IN THE COMPETITION TRIBUNAL OF SOUTH AFRICA

CASE NO: 11/CR/Feb04

In the matter between:

The Competition Commission	**Applicant**
And	
Telkom SA LTD	**Respondent**

Panel:	N Manoim (Presiding Member)
	Y Carrim (Tribunal Member)
	T Madima (Tribunal Member)
Heard on:	17–27 October and 1-9 December 2011 and 13 and 15 February 2012
Decision and Reasons Issued:	7 August 2012

Reasons and Order

Executive Summary

1. This case concerns Telkom's conduct in the value added services segment of the telecommunications market. Telkom was the *de jure* monopoly provider of PSTS and facilities services until 2002 and the *de facto* monopoly provider until 2005. The provision

of valued added services was a competitive sector of the market and Telkom faced competition from players such Omnilink, Firstnet, IS, UUNet and MTN NS (independent VANS providers).

2. It was alleged by the Commission that Telkom refused to supply essential access facilities to independent VANS providers, induced their customers not to deal with them, charged their customers excessive prices for access services and discriminated in favour of its own customers by giving them a discount on distance related charges which it did not advance to customers of the independent VANS providers.

3. We have concluded that during the complaint period 1999 to December 2004 Telkom refused to supply essential facilities to independent VANS providers and induced their customers not to deal with them.

4. Telkom's conduct resulted in a substantial lessening and prevention of competition in the VANS market. Telkom leveraged its upstream monopoly in the facilities market to advantage its own subsidiary in the competitive value added network market, which includes the provision of internet and virtual private network services. Telkom's conduct caused harm to both competitors and consumers alike and impeded competition and innovation in the dynamic VANS market.

5. Instead of competing on the merits Telkom devised a strategy claiming that independent VANS were conducting business illegally. Through this strategy which involved the freezing of its competitors' networks Telkom impeded the growth of its competitors and retarded innovation in the market place. The harm to competition was likely to be exacerbated in an industry characterized by network effects.

6. The Commission had sought an administrative penalty of R3,2 billion against Telkom, alternatively R1 billion in the event that we found Telkom to be only in contravention of section 8(b). At the close of proceedings the Tribunal had requested Telkom to propose alternative pricing or behavioural remedies. Telkom declined to do so.

7. In the circumstances we have found Telkom to be in contravention if section 8(b) and 8(d)(i) of the Competition Act and have imposed an administrative penalty of R449 million (four hundred and forty nine million rand).

Introduction

8. The Competition Commission contends that during the period 1999 to the end of 2004 Telkom abused its monopoly position in the fixed line telecommunication market by excluding competing value added network service providers from the downstream value added network service market.[1] This was achieved through non-pricing restrictive practices in violation of sec 8(b), 8(c) and 8(d)(i)[2] and pricing the supply of components

[1] The original complaint was filed with the Commission by 21 complainants including the South African VANS Association ("SAVA"). See Founding Affidavit, p 6.

[2] Although 8(d)(i) was not addressed in final argument the Commission did address it in it FA and it was never withdrawn as a complaint.

and services at levels that were excessive in themselves and discriminatory when compared to the rates at which the selfsame components and services were supplied to its own VANS customers in violation of sec 8(a) and 9(1)(a). The Commission furthermore contends that the two forms of exclusionary conduct and their constituent elements can be considered cumulatively as well as individually.

Background

9. The Commission referred this matter to the Tribunal on 24 February 2004 following a complaint received by it from the South African Vans Association (SAVA).

10. Telkom challenged the referral on a number of grounds including jurisdictional grounds in the High Court. After five years of litigation the Supreme Court of Appeal, on 27 November 2009, rejected the jurisdictional point and referred the matter back to the Tribunal.

11. On 22 June 2010 Telkom filed its answering affidavit in which it raised the legal point that the Commission's excessive pricing allegations did not comport to the approach set out by the CAC in *Mittal*.[3] At that stage the Commission was confident that it could prove its case as it was pleaded and therefore chose not to amend its referral. However it subsequently sought to amend its referral twice with only partial success. Associated with this was a discovery dispute between the Commission and the Commission in which the Commission sought documents from Telkom dealing with its underlying costs. The outcome of this was that no cost information was discovered by Telkom and none was traversed in evidence in these proceedings. [4]

12. The Commission limited the complaint to the period between September 1999 and 1 January 2004.[5] This period included Telkom's *de jure* exclusivity (until 7 May 2002) and its de facto exclusivity (7 May 2005).

[3] Mittal Steel South Africa Ltd and Others v Harmony Gold Mining Company Ltd and Another CAC Case No; 70/CAC/APR07, dated 29 May 2009

[4] On 27 September 2010 the Commission unsuccessfully filed its first application to expand its complaint referral. It wanted to introduce a margin squeeze case. The Tribunal dismissed the application on 14 December 2010 for lack of sufficient particularity but directed the Commission in its reasons on how to rectify the objections against the application to amend. The Commission never revived the amendment. Next, the Commission sought discovery of Telkom's underlying costs in relation to the excessive price case, based on Telkom's justification that customers' prices differed because of a differential cost basis. Telkom indicated at the hearing that it might on further consideration drop its defence. On 9 February 2011 Telkom indicated that it would no longer rely on this justification in the excessive pricing/ price discrimination complaint. On 16 March 2011 the Commission sought to amend its pleadings for the second time. The first amendment related to the range of products and services which are the subject of the Commission's complaint. Telkom agreed to this amendment in return for certain amendments and commitments provided by the Commission to limit the complaint period to 1999-2004.

[5] The Commission has referred a second complaint against Telkom for a subsequent time period.

13. The hearing of the matter proceeded over several weeks spread over a five month period.

14. The Commission's witnesses gave evidence from 17 to 27 October 2011 and Telkom's witnesses from 1 to 9 December 2011. The case was argued before us on 13 and 15 February 2012. The following witnesses were called by the Commission and Telkom:

15. Commission

    15.1.1. Mike Brierley, Independent consultant and Expert witness

    15.1.2. Tony Walt, Chief Operating Officer of Internet Solutions, a division of Dimension Data

    15.1.3. Mike van den Berg, Chief Executive Officer of Gateway Communications (Pty) Ltd

    15.1.4. Doug Reed, Group Managing Director of Vox Telecom Ltd

    15.1.5. Edwin Thompson, General Manager of Infrastructure and Technology at MTN Business

    15.1.6. James Hodge, Expert witness from G:enesis Analytics (Pty) Ltd (Genesis)

16. Telkom

    16.1.1. Anton Klopper,[6] Group Executive: Legal Services at Telkom

    16.1.2. Richard Majoor, Executive: Technical Regulations at Telkom

    16.1.3. Arnold van Huysteen, Executive: Managed Data Network Services in the Product House division of Telkom

    16.1.4. Sarel Koekemoer,[7] Manager: Complex Commercial at Telkom

    16.1.5. Craig Green, Senior Manager: Wholesale Account Management at Telkom

    16.1.6. Expert witness Geoff Edwards from Charles River Associates (CRA)

17. In the course of the hearing the Commission indicated that it would not persist in seeking the interdictory relief referred to in the amended notice of motion, prayers 1.2, 2.2, 3.2 and 4.2 and would not persist in its complaint regarding Telkom's refusal to peer with AT&T but would still persist with Telkom's refusal to supply SDN with a high capacity line.

18. Given the highly technical nature of this industry, we have for ease of convenience attached a glossary of terms as Annexure A to these reasons.

[6] Replaced Gabriele Celli

[7] Replaced Neels Mans

Overview of Telecommunications in South Africa

19. Prior to the commercialization and subsequent privatization of Telkom, telecommunications services were provided and regulated by government through the South African Posts & Telecommunications (SAPT). The SAPT was in most respects a classic post, telephone, and telegraph (PTT) monopoly, providing postal and telecommunications services and operating a system characterized by internal cross-subsidies. The SAPT was "commercialised" into Telkom SA, in October 1991 with the state as the sole shareholder. As a commercial entity, Telkom could generate profits and pay taxes, received no state subsidies, and was responsible for obtaining its own financing (although this remained subject to ministerial oversight inasmuch as the state was Telkom's sole shareholder). The old SAPT relinquished its joint role as player and regulator, and a very small Department of Posts and Telecommunications acted as interim regulator. [8] In the pre- 1991 period, licenses[9] to provide telecommunications services were issued by the relevant government department. After the incorporation of Telkom, these "authorizations" were granted by Telkom. A limited area of competition existed in the provision of data services in respect of which Telkom was content to grant authorizations. Data service providers such as FirstNet (Pty) Ltd and UUNET (Pty) Ltd were some of the early value added network operators.[10]

20. The sector underwent another series of reforms, by the newly elected democratic government in 1995/6 culminating in the White Paper.[11] This policy was called the managed liberalization of telecommunications in which it was envisaged that the sector would first be modernized and access by consumers to telecommunications increased through the granting of a statutory monopoly to a partially privatized fixed line operator in return for specified targets of universal service obligations. Pockets of competition in the Value Added Network Services sector (VANS) and customer premises equipment was to be permitted with the gradual introduction of deregulation from year three onwards.

21. Following the White Paper process Telkom was partially privatized[12] and granted a five year period of exclusivity on PSTS and facilities provision. The rationale for granting Telkom exclusivity was to enable it to expand its network and ready itself for competition. In return Telkom was required to fulfill certain universal service obligations such as the installation of 2.29million new lines of which 1.67million had to be in under-serviced areas, 120 000 payphones, providing access to 3174 villages and 20 246 priority

[8] See Horwitz on the History of Telecommunications in South Africa at http://www.vii.org/papers/horwitz2.htm

[9] These were granted in the form of authorisations by Telkom.

[10] See Klopper's witness statement, P6 and 12

[11] For more details see White Paper on Broadcasting Policy, May 1998

[12] Thintana, a consortium between SBC & Telkom Malaysia, bought 30% of Telkom. At that stage Government was the majority shareholder. Telkom was subsequently listed on the JSE and the NYSE in 2001/2 with the resultant shareholding being Government 67% and Ucingo Investment (Pty) Ltd 3%. In 2003 the shareholders were: Government 39.3%, Thintana 30%, Ucingo 3% and the Public 27.7%.

customers such as schools. The Telkom license was promulgated by the then Department of Post and Telegraphs. Interconnection and facilities leasing regulations were published as a Multi-Party Agreement between public operators. A rate regime was negotiated between Telkom and the Minister in terms of which its tariffs were regulated.

22. The Telecommunications Act of 1996 established an independent regulator, the South African Telecommunications Regulatory Authority ("SATRA), the predecessor of the Independent Communications Authority of South Africa ("ICASA") and a framework for licensing and regulating the industry. All authorisations and licenses issued to date, including those for value added network services became deemed licenses under this Act and were required to be re-issued by SATRA for compliance with the Act.[13] The 1996 Act provided for Telkom's exclusivity period and included definitions of PSTS and PTNS. While it provided for a category of VANS license it failed to include a definition of value added network services. In terms of section 40(2) VANS licensees were restricted from sub-letting, ceding or in any way parting control of the facilities they obtained from Telkom (later SNO). They were also prohibited from carrying voice or VoIP. The Act envisaged that at some future date to be determined by the Minister these restrictions would be lifted.

23. The re-issuing of licenses in terms of the Telecommunications Act was significantly delayed. The mobile operator's and Telkom's licenses were issued only after 2000. The VANS licensing regime was uncertain for a longer period of time.[14] No doubt this was influenced to some extent by the absence of a definition of VANS in the Act as well as the disputes raging at the time between Telkom and VANS providers, and which underpin the subject matter of this complaint.

24. The Telecommunications Act was amended in 2001 to provide *inter alia* for the licensing of a competitor to Telkom at the end of its exclusivity period, the SNO (now Neotel). Telkom's *de jure* monopoly ended on 7 May 2002. The licensing of the SNO however was delayed and Telkom's *de facto* monopoly lasted until May 2005. This amendment also introduced a definition of value added network services which included:

> "***value-added network services*** *means a telecommunication service provided by a person over a telecommunication facility, which facility has been obtained by that person in accordance with the provisions of section 40(2) of the Act, to one or more customers of that person concurrently, during which value is added for the benefit of the customers, which may consist of –*
>
> *(a) Any kind of technological intervention that would act on the content, format or protocol or similar aspects of the signals transmitted or received by the customer in order to provide those customers with additional, different or restructured information;*

[13] Licenses were re-issued only after the formation of ICASA in 2000.

[14] Only finalised in 2003

(b) The provision of authorized access to, and interaction with, processes for storing and retrieval of text and data;

(c) Managed data network services"

25. The restrictions on VANS licensees were only lifted in early 2005 by the then Minister of Communications.

26. Of significance to this case is that while Telkom enjoyed exclusivity over PSTS and the provision of infrastructure it did not enjoy exclusivity over value added network services. Telkom through its Telvans division also provided value added network services similar to those provided by the independent VANS operators. Telkom had also been issued with a VANS licence and was also restricted, as other VANS licensees were, by section 40(2) in respect of its downstream VANS services.

Relevant markets

27. The provision of managed data network services and internet access is dependent on access to telecommunications infrastructure. During the complaint period Telkom was the monopoly provider of infrastructure and PSTS services. PSTS services include services such as national and international long distance services, local access and public payphone services. Telkom's monopoly rights for the provision of infrastructure included the right to supply of telecommunications equipment, install, maintain and repair parts of the telecommunications networks used by other licensees. Other licensees such as VANS providers or PTN licensees were required to obtain these telecommunications facilities from Telkom in terms of section 40(2) of the Telecommunications Act.[15]

28. The Commission's expert Mr James Hodge identified the following relevant national markets –

    28.1. A market for local access and transmission fixed leased line infrastructure;

    28.2. A market for managed data network services including the provision and management of WAN and VPN;

    28.3. A market for wholesale internet connectivity; and

    28.4. A market for retail internet access for corporate customers.

29. Telkom did not dispute these market definitions. While the latter two markets relate specifically to internet services these were regarded as value added services by SATRA.[16] We therefore assess Telkom's conduct in the market for local access circuits and transmission fixed line infrastructure in relation to VANS providers across both managed data network services and internet markets and distinguish between them only where necessary.

[15] Or the SNO post 2001.

[16] See SATRA s27 inquiry ruling 14 October 1997

Non-price conduct

30. The Commission alleged that Telkom abused its dominant position by –

    30.1.1. Refusing to supply essential facilities to certain VANS providers unless they acceded to certain conditions in letters and contracts. Through the imposition of these conditions Telkom sought to expand its exclusivity over services which in law it did not enjoy. Telkom insisted that VANS providers undertake to use the facilities in accordance with Telkom's interpretation of the Telecommunications Act and the provisions of their licenses, failing which it would refuse to provide them with facilities. Telkom did in fact "freeze" the networks of numerous VANS providers. Through the use of these contractual terms, Telkom sought to bypass the regulator which was entrusted with enforcement of the Telecommunications Act, and obtained for itself the additional protection of private law remedies. In other words, Telkom could on the basis of a breach of contract at private law rather than after a determination in its favour by the regulator, refuse to provide essential facilities which it was obliged to by the provisions of the Telecommunications Act. This conduct was a breach of section 8(b) and 8(c).

    30.1.2. Refusing to lease the access facilities to VANS providers directly and insisting on VANS providers acting as agents of their customers in leasing access facilities from it. VANS providers had to enter into agency agreements with their customers in order to obtain and manage the facilities on their behalf. This inconvenience was not experienced by customers who contracted with Telkom VANS. This made the VANS services less attractive due to the higher administrative burden, increased the cost of transferring lines and provided Telkom with information of the customer which it otherwise would not have had. This conduct was alleged to be in contravention of s8(c) and s8(d)(i);

    30.1.3. Refusing to peer with AT&T Global Network Services South Africa ('AT&T") and refusing to provide facilities to enable Satellite Data Network (SDN) to peer with AT&T. This was referred under s8(b) and 8(c). This complaint was later limited to refusing to supply SDN with a high capacity link

31. Telkom did not deny that it acted as alleged by the Commission but argued that it was justified in doing so because the VANS providers were engaged in illegal conduct. ("Illegality defence"). Telkom alleged that VANS operators had adopted a business model that effectively trespassed on Telkom's exclusivity rights in PSTS and the provisions of section 40(2) of the Telecommunications Act ("Telecoms Act") read with paragraph 1.5 of its licence. It alleged that the regulatory framework restricted VANS providers from sub-letting or ceding control over the facilities it obtained from Telkom and that Telkom's insistence that the lines be in the names of the ultimate user were simply an attempt to comply with the legislation. Furthermore VANS operators who were providing virtual private network services (VPNS) were in fact providing private network services which they were not entitled to do under their licenses. It argued that because a VPN was effectively a PTN and that VPN services were nothing more than the

conveyance of signals and therefore amounted to PSTS which only Telkom could provide

32. In relation to the third charge, the claim by the Commission was eventually limited to a refusal to provide SDN with a large capacity line in its peering with AT&T. Telkom's defence was that it enjoyed exclusivity over international gateways and that AT&T was infringing this by bypassing the Telkom network. Telkom was of the view that if it provided SDN with a larger capacity line, this would enable AT&T to undermine Telkom's exclusivity.

33. The VANS providers disputed Telkom's interpretation of the regulatory framework. They argued that they were not in breach of section 40(2) and that VPNS were part of a bundle of value added services provided by them to customers and they were entitled to provide these to their customers in terms of their licenses. Furthermore, the Act did not contain a definition of VANS and a definition or a provision that was included in Telkom's licence could not be elevated to the status of law and be imposed on the entire industry. Telkom's actions against the VANS providers were anti-competitive and an abuse of dominance, as well as a contravention of the Telecommunications Act.

34. In these proceedings Telkom conceded that its illegality defence would fail if the Tribunal were to find that its interpretation of the regulatory framework was incorrect. Telkom also conceded that facilities bought by VANS from Telkom amount to essential facilities as contemplated in section 8(b) of the Competition Act.[17]

Genesis of the dispute

35. After the 1996 reforms Telkom enjoyed exclusivity over PSTS and the provision of telecommunications facilities. Limited competition was found in the area of data and network management services. VANS providers were restricted, until a date to be fixed by the Minister, by section 40 of the Telecommunications Act from sub-letting or ceding or sharing their facilities, from conveying voice and using VoIP. The Telecoms Act did not prohibit VANS licensees from re-selling bandwidth but clause 2.5 of Telkom's license provided that Telkom could, in contract, impose such restrictions for leasing of its facilities**.**

36. During the 1980s and 1990s businesses in South Africa became more reliant on centralised information technology for efficient data management. This led to an increased need for firms to connect their different sites to each other and to a central head office or data centre. Firms began building wide area networks (WANS). See diagram in Annexure B. The increased use of centralised IT systems, the internet and email led to an increase in demand for higher transmission capacity. The WAN model of connectivity became increasingly expensive due to the high prices of leased lines and the distance-based fee charged by Telkom. An alternative network design began to emerge in which major metropolitan nodes were established and these were

[17] Para 13.1 of Telkom Answering Affidavit 12 April 2010

interconnected with each other (e.g. Cape Town with Johannesburg). All minor sites (branch offices) would then connect to the major node (e.g. all branch offices in Gauteng would connect to the major node in Johannesburg) and the data would then be sent from one major node to another. This design was the foundation of what was to become a shared network model (Virtual Private Network) developed by VANS providers. VANS providers built their own networks and sold bandwidth to firms on a shared basis. Instead of each firm now owning its own WAN it could utilise the network of the VANS provider by "purchasing" bandwidth and service levels from it. VANS providers installed points of presence (POPS) in key metropolitan areas. Their customers' offices in each of these areas could be connected onto a POP. Data could travel from these local offices onto the nearest POP and from there onto the backbone or core (Cloud). For example data from branch offices in the Western Cape would be sent to the nearest POP (maybe in Milnerton) this data would then be sent across the backbone or core network to the POP in Johannesburg and from there to local branches in Gauteng. See Annexure B for a diagram of generic VPN.

37. The development of the shared network model from the old WAN model is sometimes referred to as moving from strings to clouds.[18]

38. The core or the back bone of the network (a bunch of large capacity connected lines capable of transferring signals) in a VPN offering is called a "cloud" because it is bandwidth that is shared amongst the customers of the VANS operators. The bandwidth is not dedicated to a particular customer as in the WAN model. However customers could contract with the VANS operators for a minimum amount of bandwidth and certain service levels to ensure that they were always connected and could obtain the extent of capacity appropriate for their operations.[19] Network management services provided by the VANS operators ensured that service levels were maintained. In order for the VANS operators to connect a customer site to its POP it would order, on behalf of the customer, an access line (or circuit) connecting that site to the nearest POP.

39. The VANS operator would lease the access line in its own name but pass on the cost of it to be recovered on behalf of Telkom. This was a practice that had until the 1999 been accepted by Telkom.

40. All of the lines in the core network and the access lines from the customer's office to the VANS providers POPS were provided by Telkom. [20]

[18] See more discussion of this in Telkom SA Ltd and Business Connexion Group Ltd CT Case No 51/LM/Jun06

[19] This was also offered by Telkom in Frame Relay

[20] An access leased line is not a physical line that is handed over to the VANS operator. The line is still owned by Telkom but the capacity on that physical line (owned and installed by Telkom) is leased to the VANS or any other customer. The signal had to be conveyed by Telkom (on its network) from the customer site to the nearest VANS POP and had to be configured by Telkom for that customer. See later discussion on pricing conduct. In these hearings it was interchangeably referred to as a line, connection, link, leased line or a circuit.

41. The advantages of VPN technology are obvious. At a macro level VPN technology led to increased efficiencies in the use of a scarce resource and a concomitant reduction in adverse consequences for the environment.[21] For the end user (customer), VPN technology resulted in enormous gains – the cost of doing business was lowered for each subscriber because a shared network obviated the need for upfront capital layout for a dedicated network, network management and IT solutions could be outsourced resulting in huge savings in both personnel and infrastructure costs, the end user enjoyed flexibility and convenience because it could increase or decrease its bandwidth requirements depending on its needs at a given moment in time and additional services such as access to internet could be added to their bundle at a fraction of the cost. Large companies which in the past had to each roll out their own network, often with bandwidth lying fallow, could now utilise bandwidth offered to them on a shared basis by VANS providers. This enabled companies to outsource their IT requirements and to seek a full turn-key service from these operators, referred to as the Total Business Solutions, which included IT, IT administration, networks and network management.[22] For the VANS provider, scale and better returns on their investment could be achieved.

42. Not all VANS providers offered a VPN solution to customers. However, the larger VANS operators like Omnilink, Firstnet and MTN NS who had built networks with national footprints were in the forefront of this technology.

43. It was this model that Telkom alleged was in contravention of the prevailing regulatory framework and trespassed on its exclusivity as defined by it.

44. On 1 June 1999 Telkom provided SATRA with what is considered the final version of its exclusivity policy. Telkom's interpretation of the prevailing regulatory regime was that VANS could only provide value added services as defined in Telkom's licence. They could not provide private networks in terms of section 36A(1)(h)(iii)[23] and they could not provide PSTS (public switched services) and therefore the mere conveyance of signals. Further they were prohibited from dealing with Telkom's facilities in that they could not sub-let, cede or part with the facilities leased from Telkom nor could they carry voice on these facilities. The Telecoms Act did not prohibit the resale of bandwidth. This restriction however was found in the Telkom licence condition 2.5(b) read with PSTS licence condition 13.4.3(c) which allowed Telkom to require, in a contract with a customer, that they could not re-sell bandwidth.

45. VPNS became the point of departure for both Telkom and the VANS operators. According to Telkom those providing VPNs to their clients were infringing Telkom's exclusivity rights because, in its opinion, VPNS were PSTS services and not value added services. Hence the VANS business model as described above was illegal.

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[21] See in general our discussion in Telkom & BCX on the move away from the strings model to the cloud model.

[22] See p 50 of Commission's witness statement bundle (CWB), File 1 and transcript (T) p 458

[23] By definition a private network service licence holder could "own and manage" its own network (leasing the physical facilities or circuits from Telkom)

46. SATRA however did not agree with Telkom's interpretation.[24] SATRA contended that Telkom's exclusivity should be seen in light of the broader objectives of the White Paper and not simply in terms of the issues of facilities provision and resale. In that letter the regulator shows an appreciation of the nature of evolving technology and the risk that a regulator, if it did not strike the right balance between exclusivity and liberalisation, might stifle opportunities for the country created by technology. SATRA also indicated that it was contemplating undertaking a review of Telkom's exclusivity and its obligations as provided for in the White Paper and requested Telkom's views on this.

47. Having received a lukewarm response from SATRA, Telkom developed a commercial strategy against VANS providers as follows[25]-

    47.1. When a VANS provider requested facilities Telkom would send a standard VANS letter informing that provider that it may not resell, sublet or share any of the facilities and that the development of PTNS would be monitored by Telkom. In the event of suspected irregularity Telkom may decide to freeze the networks of the VANS provider.

    47.2. Telkom would not permit a transfer from an existing customer to a VANS provider. This was aimed at preventing Telkom customers who had their own WANS from moving over to a VANS provider.

    47.3. Where the customer was already a customer of the VANS provider, refusing to provide access circuits to the VANS provider. VANS providers could act as agents for the customer in dealing with Telkom but the link must be registered in the name of the end-user. Telkom would only accept that a VANS provider was an agent if the customer signed a letter to that effect.

48. Telkom's policy on alleged infringements of its exclusivity rights was carefully documented. If it became aware of a provider who had in its opinion infringed Telkom's rights by providing facilities to it or was reselling, sub-letting or sharing a facility it would notify the provider and request a written statement that this was not the case or it would cease or desist from these acts. If Telkom thought that the statement provided by the provider was inaccurate or inconsistent with the facts, a complaint would be lodged with SATRA. If after a reasonable period of time the provider did not provide such a statement Telkom would cease to provide it with new facilities until the provider had shown that it had ceased or desisted from providing its own facilities or that it was not reselling, subletting or sharing facilities. This effectively meant that the provider's network would be "frozen". Because Telkom faced the risk that providers would seek to self-provide facilities if it refused to supply them,[26] it also set out a process that it thought providers should follow with SATRA.[27]

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[24] See SATRA letter dated 10 June 1999

[25] See Hodge summary at para 253, CWB file 2 p 489 and the documents referred to there.

[26] In terms of section 44 of the Telecommunications Act

[27] See Hodge summary para 246

The conduct

49. Telkom then proceeded to implement its strategy with the independent VANS.[28] The aim of this according to Mr Green, testifying on behalf of Telkom, was to engage with the VANS providers and to ultimately persuade them to agree to Telkom's interpretation of its exclusivity rights and to reverse the way in which it, Telkom, had until now permitted them to do business. In order to do this they had to "get them to the table". In Telkom parlance this was called "normalization" of the VANS. Letters were sent out to VANS providers[29]in which Telkom asked them to confirm that they were not and would not use the facilities in a manner that Telkom deemed as illegal. The letters specified conditions that according to the independent VANS providers went beyond what Telkom was entitled to under the statutory provisions and requested them to confirm that they were not providing their customers with any private network facilities, carrying voice or reselling spare capacity to bypass Telkom's PSTN etc.[30]

50. Telkom also held briefing meetings with these VANS providers. In order to manage the strategy it kept details of when meetings were held, with whom, to whom letters were sent, the dates thereof and responses from them. [31]

51. An analysis of the responses was done by Telkom.[32] The larger of the VANS indicated that they believed Telkom had no authority to require its customers to give these undertakings and that they did not agree with Telkom's interpretation of its exclusivity rights and/or that they would seek legal advice. Some said they would refer the matter to SATRA and others asserted that they will continue doing business within the parameters of the 1992 agreement with Telkom. In summary the majority of these VANS were not in agreement with Telkom. At that stage only one agreed that it would comply fully with Telkom's requirements.

52. Of note is ISPA's response. At that stage Telkom and ISPA were engaged in discussions. While the details of that discussion were not canvassed in these hearings, indications are that these related to earlier similar disputes. In response to this letter ISPA indicated they would not deal with the contents thereof until discussions between Telkom and ISPA were completed. Telkom subsequently elected not to enforce its exclusivity against the ISPs.

53. It appears from Telkom's own schedule that follow-up letters were sent to VANS providers during August and September 1999.[33] In response some changed their position. [34]

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[28] See Green witness statement p 341 Telkom witness bundle (TWB), CCB 6, P 11258 and the CCB 5, p 1937

[29] See Annexure F5a of the Commission's Referral p 199, the CCB 6, p 11278

[30] See CCB 6, p 11278

[31] See CCB 6, p 11280 and 11548 and file 5 at p 2003-2005

[32] See also the summary in Hodge Table 15 and p 11548 of CCB, 6

[33] Letters were, inter alia, sent to BCS, Omnilink, Trafex, Firstnet and ISP

[34] See BCSNet and PQ saying that they will comply.

However the majority maintained their opposition. During this period, the South African Vans Association (SAVA) filed a complaint with SATRA in terms of s53 of the Telecommunications Act asking SATRA to direct Telkom to cease its refusal or threat to refuse to provide facilities if they did not provide the confirmations sought by Telkom.[35] SATRA also initiated a s100 investigation into Telkom's behavior. Both rulings went against Telkom.[36]

54. Telkom then embarked on a "freezing" of the VANS networks. As explained by Telkom's Mr Green, "freezing" meant that Telkom refused to provide additional links to a VANS provider but continued to provide it with what it had provided to date. Telkom maintained a schedule of the details of the freezing and the reasons therefore.[37]

VANS provider	Date of Freeze	Reason
BCSNet	22 October 1999	Telkom chose to freeze this network because of the contradictory statements in its second letter and its application against Telkom
Omnilink	2 September 1999	Given the previous allegations between Telkom and Omnilink Telkom chose to freeze Omnilink's network
Trafex (AT&T)	10 September 1999	As Telkom was awaiting the SATRA decision they froze the network of Trafex
FirstNet	10 September 1999	As Telkom was awaiting the SATRA decision they froze the network of Trafex
SDN	10 September 1999	Due to lack of response to letters sent out asking for confirmation SDN was not using facilities illegally
EDS	10 September 1999	Due to lack of response to letters sent out asking for confirmation EDS was not using facilities illegally
Pinpoint	10 September 1999	Pinpoint indicated it was going to seek legal advice before responding, however, they did not responf to the second letter sent and as such Telkom froze their network
SITA	10 September 1999	Due to SITA not responding in the appropriate

[35] See Annexure C P 102 of Commission's pleadings file 1

[36] See SATRA ruling 10 September 1999 & SATRA ruling dated 10 September 1999 at p 129 of Commission's pleadings bundle 1. Both were challenged by Telkom on procedural grounds. The former was eventually set aside on procedural grounds and the latter was considered afresh by ICASA in 2002.[36] In the former (s53) ruling the regulator viewed Telkom's conduct as anti-competitive, conferring undue preference to its own VANS business and discriminating against other VANS.

[37] See the document "Enforcing Telkom's Exclusivity" 24 January 2000 and Table 16 of Hodge.

VANS provider	Date of Freeze	Reason
		manner to Telkom's letter
Brainware/ Acronym	15 September	Due to lack of response to letters sent out asking for confirmation Brainware was not using facilities illegally

55. During this time Telkom also approached the customers of the VANS providers claiming that the VANS providers were infringing the Telecommunications Act and their own license conditions by providing these services to them.[38]

56. The freezing of the networks and approaches to their customers by Telkom clearly had an impact on the VANS providers. A number of them requested "normalization". This process involved meetings between them and Telkom product or account managers in which Telkom obtained information about their networks and suggested to them how to "normalize" it.[39] Various options were put to the VANS providers –

    56.1.1. "*The end-users should establish their own private telecommunication networks (PTN) by ordering their facilities directly from Telkom. Connection between the various PTNs and the VANS network should be established by means of access circuits that the end-users rent from Telkom.*

    56.1.2. Connectivity between the end-users and the VANS networks should be supplied by means of Telkom's Frame Relay network.

    56.1.3. Telkom may take over the frame relay networks of the VANS providers provided that Telkom will be able to manage the networks that it fully complies with Telkom's requirements and the purchase price is acceptable to Telkom.

    56.1.4. *In those cases where the entire networks of end-users have been taken over by VANS providers, the facilities can be transferred back into the names of the end-users where feasible*."

57. The majority of VANS providers expressed their dissatisfaction with Telkom's exclusivity position. Exclusivity letters were sent to 26 VANS providers in 1999 and by 24 January 2000 seven of them had their networks frozen. The vast majority of those who had their networks frozen refused to "normalize" their networks and resisted Telkom's attempts to do so.

58. The agency agreements and the insistence by Telkom that access circuits be registered in the name of the end-users were also challenged by the VANS. However after a period of inconvenience they acceded to this arrangement for different reasons. For some it

[38] Commission's pleadings file 1 p 119

[39] Green T 1747

was more convenient that the credit risk was passed onto Telkom, for others it was a matter of getting on with providing their customers with a service.[40]

59. In response to the freezing, operators such as Omnilink, apart from taking the matter to SATRA, tried to manage the squeeze on their capacity. In one instance Omnilink migrated one of its customer's off the shared network and onto its own WAN.

60. Others such as BCSNet changed their stance after receiving follow up letters and acceded to Telkom's demands.

VPN: VANS v PSTS debate

61. Much time was spent in our hearings on the question of whether or not a VPN service constituted a value added service or a PSTS (over which Telkom enjoyed exclusivity) and we were urged by Telkom to study the provisions of the Act and its license to arrive at a firm view.

62. It is unnecessary for us to decide this dispute for two reasons. In the first instance the content of VANS licenses, including whether or not they can provide VPN services has already been decided by SATRA and ICASA. In 1997 SATRA held an inquiry and concluded that internet services were value added services. In 2000 ICASA held a s27 enquiry[41] into whether VPNs are a managed data network service (MDNS) and concluded that a VPN is neither a MDNS or a PTN but a service characteristic arising from the "use of software based on technological intervention in the management, configuration and operation of a Vans, which is a legal service in terms of section 40 of the Act". In other words a VANS licensee could provide VPNS. Although Telkom disagreed with the regulator's findings in these enquiries, both conclusions were valid views of a sectoral regulator empowered by legislation to provide such direction and guidance to the Telecommunications industry.[42] Moreover the definition of VANS introduced into the Telecommunications Act in 2001 explicitly contemplated the provision of VANS to "one or more customers of that person concurrently" which supports the conclusion that the business model of the VANS was not illegal as alleged by Telkom.

63. In *Telkom v Internet Solutions* (the IS s100 matter)[43] ICASA found that IS was providing a legitimate VANS.[44] In *Telkom SA Ltd v AT&T Global*[45] (the AT&T case) ICASA held that a VPN is not a PTN but an MDNS which falls into the definition of VANS in section 40(2) of the Telecommunications Act. ICASA also found that AT&T was not providing a PSTS nor was it subletting facilities leased from Telkom. ICASA found that Telkom was

[40] See Brierley evidence at T 269

[41] Of the Telecommunications Act

[42] See letters written by Telkom to the regulator

[43] Telkom had lodged a complaint against IS alleging that it was providing a PTN by using IP-Net technology.

[44] See CCB 5 p, 2327

[45] See CCB 5, p 2343

giving its own VANS provider an undue preference by unlawfully withholding facilities from AT &T.

64. Despite these rulings by SATRA and ICASA Telkom challenged them on review to the High Court. In a number of cases the regulator's decisions were over-turned on the basis of procedural grounds. However the substantive issues decided by SATRA and ICASA have never been overturned. In the critical and highly relevant matter to this case, namely the AT& T ruling of 2002, Telkom had filed a notice of review in the High Court but did not persist with it. Neither Telkom nor its legal representatives nor the Commission could find evidence of this ruling being overturned. If this ruling had in fact been overturned, no doubt this would have been placed before us post haste. Hence the ruling by ICASA, albeit only handed down in 2002, stands.

65. In the second instance Telkom's own conduct of selective sanctions – both in respect of identity and degree - suggests to us that its illegality arguments were a matter of commercial convenience rather than principle. Instead of switching off the networks of those alleged illegal providers Telkom elected to "freeze" their networks, the effect of which was that they were permitted to continue conducting the alleged illegal business (from which Telkom continued to earn revenues) but were prevented from expanding their networks and thus their business. In addition some VANS providers such as internet service providers were not frozen for as long as they were engaged in "talks" with Telkom.

66. Furthermore Telkom's Exclusivity Policy as expressed by Tom Barry, Telkom's Chief Operating Office at the time, was not shared by all *within* Telkom. There was disagreement within Telkom's own ranks about the alleged illegality of the VANS business model. As we show below its own documents support the conclusion that its illegality arguments were nothing more than a contrivance for an exclusionary strategy against data service providers and its prospective upstream competitor.

The genesis & rationale of Telkom's Exclusivity Policy

67. Around May 1998, two years after exclusivity and roughly one year before the complaint period, Telkom developed a "WAR Strategy" in response to what it perceived to be a competitive threat posed by independent VANS providers.[46] Until this point in time Telkom was content to sell its facilities to these VANS providers and partner with them in tenders for the provision of total business solutions for corporate customers. However, in 1988 Telkom became concerned that the present wave of VPNs was threatening its revenues and that the VANS operators were creaming off the network management and service fee. Telkom however did not have the competency to provide these services. The gap analysis on p896 of the WAR document shows that Telkom was lagging behind in this rapidly growing sector and lacked the skills necessary to compete with the likes of Omnilink and Didata who were migrating large corporates away from the corporates' own WANs onto their networks. Critical to these large corporates were total business solutions and service level agreements regulating network performance, a service that Telkom despite its large network and staff numbers could not provide.

[46] See Commission's Core Bundle (CCB) page 893

68. From this document it is evident that Telkom's central concern was as follows. Operators such as Omnilink who were providing corporate customers with a total business solution were making revenues in the VANS space that Telkom was not, could sell additional services to customers more easily, were well positioned to provide future services for example the integration of voice and data (after de-regulation) and were also in a position to switch those large customers to Telkom's future competitor in the fixed line market. The latter was possible because the fixed lines were leased in the name of the VPN/VAN provider and not the ultimate customer. Thus a VPN operator who had multiple customers running across its own network could switch the entire customer base to Telkom's competitor.

69. Thus we see two central competitive threats identified by Telkom by the prevailing VANS model. Independent VANS providers with their large corporate customer base were poised to provide intense competition to Telkom post-deregulation in the downstream VANS market. These providers were also strategically placed to switch large customers to Telkom's competitor in the upstream infrastructure market post 2002.

70. Another concern identified by Telkom was that the pricing of its Diginet[47] lines to the VANS encouraged re-selling. The implication of this is that its pricing was on the high side and encouraged VANS to re-sell in order to achieve scale.

71. A total solution was then suggested to address these concerns. The comprehensive response to the competitive threat presented by independent VANS included product development, service development, changes in tariff structures, integration of voice and data and internal sales and account management. The stated objective was for Telkom to "own the customer" and not be merely a pipe provider. The WAR team was given the mandate to deliver a total business solution by March 1999.

72. In this document nothing is said about the illegality or otherwise of the VANS services. Of significance is the fact that under the heading "Regulatory" what was noted for further investigation is that Telkom under its license is required to show a cost separation between the PSTS and VANS operations. Recall that Telkom also had a VANS license (a competitive sector) and was required by regulation to separately report its VANS and PSTS costs to SATRA and ICASA. Hence Telkom under its VANS licence was also subject to the restrictions contained in section 40(2). This note suggests that Telkom was seeking to combine its PSTS and VANS offerings in contravention of the prevailing regulations. It also foreshadows what was to become Telkom's stance on its Frame Relay and ATM offerings namely that they were PSTS services. In other words in order for Telkom to claim exclusivity over VPNS and to escape the very claim of illegality it was alleging and its separate cost reporting obligations, it had to describe them as PSTS services over which it enjoyed exclusivity and not as VANS. This is why we see in

[47] A diginet line refers to a dedicated constant bit rate data connection between 2 points running at bandwidth speeds of up to and including 64 kb/s. A diginet plus line runs at bandwidth speeds from 128 kb/s up to 1984 kb/s at increments of 64 kb/s. It's not merely a simple copper connection from the customer's premises to the nearest Telkom exchange.

several documents dealing with ATM products, that Telkom is at pains to state that these would be marketed as "PSTS products".

73. During April/May 1999 Telkom began to develop a policy outlining its interpretation of its exclusivity rights and in particular the rights of independent VANS licensees. In an internal memorandum from the Regulatory department[48] written with special reference to Omnilink, the author explores what is meant by "due and proper use" of the facilities by other parties without it being considered resale in the managed data network services.[49] Omnilink was the largest and most comprehensive VANS operator providing total business solutions and therefore Telkom's largest competitor.[50] The document sets out the views of the VANS providers who see their services as bona fide value added services and therefore constituting due and proper use. However he concludes, by an interpretation of the prevailing law, regulations and Telkom's licence conditions that VANS licensees are providing PTNS which they are not entitled to[51], alternatively that they are reselling which they were also not entitled to do.[52] The opinion then sets out what services were provided by Ominlink and the arrangement with Telkom until that point in time. Until that point in time Telkom's rental charges for the facilities (lines) were passed onto customers directly for collection by Omnilink on behalf of Telkom. This had been approved/recommended by Telkom and was in place solely for providing a higher level of service to the customer. However the memo advises that this must now change and that the facilities must be in the name of the end customer, even if Omnilink acted as an agent for the customer. The advice was that the legal relationship must change so that the customer must be owned by Telkom. This advice is in line with one of the objectives listed in the WAR strategy.

74. Of greater significance however is the statement that Telkom *must* contest the use of the facilities by Omnilink to provide a PTN to its customers. This is because if Omnilink was providing a "*bona fide VANS it could possibly be argued that the access circuits are part of a VANS network whose use by VANS customers would constitute due and proper use to access the value added service*".[53]

75. This is a highly revealing statement. On the one hand it demonstrates that Telkom's interpretation of the regulatory framework could be challenged and was not as unambiguous as claimed by it. On the other, Telkom's own regulatory department understood and accepted that the leasing of access circuits to VANS operators for use by their customers could be legal in some circumstances and would not amount to a sub-letting or ceding.

[48] CCB 1992 handwritten title, from Dr Celli

[49] P 1923

[50] See document 24 Jan 00 p 1978

[51] Section 38(1)

[52] Section 40(4) and Telkom License condition

[53] CCB 5, p 1925 para 3

76. At this point in time Omnilink had requested a 34Mbit link for its customer Old Mutual. Unbeknown to it, the request had been put on ice inside Telkom.[54] Correspondence between Paula Pratt and Todd shows that Omnilink was being put off.

77. We are given an early indication of Telkom's Exclusivity Position in an email from A Todd to Crossley, who shares the Exclusivity Confidential plans.[55] At that stage it was expected that by 23 June 1999 letters will be sent out to Omnilink and other VANS providers. There is also an internal plan for communicating the official position by that date.

78. This official position is later to be found attached to a letter by Tom Barry.[56] In an internal memorandum entitled "Telkom's Exclusivity Rights" dated 21 May 1999 Mr Barry sets out Telkom's official position and urges all the recipients[57] that the attached document is the official Telkom position on the issue of exclusivity and everybody should now begin to use it. The memo also urges the recipients to ensure that no employee or department in Telkom believes that he or she has the right or the ability to grant any customer private or governmental authority to provide services to themselves. It further urges Victor Moche and his team to lobby support for this position with the Ministry and/or SATRA.

79. The development of this policy begs the question: If this is what the Telecommunications Act read with the regulations and Telkom's license stated then why did Telkom consider it necessary to have to persuade its own employees about its exclusivity and the rights of others? Why was it at all necessary for Telkom to lobby support for it with the drafters of the law and the regulations and SATRA? The obvious answer is that Telkom's interpretation of its exclusivity rights in relation to VANS did not have a clear or unambiguous basis in legislation.

80. Telkom's own documents confirm this. In an internal document produced by Product Management, a division in Telkom[58] it is made clear that "*the legalities around this issue are however open for interpretation and this is regarded as a grey area*". The memo, written with specific reference to Omnilink, argues for a different position to be adopted by Telkom and cautions that Telkom's exclusivity policy could marginalize the VANS business. In motivation it sets out how Telkom's revenues were being boosted by Omnilink, arguing that VANS were not eroding Telkom revenue but enhancing it.

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[54] CCB 5 p 1940

[55] CCB 5 p 1942

[56] CCB 5, p 1987

[57] Sizwe Nxasana, Bheki Langa, Wilbur Crossley, Victor Moche, Pinky Moholi, Al Todd, Cavell Deall and Francois Lutsch

[58] See CCB 3, p 936. We assume this was written after Feb 1999, before the finalization of the official position communicated by Tom Barry. See also Hodge witness statement, Commission's witness statement files p 488 para 249

81. Furthermore Mr Klopper, head of legal services at Telkom, accepts that it is not easy to separate out value added services from VPN services and that the line between the two is almost impossible to identify.[59] In these hearings Telkom claimed that there was a grey area in the regulatory framework of VANS and that Telkom had taken the view that VPNS were PSTS and not VANS. Klopper, when asked by Mr Brassey, counsel for the Commission, in an effort to understand what constituted value added network services, conceded that he could not actually delineate its ambit. In that exchange Klopper at first attempted to evade the question, but finally admitted that VANS at the very least consisted of services that were listed in Telkom's license. When pressed about VPNs he struggled between conceding that it could be a value added service as long as there was *some* value-add (but how much he couldn't say) to conceding that this was a ***new value added service as a result of new technology*** but in Telkom's view couldn't be provided by VANS licensees.

82. As summarized by Klopper under cross examination -

    82.1. "*But what you must keep in mind Mr Brassey as well is that technology was developing but the legislation wasn't developing. So what we sat here with was new technology, with the new types of VANS services, it wasn't envisaged by the legislature at that stage.*"[60]

83. In the managed data space different types of technologies were emerging at lightning speed and the VANS providers had developed an efficient business model with the use of these technologies. If the legislature - in Telkom's own words - had not envisaged new technologies such as VPN technology how then could Telkom claim it was illegal?

84. In conclusion we find that there is no need for us to decide whether or not VPNS were VANS or PSTS, because SATRA and in its later incarnation ICASA, have already decided that VANS licenses were entitled to provide VPN services. Moreover Telkom's own evidence on balance, confirms that VPNS were in fact VAN services.

Contravention of s8(b)

85. Section 8(b) of the Competition Act provides that it is prohibited for a dominant firm to refuse to give a competitor access to an essential facility when it is economically feasible to do so. An essential facility is defined in section 1(1)(viii) as "...an infrastructure or resource that cannot be reasonably duplicated and without access to which competitors cannot reasonably provide goods or services to their customers."

86. Unlike the position in the UK, there is no requirement in section 8(b) of the South African Competition Act to demonstrate anti-competitive effects. If the elements of section 8 (b) are proved then the anti-competitive harm is presumed.

87. Telkom was a dominant firm in the access facilities market. It has not denied the conduct complained of and has admitted that the facilities in question amounted to

[59] See the debate between him and Mr Brassey as to the elements of a VANS license.

[60] See T 1228

essential facilities as contemplated in section 8(b) of the Act. Telecommunications facilities such as Diginet access lines and copper links were, and still are, an essential input in the business of VANS operators. There was no evidence put up by Telkom that it was not economically feasible for it to supply these facilities. The only and central plank of its defence was that in its view VANS were acting illegally by conducting their businesses in the way that they did and this was a basis for its refusal. This point has been decided against Telkom by SATRA and ICASA and cannot be a justification.

88. But even if we assume for argument's sake that the illegality issue was undecided by ICASA, Telkom itself has relied on it inconsistently and selectively - electing to freeze rather than switch off its competitors' networks, freezing some and not others - thereby demonstrating that its refusal to supply was not a matter of law but rather a matter of commercial strategy. The Commission argued that Telkom had "waived" its rights to assert exclusivity or illegality as a justification by such inconsistent application. We view it as a contrivance through which Telkom could migrate the customers of independent VANS providers onto its own data network.

89. There was a suggestion by Telkom's representatives that the mere threat of refusal i.e. requiring VANS operators to agree to its terms and conditions in order to obtain supply- did not amount to an actual refusal to supply. However this point was not argued to any appreciable extent and nor did Telkom raise a formal objection thereto. Even if the Commission's referral affidavit made no mention of the actual freeze, the Commission's factual and expert witness statements did. Telkom was fully aware of the case that it had to answer and in fact did so through its answering affidavit and witness statements.

90. In competition law, a dominant firm's requirement that a downstream competitor accede to unreasonable conditions in order to obtain supply could nevertheless still amount to a refusal to supply. This is sometimes referred to as a constructive or effective refusal to supply, because the conditions of supply are so burdensome or were aimed to extract concessions which it would otherwise not be able, or so unreasonable as to render the purchase of the input uneconomical.[61] For sectors such as health, banks, stock markets, financial services and manufacturing, where the accuracy and currency of data are critical, even a slight delay or degradation in quality in the provision of telecommunications infrastructure could amount to a constructive or effective refusal.[62]

91. A point in case is Telkom's delay in fulfilling SDN's request for a higher capacity transmission line led to congestion on its existing lines and impeded its growth. Likewise Telkom's delay in fulfilling Omnilink's request impeded its ability to service its customers Old Mutual and Nedcor.

92. The requirement by Telkom that its competitors accede to conditions of supply that were not contained in legislation or regulation and which adversely impacted on their businesses did amount to a constructive refusal to supply.

[61] 2001/892/EC: Commission Decision of 25 July 2001 relating to a proceeding under Article 82 of the EC Treaty (COMP/C-1/36.915 – Deutsche Post AG – Interception of cross-border mail) at par 141

[62] Also see Walt witness statement p 64 of CWB

93. Of course in the case of those VANS providers who did not accede to its conditions of supply Telkom did in *fact* freeze supply. Omnilink's network was frozen from 2 September 1999 until June 2001, BCSNet's network was frozen in October 1999, Firsnet's on 10 September 1999, Trafex and Pinpoint on 10 September 1999. These networks were unfrozen only when these firms signed Heads of Agreements with Telkom. In the case of Omnilink this happened almost 20 months later and for Firstnet more than two years later.[63]

94. We have said previously that Telkom conceded that the facilities in question were essential as contemplated in section 8(b) of the Act and that its only justification for refusal was that the VANS were using the facilities in contravention of the law. This was found not to be the case by SATRA and ICASA.

95. While it is unnecessary to show harm for purposes of section 8(b) the effect of Telkom's refusal was clearly adverse to both the VANS providers and their customers who relied on them for network services and ultimately the consumer who relied upon the services of these customers. The VANS providers could not provide their customers with upgrades to their existing capacity nor could they provide them with additional core capacity. For customers such as banks for whom availability of network was crucial the quality of service was degraded. A case in point was Omnilink's customer, the Nedbank Group. As a response to the freeze and bandwidth constraint it faced, Omnilink migrated Nedbank off from its network onto a WAN, ironically the very model that was fast becoming outdated. Not only was this far more expensive, it also caused huge inconvenience to both Nedbank and to Omnilink.

96. Moreover Omnilink could not grow its customer base (because of bandwidth constraints on its core networks) nor could its customers grow their network footprint or increase the capacity of the existing network during this period.

97. In light of the above Telkom is found to be in contravention of section 8(b).

Section 8(d)(i)

98. Section 8(d)(i) provides that it is prohibited for a dominant firm to require or induce a supplier or customer to not deal with a competitor unless that firm can show technological, efficiency or other pro-competitive gains which outweigh the anti-competitive effect.

99. In section 8(d)(i) there is a requirement to show harm. Once that has been shown the onus is on the dominant firm to show that that anti-competitive effect was out-weighed by pro-competitive gains.[64] In order to show harm for purposes of section 8(d)(i) it is not necessary to show that competitors must first exit a market or even that they lost market share before harm. All that is required to be shown is that Telkom's conduct was likely to result in preventing or lessening competition which would include the impeding of

[63] Walt witness statement p 99 and Hodge witness statement p 498 of CWB.

[64] See our approach to section 8(d)(i) set out in The Competition Commission v SAA (Pty) Ltd , CT Case No: 18/CR/Mar01 at para 99-100

competition.[65] The VANS market was a growing market and the VPN segment in particular was growing in leaps and bounds. All the players were enjoying some growth. It would be sufficient to show that Telkom's conduct was likely to substantially impede competition.

100. The conduct complained of here was that Telkom insisted that the leased lines be registered in the names of the end users and that VANS providers could only obtain these from Telkom through agency agreements. Telkom did not deny the conduct but claimed that it required this in order to comply with the prohibitions on sub-letting and ceding.

101. This issue has also been decided against Telkom by SATRA and later ICASA in the IS and AT&T matters and the illegality defence is not available to Telkom.

102. But even if we assume for arguments' sake that this was not the case, Telkom's own regulatory department held the view that Telkom's interpretation of the law was not necessarily clear and unchallengeable.

103. It was accepted by Telkom that under the prevailing regulatory framework VANS providers could under their VANS licenses, provide value added network *services* as well as build value added service *networks*. This is why we see in the memo by Telkom's regulatory department with specific reference to Omnilink Telkom's the view that *" it could possibly be argued that the access circuits are part of a VANS network whose use by VANS customers would constitute due and proper use to access the value added service".*

104. Recall that prior to this "illegality" claim and the WAR strategy, the revenues collected by independent VANS providers from their customers was passed onto Telkom by the VANS providers, an arrangement that suited Telkom. During this period Telkom did not offer a wholesale price for access services to independent VANS but treated them as retail customers. The VANS providers made no margin on leased lines but collected the cost from their customers and passed this over to Telkom. Telkom, on the other hand, received its revenues from leased lines without carrying the credit risk. That some within Telkom saw the benefit of this was expressed in the memo discussed earlier.

105. Yet, despite its own view that VANS providers could build their own networks and that Telkom's revenues from access lines was not threatened, Telkom insisted as part of its WAR strategy, and at huge inconvenience and cost to everybody, that end customers contract directly with it. The obvious gain that Telkom wished to achieve with this strategy and expressed by it in its WAR strategy was to "own the customer".

106. There is no doubt that the customers of VANS providers were hugely inconvenienced by Telkom's insistence (requirement) that they contract directly with Telkom for their access lines. Lines had to be transferred from the VANS providers' names to those of the customers resulting in delay, increased costs and increased administration for both the VANS providers and their customers.

[65] See Nationwide Airlines (Pty) Ltd and Comair Ltd v SAA (Pty) Ltd, CT Case No 80/CR/Sept06, at par 184

107. But Telkom did not just stop there. Telkom in fact approached the customers of independent VANS to dissuade them from contracting with them on the basis that they were engaging in illegal activities. Telkom does not deny this conduct. Two such examples related to Firstnet and Omnilink. The AA, a customer of Firstnet, advised Firstnet in writing that Telkom had approached it and had informed it that the VANS providers were acting illegally. The AA expressed grave concerns about the future of their business with Firstnet and the impact any of Telkom's actions might have on the AA's business. On 20 July 1999 Omnilink received a letter from Proactive its customer advising that Telkom had its local lead applications but was refusing to proceed with them until the "issues" with the VANS providers had been sorted out. These applications had been submitted by Omnilink on behalf of Proactive. The customer subsequently informed Omnilink that it would not put its business at risk in any way and that it would proceed with the Telkom infrastructure upgrade directly. The inducement here was not in the form of discounts or favourable terms but a campaign to instill uncertainty in the minds of the VANS's customers about the risk to their business.

108. Telkom did not raise any technological, efficiency or pro-competitive gains in respect of this conduct. Its central defence was that the VANS were acting illegally and infringing on Telkom's exclusivity. This issue had been decided against it by SATRA and ICASA and Telkom's own regulatory department noted that the alleged illegality claim could be challenged.

109. Telkom's conduct in insisting that access lines be transferred into the names of the end customers and that VANS operators act as agents for them, together with Telkom's approaches to customers of independent VANS providers with claims of illegality was designed to induce customers not to deal with Telkom's competitors in the VANS market and resulted in a substantial lessening or prevention of competition in that market. Telkom provided no pro-competitive justification for this conduct. Its claims of illegality have been decided against it. In light of all of this we find that Telkom had contravened section 8(d)(i) of the Act.

Pricing conduct

110. The Commission alleges that Telkom's conduct in the pricing of access facilities or circuits, contravenes section 8(a) and 9(1) of the Competition Act.

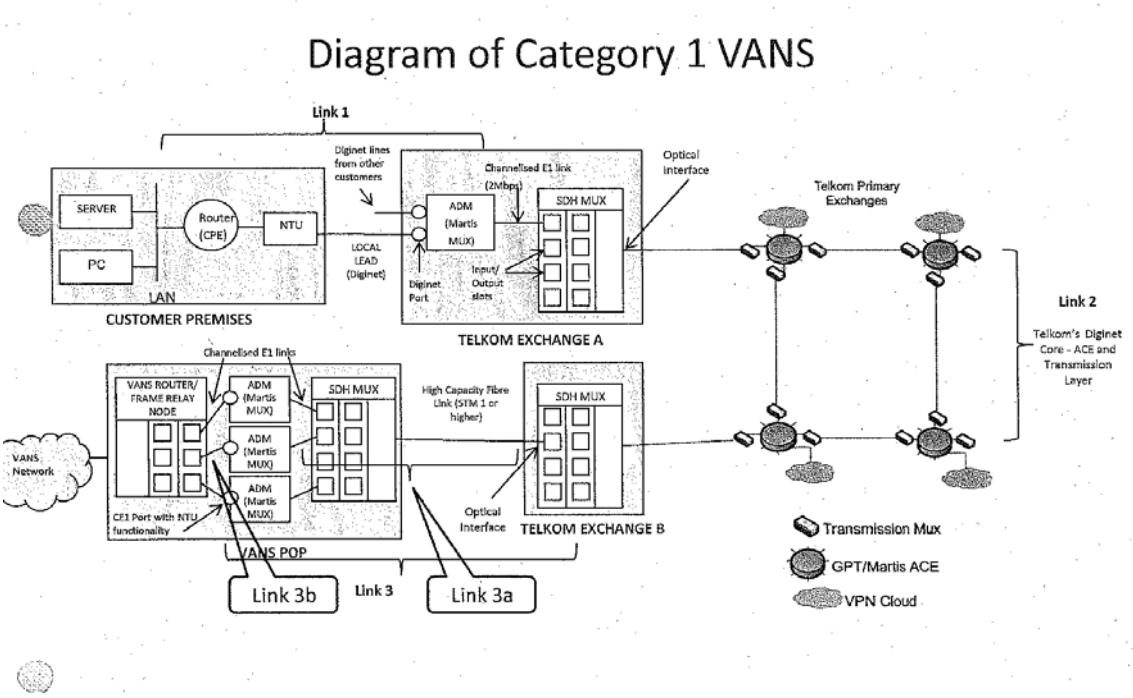
111. The proceedings in relation to the pricing conduct involved extensive technical evidence. A brief overview of the relevant network architecture follows.

112. VANS providers' PoPs can be classified into three main categories, referred to as category 1, 2 and 3, depending on how they connect to Telkom's local exchange. For each category Telkom's equipment hosted at the VANS PoP as REE (Remote Exchange Equipment) differs.[66] The bigger VANS sites that receive large volumes of traffic and

[66] For category 1 the REE consists of Synchronous Digital Hierarchy (SDH) as well as Add Drop Multiplexers (ADMs, often referred to as Martis MUXs), for category 2 the REE consists of only Martis MUX and in category 3 there is no REE.

realise the highest scale efficiencies are categorised as category 1 VANS and the VANS service providers that receive low volumes of traffic and where no scale efficiencies exist are categorised as category 3 VANS.

113. We will only focus on a category 1 VANS provider to illustrate how data originating from the end customer's premises travels through the network to the VANS PoP, as set out in the diagram below. This is called an access circuit or link.



114. The circuit consists of three separate links, link 1, 2 and 3. Link 1 connects the end customer's premises to the nearest Telkom local exchange A, link 2 connects Telkom's local exchange A to Telkom exchange B, which is the nearest Telkom exchange to the VANS PoP and link 3 connects Telkom exchange B to the VANS provider's PoP.

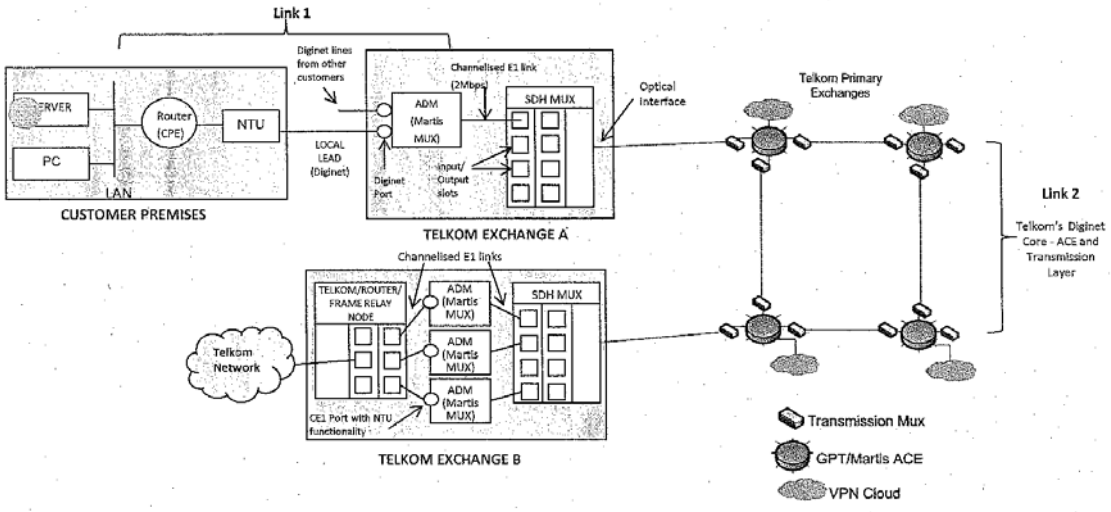
115. Link 1 starts at the customer's premise. At the customer's premise is a Router that performs a gateway function and which can either belong to the customer or to the VANS service provider. The Router is the link between the wide area network to the right in the diagram and the customer's local area network to the left of the Router. The Router connects to a NTU (network terminating unit) which serves as a 'plug' to which the local lead connects. The NTU is also within the premises of the customer. The NTU is connected to a pair of local leads which are two pairs of copper that form an electrical loop between the customer's premise and terminates on a port on the Diginet multiplexer, called time division multiplexer technology (TDM) that is located at the nearest Telkom exchange A . The TDM device multiplexes all the individual Diginet circuits coming from various customers' premises into a single E1 link of 2-megabit per second capacity, a high capacity link, which then connects to a higher order MUX, the SDH MUX. The SDH MUX consists of various input/output slots and it multiplexes the

Channelized E1 links into an optical fibre based link for transmission over Telkom's network. These are high capacity links starting from 155 Mbps.

116. Link 2 is part of Telkom's internal transmission network, Telkom's Diginet Core. From the SDH MUX the data goes to the nearest ACE enabled exchange (depicted by the circles in the diagram). ACE stands for automatic cross connecting equipment and it takes the 155 MBs coming into it and unscrambles it into individual 2 megabit per second circuits to be routed into different directions. It connects the data to where it needs to go and then multiplexes it again before it sends it to the next ACE, if necessary, or directly to exchange B. The higher order Mux in Telkom exchange B will again take the 155 Mbs link and unpack it into individual 2 Mbs links and feed it into individual Martis Muxes at this exchange.

117. Link 3 involves connecting the data line from Telkom's exchange B to the VANS' PoP after travelling over Telkom's network and reaching Exchange B. Link 3 is divided into link 3a and 3b. It is common practice for larger VANS providers to host Telkom's SDH equipment and Martis MUXs within their PoP owing to the large volumes of traffic received by them. This allows the VANS provider's PoP to be connected from exchange B by means of a high capacity STM link, 155 Mbs link, instead of connecting each customer individually from the exchange, link 3a. It is then deployed into a higher order Mux that at the VANS' premises that break it up into 2 Mbs links that are fed into individual Martis Muxes, channelized through multiple E1 links.

Diagram of Telkom access links to its own networks



118. Not all Telkom exchanges were in fact PoPs and therefore an additional link (Link 2) would have to be installed to connect the end customer to a PoP enabled exchange. Link 2, as represented in the Telkom diagram, is a simple representation of a circuit that may have had to travel across many exchanges in order to reach a PoP-enabled Telkom exchange. Telkom claims that the difference in the architecture of the access circuits is that there is no need for link 3 for Telkom's own customers because they would not need to be connected to a third party PoP and that they would instead be

connected directly to the Telkom cloud. The essential difference between the two architectures would then only be link 3.

119. The Commission alleged that Telkom charged prices to independent VANS' customers that amounted to both excessive pricing and price discrimination. It was alleged that Telkom charged VANS providers a flat fee and a per kilometre rate (distance charge) for link 2 whilst Telkom's VANS customers were charged only a flat rate. In relation to Link 3, it was initially alleged that Telkom charged its own VANS customers about half of what it charged independent VANS and their customers for the rental of end connections which consist of NTUs, local lead and Diginet ports. During argument this was narrowed down to allege that Telkom charged VANS' customers with a port charge when no such charge was levied against Telkom's own customers.[67] As a result the rate charged by Telkom to its own customers was significantly lower than the rate applied to the customers of an independent VANS provider. The Commission argued that taken together Telkom's pricing amounts to price discrimination in that it charged the independent VANS customers more than its own customers for equivalent services. It also argued that the price charged to the independent VANS customers is excessive on an inferential basis. In other words because the lower price charged by Telkom to its own customers was profitable for Telkom, the price charged to independent VANS customers was clearly excessive.

120. Telkom opposed the Commission's excessive pricing allegation on the basis that its pleadings were defective in that they did not comport with the test set out by the CAC. In relation to the price discrimination Telkom denied that it charged the VANS customers for components of link 3 as alleged by the Commission. In relation to link 2 Telkom admitted that it did not charge its own customers a distance charge but claimed that this was for two reasons - one that it did not wish to discriminate between its customers and that the diginet service of independent VANS (which it calls point to point) differs from the service provided by Telkom to its own customers (which it calls point-to-cloud) as set out above. Link 3a is not present in Telkom's VANS service.[68]

121. Moreover, it argued that the difference in price was justified by a difference in cost in delivering the service to its own VANS customers as opposed to VANS customers. However, during pre-trial preparations in 2011 Telkom indicated to the Tribunal that it was not going to use cost as justification for its alleged price discrimination conduct anymore. It withdrew the cost justification and did not offer any alternative justification for why the transactions are not equivalent apart from its point- to -point and point -to -cloud argument.

[67] The pricing allegations regarding link 3 was narrowed during cross-examination of Brierley and Van Huysteen so that only this issue remained.

[68] According to Telkom a point-to-point service originates at a customer's premises and terminates at the independent VANS premises. A point-to-cloud service also originates at a customer's premises but terminates at a Telkom premises. See T 1387

122. Telkom's expert witness, Edwards, later pointed out that the Commission was essentially alleging a margin squeeze case rather than a price discrimination case and that if the Commission's expert wished to understand whether Telkom's pricing was potentially exclusionary he should have compared the prices of Telkom's full VPN bundles with the VPN bundle prices that Telkom would be able to profitably charge if it had to buy end-to-end Diginet leased lines from itself. If the former is less than the latter, there may be what is called a margin squeeze with respect to those bundles. During 2010 the Commission did seek to amend its pleadings to include a margin squeeze contravention but the Tribunal dismissed the application on the basis that the Commission's pleadings lacked the necessary averments for it to comply with the Tribunal Rules. However in that ruling the Tribunal did give the Commission directions on how to rectify the deficiencies in its pleadings, guidance that the Commission. The Commission elected not to pursue this.

Section 8(a) Excessive pricing

123. Section 8(a) provides that it is prohibited for a dominant firm to charge an excessive price to the detriment of consumers. An excessive price is defined in section 1 (ix) as a price for a good or service that bears no reasonable relation to the economic value of that good or service. In *Mittal Steel v Harmony*[69] the CAC held that the Tribunal had erred in its approach when it found that Mittal had charged an excessive price without establishing that "the economic value of the good or service". In order to ascertain this one had to make factual determinations of the actual price and the economic value as well as a value judgment on whether the difference between the actual price and economic value is unreasonable and to the detriment of consumers. The court held that a fairly robust approach may have to be taken to do the empirical enquiry and that this could be determined in a variety of ways such as comparing prices of roughly similar products, looking for price increases where there was no corresponding rise in costs, or comparing prices of the same firm or other firms with broadly comparable cost structures at comparable levels of output if the other markets are shown to be, or can be assumed to be characterised by effective competition in the long run. These exercises necessarily involve taking account of price and cost of supply. The matter was remitted to the Tribunal to determine the "economic value of the good or service".

124. The Commission's pleadings failed to allege what the economic value of the good or services were as required by *Mittal*.[70] It only alleged that Telkom was providing access to its customers at prices which were cheaper than those charged to private VANS providers and their customers, namely 1) Telkom customers only paid a flat rate while private VANS' customers paid a distance charge on top of a flat rate and 2) Telkom charged its customers about half what it charged private VANS providers' customers for

[69] Mittal Steel South Africa Ltd and others v Harmony Gold Mining Company Ltd and another, CAC Case No: 70/CAC/Apr07

[70] This was pointed out by Telkom in its answering affidavit in April 2010.

the rental of end connections. Without comparing these prices with any measure of economic value the Commission concludes that since the prices at which private VANS customers were being charged were higher than those charged to Telkom's own VANS customers the prices were excessive. What the Commission was effectively arguing was that the price Telkom charged its own customers could be deemed to constitute the economic value. [71] Recall that the "structural approach" taken by the Tribunal in that case was rejected by the CAC as being inconsistent with the provisions of section 8(a) of the Competition Act. Notwithstanding the pleading problem the Commission persisted with the particulars of the complaint as was referred in 2004 but did not lead any evidence that these charges were indeed the economic value of the access circuit as required by *Mittal*. Accordingly we do not have enough information to conclude that these charges could serve as a proxy for economic value. On this basis alone the Commission's excessive pricing allegation – in relation to the entire access circuit charges (link 3 and link 2 charges) must fail.

125. However during the hearing additional difficulties emerged in relation to the component charges of link 3. There was an acceptance by the Commission's expert technical witness, Mr Brierley, that Telkom was entitled to charge for components that were necessary. However it became difficult to pinpoint what components were necessary. Technical justifications were provided by Telkom for almost every change and charge it made to link 3. The lack of supporting documentary evidence in the form of invoices or purchase orders also made it harder to identify specific instances of such over-charging. No doubt the Commission's task was made more difficult because so much time between the lodging of the complaint and the hearing of the merits had elapsed. People had moved on, companies had been bought and sold and documents had been archived or left behind.

126. Accordingly we make no findings in relation to the excessive pricing allegations and to the charges in relation to link 3 and assume for purposes of our assessment under section 9(1) below that the only relevant price difference between the two respective access circuits for consideration by us was that Telkom charged VANS customers a distance charge on link 2 whereas it charged its own customers a flat rate. It is not surprising that VANS providers were suspicious of Telkom's pricing in respect of Link 3 which was opaque and lacking in transparency. That said this is not sufficient to prove that technically the difference in the provision of services at this stage justified the distinction. For this reason we can make no finding that the differential treatment in respect of link 3 amounted to excessive pricing or price discrimination. This then leaves us to assess whether Telkom's distance charges to VANS customers in relation to link 2 constituted price discrimination and a contravention of section 9(1).

[71] In January 2011, at a very late stage of preparation, the Commission sought to amend its pleadings in order to meet the *Mittal* test based on legal advice do so. However, the Tribunal did not grant the application on the basis that the Commission had failed to properly explain the late application.

Section 9(1) Price Discrimination

127. In terms of section 9(1) of our Act price discrimination is prohibited when there is a reasonable possibility that the discrimination in price for the sale of goods or services in equivalent transactions would substantially prevent or lessen competition.[72]

> *"9.1 An action by a dominant firm, as the seller of goods or services is prohibited price discrimination, if-*
>
> *(a) It is likely to have the effect of substantially preventing or lessening competition;*
> *(b) It relates to the sale, in equivalent transactions, of goods or services of like grade and quality to different purchasers; and*
> *(c) it involves discriminating between those purchasers in terms of –*
>
> *(i) the price charged for the goods or services;*
> *(ii) any discount, allowance, rebate or credit given or allowed in relation to the supply of goods and services;*
> *(iii) the provision of services in respect of the goods or services; or*
> *(iv) payment for services provided in respect of goods or services."*

128. Recall that Telkom had initially in its answering affidavit invoked a defence of differential costs under 9(2) but had later revoked it.

129. At the hearing Telkom argued that the transactions were not equivalent in two respects. First, Telkom argued that it was not offering the "equivalent service" to independent VANS and their customers as to its own VANS customers. Telkom argued that when it provides Diginet leased lines to independent VANS providers and their end-customers Telkom provides a point-to-point (end-to-end) service that connects one non-Telkom customer's site to another non-Telkom customer's site.

130. Second that Telkom sold its access lines to its own customers as part of a bundle. The Commission was seeking to compare the stand-alone prices charged by Telkom to independent VANS providers and their end-customers for end-to-end Diginet lines with the "notional prices" charged by Telkom to its own end-customers for Diginet access links. Prices to its customers for the access circuit were notional, because the access circuit was sold with the VPN service in a bundle. To its own customers it offers a bundled product consisting of access links and the VPN, thus a point-to-cloud service. Its clients could thus not purchase these items separately and there was no stand-alone price for the various items of the VPN bundle. In the case of FrameRelay although component items were listed separately in its price list the end-customer could still not purchase the items separately. The effect of this was that Telkom was able to cross-subsidize within the core when pricing its point-to-cloud service for its own customers. What it lost in the access circuit it recouped in the VPN cloud. Furthermore an access circuit was sold as one indivisible circuit. There was no market for elements of the

[72] See also *Economics for Competition Lawyers* by Gunnar Niels, Helen Jenkins and James Kavanagh, p 215

service. A customer could not buy link 1, 2 and 3 separately. Therefore a difference in price on link 2 only as a component of the access circuit could not be a subject of a price discrimination claim.

131. The bundling argument was first raised by Telkom's expert witness statement and not in Telkom's answering affidavit or factual witnesses. At that stage only the distinction between point-to-point (end to end) and point to cloud distinctions were drawn. Dr Edwards put forward the theoretical possibility of bundling and recoupment. It was argued that FrameExpress, the Telkom service equivalent to the VPN service provided by independent VANS, was sold as a bundle, in the same way as a pair of shoes. A customer paid a single price for the two shoes say R100. Whether the price of each shoe was R50 each or the one R10 and the other R90 was immaterial to the customer because she paid a single price for both. The price that could be attached to either shoe in the pair was therefore "notional".

132. Van Huysteen in his oral testimony during the hearing acknowledged that the service offered in Link 2 was *exactly the same for VANS customers as well as Telkom's customers and that it consisted of two charges, a fixed charge and the distance charge*. He explained that the distance component was calculated as the crow flies, between premises A at the entry point and B the exit point. If a longer route was followed it was not taken into consideration. The difference between the Telkom VANS and the independent VANS only lay in the billing of the link 2 service.[73] For its own customers Telkom decided to zero-rate the distance element because customers at further distances were "complaining" because Telkom did not, for commercial reasons, have a PoP in each exchange which meant that some of its VPN customers who did not have a PoP closer to their site would pay more than a customer who did. For instance, a Johannesburg company with a branch in Nelspruit's closest PoP would be in Pretoria, for which it would have to pay a distance charge, while the company's branch in Pretoria would not be charged a distance charge. To Telkom it therefore made sense to drop its distance charge in order to offer the service to all its customers on an equal basis rather than deploying a very expensive VPN PoP in Nelspruit where it only had two or three customers.

133. However he then advanced the bundling and recoupment theory, an explanation that had not been previously advanced in his witness statement. He alleged that Telkom could drop the distance charge because it could *recover the revenue in the point-to-cloud pricing methodology but not in the end-to-end Diginet service that it was selling to VANS*. Therefore, although the *service offered in Link 2 was the same* the lost revenue could only be recovered in the point-to-cloud service model and not in the point-to-point service.[74]

[73] See T 1565

[74] See T 1571

134. There was some elision between the notion of a bundle (where two items are sold together) and the point-to-cloud distinction (which was perhaps better suited to a justification for link 3).

135. Several factors militate against the bundling theory (counter-balancing) and suggest that it was nothing but a recent fabrication by Telkom.

136. First Telkom's own explanation as to why it elected to drop the distance charge does not bear out a bundling theory. In his witness statement Van Huyssteen explains that Telkom did not charge the distance rate because "*it would have meant charging [its own] different end customers different prices for what was (and accordingly regarded by the end customer to be) the same service*". He explains further that this would have contravened its PSTS licence. Although this explanation that different charges for the same services would amount to undue discrimination in itself is unsatisfactory – after all nothing prevented Telkom from levying different charges for services with different costs for example local and long distance calls[75] - nowhere is the bundling and recoupment explanation provided. Van Huysteen simply insists on making the point to point and point to cloud distinction. This is a man who has been at the helm of the Managed Data Network Services in the Product House Division of Telkom and with his experience and qualifications he would be expected to have a thorough knowledge of the product and would be best placed to know if such recoupment was in existence.

137. No evidence was led that the "bundle with the two components would cost RX". The evidence, in fact as confirmed by Telkom's own witnesses, was that the components were always priced separately.

138. Third - and as much as Telkom wished to package it as such for purposes of its challenge to the independent VANS – Frame Express was not a typical basic "PSTS" service and could not be sold "off the shelf" like a pair of shoes.[76] By definition the service involved connecting premises of a customer located in different geographical locations to either a head office and/or a central data centre. The complex network of each customer and the bandwidth requirements and the consequential costs would be different. Customers contracted for different committed information rates at different prices. Even if the customer contracted for a basic connectivity rate the cost of the service would be affected by a customer's needs for expansion, contractions, redundancies and speed. No explanation was forthcoming from Telkom how it would sell the same bundle for purposes of expansion and contraction and how it would recover losses associated with contractions or changes in network design.

[75] Telkom like all licensees was required not to discriminate *unduly* between customers. Operators were and are entitled to charge different prices for the same or similar services when they can show different costs. This is an accepted principle under both telecommunications and competition law. It is a principle used by Telkom and accepted by the regulator in pricing for basic services.

[76] See document where Telkom says that ATM which was a more technologically advanced technology in the VPN/data space must be marketed as a "PSTS".

139. Fourth, in the thousands of documents that had been discovered by Telkom not one shred of evidence in the form of product documents, internal strategic documents or financial management reports was placed before us to support the theory of bundling and recoupment. That an organisation the size of Telkom would not have such memoranda or information is highly implausible. Indeed Van Huysteen conceded that Telkom would have to support this theory by showing us relevant revenue figures showing the loss and extent of recoupment, none of which were placed before us.[77]

140. Finally the exercise done by Hodge puts paid to this theory of counter-balancing. Hodge, the Commission's expert, said that he could not find any pricing evidence showing that Telkom had recouped the distance charge in its VPN core. In reaction to Van Huyssteen's late explanation that costs in Link 2 are recouped in the core/cloud, Hodge prepared a schedule, Exhibit 16.6, showing the margin in the cloud from which Telkom might be expected to recoup the distance charge. In it Hodge examined the rates of charging in the cloud and showed that the revenues recovered were wholly insufficient to cover the decrease in revenues resulting from the change. Moreover, Hodge argued that as more and more customers in remote locations joined Telkom's VPN offering the result would be to unsettle and so distort the average-based equilibrium initially created. The under-recovery in the cloud would thus worsen pulling the re-balancing out of line because the average distance that was used for recovery purposes was necessarily lower than the actual average distance that then prevailed. The schedule was put to Dr Edwards for comment, but he declined to engage with it because he "lacked the time".[78] No actual revenue or margin information was put up by Telkom, but at the level of principle one can accept Hodge's reasoning that as more and more customers in remote locations joined Telkom's VPN offering, the cost of that would increase leaving less behind for recoupment in the core.

141. Even if we are to assume that Telkom's product was in fact a bundle then the proper comparison would be to compare equivalent bundles between Telkom and the VANS providers' bundles and perform a cost price analysis in order to arrive at a determination of anti-competitive conduct in contravention of the Act.[79] No such comparison could be conducted because Telkom resisted the production of its cost information. Van Huysteen himself conceded that in order for Telkom to show that it in fact recouped its losses in the access from the cloud, it would have to put up revenue and cost figures to support this - which it failed to do.

142. In summary Telkom's bundling and recoupment theory was not a credible one and was not supported by its own evidence.

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[77] T1638 - 1639

[78] For an economic expert claiming to be independent and wishing to assist the Tribunal in its truth finding function, Dr Edwards demonstrated a rather disappointing un-cooperative attitude in these proceedings

[79] See *Economics for Competition Lawyers* p 260 and Lear Competition Notes: "*Which Test For Bundled Discounts",* Massimo Tognoni and Cristiana Vitale September 2009.

143. This leaves us with only one issue to consider namely whether the access circuits of VANS customers and Telkom's customers were equivalent transactions for purposes of section 9(1). Telkom maintained that the transactions are not equivalent because it provided a point-to-point Diginet service to the customers of VANS in which end to end connections are provided (link1 and link3) and the rental of which is charged at a fixed and distance-dependent rate (link 2). In contrast the sale of access services to its own customers consists of a point-to-cloud service which requires only one end connection (link 1) and the rental of which it charged at a fixed distance-independent rate (link 2).

144. The requirement of "equivalent transactions" for purposes of a price discrimination case is not easy to establish.

145. The notion of equivalence has been considered by the Tribunal previously. In *Nationwide Poles v Sasol Oil* the Tribunal opined that functional equality (ie the same thing such as business class seats) did not necessarily result in equivalence in the sense that their economic effect is different.[80]

146. O'Donoghue and Padilla suggest that whether transactions are equivalent or not should be looked at in the light of all the circumstances and cannot be assessed solely from the perspective of either the dominant firm or its trading parties –

146.1. "*In principle all relevant evidence should be looked at in determining whether transactions are equivalent including the physical or chemical composition of the products, their functional or performance characteristics, physical appearance and the extent to which they are fungible*." [81]

.

147. Functional or physical equality at least provides us with a starting point to assess equivalence. This is a basic requirement by O'Donoghue & Padilla. But the compared products need not be identical in all respects as long as the essence of what is provided to one customer is similar to that provided to others.

148. Telkom's witnesses, while accepting that these access services were *the same*,[82] persisted with the distinction between point-to-point and point-to-cloud.

149. This reliance on a technical terminology to distinguish the two services can be misleading and certainly can cloud issues. With a few adjustments these alleged technical differences could disappear. For example in instances where Telkom has installed a REE (remote exchange equipment) at the VANS PoP the PoP effectively becomes a local exchange and the service to that PoP could conceivably be called a point-to-cloud service. In addition Telkom does not have a PoP in every exchange and

[80] Nationwide Poles v Sasol Oil CT Case No: 72/CR/Dec03 Para 132. See also *Bulb Man v Hadeco, CT Case No:* 81/IR/Apr06

[81] O'Donoghue R & Padilla A J "*The Law and Economics of Article 82 EC*" (2006) Hart p 563

[82] See Van Huysteen T1571

hence link 2 is required for both Telkom and the independent VANS end customers. Conceptually it could be argued that Telkom is providing access lines (access services) from customer premises to a PoP in order to access a VPN service. Technically for the customer in for e.g. Nelspruit the comparison would be to the nearest VPN POP in Johannesburg.

150. However given our findings in relation to harm discussed below we find it unnecessary to conclude on the notion of equivalence.

151. In telecommunications regulation access links to services rendered by vertically integrated telecommunications operators – whether these are in the internet or managed data space - have been identified as a market warranting regulation by regulators the world over. The underlying theory of harm that such regulations seek to address is that of a dominant firm leveraging its upstream monopoly power in a downstream competitor sector to disadvantage its competitors by a number of tactics which could include price discrimination, quality degradation, raising rivals costs, refusing to provide wholesale tariffs and refusal to supply essential inputs.[83]

152. Pricing behaviour such as discrimination by a vertically integrated monopoly provider against its downstream rivals is consistent with the economic and regulatory literature which suggests that this is likely to occur in situations where a dominant operator of an upstream input also competes in the downstream market that makes use of the input.[84] If rivals in the downstream market are placed at a cost disadvantage then the dominant firm could achieve market power in the downstream market.[85] Such conduct is recognised by the vast majority of telecommunications and competition law regulators as evidenced by their efforts to regulate dominant operators in access markets. So much so that *ex-ante* regulation of access to facilities has been introduced in almost every jurisdiction, including South Africa, in anticipation of such complaints.[86] Often these dominant firms are obliged by law to provide facilities on an equal or non-discriminatory basis.[87]

153. However from an anti-trust perspective, the economic objective of pricing conduct of a vertically integrated dominant firm is highly relevant. Such a firm may engage in price discrimination or quality degradation (form of conduct) but its intended effect may be to raise rivals costs or to induce customers not to deal with a competitor. All these would

[83] Telkom now offers wholesale infrastructure products to its VANS competitors

[84] See William H Melody *Telecom Reform* 1997, *Telecommunications Regulation Handbook* (Ed Hank Intven) 2000. See also *Thornton et al*.

[85] See also O 'Donoghue R and A J Padilla (2006) 344

[86] See ICN Guidelines. See also EU Access Directive, EU Access Notice, Ofcom Guidelines, Section 67(1) of the Electronic Communications Act of South Africa and s53 of the Telecommunications Act of South Africa.

[87] See for example section 43 and 44 of the Telecommunications Act and the regulations thereunder.

be aimed at placing competitors at a cost disadvantage and be considered as exclusionary conduct.[88]

154. That Telkom had achieved something along these lines with its flat rated discount to its own customers was confirmed by it -

154.1. " *FrameExpress is still growing at more than 30% per annum... All the current VANS are using Frame Relay networks to compete with Telkom and we can expect that this trend will continue over the next few years. Our pricing strategy on FrameExpress up to now has been very successful in that the VANS are feeling the impact of our flat rated access, as well as the fact that our usage component is fixed. We even had a complaint lodged at ICASA against Telkom by SAVA as they were losing business as a result of our pricing*".[89]

155. The disadvantage to VANS providers notwithstanding, one of the difficulties experienced in this matter was that it appeared at times that the Commission was advancing a margin squeeze case (as alleged by Dr Edwards but not pleaded by the Commission) or a section 9(1) case but relying to a large extent on link 3 in making its equivalence argument.

156. The Commission's pleaded case was that Telkom's conduct caused harm to consumers. However in the presentation of its case it was not quite clear whether harm was alleged to have been caused to the consumer or the VANS intermediary. The Commission's expert Hodge concluded that the cost disadvantage to independent VANS providers was significant and that the total price charged by independent VANS providers for a VPN solution would be 40% higher than Telkom's final price thereby suggesting a margin squeeze or raising of rivals costs.[90] It appeared to us from the evidence of Brierley that this cost was recovered from end customers by the VANS operators. However it wasn't clear whether or not all the costs were recovered. Price discrimination often leads to mixed outcomes, with some gains and some losses. Intermediaries may lose but consumers may gain, some consumers may lose and others may gain. In this instance it was not easy for us to determine the net impact on competition.

157. For all the above reasons we cannot find a contravention of section 9(1).

158. Another way of assessing Telkom's price discrimination conduct would be to view it through the lens of section 8(d)(i). Recall that Telkom was insistent on transferring access lines directly into the names of end customers despite the fact that it was recovering revenues for those lines from VANS operators. Once thus regime was in place Telkom had direct access to the end customers of independent VANS operators –

[88] In our legislation this would be under sections 8(c) and 8(d) rather than section 9(1)

[89] Telkom Corporate and Global Segment Pricing Strategy 2002- 2003 CCB 3, p 1089

[90] See Hodge witness statement CWB p 463

they were now *Telkom's* customers for access services. Telkom was now able to approach the erstwhile customers of the VANS operators directly with the promise of a distance discount on Frame Express if they were willing to switch to Telkom. That this was the most probably objective of the flat price strategy is confirmed by Telkom itself when it claimed that FrameExpress was growing and the VANS providers had lost business. But this was not the case advanced by the Commission. The Commission did raise a concern that after the migration of access lines into the names of end customers, Telkom would have access to the customers of independent VANS. But it stopped short of linking this to the pricing conduct of Telkom. This is probably why no evidence was led from customers to the effect that they were indeed approached by Telkom with the discount or had switched as a result of the offer. Without the evidence of end customers we are unable to determine whether or not this conduct also amounted to a contravention of section 8(d)(i).

Conclusion on merits

159. We find that Telkom has contravened sections 8(b) and 8(d)(i) of the Competition Act.

160. The real issue in the dispute claimed by Telkom was not a gap or grey area in the regulatory framework or the legality or otherwise of VPNS but rather that the independent VANS had managed to acquire large corporate customers because – as conceded by none other than Klopper under cross examination - they were more efficient and cheaper than Telkom and provided service level agreements to customers when Telkom didn't.[91] Unlike the lumbering Telkom they were nimble and responsive to their customer's needs. They were able to earn margins that Telkom could not because they had the "mission critical skills" that Telkom lacked. Post exclusivity they were uniquely positioned to switch a large customer base to Telkom's competitor's facilities. Post – deregulation they would be able to provide a larger number of services, including voice, to their customers. This competitive threat posed by these VANS was identified early on by Telkom in its WAR strategy.

161. More importantly in an industry with network effects, VPNS in the post deregulation market represented the greatest threat to Telkom's revenues because the provider could upsell any new services to its customers. Once the section 40(2) restrictions were lifted by the Minister and with convergence on the regulatory horizon, these VANS providers would also be able to provide voice and VoIP services to their customers and could effectively compete head on with Telkom thus threatening Telkom's traditional revenue base. [92]

162. This is also why, as part of its strategy, Telkom endeavoured to "delay" the resolution of the regulatory dispute by SATRA and ICASA. Every decision of the regulator which went against Telkom's interpretation of its exclusivity and the VANS/VPN debate was

[91] As conceded by Klopper, see T 1227 - 1229

[92] See our discussion on MDNS and convergence in the VPN space in Telkom & BCX.

challenged by Telkom in the High Court.[93] Despite these rulings by SATRA & ICASA, Telkom insisted that VPNS were a PSTS and not VANS and took the law into its own hands.

163. Having taken the law into its own hands, Telkom enforced its exclusivity rights (as claimed by it) acting as judge, jury and enforcer in a selective manner. It elected not to switch off the VANS providers which it claimed were acting illegally but instead found a strategy to squeeze their expansion. Telkom's counsel submitted that Telkom adopted the "freezing" tactic rather than switching them off completely because it wanted to give them a "taste" of what could happen. This view was also expressed by Green. However Green conceded that Telkom was concerned about losing revenues by a complete switch off.[94]

164. But imagine the complete and utter outcry a complete switch off would have caused. Banks, government, stock exchanges, mines, airports, manufacturers – indeed the entire economy of the country would have come to a standstill had Telkom elected to switch off these VANS. Telkom would not have been able to survive the fallout of such a decision.

165. Being mindful of this, the strategy it adopted was carefully constructed so as to avoid such a reaction but also to preserve significant revenues in the upstream infrastructure (facilities) monopoly market and to retard the growth of competition in the downstream competitive VANS market. It was also designed to prevent the VANS providers from resorting to self-provision in terms of section 44.[95] In terms of that section if Telkom refused or was unable to provide the facility, a requester could under certain conditions self-provide after obtaining permission from ICASA. Telkom's policy also sought to block this option for its VANS competitors.[96]

166. While Telkom bullied its downstream competitors into line, it exploited to its advantage, the very alleged grey area in the regulatory framework and new technologies to subvert the requirement by the regulator of separate cost accounting for its PSTS and VANS services. Telkom engaged in voice and data integration although its exclusivity extended only to infrastructure provision and voice services and despite the requirement of separate accounting. We see in Telkom's marketing documents for ATM products (VPN products) it is at pains to state that the product must be marketed as a PSTS product, a completely unnecessary decision if the product was as claimed by Telkom a PSTS product. [97] At the same time it was able – and this was the ultimate aim of the WAR strategy – to migrate VANS customers onto its own networks. Recall that the

[93] See the four judgments included in Telkom's Core Bundle 11 at p 4404, 4435, 4465 and 4476

[94] Green T 1773 - 1774

[95] In terms of that section if Telkom refused or was unable to provide the facility, a requester could under certain conditions self-provide after obtaining permission from ICASA. Telkom's policy also sought to block this option for its VANS competitors

[96] See that earlier policy about "SATRA is very busy etc"

[97] See CCB 3, p 1007

freezing of their networks brought many a VANS to the table to negotiate with Telkom. These operators handed over sensitive information about their networks and customers to Telkom and were required to re-configure and re-arrange their businesses to the dictates of Telkom. [98]

167. Frame Express was Telkom's own VPN offering. The objective of the normalization process was to benefit Telkom by inter alia taking over the entire customer base of a VANS provider and transferring the base onto Telkom's Frame Relay network, insisting that the connection between the VANS and its customer take place on Telkom's Frame Relay and/or require the transfer of the facilities back into end-users names so that these would become Telkom's customers.

168. During this normalization Telkom also sought to introduce new contractual terms for the provision of facilities to VANS, the effect of which was to bypass SATRA and to provide Telkom with private law remedies in the event of a breach. In fact in relation to VPNS, and in order to bypass SATRA's ruling, there was a suggestion that Telkom specifically prohibit the use of the facilities for VPNS in its contract terms. [99]

169. As we can see the normalization process, and the methods through which Telkom achieved this – namely the undertakings it sought from these VANS and a subsequent freezing of networks if this was not obtained - was nothing more than the fulfillment of the objectives of the WAR strategy namely that Telkom, through its VANS division, would provide Total Business Solutions to large corporates and would own the customer.

170. Much was made by Telkom about the universal service obligations imposed on it by the Minister and later ICASA as some kind of justification for its conduct. But this justification is unsustainable because the universal service obligations imposed on Telkom were a *quid pro quo* for the exclusivity it enjoyed over *PSTS services and facilities provision*, and not in relation to the competitive VANS segment. Universal service obligations had not been imposed on Telkom for value added services precisely because these were not PSTS and were outside of Telkom's exclusivity. Telkom was well aware of the weakness in this argument. This is why it went to great pains to market its VANS (VPN) products as PSTS and had to allege that the VANS providers were providing *PSTS services* and not VANS because its claim of exclusivity could only lie within that segment of the market.

171. If it was intended by the policy makers and regulator that Telkom enjoy exclusivity over all telecommunications services there would have been no need to create a separate category of VANS licenses and Telkom would not have needed one. That its universal service obligations had nothing to do with the competitive VANS sector is confirmed by the WAR strategy document itself. Not a single mention is made of this rationale let alone the so called illegality of the VANS model.

[98] See Green T 1776 - 1778

[99] See 24 Jan 00 document, CCB 5, p 1978

172. In these proceedings Telkom maintained, quite unconvincingly, that VANS providers did not suffer harm as a result of its conduct and pointed to the fact that despite the freezing of their networks they were still able to grow in the market. It also maintained that any harm that may have been caused to independent VANS providers by the freezing of their networks was insubstantial. These contentions cannot be taken seriously.

173. To suggest that customers would not be alarmed at the possibility that their business was being conducted illegally is preposterous. It is no stretch of the imagination to infer, in an industry where the essential input for the rendering of services by competitors is withheld and a campaign is mounted in which the customers of those competitors are targeted, that that was likely to cause inconvenience, congestion, reputational damage, litigation and loss of revenue for the VANS providers whose networks were either frozen or supply delayed. In this case actual harm has been demonstrated. Not only did the cheaper more efficient VANS providers find themselves without inputs essential to the service they were rendering, their customers were being targeted by Telkom on the basis of alleged illegality.

Remedy

174. The Commission persisted in its prayer that we impose an administrative penalty of 10% of Telkom's total turnover for the year 2004 in terms of section 59 of the Competition Act. This would amount to a fine of approximately R3,2 billion. At the hearing the Commission argued that in the event that the Tribunal found Telkom only to have contravened section 8(b), an administrative penalty of R1bn would be appropriate.

175. Prior to argument on 13 February 2012, heads were filed by the Commission on 30 January 2012 and by Telkom on 6 February 2012. However, on Monday 13 February 2012, on the first day of argument, the Commission filed an additional document to which it referred as *a "Note on Commission's Oral Evidence".* Telkom then asked the Tribunal for an opportunity to respond to this and during argument on 15 February 2012 the Tribunal gave directions that Telkom could file a response to the Commission's further Heads of Argument in terms of cross referencing, pointing out that no further argument would be allowed, i.e. Telkom was only to indicate references in the record that contradicted those referred to by the Commission. The Commission could respond to Telkom's list if it wanted to. The Tribunal took this opportunity to request Telkom to consider any pricing or behavioural remedy that it might be willing to have imposed on it.

176. On 21 February 2012 Telkom filed its Responsive References to the Commission's written Heads of Argument in Reply but in relation to the issue of remedy indicated that:

> *176.1.1.1. "Telkom has given serious consideration as to whether it is able to offer a pricing or behavioural remedy in this matter if it is found to have contravened the Competition Act 89 of 1998 in the manner alleged by the Competition Commission. However, in view of the fact that the events in question occurred in an entirely different regulatory regime and that the conduct complained of has ceased, Telkom has not, in the available time,*

been able to conceive of an appropriate remedy for such circumstance. Telkom is nevertheless willing to engage with the Commission (if the Commission is interested in doing so) in an attempt to find common ground on a potential behavioural remedy, if any appropriate remedy of this nature exists; and if an agreement can be reached in this regard before the Tribunal is due to give its judgment in this matter, the Tribunal will be informed accordingly."

177. Having received no proposals on a behavioural or any other appropriate remedy from Telkom and the Commission, the only remedy to consider is that of an administrative penalty.

178. For the purpose of sections 8(b) and 8 (d)(i) an administrative penalty is competent for a first time contravention and this is what we go on to consider. [100] We have previously held that our approach to penalties cannot be formulaic and each case must be decided on its merits. At the same time meaningful distinctions must be made between contraventions of the Act. After all a failure to notify a merger cannot be treated in the same way as a cartel.

179. In *Competition Commission v SAA*, an abuse of dominance case the Tribunal provided guidelines on how penalties could be computed. Since then in *SPC v Competition Commission*, the CAC has provided some guidance on how we should approach the imposition of penalties. That case concerned a contravention of section 4(1)(b). We have attempted to apply *Competition Commission v Aveng & Others*.

180. In *Competition Commission v Aveng & Others* we identified the following six step approach to assessing an appropriate penalty for the purpose of section 59(3). These steps are:

180.1. **Step One**; determination of the affected turnover in the relevant year of assessment;

180.2. **Step two**; calculation of the 'base amount' being that proportion of the relevant turnover relied upon expressed as a percentage of the affected turnover obtained in step1;

180.3. **Step three**; where the contravention exceeds one year, multiplying the amount obtained in step 2, by the duration of the contravention;

180.4. **Step four;** rounding off the figure obtained in step 3, if it exceeds the cap provided for by section 59(2).

180.5. **Step five;** considering factors that might mitigate or aggravate the amount reached in step 4, by way of a discount or premium expressed as a percentage of that amount that is either subtracted from or added to it.

[100] Section 59(1)(a).

180.6. **Step six;** rounding off this amount if it exceeds the 10% total turnover cap provided for in section 59(2). If it does, it must be adjusted downwards so that it does not exceed the cap.

181. The approach adopted in *SAA* and *Aveng* however are not mutually exclusive because ultimately we would have to give some weight to the factors listed in 59(3).

182. We start off by considering the affected turnover. Some difficulties were experienced here about whether the affected turnover should be limited to Telkom sales of Diginet lines or should include its VPN/VANs revenues.

183. Telkom argued that only 62% of the total revenue of Diginet access should be considered in calculating affected turnover as the amount of R1,927,086,128.46 for 2004 also included other point-to-point services that had nothing to do with VPN services. The correct amount should therefore be R 1,194,793,399.64.[101] Added to this is the turnover for VPN services, R 250,139,829.74 and for Internet Access R 159,873,512.26. The affected total turnover for 2004 is therefore R 1,604,806,741.64.

184. Next we calculate the base amount which is the proportion of the relevant turnover to be considered for the fine before any adjustments are taken into account, on a scale between 10-30%, multiplied by the number of years in which the conduct took place. We must bear in mind that the nature of the contravention is an abuse of dominance and not a cartel and would therefore be at the lower end of the scale, namely between 10-15%. At the same time Telkom has been found to have contravened two sections of the Act involving conduct that affected a critical sector of the economy. Its actions resulted in increasing the costs of telecommunications in the competitive sectors of the industry and increased the cost of doing business in South Africa. Taking this into account and that Telkom was a dominant firm which enjoyed exclusivity over PSTS and the provision of infrastructure and that the geographic area in which the conduct took place was the whole of South Africa we consider 10% to be an appropriate percentage. The contravention took place – at least for purposes of this complaint – for a period of four and half years. However, we will for our purposes round it off to four years (4) only.

185. Therefore the basic amount of the fine is: 10% of the affected turnover of R1,604,806,741.64 for 2004 which is R 160 480 674.16 multiplied by 4 years which amounts to R 641 922 696 (rounded off) which is way below the cap of R3,2 billion.[102]

186. However there are some mitigating and aggravating factors. The single most significant factor was the regulatory environment in which the contravention took place. The Telecommunications Act, the establishment of SATRA and the regulation of a monopoly PSTS and the dual regulatory model of the Act, which required the involvement of both the regulator and the Minister, were all untested waters. The transition to independent regulation was indeed difficult for the industry, the regulator, Ministry and Telkom, which until then, had effectively played both regulator and provider.

[101] Telkom Heads p 164

[102] T 2383

An independent regulator was only established in 1997 and since inception was plagued by capacity problems and controversies. A large contingent of the SATRA staff in fact came from the erstwhile parastatal or the Department of Communications. Conflicting decisions were handed down by SATRA and the Minister and conflicts between the Ministry and the regulator became legion.[103] The dual regulatory model[104] allowed industry players to lobby both regulator and Ministry for preferred outcomes. Telkom's dominance in the industry and its previous responsibilities for country wide technical matters (which was now the purview of the regulator) provided it with an advantage over the regulator and with the department. The environment was ripe for ineffective regulation and abusive practices by a monopoly that until then had been both regulator and player. At the same time the difficulty of balancing conflicting policy objectives for Telkom's shareholder, the Minister of Communications, played some role in this. The Ministry was responsible for development of the entire telecommunications sector but was also the line Ministry for Telkom as the government shareholder. It was required to promote liberalisation in terms of the White Paper but also under a duty to protect Telkom's monopoly. The provisions of the shareholder agreement between Telkom and government are still secret, but one can infer that Telkom's conduct in the marketplace suggests that it felt 'protected' by government. [105]

187. Second, Telkom's monopoly rights were granted by statute and the regulatory framework did not provide early guidance on the line between PSTS and VANS even though subsequent rulings by the regulator did. The context in which the conduct took place also has relevance. This was not a homogenous PVC or steel product. Telkom's conduct took place in an environment in which legislation and regulations lagged behind technological advances. Innovation in the telecommunications sector was taking place at lightning speed especially in the data space. Content rather than mere switching of signals started to become the focus of returns on investment. Even though its monopoly was protected by legislation Telkom was still a lumbering parastatal in the throes of modernization and still laboured under legacy issues.

188. Third, at the time of its partial privatization Telkom was in serious debt and its modernization could only be achieved through some financial injection.[106] But a private investor such as SBC was determined to make a significant return on its investment and indeed did so by preserving and extending its monopoly. SBC sold half of its indirect shareholding of 30% in Telkom for R 3.58bn in 2004.

[103] See the matter of WBS & Telkom concerning interconnection guidelines

[104] SATRA held hearings and inquiries for licensing of public operators and the making of regulations but its decisions only had the status of recommendations to the Minister. See for example the litigation in the licensing of the third mobile operator (now Cell C).

[105] The fact that Telkom has been reported to be losing data revenue is quite alarming in a market in which it still has the largest fixed line network.

[106] See http://www.hellkom.co.za/newsviewer/local/1847/Telkom%27s-debt-hurts-profits

189. We also take into account that Telkom has not previously been found to have contravened the Act.

190. However the decision by Telkom to impose its own interpretation of its exclusivity rights and then taking the law into its own hands cannot be placed at the door of a government policy. This was Telkom's own decision as was its decision to challenge every decision by the regulator that went against it.

191. Even after ICASA had given its ruling in 2002, that VPN services were not PSTS Telkom continued to freeze VANS competitors' networks. The freezing of the networks meant that VANS could not upgrade their networks to provide quality service to their clients. Moreover, the agency agreements in effect meant that VANS could not provide a "one stop shop" service to their clients. In general, Telkom's conduct made private investment in the local internet sector more risky.

192. The telecommunications sector had been identified as a strategic industry through which economic development could be achieved. Several Presidential initiatives sought to bring the cost of telecommunications down, so that it ICT could become an effective driver of growth and development. Telkom's conduct resulted in more expensive services and retardation of innovation. In an industry characterized by network effects this harm to competition is likely to continue far into the future. Indeed South Africa, despite deregulation, is still regarded as having higher telecommunications costs than comparative economies.[107]

193. All independent VANS providers were wholly dependent on Telkom for the provision of access facilities. As a result of Telkom's conduct some VANS providers such as Datapro and FirstNet, exited the market while others struggled to grow their businesses. For instance Internet Solutions' market share decreased considerable to less than half of the share it enjoyed during 1999, UUNet saw a drop in its market share in 2002 and Datapro's market share declined from 13.55 to 9.8% between 2001 and 2002. In this time Telkom's market share increased from 5% in 1999 to 31% by 2004.[108]

194. Having regard to the extent of harm caused by Telkom as summarised in our conclusion on the merits and taking into account all the factors discussed here, we accordingly reduce the amount of R 641 922 696.00 by 30% to R 449 345 887.00, rounded down to R449 million.

195. Telkom's conduct might have been viewed in a more sympathetic light– after all the uncertainty in the regulatory framework created by the lack of appropriate definitions in the Telecommunications Act and conflicting government objectives was not of its own doing – but for the fact that it enforced its alleged exclusivity with cynicism and a touch of hypocrisy. Despite enjoying a statutory monopoly Telkom, by taking the law into its own

[107] See www.balancingact-africa.com/news: "South Africa Telecoms 'among world's most costly' says survey" as well as TIPS document above

[108] See Genesis report CWB p 471

hands, sought to extract monopoly rents and extend the ambit of its exclusivity through its conduct. Had Telkom's actions not been tainted in this way we would have increased the level of the discount to above 50%. Its behaviour in this respect was an aggravating factor leading to the reduction in the discount that might otherwise have been granted.

196. Therefore, the final penalty amount is **R449 000 000.00 (four hundred and forty nine million rand)** which represents less than 2% of Telkom's annual turnover for 2010/11 of R 32,5 billion payable as follows:

196.1. 50% to be paid within 6 months of date of order; and

196.2. the balance to be paid within 18 months of date of order.

_____ **7 August 2012**

Yasmin Carrim **Date**

Concurring: N Manoim and T Madima

Researcher: R Badenhorst

For the Applicant: MSM Brassey SC and NH Maenetje SC instructed by Gildenhuys Lessing Malatji Incorporated

For the Respondent: W van der Linde SC and A Cockrell SC and H Shozi instructed by Mothle Jooma Sabdia Inc.

ANNEXURE A

GLOSSARY OF TERMS

Access infrastructure -

This is often referred to as the last mile access to the customer and enables the customer to connect to the core network (specifically the PoP) of the VANS provider or ISP.

ADSL- Asymmetric Digital Subscriber Line

ATM- Asynchronous Transfer Mode

Type of technology used in packet based switching. It's a cell-based switching technique where cells of fixed size are transmitted. It allows better network management and quality service guarantees can be provided.

CE1- Channelised E1

A 2Mbps Time Division Multiplex circuit, which can be sub-divided into 31x64kbps sub-circuits

CHIPAC -

Wholesale product offered by Telkom which mimics the REE scenario of the VANS. The only difference is the exchange equipment remains in the local exchange and is not hosted at the VANS PoP which is normally in a building close to the exchange.

Core infrastructure -

Access to these facilities is essential for service providers wanting to build their own networks. Specifically high bandwitdth leased lines would be used to connect and enable the transmission of data between the various PoPs of the service provider's core network and its international links.

Diginet -

Diginet leased lines refers to a dedicated constant bit rate data connection between two points running at bandwidth speeds of up to and including 64 kb/s. Diginet plus refers to bandwidth speeds from 128 kb/s up to and including 1984 kb/s at increments of 64 kb/s.

Point-to-point diginet refers to a connection between two different customer premises.

Point-to-cloud diginet refers to a connection between a customer premises and the nearest Telkom exchange building where a VPN PoP is located.

Diginet port is a card in the Diginet multiplexer ("DMUX") to which each individual connection connects.

Diginet Circuit - the end-to-end service connecting two end points.

Constant bit rate -

Refers to a data connection where bandwidth is fully dedicated to the connection (i.e. no sharing or overselling of the bandwidth takes place).

ECA-Electronic Communications Act

FrameExpress -

Refers to a frame relay based protocol that superseded X.25 as the next technology capable of being used in the provision of VPN services. It was superseded by the next technology namely ATM and later MPLS. Frame-relay offered an improvement over X.25 as it offered higher speeds of transmission due to the variable sized frames in which the data was transmitted. It was also able to route data through alternative pre-determined routes should a link fail.

Hosting -

Taking aspects of the client's applications and web presence and hosting them at the ISP/VANs

ICASA-Independent Communications Authority of South Africa

ICT-Information and Communications Technology

IP- Internet Protocol

ISP-Internet Service Provider

There are three tiers of business in the internet access industry:

Tier 1 has national networks in major cities, links with global internet, 2 or more International PoPs, peering arrangements with other tier 1 ISP's

Tier 2 has limited national footprint, 1 or no international links, 1 or no international PoP, has few peering arrangements with tier 2 and 1 or no peering arrangement with tier 1

Tier 3 is a regional operator with no peering agreements, buys local IP transit, buys International IP transit from tier 1 and 2 and is basically a reseller of other larger ISPs service and infrastructure.

ISPA- Internet Service Provider Association

IT-Information Technology

Local Lead – The copper pair, two copper wires forming an electrical loop, that connects the NTU at the customer premises to the Diginet multiplexer in the nearest Telkom exchange.

MDNS- Managed Data Network Services

MDNS enables customers to connect to their various sites and exchange data. Can be WAN or VPNS.

MPLS – Multiprotocol Label Switching

Its technology used to connect lots of sites together to allow data to flow between them. It is able to intelligently route data by automatically utilizing alternative routes should a link fail and to prioritize data packets over others. It superseded ATM.

NEOTEL- Neotel (Pty) Ltd

NTU- The NTU is located at the customer premises and serves as a plug to which the local lead connects. It is a device that converts the digital signals received from the customer equipment into analogue signals that can be transmitted over the Local leads over a fairly long distance.

Packet based switching -

Customer data is broken into small packets which are transmitted over the network and re-assembled at the destination.

PSTN-Public Switched Telecommunications Network

PSTS- Public Switched Telecommunications Services

PoP-Points of Presence

VANS providers build their own network points of presence at various locations across the country which would be connected by leased lines from Telkom and which would be shared by their customers.

Peering

It is an arrangement between two internet entities such as ISP's where traffic is conveyed between the two entities using links at locations for which costs are typically shared.

REE- Remote exchange equipment

The presence of REE in the VANS PoP enables data from the exchange to reach the VANS provider's PoP by means of a high capacity link similar to that which form's Telkom's transmission layer infrastructure.

Remote Access

Clients that are mobile could dial in to their secure network and access their applications as if they were in the office.

Router – the device that connects network points in an IP based WAN

SAIX-South African Internet Exchange

SATRA – South African Telecommunications Regulatory Authority, the precursor to ICASA.

SAVA - South African VANS Association, an industry body of VANS providers.

SLA-Service Level Agreement

SNO- Second Network Operator

Telecoms Act -The -Telecommunications Act 103 1996

ECA - The -Electronic Communications Act 36 of 2005

VANS - Value Added Network Services

VANS providers offer a range of services to their clients that include virtually operating the customer's entire network such as leasing telecommunications and routing and switching functionality and to provide managed data network services. r

VPN- Virtual Private Network

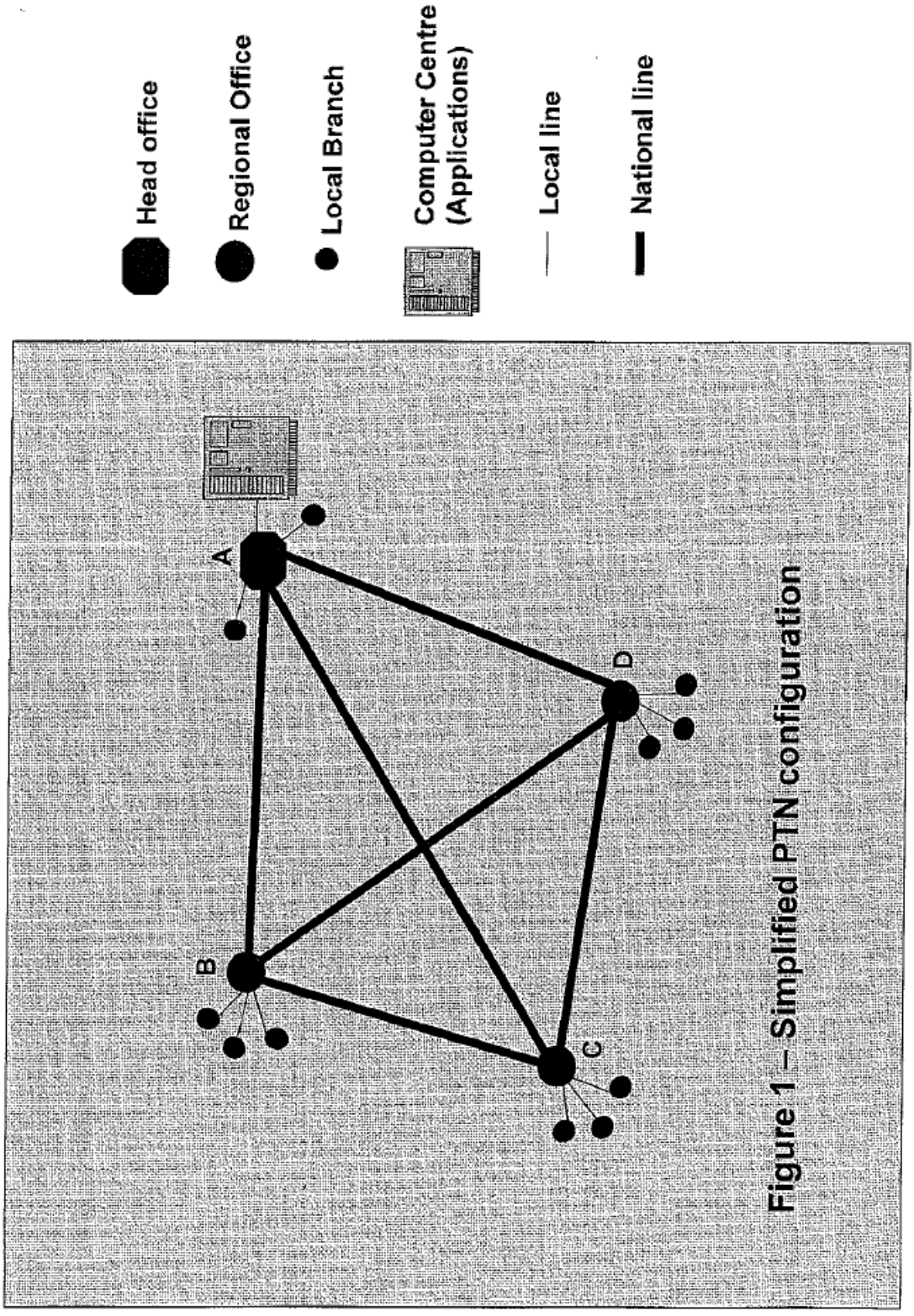
This is the VANS' shared infrastructure network. A firm would make use of a VANS provider's cloud or core network and merely connect each site to this cloud.

VoIP- Voice over Internet Protocol

WAN-Wide Area Network -

Private national networks that were built by purchasing dedicated leased line capacity from Telkom to connect each site to the head office and sometimes to each other.

Example of a WAN



Example of a VPN

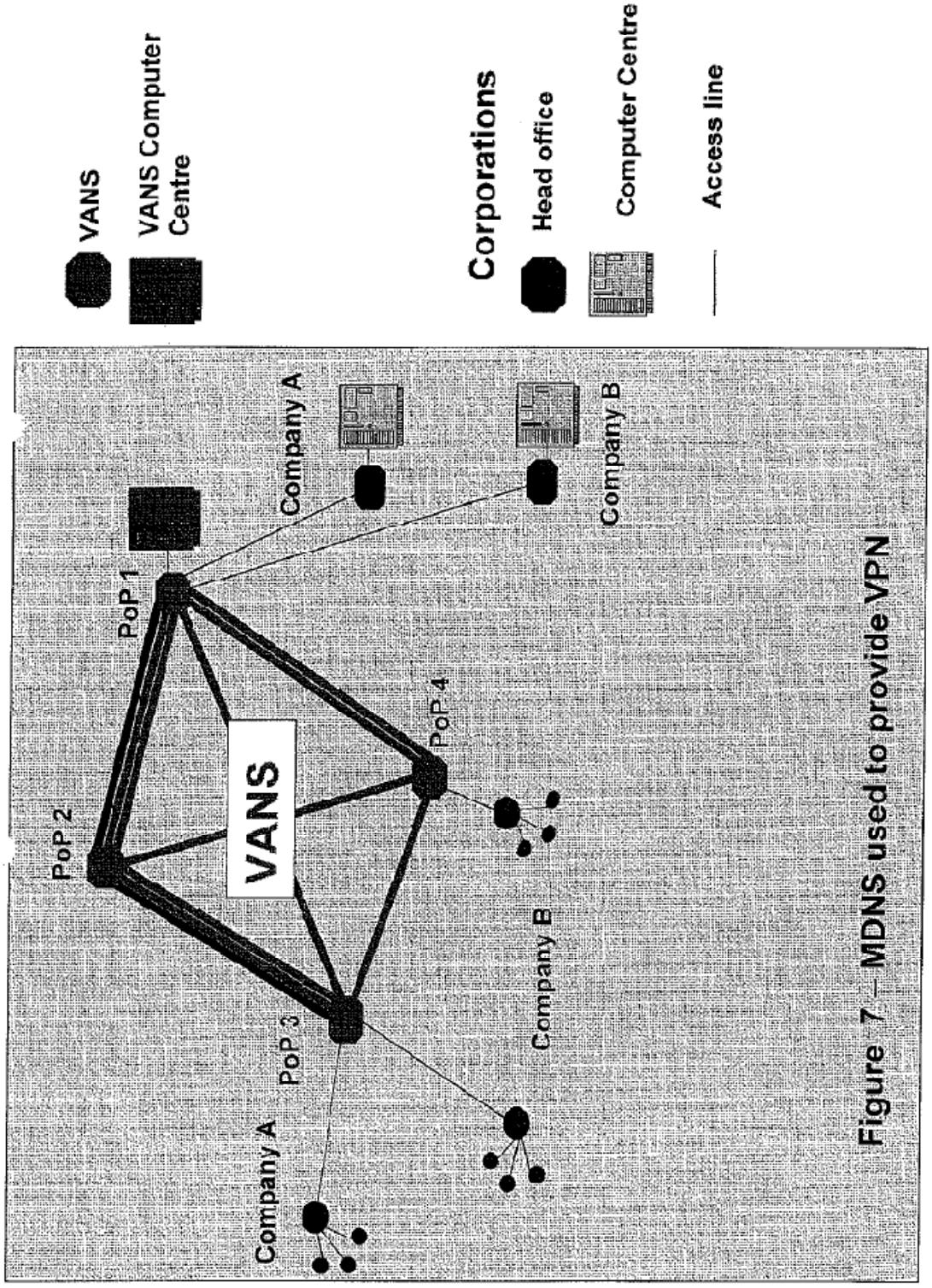


Figure 7 – MDNS used to provide VPN