

# Telecommunications Pricing Regulation

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# Introduction

This chapter focuses on retail pricing regulation in the telecommunications arena.<sup>2</sup> It begins with a look at why it is important to regulate telecommunications pricing. The next section sets out the relevant provisions of the Telecommunications Act, 103 of 1996. The following two sections detail the implementing of pricing regulation regarding the public switched telecommunication services (PSTS) and mobile cellular telecommunication services (MCTS) market segments, respectively. The next section details the rules for the keeping and producing regulatory accounts. The conclusion offers several recommendations for an improved regulatory regime for pricing regulation.

## 1. WHY PRICING REGULATION?

Pricing regulation is necessary where markets fail to produce competitive prices.<sup>3</sup> This is certainly true in South Africa. A monopoly situation does not produce competitive prices and Telkom has enjoyed a monopoly in respect of PSTS for more than eight years since the start of the current regulatory regime. A duopoly in the MCTS market segment also does not produce competitive prices.<sup>4</sup> Thus, effective pricing regulation is essential in the South African telecommunications market.

The importance of effective pricing regulation has been expressed clearly by various experts, including the following.

The importance of price regulation during the development of competition is not to be disputed. However, the regulatory approach must be commensurate with market conditions. Telecommunications networks involve huge investments. At the early stage of market liberalisation, the incumbent would still possess enormous market power. Without *ex ante* regulation, damage to the competition environment could be done before new entrants could ever establish a foothold, thus shying away potential investors.<sup>5</sup>

## 2. THE TELECOMMUNICATIONS ACT PROVISIONS REGARDING PRICING

### 2.1 Determining Fees and Charges for Telecommunication Services – The Rate Regime

Section 45(1) of the Telecommunications Act states that the fees and charges that may be levied by a licensee for telecommunication services are to be determined in a manner that may be prescribed by regulation by the Independent Communications Authority of South Africa (Icasa).<sup>6</sup> Generally the regulations made are referred to as the

<sup>2</sup> A discussion of wholesale pricing regulation is included in Chapter 6 herein, on interconnection and facilities leasing. See also J Hodge, Determination of Administered Prices in Telecommunications in South Africa, paper prepared for the National Treasury; H Intven (ed) Telecommunications Regulation Handbook, Module 4 - Price Regulation (2000); L Thornton, et al Telecommunications Legislation as Barriers to E-Commerce, Cyberlaw@SA II: The Law of the Internet in South Africa (R Buys ed) (Van Schaik Publishers 2004) 250 et seq.

<sup>3</sup> See Intven (note 2 above).

<sup>4</sup> See para 4.2 below.

<sup>5</sup> *MH Au* 'Why Regulate Price Cuts?' 21 November 2004, available at [http://www.ofta.gov.hk/en/dg\\_article/au\\_articles/20041121.html](http://www.ofta.gov.hk/en/dg_article/au_articles/20041121.html).

<sup>6</sup> Prescribe is defined to mean prescribed by regulation and regulation is defined to mean a regulation made under section 96 of the Telecommunications Act. Section 96 empowers Icasa to prescribe regulations, however, no regulation prescribed by Icasa is effective unless and until approved and published by the Minister of Communications in terms of section 96(6).

rate regime.

Evident from the wording of section 45(1), it is within Icasa's discretion whether to prescribe the manner for determining fees and charges for licensees. However, section 45(2) provides that Icasa must prescribe the manner for determining fees and charges in 'fields' where there is insufficient competition. Presumably, 'fields' refers to the various categories of services that may be licensed in terms of section 33 of the Telecommunications Act, for example, PSTS and MCTS. It is also within Icasa's discretion to determine whether there is insufficient competition.

There is a proviso in section 45(2) of the Telecommunications Act, which provided that the Minister had to determine the rate regime in respect of Telkom SA Limited (Telkom), which would be in force for three years from the date when Telkom's PSTS license was issued. The Telecommunications Amendment Act 64 of 2001 amended the three-year period because Icasa<sup>7</sup> had not yet prescribed the rate regime for Telkom despite the lapse of the three-year period.<sup>8</sup>

Section 45(3) of the Telecommunications Act states that as from a date determined by the Minister of Communications, all public schools<sup>9</sup> and public further education and training institutions<sup>10</sup> will be entitled to a 50 percent discount from PSTS providers on telecommunication calls to an Internet service provider (ISP) and to fees and charges levied by ISPs. As at July 2004, the Minister had not yet determined the date on which such discount would begin. No discounts have yet been offered by Telkom or by ISPs (which are licensed as value added network services (Vans) providers).

## 2.2 Accounts and Records to be kept by Licensees

Section 46(1) of the Telecommunications Act requires telecommunication services licensees to keep accounts and records relating to the provision of telecommunication services, as may be prescribed by Icasa.

Section 46(2) specifically relates to Telkom and stipulates that Telkom must keep accounts as may be prescribed by Icasa in respect of at least<sup>11</sup> the following:

- each telecommunication service provided, where another person provides that service in competition with Telkom Vans<sup>12</sup>
- each interconnection to its telecommunications system<sup>13</sup> or instance where telecommunication facilities are made available.<sup>14</sup>

In addition, section 97 of the Telecommunications Act provides that Icasa may direct any licensee to give to it, accounts, records and other documents or information relating to any matter in respect of which a duty or obligation is imposed on the licensee.

<sup>7</sup> And its predecessor, the South African Telecommunications Regulatory Authority (Satra).

<sup>8</sup> Telkom's exploitation of this apparent lacuna in the regulatory framework, to increase fees and charges above that allowed will be discussed below at para 3.3.

<sup>9</sup> Public schools are public schools as defined in the South African Schools Act 84 of 1996.

<sup>10</sup> Public further education and training institutions are those defined in the Further Education and Training Act 98 of 1998.

<sup>11</sup> Section 46(2)(c) provides that Icasa may prescribe other parts of Telkom's operations where separate accounts must be kept.

<sup>12</sup> Vans are regulated in terms of section 40 of the Telecommunications Act, inter alia.

<sup>13</sup> Interconnection is regulated in terms of section 43 of the Telecommunications Act, inter alia.

<sup>14</sup> The making of telecommunication facilities available is regulated in terms of section 44 of the Telecommunications Act, inter alia.

### 3. THE REGULATION OF PSTS RETAIL PRICING

#### 3.1 The Ministerial Rate Regime

The Minister of Communications<sup>15</sup> issued a determination of the rate regime in terms of the proviso in section 45(2) of the Telecommunications Act in May 1997.<sup>16</sup> The determination was only applicable to certain services listed, which were called ‘Basket Services’. Such services included<sup>17</sup> –

- Installation Services (for exchange lines)
  - residential customers
  - business customers
  - direct dialling inward/outward for business customers
  - ISDN services
  - Switched telematic services
- Rental services (provision and maintenance of exchange lines)
  - residential customers
  - business customers
  - direct dialling inward/outward for business customers
  - ISDN services
  - Switched telematic services
  - Point-to-point telecommunication circuits leased to customers (excluding Interconnection services)
- Call services (from customer premises equipment or payphone)
  - Local calls
  - Fixed to mobile calls
  - Long-distance calls
  - International calls
  - Switched telematic services
  - Directory information services
  - Telephone operator services

It excluded other services, including certain PSTS, namely interconnection services and emergency numbers.<sup>18</sup> It also allowed the elimination of services from the basket from time to time<sup>19</sup> Telkom could apply to the Minister of Communications to add or replace an element of the Basket Services but only if it was a substitution of an existing service or in the case of packaged offerings with regard to existing services.<sup>20</sup>

The initial rate regime was a classic price cap mechanism,<sup>21</sup> with the productivity factor set at 1.5 percent<sup>22</sup> and a maximum price movement of any service within the basket within the price control period of one year, of 20 percent.<sup>23</sup>

<sup>15</sup> Then known as the Minister for Posts, Telecommunications and Broadcasting.

<sup>16</sup> Notice 772 of 1997, Ministerial Determination on Fees and Charges for Telecommunication Services, published in Government Gazette 17984 dated 7 May 1997.

<sup>17</sup> See Schedule A of Notice 772 of 1997 (note 16 above).

<sup>18</sup> Non-PSTS that were specifically excluded were Vans, MCTS and customer premises equipment.

<sup>19</sup> See Schedule A of Notice 772 of 1997 (note 16 above).

<sup>20</sup> Para 3 of Notice 772 of 1997 (note 16 above).

<sup>21</sup> For a discussion of price cap regulation generally, see H Intven (ed) Telecommunications Regulation Handbook, Module 4 – Price Regulation (2000) paras 4.3-4.

<sup>22</sup> Notice 772 of 1997 (note 16 above) para 2 and Schedule b.

<sup>23</sup> Para 4(b) of Notice 772 of 1997 (note 16 above).

A price cap mechanism was probably chosen at the time because it was generally considered regulatory best practice where there is considerable scope for efficiency gains. In addition, it is unlikely that the government had adequate cost information or expertise to engage in other cost-based regulation.<sup>24</sup>

As the process leading to the publication of the initial rate regime was not a public process, it is difficult to say why a particularly conservative productivity factor was chosen. However, one can guess that some or all of the factors below may have played a role.

- The considerable debt held by Telkom at the time and the need to place Telkom on better financial footing;
- The desire to attract a strategic equity partner for Telkom;
- The universal service and access obligations imposed on Telkom in exchange for its exclusivity period; and
- The lack of regulatory accounts kept by Telkom limiting the ability of government to accurately set the price cap.<sup>25</sup>

Paragraph 7 of Telkom's PSTS license gave Telkom the right to call for a rate regime review after three years if it felt that the existing or future rate regime was 'reasonably likely to have a materially adverse impact on the Licensee or the Licensee's ability to fulfil its obligations under [the] license...'<sup>26</sup> Telkom never invoked this right.

Because Telkom did not call for a rate regime review, it should be assumed that the rate regime was not having a 'materially adverse impact' on it, reinforcing the perception that the initial productivity factor was too conservative. This fact, along with the fact that Telkom had decreased its debt, a private investor had been found, and a coming to the end of Telkom's universal service and access obligations set out in its license, should have suggested that the productivity factor would increase significantly after the exclusivity period. This, however, did not happen.

### 3.2 The First Icasa Rate Regime

In addition to publishing the first rate regime in May 1997, the Minister of Communications issued a policy direction in terms of section 5(4)(a) of the Telecommunications Act.<sup>27</sup> That policy direction, inter alia, stated that any review of the rate regime should not have a material adverse impact on Telkom or Telkom's ability to meet universal service and access obligations set out in its license.<sup>28</sup>

Icasa began a review of the rate regime in December 2000 with a notice indicating its intention to conduct an enquiry in terms of section 27 of the Telecommunications Act.<sup>29</sup> Icasa's Consultation Document included in the notice

<sup>24</sup> Hodge (note 2 above).

<sup>25</sup> Hodge (note 2 above).

<sup>26</sup> Licence Issued to Telkom SA Limited to Provide Telecommunication Services under s 36 of the Telecommunications Act, 1996, Notice 768 of 1997, Government Gazette 17984 dated 7 May 1997.

<sup>27</sup> A policy direction is a direction issued by the Minister, which must be consistent with the Telecommunications Act, directing Icasa to carry out its powers and functions in terms of a stated policy.

<sup>28</sup> Notice 773 of 1997 Ministerial Policy Direction on Fees and Charges for Telecommunication Services, published in Government Gazette 17984 dated 7 May 1997.

<sup>29</sup> Notice 4715 of 2000 published in Government Gazette 21925 dated 22 December 2000.

was quite comprehensive and asked many questions to elicit public comment. The findings of the section 27 enquiry were published in the Government Gazette on 23 April 2001.<sup>30</sup> Icasa also published a notice of its intention to make rate regime regulations in terms of section 96 of the Telecommunications Act.<sup>31</sup>

Some areas of concern emerged from the section 27 enquiry carried out by Icasa. First, the initial productivity factor was too low. Second, residential customers were extremely vulnerable to rate rebalancing and had to be protected. And third, abuses of the forecasted Consumer Price Index (CPI) had to be curbed.

In the proposed regulations, Icasa removed the potential for abuse of CPI forecasts by using the September-to-September increase in CPI where information would be available from Statistics South Africa,<sup>32</sup> instead of the January-to-January forecasted CPI, previously used. The forecasted method had served only Telkom's interests, with it overestimating the CPI increase by 1,0 percent in the 1997 filing and 0,9 percent in the 1999 filing, but only underestimating by 0,1 percent in the 1998 filing and 0,2 percent in the 2000 filing.<sup>33</sup>

Icasa proposed providing better protection for residential customers by introducing a residential sub-basket,<sup>34</sup> and limiting further the maximum increase for any single service.<sup>35</sup> However, it was probable that Telkom's rebalancing of rates had already been taken too far, which left residential customers subsidising Telkom's competitive Vans and other business services.<sup>36</sup>

Arguably, the most important aspect of the rate regime review — determining what the productivity factor should be — could not be answered effectively because Telkom had failed to produce regulatory accounts.<sup>37</sup> All that the interested parties could do was voice their opinions on high prices. Against this, Telkom argued that the productivity factor should be 0,0 percent because 'it had already achieved virtually all efficiency improvements possible,'<sup>38</sup> and that 'its profitability has been considerably reduced' by its obligations for universal service and access set out in its license.<sup>39</sup>

Icasa was put in the difficult position of believing that a more liberal productivity factor was needed but lacking the regulatory accounting data from Telkom to determine exactly what factor would be reasonable. In the end, Icasa recommended a productivity factor of 5 percent,<sup>40</sup> which was at least consistent with productivity factors set in other comparable jurisdictions.<sup>41</sup>

Despite a lack of regulatory accounting data from Telkom, Icasa could have made greater use of the information in Telkom's annual reports to provide a sounder empirical basis for its recommendation, as demonstrated by William H Melody in his assessment of Telkom's price increase for 2003. Icasa could have built a stronger case by determining the soundness of Telkom's financial footing, Telkom's productivity improvements, and the real cost increases of

<sup>30</sup> Notice 886 of 2001 published in Government Gazette 22240 dated 23 April 2001.

<sup>31</sup> Notice 887 of 2001 published in Government Gazette 22241 dated 23 April 2001.

<sup>32</sup> Notice 887 (note 31 above) at 3(a).

<sup>33</sup> Hodge (note 2 above).

<sup>34</sup> Notice 887 (note 31 above) at 3(b).

<sup>35</sup> Notice 887 (note 31 above) at 6(b).

<sup>36</sup> Hodge (note 2 above).

<sup>37</sup> See paragraph 5.1 below.

<sup>38</sup> Notice 886 of 2001 (note 30 above) para 7.1.

<sup>39</sup> Notice 886 of 2001 (note 30 above) para 9.2.

<sup>40</sup> Notice 887 of 2001 (note 31 above) 3(a)).

<sup>41</sup> Hodge (note 2 above).

telecommunications equipment (as opposed to CPI). In fact, had ICASA made such determinations, it might have concluded that a 5 percent productivity factor was too low, considering labour productivity had improved by an average annual rate of 14,1 percent from 1997 to 2000.<sup>42</sup> If Icasa had erred on the side of consumers in setting a relatively high productivity factor, this may have served as an incentive for Telkom to produce regulatory accounts to justify a lower productivity factor.

After the period for comments on the proposed regulations, Icasa, it was reported, proposed a productivity factor of 3 percent.<sup>43</sup> It has been suggested that Icasa decided to set the productivity factor at 3 percent (rather than the 5 percent originally proposed) to try to avoid litigation initiated by Telkom.<sup>44</sup> Publicly Icasa stated that the weakening of the world economy had influenced its decision.<sup>45</sup>

In fact, Icasa's attempted compromise only weakened its position as regulator and guardian of the public interest. As with all regulations, Icasa submitted its regulations to the Minister of Communications for approval and publication. However, the Minister did not approve the regulations. The Minister sent them back for reconsideration, in particular over the issue of the productivity factor. It is understood that the Minister suggested to Icasa that the productivity factor should be 1,5 percent. Icasa had little choice; it could make regulations with a productivity factor of 1,5 percent or risk continued non-approval of its rate regime regulations. The Minister's proposed 1,5 percent was midway between the Telkom position and Icasa's regulations originally sent to the Minister (0 percent and 3 percent respectively) and significantly below the originally proposed 5 percent, which itself was probably too low.<sup>46</sup>

The Minister finally approved and published the rate regime regulations on 26 November 2001.<sup>47</sup> The rate regime regulations, like the previous rate regime set out by the Minister of Communications, set out a classic price cap mechanism. They were only applicable to basket services. The delineation of basket services did not change.<sup>48</sup> Furthermore, Telkom can still apply to Icasa to add or replace an element of the basket services but only if there is a substitution of an existing service or in the case of packaged offerings with regard to existing services.<sup>49</sup>

The new regulations differ from the initial rate regime in three respects. First, the original rules did not have a residential sub-basket, which the new regulations do have. The residential sub-basket consists of line rental, local, national and international calls and payphones.<sup>50</sup> Second, the original rules did not permit a carryover. The new regulations allow Telkom to carry over to the next year any unused increase in both the basket and residential sub-basket.<sup>51</sup> Third, the original rules enabled a 20 percent real movement in the price of any single service. The current regulations limit such movement to five percent.<sup>52</sup>

<sup>42</sup> See W H Melody *Assessing Telkom's 2003 Price Increase Proposal: Price Cap Regulation as a Test of Progress in South African Telecom Reform, and E-economy Development* (November 2002) paras 4-5 (available at [link.wits.ac.za/research/wm20021130.htm](http://link.wits.ac.za/research/wm20021130.htm)).

<sup>43</sup> L Stones "Icasa to curb Telkom's price hikes", *Business Day* (14 September 2001).

<sup>44</sup> Hodge (note 2 above).

<sup>45</sup> L Stones "Minister meddled in Icasa's proposals", *Business Day* (6 November 2001).

<sup>46</sup> Hodge (note 2 above).

<sup>47</sup> Government Notice No R 1248 Regulations: Fees and Charges in the Public Switched Telecommunications Sector, published in *Government Gazette* 22870 dated 26 November 2001.

<sup>48</sup> See Schedule A of No R 1248 (note 47 above).

<sup>49</sup> R 1248 (note 47 above) para 7.

<sup>50</sup> No R 1248 (note 47 above) para 4.

<sup>51</sup> No R 1248 (note 47 above) para 5.

<sup>52</sup> No R 1248 (note 47 above) para 8(2).

### 3.3 The Rate Regime Dispute

One could argue that Telkom abused its position as a partially state-owned entity to influence a situation that forced Icasa to set the productivity at such an unreasonably low percentage (1,5 percent). Worse to come, however, was Telkom's refusal to abide by Icasa's rate regime regulations once they were approved and published by the Minister of Communications.

When the Telecommunications Act was first promulgated, section 45(2) provided that Minister of Communications' determination of the rate regime in respect of Telkom would be in force for three years from the date when Telkom's PSTS licence was issued. Three years from the issuance of Telkom's licence was 7 May 2000.

By 7 May 2000, however, Icasa had not made and the Minister of Communications had not approved and published the new rate regime regulations. The Minister finally approved and published the rate regime regulations only on 26 November 2001.

Telkom, however, on 14 November 2001 filed its tariff increases to be implemented 1 January 2002. That tariff filing did not abide by the Ministerial rate regime, nor did it abide by the first Icasa rate regime regulations. It used a productivity factor of 0 percent. As a result, instead of a nominal increase of rates of 2.9 percent, Telkom increased rates 5.5 percent – 2.6 percent higher than the regulations allowed. Telkom also removed the 50–100 km band from the call structure, making all such calls long distance. This primarily affected Johannesburg – Pretoria traffic and significantly raised the price of what were previously local calls. Telkom had done a similar thing in the 1999 tariff filing, dropping the call category of 100–200 km.<sup>53</sup>

The rate regime put in place by the Minister of Communications in 1997 did not set out procedures for the filing of tariffs. However, Telkom's PSTS licence did include some procedures, including a provision indicating that tariff increases in terms of the rate regime had to be filed at least 30 business days prior to their planned implementation. So, if Telkom wanted to increase tariff rates on 1 January 2002, it was required to submit its tariff filing mid-November 2001. There was, however, no requirement that Telkom increase rates as of 1 January of any year.

Although the Telecommunications Act was amended to extend the life of the Ministerial rate regime until a new one was promulgated, the amendment was placed in the Telecommunications Amendment Act, 2001, which only came into force on 30 November 2001.<sup>54</sup>

Telkom exploited this set of events by filing its proposed tariff increases prior to the coming into force of the regulations. It filed in what it believed was a rate regime lacunae,<sup>55</sup> not following any set of rules.<sup>56</sup>

Understandably, Icasa objected to Telkom putting in place the rate increases in its November 2001 tariff filing because they did not abide by the rate regime

<sup>53</sup> Hodge (note 2 above).

<sup>54</sup> Telecommunications Amendment Act, 64 of 2001 published in Government Notice 1264 in Government Gazette 22889 dated 30 November 2001.

<sup>55</sup> Although the rate regime lacunae also existed in 2000/2001, there apparently was no dispute regarding the filing of the tariff rate increases that became effective 1 January 2001.

<sup>56</sup> Arguably, even if the new regulations did not apply, the previous Ministerial rate regime should have applied. See the unreported judgment of the High Court (Transvaal Provincial Division) in the matter of *Independent Communications Authority of South Africa v Telkom SA Limited and Another* (TPD, 31 December 2001, case no 33507/2001) 7.



regulations. Icasa sought an interdict against Telkom in the High Court in respect of implementing such increases.<sup>57</sup>

Telkom, on the other hand, insisted that it was not required to abide by such regulations for its January 2002 rate increases because the regulations had not yet been published by the Minister of Communications and challenged the validity of Icasa's first rate regime regulations. It later submitted an application to the High Court seeking a review of Icasa's regulations.<sup>58</sup>

Icasa's request for an urgent interdict was turned down on the basis, *inter alia*, that Telkom offered to reimburse consumers in the eventuality of a court finding that its tariff filing was invalid.<sup>59</sup> The court also was under the impression that Telkom had abided by the previous Ministerial rate regime regulations, although this was in fact, not true.<sup>60</sup>

The substance of the matters was not finally adjudicated because Icasa reached an out of court settlement with Telkom on 5 June 2002.<sup>61</sup> The settlement allowed Telkom to implement its tariff increases in spite of the fact that they were in violation of the rate regime regulations. However, Telkom is supposed to reimburse consumers R320,000,000 over the following two year period (2003/2004) by imposing increases below the maximum permissible by the rate regime regulations. Telkom is also supposed to, among other things, ensure local call increases do not exceed what they would have been over a three year period (2002/2003/2004) if the rate regime regulations had been abided by, and offer a special lifeline service to defaulting customers so that such customers could still receive incoming calls and make outgoing emergency calls. Icasa agreed to amend the rate regime regulations for clarity. The Minister finally approved and published the amended rate regime regulations on 24 October 2002.<sup>62</sup>

Despite Telkom's arguments, Telkom's 2002 Annual Report indicated delivering labour productivity improvements of 11 percent (after announcing the end of efficiency improvements a year earlier). Profit and operating revenue each increased eight percent, earnings per share 17 percent and cash flow from operations 16 percent.<sup>63</sup> Clearly, Telkom's arguments for a productivity factor of 0,0 percent were not supported by the facts, and its putting into place tariff increases in violation of the rate regime regulations was unconscionable.

### 3.4 The Filing of Tariffs

Those services providers who are subject to pricing regulation are required to file tariffs with Icasa. The purpose of the filings is for Icasa to determine whether the proposed rate increases (or decreases) conform to the rate regime regulations in force at the time.

Paragraph 6 of Icasa's 2002 rate regime regulations sets out the filing requirements for Telkom. It requires that Telkom file tariffs at least thirty business days before the proposed date on which the proposed rates are to become effective. The regulations also indicate that Icasa may specify the form in which the tariff

<sup>57</sup> Case number 33507/2001 (Transvaal Provincial Division).

<sup>58</sup> Case number 10716/2002.

<sup>59</sup> See *Icasa v Telkom* (note 55 above).

<sup>60</sup> *Icasa v Telkom* (note 55 above) 4 (the Court's discussion of Telkom's argument).

<sup>61</sup> Settlement Agreement entered into between the Independent Communications Authority of South Africa and the Chairperson of the Independent Communications Authority of South Africa and Telkom SA Limited.

filings are to be made.<sup>64</sup> Telkom is also required to file the standard terms and conditions under which it offers services.<sup>65</sup>

The regulations permit Icasa to ‘disapprove’ the proposed rates only if-

- the calculations contain mathematical errors, or
- the terms and conditions violate applicable laws, including without limitation, policy directions, regulations and the Rate Regime, in a material respect.<sup>66</sup>

Thus, Icasa does not approve Telkom’s rates as is sometimes assumed. It carries out an administrative function in determining whether the calculations are correct. It is also supposed to carry out an audit type process to determine whether the standard terms and conditions are consistent with all law.<sup>67</sup> In addition, if Icasa does not disapprove the tariff filing within fifteen business days of the proposed effective date, the tariff filing is deemed approved (whether the calculations are correct and whether the terms and conditions violate applicable law).<sup>68</sup>

## 4. THE REGULATION OF MCTS RETAIL PRICING

### 4.1 The Rate Regime

The initial rate regime for the MCTS licensees was provided for in the MCTS licences, in particular in paragraph 13.<sup>69</sup> Paragraph 13.5 of the original Vodacom and MTN licence provided that the licensees could increase tariff rates by no more than the percentage year on year increase in CPI, unless a greater increase was otherwise approved by the then Postmaster General. Paragraph 13.7 indicated that the base tariff rates were annexed to the licence. The provisions of Vodacom’s and MTN’s amended licences, in paragraph 13, are substantially similar.<sup>70</sup> Cell C’s licence does not include similar rate regime provisions. In issuing the licence, Icasa thus determined not to regulate Cell C’s rates.<sup>71</sup>

The rate regime for Vodacom and MTN is a price cap mechanism, not unlike the regime for Telkom. However, the productivity factor is set at 0 percent. It is also different from the regime applicable to Telkom in that the price cap applies to each tariff plan.<sup>72</sup> As a result, there is no need for the imposition of a maximum movement for individual plans. There is thus also no control on a basket of tariff plans that an MCTS licensee provides.<sup>73</sup>

<sup>64</sup> Government Notice No R 1333 Regulations: Manner of Determining Fees and Charges for Telecommunications Services in the Public Switched Telecommunications Services (PSTS) Sector published in Government Gazette 23986 dated 24 October 2002.

<sup>65</sup> Melody (note 42 above) para 4.

<sup>66</sup> No R 1333 (note 62 above) para 6(2).

<sup>67</sup> No R 1333 (note 62 above) para 6(1).

<sup>68</sup> No R 1333 (note 62 above) para 6(4).

<sup>69</sup> It is not clear whether Icasa does in fact carry out this audit type function regarding the standard terms and conditions proposed by Telkom. It is also not clear whether the time allowed (15 business days) is enough to carry out this function effectively.

<sup>70</sup> No R 1333 (note 62 above) para 6(3).

<sup>71</sup> Notice 1078 of 1993 published in Government Gazette 15232 dated 29 October 1993.

<sup>72</sup> Notices 1483 and 1484 of 2002 published in Government Gazette 23760 dated 19 August 2002, Vodacom’s and MTN’s licences respectively.

<sup>73</sup> Notice 1601 of 2001 published in Government Gazette 22429 dated 29 June 2001. But see para 12 regarding Cell C’s tariff filing requirements.

<sup>74</sup> Notices 1483 and 1484 (note 70 above) para 13.5.

<sup>75</sup> See Hodge (note 2 above).

Community Service Telephones<sup>74</sup> (CSTs) by all MCTS licensees are regulated differently from the regulation of commercial rates. Any increase in tariff rates for CSTs must be approved by Icasa.<sup>75</sup> Vodacom and MTN are also required to decrease tariff rates for CSTs if interconnection charges and other fees payable by the Licensee to Telkom are less than that provided for at the time.<sup>76</sup>

The establishment of an initial rate regime for MCTS licensees was conducted in absence of much information on which to base determinations such as the determination of an appropriate productivity factor. MCTS was a new market segment in South Africa, so there were no costs or operational history. The initial productivity factor of 0 percent seems relatively lenient but not unreasonable for an initial period where the licensees would have to roll out a new network to cover a significant geographic area and percentage of population. There may also have been less concern about getting the productivity factor correct, given the existence of some competition in the market segment.<sup>77</sup>

## 4.2 Rate Regime Reviews

Icasa began a review of the MCTS rate regime in June 1999 with a notice indicating its intent to make regulations regarding the manner of determining fees and charges.<sup>78</sup> The regulations proposed a price cap mechanism, with the productivity factor set at 1.5 percent for each basket and each service within the basket.<sup>79</sup> The regulation proposed the following baskets -<sup>80</sup>

- Basic Basket
  - Local calls
  - National calls
  - Mobile to mobile calls
  - Calls to 0800 numbers
  - Calls to 089 numbers
  - Directory calls
  - Call forwarding: local calls and national calls
  - Voice mail
  - Monthly subscription (which includes free minutes where applicable)
- International Voice Basket
- Data and Fax Basket
- Faxmail Basket

<sup>74</sup> Community Service Telephone was defined in the original Vodacom and MTN licence as Terminal Equipment which is registered as such by a Licensee in its own records; and is made available to the general public for the provision of the Service, and to this end is freely accessible; and is located in an Under-served Area or in a Community Centre; and is provided at tariffs which include a Community Service Telephone Tariff in terms of the licence. Notice 1078 of 1993 (note 69 above). The definition in Vodacom's and MTN's amended licences is the same. Notices 1483 and 1484 of 2002 (note 70 above). The definition in Cell C's licence is slightly different. Notice 1601 of 2001 (note 71 above).

<sup>75</sup> Notice 1078 of 1993 (note 69 above) para 13.6 (Vodacom's and MTN's original licence); Notices 1483 and 1484 of 2002 (note 70 above) para 13.6 (Vodacom's and MTN's amended licences, respectively); Notice 1601 of 2001 (note 71 above) 12.5 (Cell C's licence).

<sup>76</sup> Notice 1078 of 1993 (note 69 above) para 13.10 (Vodacom's and MTN's original licence); Notices 1483 and 1484 of 2002 (note 70 above) para 13.10 (Vodacom's and MTN's amended licences, respectively). There is no similar provision in Cell C's licence.

<sup>77</sup> Hodge (note 2 above).

<sup>78</sup> Notice 1320 of 1999 published in Government Gazette 20205 dated 11 June 1999.

<sup>79</sup> Notice 1320 of 1999 (note 78 above) para 3.

<sup>80</sup> Notice 1320 of 1999 (note 78 above) definition of Basket of Services.

The proposed regulation allowed the licensees to eliminate services from the basket from time to time.<sup>81</sup>

The rate regime regulations for MCTS have, as at July 2004, not been promulgated. There may be a number of reasons for this. First, there is some degree of competition in the market segment. Second, there are huge resource constraints at Icasa and other issues, such as the licensing of the third MCTS licensee (Cell C) and the SNO, have taken priority.<sup>82</sup>

If the primary reason that the rate regime regulations for MCTS have not been promulgated is resource constraints at Icasa, that is somewhat understandable. However, the existence of two or even three competitors in the MCTS market segment does not equal competition sufficient to forbear regulating prices. The MCTS market segment is one in which there are huge entry barriers, the most significant of which is regulatory — the need to obtain services and frequency use licences. Further, studies in other markets have suggested collusion is more likely than competition. And while a finding of collusive behaviour in other markets does not necessarily indicate collusion in the South African market, it does establish that there is a high probability of collusion in this market segment.<sup>83</sup>

Given persistently high MCTS rates, there would appear to be enough evidence to suspect that there might be some collusion in the MCTS market segment, suggesting an investigation would be a useful exercise. Of course, at this point the concern is not that collusion happened in the past, but rather that it continues to occur.<sup>84</sup>

### 4.3 The Filing of Tariffs

The MCTS licences set out the tariff filing requirements.<sup>85</sup> The MCTS licensees must file tariffs at least seven days before the tariff rate is to come into effect and the form of tariff filings must be approved by Icasa and filings must include a description of the service and details of the nature and amounts payable for the service.<sup>86</sup> If the charges vary in amount or nature, details must be provided.<sup>87</sup> In addition, tariff filings must be precise and detailed enough to be used to work out the nature and amounts payable for each service.<sup>88</sup>

## 5. REGULATORY ACCOUNTS

Regulatory accounts house the most important information required for effective pricing regulation. They provide the detailed cost information that makes effective price regulation possible.

Sections 46 and 97 of the Telecommunications Act concern the accounts and records to be kept and produced by a licensee. The sections provide that licensees must keep accounts as prescribed<sup>89</sup> and produce accounts as directed by Icasa.<sup>90</sup>

<sup>81</sup> Notice 1320 of 1999 (note 78 above) para 5.

<sup>82</sup> Hodge (note 2 above).

<sup>83</sup> Hodge (note 2 above).

<sup>84</sup> Hodge (note 2 above).

<sup>85</sup> Notices 1483 and 1484 of 2002 (note 70 above) paras 13.1-13.4 (Vodacom's and MTN's amended licences, respectively); Notice 1601 of 2001 (note 71 above) paras 12.1-12.4 (Cell C's licence).

<sup>86</sup> Notices 1483 and 1484 (note 70 above) para 13.2; Notice 1601 of 2001 (note 71 above) para 12.2.

<sup>87</sup> Notices 1483 and 1484 (note 70 above) para 13.3; Notice 1601 of 2001 (note 71 above) para 12.3.

<sup>88</sup> Notices 1483 and 1484 (note 70 above) para 13.4; Notice 1601 of 2001 (note 71 above) para 12.4.

<sup>89</sup> S 46 of the Telecommunications Act.

<sup>90</sup> Section 97 of the Telecommunications Act.

The content and format in which the licensees must submit their regulatory accounts to Icasa are prescribed in the Chart of Accounts and Cost Allocation Manual (COA/CAM). Three different sets of COA/CAM are currently applicable. Volume 1 sets out high level principles on regulatory accounting. Volume 2 sets out requirements for MCTS licensees. Volume 3 sets out requirements for PSTS licensees. COA/CAM are supplemented by Procedures Manuals, which include more detail than COA/CAM. Procedures Manuals are developed by each licensee and approved by Icasa.<sup>91</sup>

Icasa has exempted new licensees from having to comply with COA/CAM. Cell C (Pty) Ltd, Sentech (Pty) Ltd, the Second National Operator, under-serviced area licensees and local access telecommunications and public pay telephone services licensees have been exempted completely. Vodacom (Pty) Ltd and Mobile Telephone Networks (Pty) Ltd were exempted from compliance with Volume 1 until Volume 2 had been updated.<sup>92</sup> The updated Volume 2 was published on 5 July 2004.<sup>93</sup>

## 5.1 PSTS Regulatory Accounts

Before the promulgation of COA/CAM by Icasa in 2002 for PSTS licensees and in 2004 for MCTS licensees, certain provisions in the PSTS and MCTS licensees were applicable to regulatory accounts.

Paragraph 8 of Telkom's PSTS licence concerns the preparation of regulatory accounts. In accordance with that paragraph, Telkom is required to establish regulatory accounts in accordance with COA/CAM.<sup>94</sup> Regulatory accounts are defined in paragraph 8.1 as accounts on an historic and a current cost basis in respect of retail activities and wholesale activities separately. Paragraph 8.3 requires Telkom to prepare sufficient accounting and reporting arrangements to comply with paragraph 8.

Paragraph 8.5 allows Icasa to request an audit report in respect of each of the regulatory accounts. The audit report must state whether in the opinion of the auditors, the regulatory accounts comply with COA/CAM and accurately represents the assets, liabilities, revenues, and expenses.<sup>95</sup>

Paragraphs 8.4 and 8.7 of Telkom's license provide Telkom with generous time in which to comply with the requirement to produce regulatory accounts. Paragraph 8.4 states that Telkom does not have to prepare regulatory accounts until it has put in place the necessary accounting and management information systems that will enable it to do so. The paragraph, however, does indicate that such systems must be in place by no later than five years after the issuance of the licence (which was 7 May 2002).<sup>96</sup> The paragraph also indicates that Telkom is not required to do anything that would impose an 'undue burden' on it, 'having regard to its obligations' in terms of the licence.<sup>97</sup>

<sup>91</sup> See para 1.6 of COA/CAM published on 19 July 2002, Notice 1282 of 2002 published in Government Gazette 23632 dated 19 July 2002, for a discussion of the COA/CAM structure.

<sup>92</sup> Notice 278 of 2002 published in Government Gazette 23166 dated 28 February 2002.

<sup>93</sup> Notice 1302 of 2004 published in Government Gazette 26520 dated 5 July 2004.

<sup>94</sup> Notice 768 of 1997 (note 26 above) para 8.2.

<sup>95</sup> Notice 768 of 1997 (note 26 above) para 8.5.

<sup>96</sup> Notice 768 of 1997 (note 26 above) para 8.4.

<sup>97</sup> It is difficult to imagine what undue burden with regard to Telkom's obligations could possibly be imposed by the basic and critical requirement for pricing regulation, to produce regulatory accounts.

Paragraph 8.7 states that until such time that COA/CAM is promulgated by Icasa, Telkom must produce audited annual financial statements in accordance with generally accepted accounting principles. It also states that the COA/CAM may be changed from time to time and that if it is changed, Telkom is entitled to a reasonable time to comply with any new COA/CAM promulgated.

Icasa initiated the regulatory process for the development of COA/CAM in 2001. Icasa requested tenders for the development of COA/CAM for the PSTS market segment in June 2001.<sup>98</sup> On 28 February 2002, it provided notice of its intention to prescribe Volumes 1 and 3.<sup>99</sup> Finally, on 19 July 2002, the Minister of Communications approved and published Volumes 1 and 3 of COA/CAM.<sup>100</sup>

Volume 1 of COA/CAM states that Telkom must submit its first regulatory accounts within six months of the first financial year end after the COA/CAM regulations came into force (which was September 2003, 16 months after Telkom was to have submitted regulatory accounts if Icasa had made the COA/CAM regulations on time).<sup>101</sup>

According to Telkom's license, Telkom was supposed to have produced its regulatory accounts by no later than 7 May 2002 in accordance with the COA/CAM. However, because the COA/CAM applicable to Telkom was not in place until 19 July 2002, it did not do so. In terms of the COA/CAM regulations, Telkom was required finally to produce regulatory accounts by September 2003. As at July 2004, Telkom, however, has not provided to Icasa regulatory accounts. Despite Icasa's indication that it would punish this violation,<sup>102</sup> it has apparently not done so. Telkom's continued disregard for the law makes it impossible for Icasa to effectively regulate Telkom's rates.

## 5.2 MCTS Regulatory Accounts

Vodacom and MTN were supposed to produce accounts in accordance with COA/CAM determined at the time by the Postmaster General in terms of their original licence.<sup>103</sup> Vodacom and MTN produced accounts in accordance with the COA/CAM that had been determined by the then Postmaster General, up to the year 2002.

Vodacom's and MTN's amended licences, issued in August 2002, provided that Vodacom and MTN are supposed to produce accounts in accordance with the COA/CAM determined by Icasa. However, the licence went on to provide that until Icasa promulgated the COA/CAM for MCTS licensees, the licensees were required only to keep and produce records in accordance with generally accepted accounting principles.<sup>104</sup>

Icasa requested tenders for the review of Volume 2 of the COA/CAM for the MCTS market segment in August 2002.<sup>105</sup> On 17 June 2003, it provided notice of its intention to prescribe Volume 2.<sup>106</sup> Finally, on 5 July 2004, the Minister of

<sup>98</sup> Notice 1561 of 2001 published in Government Gazette 22400 dated 22 June 2001.

<sup>99</sup> Notice 279 of 2002 published in Government Gazette 23167 dated 28 February 2002.

<sup>100</sup> Notice 1282 of 2002 published in Government Gazette 23632 dated 19 July 2002.

<sup>101</sup> Notice 1282 of 2002 (note 100 above) para 1.3.

<sup>102</sup> Langa, M 'Four Year Icasa Anniversary and Ten Years of Communications Regulation: Keynote Address for Stakeholders Evening (30 June 2004) 7-8.

<sup>103</sup> Notice 1078 of 1993 (note 69 above) para 12.1.

<sup>104</sup> Notices 1483 and 1484 of 2002 (note 70 above) para 12A.

<sup>105</sup> Notice 1447 of 2002 published in Government Gazette 23758 dated 16 August 2002.

<sup>106</sup> Notice 1742 of 2003 published in Government Gazette 25105 dated 17 June 2003.

Communications approved and published Volume 2 of the COA/CAM.<sup>107</sup>

In terms of the regulations exempting Vodacom and MTN from the requirements of Volume 1, Volume 1 becomes applicable with the publication of Volume 2.<sup>108</sup>

Unlike Telkom, which was supposed to have submitted regulatory accounts within six months of its year-end following the promulgation of Volumes 1 and 3, Vodacom and MTN are required to work out a schedule for implementation with Icasa in terms of paragraph 1.8 of Volume 2. Once that is done, they are to submit regulatory accounts within six months.<sup>109</sup>

## Conclusion

Retail pricing regulation is one of the most important elements of an effective telecommunications regulatory regime. It is critical where the market fails to produce competitive prices, such as in South Africa.

Retail pricing regulation, however, is an area that requires sufficient and sufficiently detailed information from regulated entities. It requires cooperation from those entities. It also requires a great deal of skill and expertise from those doing the regulating. Apart from politicians getting the policy and legislative framework correct, considerable economic, financial, technical and legal skills are required in the implementation of effective pricing regulation. This is a huge challenge for South Africa, giving that it began regulating the industry less than ten years ago and given that policy and the legislative framework have changed within that time frame.

Some improvements in the regulatory framework and the implementation thereof can be achieved. Some of the areas that require improvement were identified in Chapter 1 herein.

- Enforcement of the regulatory framework requirement on Telkom to produce regulatory accounts;
- Review of the rate regime; and
- Changing the rate review process to allow public participation.

Others include the following.

- Providing more human and financial resources for Icasa;
- Changing the Telecommunications Act to allow Icasa to publish its own regulations;
- Concluding studies regarding the rates for PSTS and MCTS, with a view to establishing whether rates are too high; and
- Investigating alternative mechanisms to effectively regulate retail pricing.

<sup>107</sup> Notice 1302 of 2004 published in Government Gazette 26520 dated 5 July 2004.

<sup>108</sup> Notice 278 of 2002 (note 92 above).

<sup>109</sup> Notice 1302 of 2004 (note 107 - above) para 1.8.

