on the market definition of wholesale call termination for fixed and mobile networks", at page 25 of the Explanatory Note.

<sup>22</sup> "Presented below is a summary of these developments as well as the Authority's view on whether there is any factor that materially changes the market definition, as outlined in the 2007 Findings document", at page 25 of the Explanatory Note.

<sup>23</sup> "The EC's view on market definition remains unchanged and is consistent with the Authority's view (as outlined in the 2007 Findings document and the Guideline for conducting Market Reviews)", at page 26 of the Explanatory Note.

<sup>24</sup> "As discussed in the 2007 Findings document the Authority applied a Hypothetical Monopolist test to define the market for wholesale call termination...in the 2007 Findings Document the SSNIP test is described in detail...[T]hese issues are not discussed in detail in this document as the Authority's views are unchanged from those outlined in 2007. The Authority refers interested parties to the relevant sections of the 2007 Findings Document for further information", at page 27 of the Explanatory Note.

<sup>25</sup> "As discussed in more detail in the 2007 Findings document...", at page 29 of the Explanatory Note.

<sup>26</sup> "The issues around MNP are discussed in detail in the 2007 Findings Document and are not repeated here", at page 31 of the Explanatory Note.

paragraph 1.9.5;<sup>28</sup>

paragraph 1.9.5.1;<sup>29</sup>

paragraph 1.9.5.2;<sup>30</sup>

paragraph 1.9.5.3;<sup>31</sup>

paragraph 1.9.5.4;<sup>32</sup>

paragraph 1.9.5.6;<sup>33</sup>

paragraph 1.9.5.7;<sup>34</sup>

paragraph 1.9.5.8;<sup>35</sup>

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<sup>27</sup> "In the 2007 Findings Document, the Authority concluded that SIM Card Swapping (to the extent that it occurs) is unlikely to constrain wholesale mobile call termination to competitive levels. Section 3.5.6.2 of the 2007 Findings Document discussed in detail the range of evidence and analysis used to come to that conclusion", at page 34 of the Explanatory Note.

<sup>28</sup> "In addition to the range of potential substitutes outlined above, a number of stakeholders argued in the 2007 Findings consultation on Wholesale Call Termination that there was (sic) a range of factors unique to South Africa that acted as a constraint on wholesale mobile call termination fees", at page 35 of the Explanatory Note.

<sup>29</sup> "The reasons are outlined in detail in the 2007 Findings Document and are not repeated in this document", at page 35 of the Explanatory Note.

<sup>30</sup> "In the 2007 Findings Document, the Authority stated the following regarding the effectiveness of off-net mobile calls as a substitute for fixed-to-mobile calls...", at page 36 of the Explanatory Note.

<sup>31</sup> "In section 3.5.6.7 of the 2007 Findings document, the Authority discussed a range of additional reasons why the presence of on-net mobile calling was not a sufficient reason to expand the market definition of wholesale mobile call termination. This analysis is not repeated in this document but the Authority noted that this analysis is still relevant", at page 37 of the Explanatory Note.

<sup>32</sup> "The Authority refers interested parties to Section 3.5.6.10 of the 2007 Findings Document, which includes additional detailed analysis on the potential for SMS (and Instant Messaging) to act as a demand side constraint on wholesale call termination prices", at page 38 of the Explanatory Note.

<sup>33</sup> "In the 2007 Findings Document, the Authority discussed in detail evidence on expected switching and required switching in response to marginal changes in the price of wholesale call termination (see Section 3.5.6.1 of the 2007 Findings document). The Authority notes the conclusions of that analysis are still relevant but consider that it is not necessary to repeat the arguments in this document", at page 40 of the Explanatory Note.

<sup>34</sup> "Consistent with the conclusions of the 2007 Findings Document, the Authority does not consider that LCR influences the definition of the market for wholesale call termination", at page 41 of the Explanatory Note.

paragraph 1.9.6.1,<sup>36</sup>

paragraph 1.9.6.2,<sup>37</sup> and

paragraph 1.14.<sup>38</sup>

Telkom considers that the statements made in these paragraphs are grossly misleading and further exacerbate the Authority's misdirection in law in relation to its interpretation, application and administration of Chapter 10 of the Act. As such, any substantive determination made by the Authority pursuant to such misdirection is impermissible, void, unlawful and unenforceable in law.

### **6.3 An assessment of the effectiveness of competition and the identification of licensees with Significant Market Power**

#### 6.3.1 GENERAL COMMENTS

Telkom notes that the Authority has relied upon the generality of section 67(4) of the Act in purporting to undertake an assessment of the effectiveness of competition in the proposed relevant market for the rendering of wholesale call termination services. In this regard, the Authority has stated at paragraph 2.1 of the Explanatory Note that:

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<sup>35</sup> "The Authority provided detailed reasoning for its views in its 2007 Findings Document and these are not repeated in this document", at page 41 of the Explanatory Note.

<sup>36</sup> "The Authority's reasoning is discussed in detail in the 2007 Findings document (in Section 3.5.7.2)", at page 43 of the Explanatory Note.

<sup>37</sup> "The Authority's reasoning is discussed in detail in the 2007 Findings document (in Section 3.5.7.3)", at page 43 of the Explanatory Note.

<sup>38</sup> "More detailed analysis of the geographic market for wholesale call termination is outlined in the 2007 Findings Document (in Section 3.8). the Authority refers interested parties to this more detailed analysis", at page 46 of the Explanatory Note.

*“...section 67(4) of the Electronic Communications Act sets out a number of factors that must be considered as part of assessing competition and identifying licensees with SMP.”<sup>39</sup>*

Furthermore, the Authority states that recourse was had to information solicited by it from licensees. Here, the Authority asserts that:

*“The information used to evaluate the effectiveness of competition was collected through a request for information in the form of a questionnaire. This request was made on the 9<sup>th</sup> of October 2009 via the Government Gazette (GG 32628) as well as through direct communication with licensees.*

*The Authority collected market data from various providers of electronic communications networks (sic) services (“ECNS”) and electronic communications service (“ECS”) in order to carry out its market definition and market analysis, based on established economic and legal principles.”<sup>40</sup> (own emphasis)*

Firstly, Telkom wishes to express its reservations concerning the Authority’s misdirection in law regarding the interpretation of the powers conferred upon it by the Legislature, as well as the manner in which those powers are required to be exercised. In this regard, Telkom is of the considered view that the Authority, in stating that section 67(4) of the Act sets out factors that must be considered as part of assessing competition and identifying licensees with SMP, has misdirected itself in law and erred in the correct interpretation of section 67(4) of the Act. In this regard, Telkom has interpreted the requirements of section 67(4) of the Act as being concerned with directing the Authority

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<sup>39</sup> Page 49 of the Explanatory Note.

<sup>40</sup> Page 49 of the Explanatory Note.

to promulgate regulations intended to provide for the overarching *ex ante* regulatory framework which the Authority may subsequently rely upon in undertaking market analyses. Telkom has not interpreted section 67(4) of the Act, as suggested by the Authority, to confer upon the Authority the powers to undertake such market analyses *absent* the mandatory prescription of the regulations which are intended to *discipline and guide the Authority in making substantive fact-centric determinations* (own emphasis).

Therefore, section 67(4) of the Act amounts to an *enabling provision* which empowers the Authority to prescribe regulations, and not to undertake market analyses as suggested by the Authority in paragraph 2.1 of the Explanatory Note. Indeed, sections 67(5), (6), (7) and (8) of the Act set out the *substantive subject-matter that is required to be given treatment to by the regulations mandated to be prescribed in section 67(4) of the Act* (own emphasis). The consistent cross-referencing in sections 67(4)(b), (c), (d) and (e) of the Act in relation subsections (5), (6), (7) and (8) of the Act emphasises the Legislature's intention of having contemplated the section 67(4) regulations to set out and give treatment to the substantive subject-matter detailed in those subsections.

Thus, the reliance by the Authority on the generality of the *enabling provision* of section 67(4) of the Act in order to derive the powers to undertake market analyses amounts to a gross misdirection in law and renders any substantive determination arrived at by the Authority to be impermissible, void, unlawful and unenforceable in law.

Secondly, Telkom wishes to express further reservations regarding the Authority's purported reliance upon "...established economic and legal principles" in the course of the Authority purporting to carry out its market definition and market analysis.<sup>41</sup> In this regard, Telkom considers the statement extremely perplexing, grossly misleading and

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<sup>41</sup> Paragraph 2.1 of the Explanatory Note, at page 49.

inconsistent with the obligations imposed upon the Authority by the generality of the common law and administrative law to conduct itself in a fair, reasonable and transparent manner when purporting to exercise its statutory powers. To this end, Telkom wishes to record that it has not been availed, nor is it aware of any other licensee which has been availed “the established economic and legal principles” which the Authority has purported to have had recourse to in undertaking the market analyses.

The requirement that the Authority prescribe the contemplated overarching *ex ante* regulatory framework in accordance with section 67(4) of the Act is intended to precisely provide for the means upon which the Authority may lawfully rely in undertaking market analyses. Were the Authority to have promulgated such regulations, in conducting its market analyses, the Authority would simply have had regard to the principles enshrined in such regulations and invoke and rely upon them in its fact-centric exercise of defining the relevant market, assessing the effectiveness of competition and ascribing licensees to be in possession of SMP. To this end, and to the extent that the Authority has not prescribed such regulations, it may not then substitute the requirements for such regulations in law with its own “established economic and legal principles.”

### 6.3.2 UNDERTAKING A MARKET ANALYSIS REGARDING THE POSSESSION BY LICENSEE(S) OF SMP

Telkom has alluded to the absence of the regulations envisaged to be promulgated in section 67(4) of the Act above. With regards to the ascription of licensees as being in possession of SMP in a relevant market, the vacuum inherent in the absence of such regulations presents more acute considerations which effectively constrain the Authority from arriving at a factual determination. In this regard, Telkom is of the view that the Authority has not sufficiently discharged the burden of proof in relation to the manner in which it has arrived at its determination regarding the ascription of SMP upon licensees as stated in paragraph 2.2.1. Here, the Authority has stated that:

*“The criterion of dominance implies that each operator has SMP in the market for wholesale call termination on their respective networks because each operator has a market share above 45%. This is due to fact that the market as defined means that each operator has 100% market share over wholesale call termination on its own network.”<sup>42</sup> (own emphasis)*

Therefore, in the absence of the envisaged section 67(4)(d) regulations, Telkom views as curious the manner in which the Authority has ascribed SMP to licensees without sufficiently demonstrating, through recourse to a fact-centric analysis, the methodology used to calculate such market shares.

### 6.3.3 UNDERTAKING A MARKET ANALYSIS REGARDING THE EFFECTIVENESS OF COMPETITION IN A RELEVANT MARKET

With regards to the statutory provisions which the Authority purports to rely upon as stated at paragraph 2.3.1 of the Explanatory Note, Telkom wishes to express its concerns regarding the Authority’s gross misinterpretation of section 67(4) of the Act which amounts to a misdirection in law. In this regard, the Authority has stated that:

*“Under section 67(4) the ECA mandates the imposition of certain pro-competitive measures on SMP licensees in markets where ICASA finds competition ineffective.”<sup>43</sup> (own emphasis)*

Further, the following appears at footnote number 46 which is a reference to paragraph 2.3.1 of the Explanatory Note:

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<sup>42</sup> At page 50 of the Explanatory Note.

<sup>43</sup> At page 50 of the Explanatory Note.

*“Section 67(4) states that ‘...pro-competitive conditions may be imposed upon licensees having significant market power where the Authority determines such markets are found to have ineffective competition.”<sup>44</sup> (own emphasis)*

Telkom considers that the two statements made by the Authority in relation to the interpretation of section 67(4) of the Act are contradictory and irreconcilably inconsistent with each other. Here, on the one hand, the Authority states at paragraph 2.3.1 that the Act *mandates* the Authority to impose pro-competitive measures upon a mere finding that a relevant market is characterised by ineffective competition, while on the other hand, the correct citation of the provisions of section 67 (4) of the Act by the Authority reveals that the imposition of such pro-competitive measures is not obligatory and mandatory as suggested by the Authority at paragraph 2.3.1 of the Explanatory Note, but *discretionary*.

Telkom associates itself with an interpretation of section 67(4) of the Act which merely provides for the *discretionary imposition* of pro-competitive measures. This interpretation is supported by the Legislature’s usage of the word “**may**” and not “**must**”. It is trite that the word “may” is not to be read as connoting the obligatory import of the word “must” and that the latter is *directory* while the former is *discretionary*.

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<sup>44</sup> At page 60 of the Explanatory Note, footnote number 46.

## **7 COMMENTARY ON THE ECONOMIC ANALYSIS UNDERTAKEN BY THE AUTHORITY**

Notwithstanding Telkom's legal objections to the process followed by the Authority, Telkom will still like to selectively comment on the issues raised in the document itself. The fact that Telkom discusses the merits of the points raised by the Authority should in no way be seen to undermine or detract from Telkom's legal arguments.

From an economic perspective, Telkom's main objections are:

- The Authority has not sufficiently consulted on the proposed remedies and has not conducted appropriate cost/benefit and impact assessment analyses.
- On fixed termination, the Authority has not correctly applied the principle of cost orientation, as it has failed to recognise the cost of the access deficit imposed on Telkom.
- The Authority is inconsistent in its application of cost orientation and its choice of remedies, leading to distortions of competition that undermine consumer welfare. This lack of focus upon cost orientation is a critical failure by the Authority, and one that needs to be remedied as a matter of urgency.

The remainder of this section provides Telkom's comments with respect to:

- The process for defining markets and consulting on remedies;
- Market definition and SMP assessment;
- The application of cost-orientation principles for FTRs;
- The application of cost-orientation principles for MTRs; and
- Blended termination rates.

**7.1 Process for defining markets and consulting on remedies**

The following diagram summarises Telkom’s view on a reasonable interpretation of section 67(4) of the Act and the sequential administration and implementation of Chapter 10 of the Act. Telkom has previously alluded to this schematic representation of the implementation of Chapter 10 of the Act.

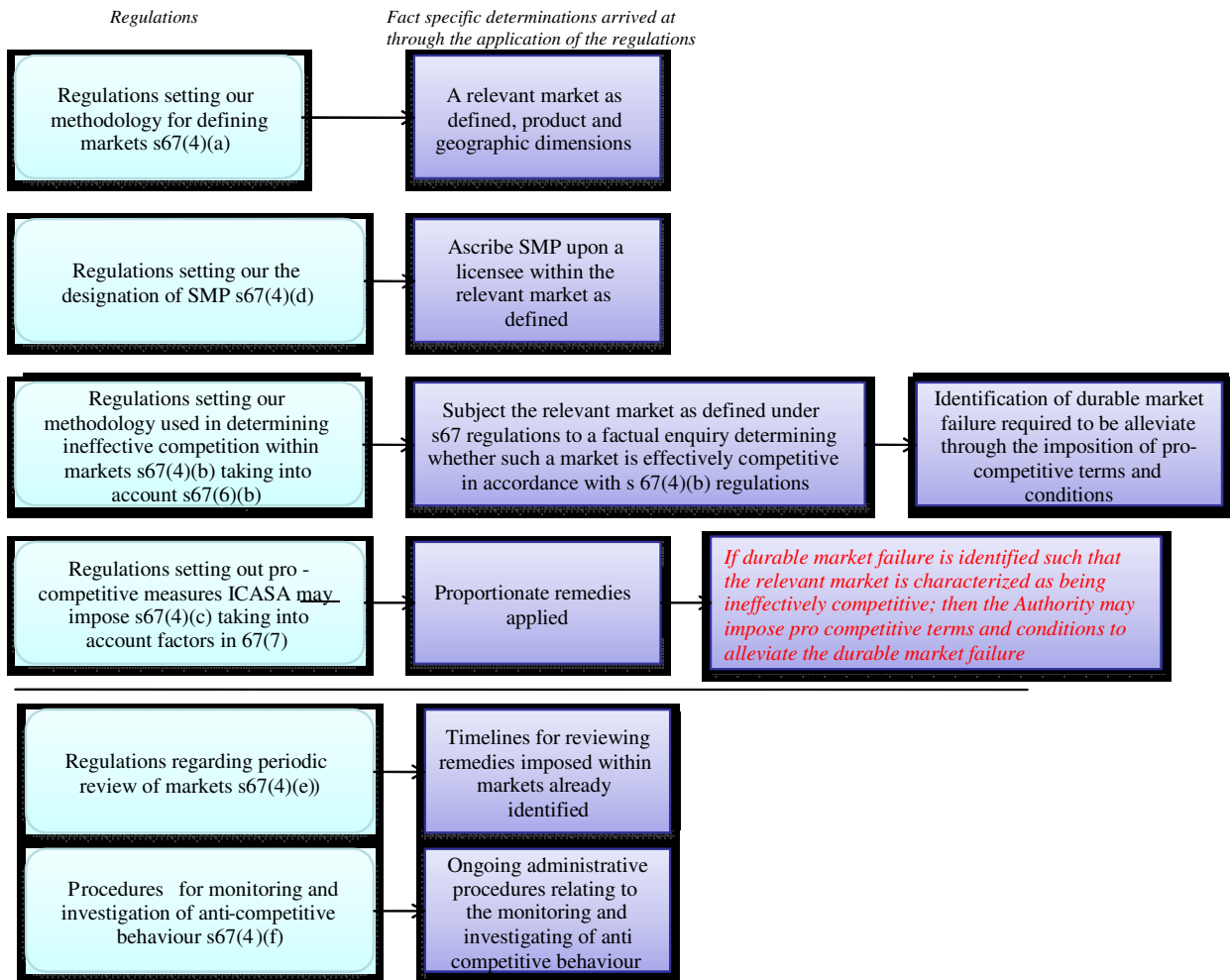


Figure 1. The contemplated operation of the ex ante overarching regulatory framework for conducting market reviews

It is important to emphasise that the purpose of these duties is not just to follow process – it is to ensure that the Authority undertakes a comprehensive and robust analysis, which it then uses to make informed regulatory decisions. Telkom remains concerned that the basic approach adopted by the Authority allows too little scope for stakeholder to provide views, and thereby undermines the robustness of the conclusions that the Authority draws. This lack of robustness risks damaging the incentives for investment in the market, holding back competition and ultimately damaging the interests of consumers.

With regards to the process that should be followed, Telkom again notes that:

- The Authority should set out a framework for market definition, to be applied to all future market definitions. This should also provide a timeline for undertaking the market reviews. In line with international best practice, this should focus on wholesale markets before moving to retail markets. It is important to ensure that any ‘bottlenecks’ at the wholesale level are removed before considering whether regulation is required at the retail level. This order of priorities has clearly been applied in European markets.
- Following consultation on the appropriate market definition and SMP assessment, there should be a second consultation round during which stakeholders have the opportunity to comment on the appropriateness of the imposed regulatory remedy.
- The Authority should undertake a regulatory impact assessment before imposing remedies. This should seek to ensure that the remedy which is imposed is the least distortionary to meet the intended output. It should be remembered that imposing remedies is second best to competition and that the remedies themselves have the potential to create market distortions and reduce welfare.
- The analysis undertaken by the Authority should be specific to the South African market. The Authority continues to rely too heavily on benchmarks for both the market definition and, in particular, for the setting of remedies. As Telkom has

pointed out previously on a number of occasions, there are specific country characteristics that imply remedies should not be lifted straight from European markets. These include:

- The presence of a substantial access deficit;
- The strength of competition between the fixed and mobile operators due to fixed/mobile substitution by consumers; and
- The nascent stage early stage of market development.

The above process increases the levels of transparency, regulatory certainty and consistency and is more likely to lead to an appropriate set of remedies being imposed that increase overall welfare.

Telkom also notes that the Authority should consider the overall development of the communications market in South Africa when it defines remedies. Despite issuing licences to Cell C, MTN and Vodacom, the market has been dominated by only two operators. This duopoly has allowed the operators to continue to make monopoly profits as consumers have been denied the benefits of competition. Telkom Mobile is now seeking to enter the market with a strategy focused upon using heavy up-front investment, leading to a high-quality and reliable service, delivered at affordable prices. This strategy is designed to position Telkom Mobile as the major challenger to Vodacom and MTN, allowing South African mobile consumers to finally start to realise the benefits of competition.

The South African market is therefore at a cross-roads and Telkom cautions the Authority not to take regulatory decisions now which may deny consumers the long-term benefits of a healthy competitive market. In producing pro-competitive conditions / remedies the Authority should be guided by the need to:

- Be proportionate, so that any remedy imposed is the minimum necessary to address the problem identified;
- Promote sustainable network and retail competition; and
- Ensure that customers derive the best possible long-term deal in terms of price, quality, innovation and value for money.

## **7.2 Market definition and SMP assessment**

While the Authority has significantly improved on its approach to market definition and SMP assessment, it is nevertheless inconsistent and selective in the way that this is applied. More specifically, the Authority starts from a position of arguing that the market definition is

*“Wholesale call termination on an electronic communication network operating in South Africa”*

The Authority then identifies various retail services that utilise those wholesale products, namely fixed-to-fixed (FTF), fixed-to-mobile (FTM), mobile-to-mobile (MTM) and mobile-to-fixed (MTF) calling. In doing so, the Authority is implying that the wholesale termination service offered by a mobile operator is in the same market as a fixed operator. However, the Authority’s own analysis finds that fixed and mobile services sit in separate retail markets. It implausible to argue that fixed and mobile origination services are in separate markets but that the same does not apply to termination services.

However, by defining separate glide-paths for FTRs and MTRs the Authority seems to acknowledge that fixed and mobile termination do indeed sit in separate markets. The ambiguity that this creates is unhelpful both from the perspective of Telkom and the wider market. The Authority should remedy this by clearly stating that fixed and mobile termination represent different wholesale markets.

As previously discussed in the legal analysis, the Authority must also address an ambiguity in its analysis concerning the VoIP operators, since it is currently unclear whether the Authority considers that these operators sit in fixed, mobile or some other market for termination purposes. This is important because it is not possible to determine what if any remedies are appropriate until the relevant markets are clearly defined and SMP assessed.

### **7.3 Approach to determine regulatory remedies**

The Authority finds that all operators that provide a termination services, including those providing VoIP services, are dominant in their own termination market; and goes on to conclude that it is necessary to calculate a specific cost-based termination rate for fixed and mobile operators. The Authority states that price control obligations should be applied to all operators, but that the obligations:

*“Shall be applied in a manner that is proportionate and justified. Established SMP licensees are in the greatest position to use such market power to distort the market and shall have the cost-orientation obligation imposed upon them. The obligation to charge ‘fair and reasonable’ termination rates that are not excessive will apply to all other SMP licensees providing wholesale call termination services”.*<sup>45</sup>

While Telkom agrees that the design of remedies needs to be proportional to the case in hand, there are a number of problems with the position set out by the Authority. In particular, the relevant SMP finding in this case relates to wholesale termination and therefore applies to all operators in the relevant markets. There is therefore no basis in the analysis undertaken by the Authority to justify this distinction between ‘established SMP

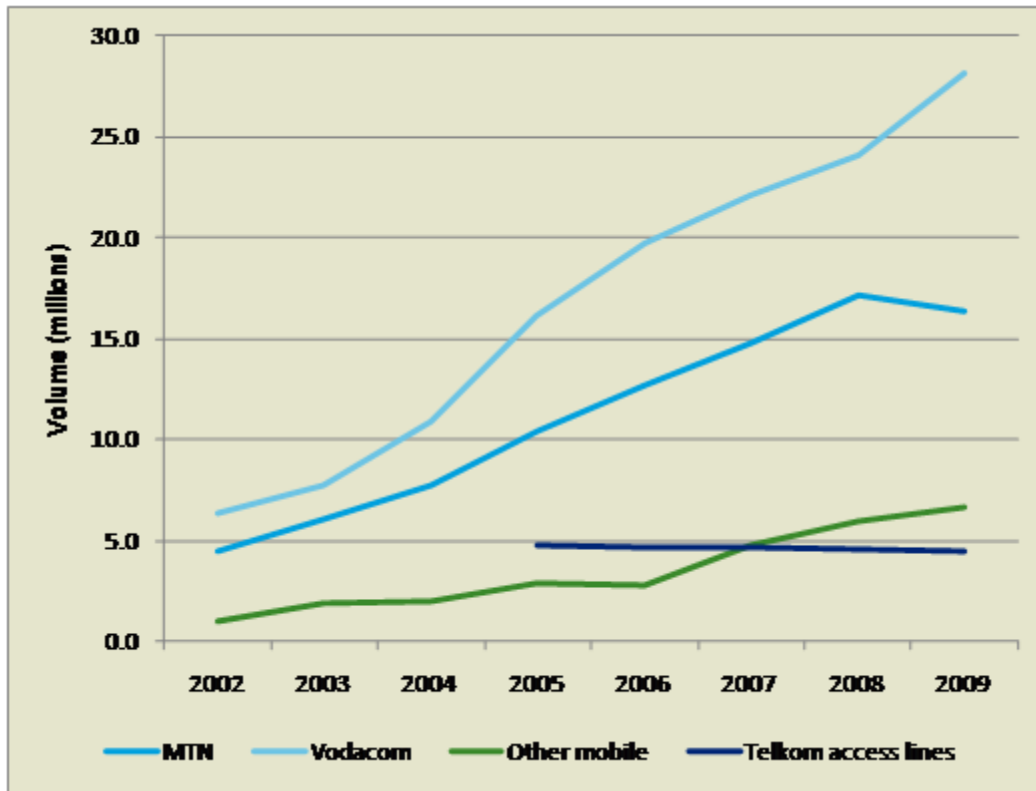
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<sup>45</sup> Gazette, p. 87.

operators' and other operators. Indeed it remains highly unclear what the Authority means by this distinction.

If it is assumed that the Authority is actually referring to the retail market when it refers to its "established SMP" finding, then this is both flawed and internally inconsistent. The findings relate to wholesale markets and not to retail markets and the Authority has presented no evidence or analysis to link the two in this context.

Moreover, even if the basis of the approach was justified (which Telkom does not accept), it is quite clear that the Authority is not implementing its remedies in a manner that proportional to the ability of operators to damage consumer welfare. As the below diagram makes clear, Telkom fixed has far fewer subscribers than even the smallest of the mobile operators and yet is subject to the most stringent reporting and compliance requirements of any licensed telecommunications operator in South Africa.



Source: Budde reports, Telkom Annual Report 2009, Deloitte analysis

This failure to consistently apply the remedies is important because the Authority has itself concluded that the existing ‘light touch’ framework of regulation has not delivered competitive termination rates.<sup>46</sup> Telkom is therefore concerned that the Authority has failed to present any analysis concerning the current level of termination rates charged by the other operators and the impact that this is having on the market.

To illustrate the point, VoIP operators are rapidly establishing themselves as major players, particularly in relation to business services. Indeed, the number of VoIP subscribers in South Africa has increased very rapidly. Indeed, as early as 2005, 78% of

<sup>46</sup> Gazette, p. 79.

surveyed corporations<sup>47</sup> were already using or planning to introduce VoIP, up from 31% in the previous year. This segment of demand is of extremely high value (VoIP revenue has been estimated to reach ZAR 100 million in 2010) and thus represents a significant threat to Telkom's ability to finance its access deficit and meet its universal service obligations.

The growth of VoIP is being subsidised by excessive termination rates levied by those operators, reaching as high as ZAR 1.35 in some cases.

Not only does this very high level of termination distort competition, the very large asymmetry implied by applying cost-orientation to only some of the operators in the market risks creating incentives for perverse call-routing behaviour and other forms of arbitrage.

Similarly, to the extent that not all operators in the market are subjected to the same universal service obligations, this can cause cherry picking behaviour, undermining Telkom's ability to fund its universal service obligations.

Telkom urges the Authority to either apply its cost orientation requirements evenly, or to explain why differential treatment is appropriate.

#### ***7.4 The application of cost-orientation in determining price control remedies for fixed termination rates with the presence of an access deficit***

In its consultation, the Authority notes that termination rates in the South African market are currently set at an "inefficient" level. According to the Authority, this leads to

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<sup>47</sup> This is from a sample of 100 companies surveyed by World Wide Worx, representing over 10% of those listed at the JSE.

distortions in the market which hinder the ability of new entrants or small operators to compete with larger operators and leads to high retail tariffs for inter-operator calls.

Having identified this issue, the Authority proceeds by imposing price control obligations on all operators, which require “fair and reasonable” pricing by all operators with SMP and further impose specific cost-orientation obligations on Telkom, Vodacom, MTN and Cell C.

The Authority justifies the decision of imposing cost oriented termination rates by noting that:

*“setting prices according to long-run cost will lead to an efficient outcome in terms of incentives for market entry.”<sup>48</sup>*

Telkom understands the reasoning behind the Authority’s decision to impose cost orientation obligations and supports this decision in principle. In fact, as discussed later in this section, Telkom has already operated consistently with the spirit of this obligation, by fully passing through the recent reduction in mobile termination rates (MTRs) in its retail tariffs.

For fixed termination rates (FTRs), the Authority proposes a glide path that implies a very large immediate cut of 50% in the first year, followed by a 20% reduction in year two and a further 17% reduction in year three.

However, while supporting the principle of cost orientation, Telkom considers the determination of the level of FTR by the Authority to be fundamentally flawed. Telkom strongly believes that the market for wholesale termination, and any remedy imposed on

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<sup>48</sup> Gazette, Annexure 1, page 88.

such market, cannot be considered in isolation from other obligations imposed on Telkom.

In particular, the Authority has not considered the implications of the Universal Service Obligations (USO) which are which are currently imposed on Telkom.

As set out in its License, Telkom is currently subject to the following Universal Service obligations:<sup>49</sup>

- Obligation to provide, to any person who requests it:
  - A Basic Telephone Service;
  - The installation and connection to an item of Terminal Connection Equipment of an item of Customer Premises Equipment capable of making use of the Basic Telephone Services; and
  - The maintenance or repair of that item of Customer Premises Equipment supplied by the Licensee.
- Obligation to provide a Public Pay-telephone Service; and
- Access to the Public Emergency Call Service and the Directory Information Service.

Such obligations, and in particular the requirement to provide POTS lines, cause Telkom to incur a significant access deficit, which is currently being recovered by a number of services including the fixed termination charge. However, the FTRs proposed by the Authority would not allow Telkom to recover such costs. This is contrary to economic

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<sup>49</sup> See Section 4 of Telkom SA License

theory which suggests that at least part of the access deficit costs should be recovered via the FTR:

- Distortions are minimised if the recovery of the costs associated with access lines are recovered by the services which cause the cost to be incurred. This implies that access deficit costs need to be recovered via voice products, including incoming calls.
- Demand for incoming calls is relatively inelastic. Therefore, a proportionally larger part of the access deficit should be recovered via the termination rates, as this would be the least distortionary and most efficient outcome (consistently with Ramsey pricing principles).
- The presence of network externalities mean that subscribers of other operators benefit from being able to reach Telkom fixed line subscribers. It is therefore efficient that part of the cost of providing access to Telkom customers is also borne by other consumers that benefit from it.

Due to the demographic, topographical and social features of the South African market, the exclusion of these costs has a major impact on Telkom's finances. In particular, the cost of the deficit in South Africa is considerably larger than in other countries due to the following reasons:

- Extensiveness of the country: the access network is very large as it needs to cover a vast territory;
- Low population density: the South African population is very dispersed over the territory, which causes large fixed costs of network roll-out to be incurred, only to serve a very small number of subscribers in each area; and

- Cable theft: Telkom incurs significant costs due to the theft of its copper cables.

Dividing the total cost of the access deficit<sup>50</sup> by the total inbound and outbound traffic provides a per-minute cost of the access deficit of ZAR 0.30 – three times higher than the proposed final FTR.

**Table 1: Calculation of Access Deficit per minute**

<b>Item</b>	<b>Value (ZAR)</b>
Revenue	(5,710,605,886)
Operating costs	12,899,283,860
<b>Access deficit</b>	<b>7,188,677,974</b>
<b>Product</b>	<b>Minutes</b>
P201 Domestic Calls - Short Distance (DIM3)	8,523,529,358
P202 Domestic Calls - Long Distance (DIM3)	3,679,393,213
P203 International Calls - Outgoing (DIM3)	520,374,699
P205 Calls to Mobile (DIM3)	4,178,769,653
P206 Calls to Internet (DIM3)	1,723,354,947
P207 Directory Enquiry Services (DIM3)	48,923,245
P208 Other Calls (DIM3)	1,755,653,751
P209 Calls to other Fixed Line (DIM3)	12,871,275
P301 Public Payphones (DIM3)	338,264,096
P701 International Calls - Incoming (DIM3)	562,793,922
P702 Calls from Mobile (DIM3)	2,222,729,937
P703 Mobile International Outgoing (DIM3)	-
P704 Mobile International Incoming (DIM3)	-
P710 Calls from other Fixed Line (DIM3)	414,770,460
P902 Other Unregulated (DIM3)	-
<b>Total Minutes</b>	<b>23,981,428,555</b>
<b>Access deficit per minute</b>	<b>0.2998</b>

The Authority's proposed glide path makes no allowance for these costs, and the document does not provide consideration of the way in which Telkom should be allowed to recover them.

<sup>50</sup> Provided in the regulatory accounts submitted to the Authority.

This is a major omission by the Authority, with damaging implications for investment incentives and the effectiveness of competition in the market. Should the Authority deny Telkom the opportunity to recover its cost, it risk harming network investment, which would primarily hurt the quality of service offered to consumer, as well as harm the competitiveness and development of the market and would reduce innovation incentives, not only for Telkom, but for the other market players as well.

Telkom is of the considered view that it would not have been in the reasonable contemplation of the Legislature that the eventuality of a Chapter 10 process would result in a licensee having price control remedies imposed upon it which require it to render the provision of services below cost, or with insufficient recovery of the costs incurred for the rendering of the services subject to the price control remedy. Indeed, this would amount to a punitive imposition of terms and conditions upon licensees, and not, as contemplated by the Legislature, that these pro-competitive terms and conditions be remedial in nature in relation to the identified durable market failure which the pro-competitive terms and conditions are intended to alleviate in a proportionate manner.

The overall implication of this is that the total cost of the access deficit (which is largely a fixed cost) is being recovered by a shrinking pool of subscribers. Unless an allowance is made for the costs associated with the access deficit and the USO, or those costs are more evenly shared amongst the operators, Telkom will be trapped in a vicious circle where the cost pressures upon it require some combination of increased prices and reduced network investment, undermining the quality of service provided. In turn this would worsen Telkom's competitive position relative to VoIP operators, Neotel and the mobile firms, further exacerbating the loss of subscribers and the regulatory cost burden imposed on those who remain.

To summarise, Telkom notes that the FTR does not, even at the current level, allow it to recover all the relevant costs of the access deficit. Unless and until the Authority has

established a clear mechanism for Telkom to recover these costs, there is no justification for reducing the FTR. On the contrary, a correct application of the cost orientation principle would imply that FTRs should be aligned with the actual costs faced by Telkom and therefore the FTR should be set at ZAR 0.37 and adjusted over time in line with changes to the costs of the access deficit.

#### 7.4.1 THE IMPLEMENTATION OF THE FTR GLIDE-PATH

In addition to the considerations above, Telkom also notes that the manner in which the Authority is planning to implement the change will negatively impact on the industry and the competitive process.

The Authority is proposing to immediately decrease FTR from the current ZAR 0.31 peak rate and ZAR 0.17 off-peak rate to a uniform ZAR.0.15. This represents a sudden 50% decrease in FTR revenues, which will cost Telkom over ZAR 167 million in the first year alone.

A decrease of this magnitude in such a short time period gives no opportunity for Telkom to adjust its business to accommodate the new rate and revise its business plan accordingly. This clearly goes against economic logic, regulatory best price and international precedent. It would create considerable disruption to the market and this is certainly not in the interest of consumers.

#### ***7.5 The application of cost-orientation in determining price control remedies for mobile termination rates***

Telkom is disappointed to note that the Authority has continued to rely too heavily upon benchmarks to set MTRs. Telkom notes that this is because the Authority has not developed its own cost model and that the COACAM cost information submitted by the Mobile operators is insufficient to use to set MTRs, because the COACAM requirement

for mobile operators are substantially less onerous than for Telkom fixed line operations. However, given the importance of the mobile termination rate on the financial viability of MNOs and in determining the retail rates paid by consumers, Telkom feels that it is negligent for the Authority to rely on benchmark rates.

Instead, Telkom proposes that the Authority should either develop its own cost model or request more disaggregated financial information be provided by the MNOs, in line with the current requirement imposed on Telkom.<sup>51</sup>

Telkom notes that it is standard practice for the regulatory authority to develop its own cost model – this occurs throughout the European Union and even in lesser developed countries than South Africa including Tanzania, Kenya and Nigeria. This is in recognition that the costs of providing mobile services can differ greatly due, primarily, to geographic, topological and competitive conditions. We would recommend that the Authority develops its cost model and that remedies are not imposed on MTRs until such time as this model has been developed.

The Authority, in the Consultation<sup>52</sup>, considers some aspects of the different types of cost models that could be required. Telkom urges the Authority to conduct a proper consultation process on this issue, in which the advantages and disadvantages of the various options can be discussed and commented upon. For example, the following options will need to be considered:

- The cost basis: should HCA or CCA be used as the basis for costs?
- The model type: should FAC or LRIC be used?

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<sup>51</sup> This proposal is consistent with Telkom's interpretation of section 67(4)(c) read in conjunction with section 67(7) of the Act where the Authority is required to set out the applicable pro-competitive terms and conditions and the manner in which these terms and conditions would be applied, interpreted and enforced

<sup>52</sup> Gazette, Page 88-9.

- The common cost allocation: should common costs be allocated based on EPMU or should Ramsey pricing be used instead?

All these and other aspects will need to be carefully examined by the Authority before implementing a cost model.

More critically, the information provided by the Authority on its approach to calculating the efficient level of MTRs is totally inadequate and provides no opportunity for constructive debate over the appropriate calculation methodology. Therefore Telkom urges the Authority not to make any decisions on MTRs until an agreement on these issues is reached.

Regardless of the above considerations, and as already emphasised, Telkom supports the principle of cost-orientation but it notes that it is important that this principle is applied consistently to all operators in the market. However, this does not mean that all termination rates must necessarily be the same. The Authority itself has recognised that termination rates should recognise differences in efficient costs between operators.

In particular, the Authority recognises that new entrants may face significant cost asymmetries with more established operators<sup>53</sup>, for example:

- Operators with smaller market shares inevitably have a higher unit cost base as a result of economies of scale;
- Smaller or entering licensees have yet to generate returns covering their costs of capital employed;

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<sup>53</sup> For example, section 2.4.3.2.5.5 of General Notice 314, Government Gazette No. 33121

- Capital expenditure for network rollout and increase in coverage is likely to be greater than for the maintenance and capacity-increasing expenditure of established operators; and
- Limited spectrum availability for entrants may result in a significantly different cost base from that of established operators.

As the Authority notes,

*“The imposition of identical obligations on all licensees ... may therefore in effect have an entirely different impact on individual licensees”.*

Differences in costs between entrants and established operators will lead to differences in the efficient termination rate, and this should be reflected in the termination rate that entrants are allowed to set if successful competition is to be guaranteed.

This has also been recognised internationally. For example, the ERG stated:

*“under some circumstances asymmetric mobile termination rates may be justified for example to take into account differentiated conditions of spectrum allocation or to encourage the growth of a new entrant on the market, which suffers from a lack of scale due to late market entry where such promotion of competition is needed and justified. Indeed, asymmetric mobile termination rates allow higher expected profits in the short term and strengthen the relative competitive position of those MNOs permitted to charge higher MTRs, thereby leading to increased competition in the long term to the benefit of end users.”<sup>54</sup>*

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<sup>54</sup> ERG, “ERG’s Common Position on symmetry of fixed call termination rates and symmetry of mobile call termination rates”, ERG (07) 83 final 080312, page 82

Telkom notes that asymmetry of mobile termination rates for new entrants, or for operators with different spectrum allocations, have been commonly applied in many European countries, including the UK, Ireland, Germany, France, Italy, Belgium, Netherlands, Switzerland and Austria.

While it is true that, more recently, a trend has emerged in Europe towards symmetric termination rates, Telkom notes that the European market is significantly more developed than the South African market and that all market players in Europe have been operating for a number of years. Therefore, Telkom considers that the situation in South Africa is closer to the market conditions that were prevalent in Europe a few years ago.

It is important to recognise that Telkom Mobile, despite its affiliation with Telkom, is a genuine new entrant into the mobile market in terms both of its cost conditions and the competitive conditions that it faces.

In particular, Telkom Mobile will be an operationally separate entity, set up based upon a business case constructed on its own financial merits. While some resources are shared, this is limited in nature and primarily relates to Telkom Mobile's use of Fixed's transmission network and site sharing facilities. However these will be paid for by Telkom Mobile at the same rate charged by Telkom Fixed to any other operator.

This means that Telkom Mobile is entering the market with all the financial and competitive disadvantages of any new entrant in a highly saturated market. Moreover, Telkom Mobile will also face a significant structural cost asymmetry with other operators given the fact that it does not have access to the 900Mhz spectrum and will therefore need to deploy a higher density of base-stations than the other operators.

Telkom Mobile is currently proposing cost-based mobile termination rates based on average subscriber forecasts across its first four years (ZAR 0.93). Given that this is calculated on the basis of increasing subscriber numbers over time, this implies that

Telkom Mobile would not recover its costs of interconnection during the three year price control period.

Given that Telkom Mobile will already have termination rates that are set below cost for the period, the application of the same glide path as other MNOs to Telkom Mobile is likely to greatly hinder its entry and produce damaging, inefficient incentives. Indeed, the Authority's proposed glide-path would force Telkom Mobile to make a very significant loss on the cost of providing termination services, leading to a considerable restriction on its ability to act as an effective catalyst for competition in the market.

In order to realise the beneficial competitive impact of Telkom Mobile's entry it is therefore crucial that its termination rates are allowed to be set at an efficient level according to its own cost conditions, recognising its status as a genuine new entrant and its other unavoidable cost asymmetries.

As a final point, Telkom notes that there is little clarity of the reporting requirements that will apply to Telkom Mobile. Telkom urges the Authority to clarify that Telkom mobile will not be subject to unduly onerous requirements and instead will be treated proportionally with its status of new market entrant. This would also be consistent with the treatment that was accorded to Cell C.

### **7.6 *Blended termination rates***

In the Gazette, the Authority has expressed a preference for imposing a single set termination rate, which does not allow for peak/off-peak differentiation. The Authority justifies this proposal by stating that:

- It believes that the impact of this would be minimal;

- A blended rate regime (which allows for time of day differentiation, provided that the average termination charge is at or below the cap) imposes higher monitoring costs for the Authority and reporting requirements for the operators; and
- It increases clarity.

Telkom strongly objects to the introduction of a single set rate and notes that the Authority has ignored a number of fundamental factors in its analysis.

Firstly, the Authority has ignored the fact that operators charge different peak and off-peak rates to reflect the difference in demand between office and non-office hours and these differences in traffic volumes have important cost implications.

In particular, investment decisions on capacity upgrades and network dimensioning are determined by peak demand. This is because operators need to ensure that their networks have sufficient capacity to support the level of traffic in the busiest hours of the day, implying that networks are dimensioned to capacities that are not fully utilised during off-peak time. However, if operators were dimensioning their networks based on “average” capacity requirements, most of the traffic during the peak hours would be dropped, which would lead to unacceptably low quality of service.

Therefore, a differentiation between peak and off-peak rates is required in order to correctly align termination rates to the underlying costs of providing the service. In light of this consideration, the proposal for a single set rate is in clear contradiction with other considerations made by the Authority in the document. For example, the Authority states that “any price regulation imposed on licensees must reflect their real economic costs”<sup>55</sup>. However, alignment to real economic costs is not taken into account by the Authority

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<sup>55</sup> Gazette, Page 83

when assessing the issue of peak/off-peak differentiation, which will distort investment incentives and lead to a deterioration in the quality of service provided by the networks.

Moreover, a differentiation between peak and off-peak rates leads to an efficient “allocation” of capacity between subscribers. By reflecting the different costs involved, different peak/off-peak rates provides the correct incentives to subscribers, so that non-urgent communications are postponed to off-peak time when the network has spare (i.e. less expensive) capacity. This leads to the economically efficient outcome of aligning network costs with consumer benefits.

Consequently Telkom rejects the Authority’s assumption that the costs of having a single rate would be minimal.

The second reason provided by the Authority for a single rate is that it would help to minimise monitoring costs. However, the majority of the ‘monitoring’ costs incurred through blended rates will be by the industry in collating the information necessary for the Authority to monitor compliance. It is therefore surprising that the Authority has reached this conclusion without any consultation with the industry on the magnitude of these costs.

The third reason provided by the authority is one of retail transparency. Telkom notes that a decision on termination charges at the wholesale level effectively imposes a change at the retail level, as otherwise operators would necessarily be forced into a margin squeeze situation. However, Telkom also notes that by imposing a decision on wholesale rates with the objective of changing the structure of the retail market the Authority has overstepped its mandate by unduly interfering in the commercial activities of licensees. Moreover, the Authority has not considered that allowing third degree price discrimination and customer self-selection is beneficial to the consumers. This is because allowing peak/off-peak differentiation enables price-sensitive, low income customers, to

take advantage of the lower tariffs charged at off-peak times. Therefore, the proposal of the Authority will actually harm that customer segment which is most vulnerable.

Even aside from this, the Authority provides no evidence in support of its claim that such retail regime would be more “transparent” for consumers<sup>56</sup>. On the contrary, to Telkom’s knowledge, consumers are well aware of the different periods for peak and off-peak rates, and in fact exploit this difference in their calling patterns.

The Authority attempts to justify its preference for a single rate based upon international precedent. However, if the intention of this is to suggest that there is an international consensus concerning single rates then this citation is misleading. While it is true that a number of regulators have preferred single rates, there are many others that have implemented blended rates. For example, in the UK, Ofcom stated:

*“We want to allow BT to use the network tariff gradient as a peak-load pricing mechanism to reflect traffic profiles and demand elasticities at the wholesale level. We believe that BT is better placed to set these charges than Ofcom because they have more information on wholesale demand than we do.”<sup>57</sup>*

Different peak/off-peak termination rates are also offered by a number of other operators in Europe and elsewhere, including Eircom in Ireland,<sup>58</sup> Portugal Telecom,<sup>59</sup> Jersey Telecom,<sup>60</sup> Singtel in Singapore<sup>61</sup> and Belgacom in Belgium.<sup>62</sup>

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<sup>56</sup> Page 92, section 2.1.2.

<sup>57</sup> Ofcom, “Review of BT network charge controls”, March 2009, page 32

<sup>58</sup> Reference Interconnection Offer of Eircom, available at [http://www.eircomwholesale.ie/regulatory/subreg\\_details.asp?id=80](http://www.eircomwholesale.ie/regulatory/subreg_details.asp?id=80)

<sup>59</sup> See Reference Interconnection Offer of Portugal Telecom, available at <http://ptwholesale.telecom.pt/GSW/PT/Canais/ProdutosServicos/OfertasReferencia/ORI/Ori.htm>

Given the absence of a clear international consensus on the best approach it is even more critical that the Authority provide a proper, evidence-based assessment of the regulatory options before making any decision, something that it has singularly failed to do.

As will be clear from the above, Telkom considers that there is a considerable risk that requiring single termination rate would distort investment decisions; and that this risk outweighs the potential for a small increase in regulatory costs from blended rates.

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<sup>60</sup> See Reference Interconnection Offer of Jersey Telecom, available at <http://www.jerseytelecom.com/templates/LayoutB.aspx?id=663>

<sup>61</sup> See Reference Interconnection Offer of Singtel, available at <http://www.ida.gov.sg/Policies%20and%20Regulation/20060602171047.aspx>

<sup>62</sup> See Reference Interconnection Offer of Belgacom, available at <http://www.belgacom.be/wholesale/gallery/content/documents/brio/2006brad8E.pdf>

## 8 CONCLUSIONS

Telkom views the undertaking of market reviews within the South African regulatory landscape as both necessary and desirable; however in order to achieve the correct outcomes in the shortest possible time due process must be followed. Telkom is of the view that the regulations in their current form are flawed from both a process and substantive issue perspective, and in this regards are in need of serious amendments.

Telkom notes that these regulations attempt to regulate termination rates for calls made to fixed and mobile subscribers (upon such networks respectively). Telkom is however concerned that VoIP is not adequately dealt with by these regulations, and seeks clarity from the Authority on the appropriate classification thereof. Telkom notes that VoIP can either be regarded as fixed, or be classified as nomadic. Regardless of its classification with respect to a type of interconnection, Telkom still notes that a market review cannot regulate types of interconnection per se, however rather call termination upon all operators networks, and thus it would be reasonable to presume the VoIP operators would fall under the ambit of this regulation.

In our commentary Telkom started by considering the events that preceded current developments. It was Telkom's observation in this regards that the Discussion document on wholesale call termination (2007) was a merely that i.e. an enquiry into the state of the market, and there is no basis upon which that process can be considered to have yielded findings that feed into the current process.

Thereafter in 2008 the Authority embarked upon a process for the promulgations of the section 67(4) regulations, which Telkom considered amounts to an overarching ex ante regulatory framework which, from time to time, the Authority may invoke when conducting market reviews. Telkom was fully supportive of this process, yet for reasons

unknown to Telkom, the Authority appears to have abandoned their efforts in this regard. Telkom is of the view that no market reviews can in effect be undertaken without the completion of this framework.

In examining then the process currently undertaken by the authority Telkom notes serious flaws, the most egregious is introduction of the concept “established SMP” which has no basis in law, and appears to suggest a compromised administrative process. Telkom contends that were the correct processes followed. although the Authority would still come to a conclusion that every operator holds SMP in their call termination markets (albeit more transparently), that instead the Authority would find as a proportionate remedy that cost based termination should be applied to all operators for call termination upon their networks. Telkom does however put forward suggestions on how we would envisage this market review could be undertaken in a manner that is both sound with respect to due process.

Notwithstanding Telkom’s reservations on the legal validity on the “findings” of this regulation, Telkom thereafter still makes comments on the substantive matters. However in this regard we also find there to be flaws. Telkom notes that wholesale markets have been defined in the absence of corresponding retail markets, and this has led to a confused outcome at best. Telkom is of the view that the wholesale markets of call termination are demand derived from the voice call origination retail markets.

Further Telkom notes that with respect to the calculation of costs, that is would be administratively injudicious if on the one hand the Authority was to regulate call termination costs, and on the other impose universal services obligations upon operators, yet not allow operators to recover their relevant USO costs through call termination charges. In the case of call termination upon Telkom’s fixed networks, Telkom insists that access deficit charges in particular be included in our termination rates. To the extent

that access deficit charges alone amount to 29c per minute, Telkom's fixed termination rates certainly cannot decrease and should in fact increase.

With respect to services to be offered by from Telkom's mobile network, Telkom notes that Telkom is willing to file interconnection rates at cost, although to the extent that Telkom suffers from spectrum asymmetries (i.e. no 900 MHz spectrum), this will be reflected in a higher termination rate versus that of the other mobile operators, on an efficient cost basis.

Overall Telkom finds there to be no basis upon which the Authority can impose symmetric termination, and proposes that cost based termination is the only basis in law for the setting of termination rates. To the extent that this may lead to asymmetries, this is acceptable, to the extent that it does not amount to an economic cross subsidy.

Lastly Telkom considered the Authority's proposal with respect to blended rates. Telkom is of the view that not only has the Authority overstepped their mandate in this regards, however such a regime does not align with the underlying economics whereby networks are dimensioned according to the capacity during peak times, with operators offering lower off-peak rates in an attempt to divert traffic from peak to off-peak times. Not only is an peak/off-peak regime economically efficient, Telkom is also of the view that it in fact leads to superior overall consumer welfare verses the blended rate proposed by the Authority. Telkom would further like to point out that geographic numbers imply a single tandem (WBZ)/ double tandem (BBZ) cost based approach, which appears to have been overlooked by the Authority.