Independent Communications Authority of South Africa
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BRIEFING NOTE ON COST STANDARD TO BE USED TO DETERMINE COST OF MOBILE AND FIXED WHOLESALE VOICE CALL TERMINATION

Date of issue: 19 August 2014

1. Purpose

1.1. The Independent Communications Authority of South Africa ("ICASA") would like to thank operators who have participated in the 2014 call termination regulatory process thus far.

1.2. The purpose of this briefing note is to inform all stakeholders of the cost standard to be to be used in the top-down and bottom-up modelling and relevant assumptions. ICASA has decided to adopt Long-Run Incremental Cost Plus ("LRIC+") as the cost standard at this time.

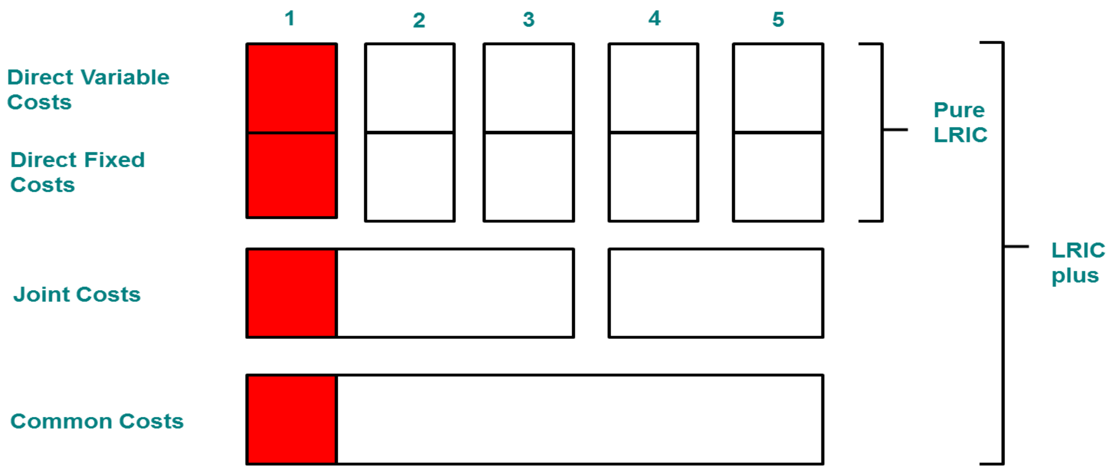
2. Form of LRIC to be used

2.1. In a briefing note dated 28 May 2014, ICASA indicated it will apply a LRIC cost standard but will, at a later date, determine the appropriate form of LRIC to be used that is best suited to the South African environment.

2.2. That the Authority considered the two forms of LRIC cost standards namely, pure LRIC and LRIC+.

2.3. The fundamental difference between the aforementioned forms of LRIC is that LRIC plus includes joint and common costs[1] while these costs are excluded for pure LRIC.

2.4. This difference is illustrated below



Source: ITU

2.5. ICASA has decided to adopt LRIC+ due to the following reasons:

2.5.1. LRIC+ would allow operators to recover a portion of joint and common costs incurred in the provision of wholesale voice call termination service through termination rates.

2.5.2. to ensure continued investment in electronic communications networks in South Africa.

2.5.3. to correct the imbalances created in 2010 wherein the 2010 Call termination Regulations applied different cost standards to different markets[2].

2.5.4. to ensure a smooth transition from a Fully Allocated Cost standard used in 2010 to an eventual cost standard of pure LRIC.

2.6. ICASA will review cost standard in use during the next call termination market review.

[1] Joint and Common costs are costs incurred in the provision of two or more increments and are not related to any one product or service. Source: Charts of Accounts and Cost Allocation Manual Regulations of 2004.

[2] The mobile termination rate was set at Fully Allocated Cost while the fixed line termination rate was set on a Long-Run Incremental basis.

3. Underlying assumptions of the top-down and bottom-up models

3.1. ICASA has undertaken to use the following approach to determine a suitable termination rate for South Africa:

3.1.1. Top-down LRIC plus model.

3.1.2. Bottom-up LRIC plus model.

3.1.3. International comparison of termination rates in peer countries to test the validity of the outputs of the top-down and bottom-up models.

3.2. Although the the top-down and bottom-up models represent different costing systems, ICASA expects the outputs of the two models to be broadly comparable for equivalent network services.

3.3. ICASA is considering the use of the following broad assumptions for both cost models:

Parameter	Top-Down Model Approach	Bottom-Up Model Approach
Mobile Termination Rate Calculation (MTR)	Consideration of access, transmission and core costs of the network for the service provisioning	Consideration of access, transmission and core costs of the network for the service provisioning
Fixed Termination Rate Calculation (FTR)	Consideration of transmission and core costs of the network for the service provisioning.	Consideration of transmission and core costs of the network for the service provisioning
Asset Valuation method	Historical Accounting Accounting adjusted for current costs	Current Cost Accounting
Depreciation Method	Tilted Annuity	Tilted Annuity
Joint, Common and Fixed Costs allocation method	Equi-proportionate mark-up allocation (EPMU)	Equi-proportionate mark-up allocation (EPMU)
Replacement Cost at Current Market Values or Modern Equivalent Asset (MEA)	Not applicable	MEA based on current prices
Weighted Average Cost of Capital (pre-tax)	ICASA WACC calculation using industry inputs	ICASA WACC calculation using industry inputs
Exchange Rate	Not applicable	Actual for 2013 and Forecasts for 2014-2017
Licence Fees and Regulatory Fees	Cosideration as part of Joint and Common Costs	Cosideration as part of Joint and Common Costs
Universal Service Fund Contributions	Excluded	Excluded
Allocation of total network costs to Services (Voice Call Termination)	Use of routing factors using operators' routing matrices	Derived routing factors based on operators' routing matrices
Consideration of Working Capital Costs	Allocation of actual Working Capital Costs	Estimation and allocation of Working Capital Costs
Network Topology to be Considered	The existing network will be modelled	Modified Scorched Node Assumption Approach
Equipment Prices and Cost Data	Not applicable	Average costs of equipment from various vendors that reflect the actual prices before discounts and actual data submitted by operators

Any enquiries relating to the 2014 wholesale voice call termination regulatory review should be directed to marketreview2014@icasa.org.za.