

NON-CONFIDENTIAL VERSION

**COMPETITION TRIBUNAL**  
REPUBLIC OF SOUTH AFRICA

Case No: 016865

**In the matter between:**

The Competition Commission

Applicant

and

Telkom SA SOC Limited

Respondent

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Panel: N Manoim (Presiding Member), Y Carrim  
(Tribunal Member) and T Madima (Tribunal  
Member)

Heard on: 17 July 2013

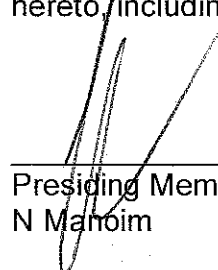
Decided on: 18 July 2013

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**Order (Non-confidential version)**

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The Tribunal hereby confirms as an order in terms of section 58(1)(a) of the Competition Act, 1998 (Act No. 89 of 1998) the settlement agreement reached between the Competition Commission and the respondent which is attached hereto including the annexures.



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Presiding Member  
N Manoim

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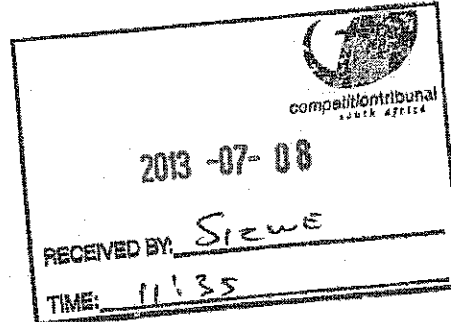
**Concurring: Y Carrim and T Madima**

**IN THE COMPETITION TRIBUNAL OF SOUTH AFRICA  
HELD AT PRETORIA**

Tribunal Case No. 55/CR/Jul09

73/CR/Oct09

78/CR/Nov09



In the matter between:

**THE COMPETITION COMMISSION**

Applicant

and

**TELKOM SA SOC LIMITED**

Respondent

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**SETTLEMENT AGREEMENT IN TERMS OF SECTION 27(1)(d) AS READ WITH  
SECTION 58(1)(a)(iii) OF THE COMPETITION ACT, 1998 (ACT NO. 89 OF 1998)  
IN RESPECT OF ALLEGED CONTRAVENTIONS OF SECTION 8 OF THE  
COMPETITION ACT NO. 89 OF 1998, AS AMENDED**

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The Competition Commission and Telkom hereby agree that application be made to the Competition Tribunal for the confirmation of this Settlement Agreement in terms of section 27(1)(d) read with section 58(1)(a)(iii) of the Competition Act, on the terms set out below:

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**1 INTERPRETATION**

**1.1 In this Settlement Agreement: -**

- 1.1.1 clause headings are for convenience and are not to be used in their interpretation;
  - 1.1.2 unless the context indicates a contrary intention an expression which denotes one gender includes the other, an expression which denotes a natural person includes a juristic person and *vice versa* and an expression which denotes the singular includes the plural and *vice versa*.
- 1.2 In this Settlement Agreement and the annexures thereto the following expressions bear the meanings assigned to them below and related expressions bear corresponding meanings: -
- 1.2.1 **'ADSL'** means asymmetric digital subscriber line;
  - 1.2.2 **'Act'** means the Competition Act 89 of 1998 as amended;
  - 1.2.3 **'Code of Conduct'** means Telkom's Wholesale / Retail Code of Conduct, which is annexed to this Settlement Agreement as Annexure C;
  - 1.2.4 **'Commissioner'** means the Commissioner of the Competition Commission appointed in terms of section 22 of the Act;
  - 1.2.5 **'Common Components'** means components that Telkom Retail and OLOs must, in common with each other, obtain from Telkom Wholesale in order to render a comparable service to their retail customers;
  - 1.2.6 **'Competition Commission'** means the Competition Commission, a statutory body established in terms of section 19 of the Act;
  - 1.2.7 **'Competition Tribunal'** means the Competition Tribunal, a statutory body established in terms of section 26 of the Act;
  - 1.2.8 **'Complaint Period'** means the period of 1 January 2005 to 31 December 2007;

- 1.2.9 **'Complaints'** means the complaints submitted by the complainants and investigated by the Commission under case numbers 2005Jun1670, 2005Dec2023, 2007Apr2868, 2007Jun2990 and 2007Dec3434;
- 1.2.10 **'Complainants'** means Internet Solutions (Pty) Ltd, Multichoice Subscriber Management Services (Pty) Ltd, Internet Service Providers Association and Verizon South Africa (Pty) Ltd
- 1.2.11 **'Confirmation Date'** means the date upon which the Competition Tribunal confirms this Settlement Agreement in terms of section 58(1)(a)(iii) of the Act;
- 1.2.12 **'Settlement Agreement'** means this agreement and its annexures;
- 1.2.13 **'Diginet'** means Telkom's Diginet service, a dedicated constant bit rate data connection between two points running at bandwidth speeds in increments of 64 kb/s up to and including bandwidth speeds of 1984 kb/s;
- 1.2.14 **'ECA'** means the Electronic Communications Act 36 of 2005;
- 1.2.15 **'ECNS'** means an electronic communications network service as defined in the ECA;
- 1.2.16 **'ECS'** means an electronic communications service as defined in the ECA;
- 1.2.17 **'HBTL'** means a high bandwidth (2 mb/s and above) national electronic communications transmission line;
- 1.2.18 **'IP'** means Internet protocol;
- 1.2.19 **'IP Connect'** means the service provided by Telkom Wholesale to facilitate the provision of Internet and IP VPN services to customers that use ADSL to connect to a backbone network;

- 1.2.20 **'IPLC'** means an international private leased circuit;
- 1.2.21 **'IP VPN'** means a Multiprotocol Layer Switching based VPN;
- 1.2.22 **'ISP'** means Internet service provider;
- 1.2.23 **'Non-common Components'** means components which are either a) ordinarily required by OLOs only and not Telkom Retail in order to access Telkom's Wholesale network services due to not being vertically integrated, or b) ordinarily required by Telkom Retail and not OLOs in order to access Telkom's Wholesale network services by virtue of its vertical integration;
- 1.2.24 **'OLO'**, an acronym for other licensed operator, means an ECNS or ECS licensee other than Telkom;
- 1.2.25 **'Party'** means either the Competition Commission or Telkom, and **'Parties'** means both of them;
- 1.2.26 **'Referral'** means the referral by the Competition Commission of certain aspects of the Complaints to the Competition Tribunal on 26 October 2009 under Competition Tribunal case numbers 55/CR/JUL09, 73/CR/OCT09 and 78/CR/NOV09;
- 1.2.27 **'Signature Date'** means the date that the Settlement Agreement is signed by the Party signing last in time;
- 1.2.28 **'Telkom'** means Telkom SA SOC Limited, a public company duly incorporated in the Republic of South Africa, with registration number 1991/05476/30 and with its registered office at Telkom Towers North, 152 Johannes Ramokhoase Street, Pretoria;
- 
- 1.2.29 **'Telkom Retail'** means Telkom's retail division and encompasses the business conducted by the division;
- 1.2.30 **'Telkom Wholesale'** means Telkom's wholesale division and encompasses the business conducted by the division;

1.2.31 'Transfer Pricing Programme' means Telkom's internal transfer pricing programme, a draft of which is annexed to this Settlement Agreement as Annexure A; and

1.2.32 'VPN' means virtual private network.

## 2 THE COMPLAINTS AND THE INVESTIGATION

2.1 Over the period 26 June 2005 to 19 July 2007, Internet Solutions (Pty) Ltd, the internet division of Multichoice Subscriber Management Services (Pty) Ltd, Verizon (Pty) Ltd and the Internet Service Providers Association submitted five complaints against Telkom to the Competition Commission for investigation.

2.2 On the basis of information solicited and obtained in the ensuing investigation the Competition Commission concluded that Telkom had engaged upon a so-called 'margin squeeze' by exacting from OLOs that are first tier ISPs or, in the case of Diginet access lines, their customers, prices for:

2.2.1 HBTLs and IPLCs that were excessive;

2.2.2 Diginet access lines, HBTLs, IPLCs and IP Connect that were being set at levels that precluded cost-effective competition with Telkom Retail's internet access and IP VPN services (via leased line or ADSL access).

2.3 The Commission also concluded that Telkom had engaged in anti-competitive conditional selling of IP VPN and Internet access services through bundling these products with Diginet and ADSL access services that were priced far lower than the equivalent access services which end customers would purchase when considering the purchase of IP VPN and Internet access from OLOs relative to Telkom Retail.

2.4 The Competition Commission, characterizing the conduct as a contravention of sections 8(a), 8(b), 8(c) and 8(d)(iii) of the Act, referred it to the Competition Tribunal on 26 October 2009 for adjudication. Following the exchange of pleadings, the Parties have agreed to settle the Referral on the terms of this Settlement Agreement.

### **3 STATEMENT OF CONDUCT AND ADMISSION**

3.1 The facts which are common cause between the Competition Commission and Telkom are that during the Complaint Period –

3.1.1 first tier ISPs attempted to compete in the provision of wholesale and retail Internet access and IP VPN services through the use and sale of backbone networks built for such services;

3.1.2 first tier ISPs had no commercially viable alternative but to build the backbone networks using transmission lines sold by Telkom, namely HBTLs and IPLCs;

3.1.3 first tier ISP customers had no commercially viable alternative but to utilize Telkom's ADSL and Diginet services to gain access to the backbone networks;

3.1.4 the prices for the Telkom access services supplied to first tier ISPs and their end customers were higher than those that Telkom Retail accounted for in pricing its bundled IP VPN services to its customers;

3.1.5 the structures of pricing amounted to a margin squeeze of the first tier ISP competitors of Telkom and anti-competitive conditional selling of IP VPN and Internet Access with Diginet and ADSL access services;

- 3.2 Telkom admits that its conduct amounted to a contravention of sections 8(c) and 8(d)(iii) of the Act.

#### 4 CESSATION OF CONDUCT

- 4.1 Telkom warrants that the conduct has already ceased or to the extent not ceased, that it will cease within six calendar months of the Confirmation Date:

- 4.2 In order to give effect to this warranty:

- 4.2.1 Telkom Wholesale will adopt and commence implementation of the Transfer Pricing Programme embodied in Annexure A in respect of IPLCs, HBTs, IP Connect and Diginet services. This entails that, Telkom Wholesale will:

- 4.2.1.1 price network services it provides to both OLOs and Telkom Retail on a non-discriminatory basis for Common Components. In other words, the transfer price raised by Telkom Wholesale for services provided to Telkom Retail will be at the same price Telkom Wholesale provides the equivalent service to OLOs;

- 4.2.1.2 price Non-common Components to OLOs at no more than cost plus a reasonable return and Non-common Components to Telkom Retail at no less than cost plus a reasonable return. There will also be no restriction (but specifically excluding network elements, such as the HOF or HOC, which of necessity are part of Telkom's network infrastructure and which are only constructed by Telkom to enable OLOs to access Telkom's network and or services provided over such network) on self-provisioning the non-common components utilised by OLOs where technically feasible.



- 4.2.2 Telkom Retail will implement the Retail Pricing Policy embodied in Annexure B. This entails that Telkom Retail will set retail prices for its IP VPN and Internet access products in a manner that ensures it covers its costs, which include both the cost of services from Telkom Wholesale at non-discriminatory transfer prices (including HBTLS, IPLCs, IP Connect and Diginet services) and all Telkom Retail own costs of selling the services. This will ensure that Telkom Retail does not engage in a margin squeeze of rival OLOs.

## **5 ADMINISTRATIVE PENALTY**

- 5.1 Having regard to the provisions of section 58(1)(a)(iii) read with sections 59(1)(a), 59(2) and 59(3) of the Act, Telkom is liable to pay an administrative penalty in respect of its contraventions of section 8(d)(iii) of the Act.
- 5.2 Telkom has agreed to pay an administrative penalty in the amount of R200 000 000 (two hundred million Rand). This penalty shall be paid as follows:
- 5.2.1 R66 666 666 (sixty six million six hundred and sixty six thousand six hundred and sixty six Rand) within 30 days of the Confirmation Date;
- 5.2.2 R66 666 666 (sixty six million six hundred and sixty six thousand six hundred and sixty six Rand), on or before the first anniversary of the Confirmation Date; and
- 5.2.3 ~~R66 666 668 (sixty six million six hundred and sixty six thousand six hundred and sixty eight Rand)~~, on or before the second anniversary of the Confirmation Date.

- 5.3 The penalty shall be paid into the Competition Commission's bank account, details of which are as follows:

Bank name:	Absa Bank
Branch name:	Pretoria
Account holder:	Competition Commission Fees Account
Account number:	4050778576
Account type:	Current Account
Branch Code:	323 345

- 5.4 The penalty shall be paid over by the Competition Commission to the National Revenue Fund in accordance with section 59(4) of the Competition Act.

## **6 AGREEMENT CONCERNING FUTURE CONDUCT**

- 6.1 Telkom shall within 30 days of the Confirmation Date prepare and circulate to its employees and relevant corporate governance structures a statement summarising the contents of this Settlement Agreement.

- 6.2 Within six months of the Confirmation Date, Telkom will -

6.2.1 implement a functional Wholesale / Retail separation within its business on the basis contemplated in, and subject to the provisions of, the Code of Conduct attached as Annexure C. This entails that Telkom Wholesale will treat OLOs and Telkom Retail in a non-discriminatory manner when providing services and will protect the confidential information of OLOs from Telkom Retail;

6.2.2 adopt and commence implementation of a Transfer Pricing Programme that will regulate transactions in the provision of network services between Telkom's Wholesale and Retail

business divisions in accordance with the Transfer Pricing Programme attached as Annexure A. Key aspects of this programme are that:

6.2.2.1 it will operationalise a system whereby a set of 'fixed network products' are traded internally from the Wholesale division to the Retail division, and a set of transfer prices are applied to these products;

6.2.2.2 transfer prices will be determined based on cost, as calculated by Telkom's regulatory cost reporting systems, or where there are corresponding wholesale products sold to external customers by reference to the pricing structure applicable to external customers;

6.2.2.3 as such, transfer pricing will enable Telkom to provide a transparently non-discriminatory approach to the pricing of services provided to OLOs.

and

6.2.3 keep separate internal accounts for its retail IP VPN and Internet access products in a way that permits the profitability of these retail products to be monitored by the Competition Commission, in keeping with the principles set out in Annexure B.

6.3 The Code of Conduct and the Transfer Pricing Programme contemplated in 6.2.1 and 6.2.2 and the obligation described in 6.2.3 will remain in force for a period of five years after the Confirmation Date.

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6.4 Telkom shall, subject to 10 –

6.4.1 in its 2014, 2015 and 2016 financial years, reduce the prices of wholesale products implicated in the complaint (namely, IPLCs, HBTLS, Diginet and IP Connect) and related retail products (VPN

Supreme and Internet Access, along with the retail IPLCs, HBTLS and Diginet provided to corporate customers) by at least the percentages contemplated in Annexure D. Such price reductions shall amount to an indicative value of at least R875 000 000 (eight hundred and seventy five million Rand) and shall be at least 70% wholesale and no more than 30% retail weighted in order to eliminate any margin squeeze whilst ensuring that wholesale product savings are passed on to the benefit of end consumers;

6.4.2 in the 2017 and 2018 financial years, charge no higher prices for the products referred to in 6.4.1 than the prices charged in the 2016 financial year.

6.5 Telkom shall within the 2014 financial year embark on a roll-out of strategic points of presence in the public sector at Telkom's cost.

## **7 COMPLIANCE PROGRAM**

7.1 Telkom shall develop or, if already developed, review and update, implement and monitor a competition law compliance programme incorporating corporate governance ("the compliance programme") in Telkom Wholesale and Telkom Retail, designed to ensure that its employees, management and directors do not engage in future contraventions of Chapter 2 of the Act.

7.2 In particular, after confirmation of this Settlement Agreement by the Competition Tribunal, Telkom shall:

7.2.1 formulate and implement the compliance programme

7.2.2 as part of the compliance programme, provide training on relevant competition law compliance to all relevant persons and/or officials employed by Telkom; and

7.2.3 review (and update where necessary) the compliance programme annually to ensure Telkom's continued compliance with the Act.

7.3 Telkom will submit a copy of the compliance programme to the Competition Commission within 120 business days of the Confirmation Date.

## **8 CO-OPERATION AND DISPUTE RESOLUTION PROCEDURE**

8.1 Telkom and the Competition Commission will, within 60 business days of the Confirmation Date, enter into a memorandum of agreement containing a Co-operation and Dispute Resolution Procedure –

8.1.1 for complaints initiated by third parties or the Commissioner,

8.1.2 arising out of alleged contraventions of the Act by Telkom which are the subject of an investigation by the Competition Commission.

8.2 The Co-operation and Dispute Resolution Procedure shall –

8.2.1 not detract in any manner from the Competition Commission's execution of its statutory duties nor derogate from its powers in terms of the Act;

8.2.2 not detract in any manner from a complainant's rights in terms of the Act; and

8.2.3 be in force for a period of 5 (five) years from the Confirmation Date or such longer period as Telkom and the Competition Commission may agree in writing.

8.3 The Cooperation and Dispute Resolution Procedure shall include –

8.3.1 reasonable time frames within which –

- 8.3.1.1 the Competition Commission will provide Telkom with a statement of the facts and contentions that inform the complaint;
- 8.3.1.2 there can be an exchange of views on the merits of the complaint;
- 8.3.1.3 Telkom will provide its statement of defence and any proposal to remedy the conduct complained of;
- 8.3.2 a process by which high level representatives (at executive/department head level) of both Parties will endeavour to negotiate a settlement of the dispute.
- 8.4 The Parties will review (and update where necessary) the Co-operation and Dispute Resolution Procedure from time to time as the need arises.

## 9 MONITORING

- 9.1 Telkom shall procure that, within six months of the Confirmation Date (or such longer period as may be agreed with the Competition Commission in writing), an audit is conducted by an independent expert accountant or economist ('the first reviewer') to determine whether Telkom's conduct is in substantial compliance with the obligations contemplated in 4 and the annexures referred to in that paragraph.
- 9.2 If the determination is positive, the first reviewer will issue a certificate of compliance to this effect and provide reasons for the conclusion.
- 9.3 If the determination is negative, Telkom may elect, within seven business days, to
  - 9.3.1 abide by the determination; or

9.3.2 refer it for reconsideration by a second independent expert accountant or economist chosen by the agreement of the Parties ('the second reviewer') or, failing their agreement, by the Chair of the General Bar Council for the time being. The second reviewer shall –

9.3.2.1 hear the Parties if one or other so desire; and

9.3.2.2 make a decision that shall, in the absence of manifest error of calculation, be final and binding upon the Parties.

9.4 When a determination becomes binding, Telkom will take immediate action to comply with the obligations set out in 4 above and, within a period set by agreement between the Parties or the reviewer in question, shall solicit and obtain a fresh determination from the first reviewer that will trigger a repetition of the process described above.

9.5 A statement of the findings of the audit shall be included in Telkom's annual report for the 2014 financial year.

9.6 Within 3 months after the end of each of the five financial years after the Confirmation Date, Telkom will –

9.6.1 undertake an audit, which may be internal, to confirm that the transfer pricing system between Telkom Wholesale and Telkom Retail complies at least substantially with the Transfer Pricing Programme and the Retail Pricing Policy;

9.6.2 provide the Competition Commission with a written report of the findings of the audit within thirty days of its finalisation.

9.7 For the period of five years after the Confirmation Date, Telkom shall include in its annual report a statement by the Chief Executive Officer, for each year in question, that Telkom has complied with the terms of this Settlement Agreement.

- 9.8 For a period of five years after the Confirmation Date Telkom shall, upon request and reasonable notice, grant the Competition Commission access during business hours to its transfer pricing and retail product accounts and such underlying documents as may be required by the Competition Commission to enable it to analyse and interpret such accounts.

## 10 VARIATION

- 10.1 This Settlement Agreement may not be varied, provided that Telkom shall be entitled, upon good cause, to make a reasoned proposal to the Competition Commission to consent to the waiver, modification and/or substitution of one or more of the terms of this Settlement Agreement, which consent shall not be unreasonably withheld.
- 10.2 In the event of the Competition Commission and Telkom agreeing upon the waiver, modification or substitution of any aspect of this Settlement Agreement, the Competition Commission and Telkom shall make application to the Competition Tribunal for confirmation by it of such waiver, modification or substitution of any one or more of the terms of this Settlement Agreement.
- 10.3 In the event of the Competition Commission withholding its consent to a waiver, modification and/or substitution of one or more of the terms of this Settlement Agreement, Telkom shall be entitled to apply to the Competition Tribunal for an order waiving, modifying or substituting any one or more terms of this Settlement Agreement. The Competition Commission shall be entitled to oppose such application.
- 10.4 The Tribunal's decision in respect of the applications contemplated in paragraphs 10.2 and 10.3 shall be binding on the parties and may not be appealed further.



10.5 For the purpose of this Settlement Agreement, 'good cause' means circumstances that could not have reasonably been foreseen by Telkom and/or the Competition Commission at the time the Settlement Agreement was entered into.

## **11 FULL AND FINAL RESOLUTION**

The Settlement Agreement, upon its confirmation by the Competition Tribunal, shall be in full and final settlement of and conclude all proceedings between the Competition Commission and Telkom relating to the Complaints.

## **12 GENERAL**

12.1 This Settlement Agreement will in all respects be governed by and construed under the laws of the Republic of South Africa.

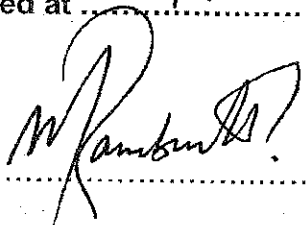
12.2 This Settlement Agreement constitutes the whole of the agreement between the Parties relating to the matters dealt with herein and save to the extent otherwise provided herein no undertaking, representation, term or condition relating to the subject matter of this Settlement Agreement not incorporated in this Settlement Agreement shall be binding on the Parties.

12.3 No variation, addition, deletion, or agreed cancellation (including this clause 12.3) shall be of any force or effect unless in writing and signed by or on behalf of the Parties hereto.

12.4 No waiver of any of the terms and conditions of this Settlement Agreement will be binding or effectual for any purpose unless in writing and signed by or on behalf of the Party giving the same. Any such waiver will be effective only in the specific instance and for the purpose given. No failure or delay on the part of either Party in exercising any right, power or privilege hereunder will constitute or be deemed to be a waiver

thereof, nor will any single or partial exercise of any right, power or privilege preclude any other or further exercise thereof or the exercise of any other right, power or privilege.

Signed at Pretoria on this 13 day of June 2013



Shan Ramburuth: Commissioner


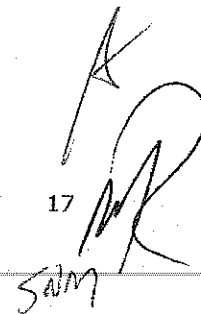
For: Competition Commission

Signed at Midrand on this 14 day of June 2013



Siphon Maseko: CEO

For: Telkom SA SOC Limited

  
Anton Kloppe  
J.E. Legal Services  
SAM

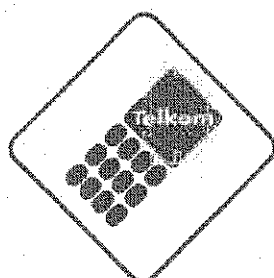
**The Annexures to this Settlement Agreement are:**

**Annexure A:**        Transfer Pricing Programme

**Annexure B:**        Retail Pricing Policy

**Annexure C:**        Code of Conduct

**Annexure D:**        Price Reductions



**Non-confidential  
extracts of the  
following document:**

**Telkom SA SOC  
Limited**

**Annexure A:  
Transfer Pricing  
Programme**

NOTE: THIS DOCUMENT CONTAINS CERTAIN EXTRACTS AND SUMMARIES OF THE CONFIDENTIAL VERSION; IN CASE OF DISCREPANCIES BETWEEN THIS VERSION AND THE CONFIDENTIAL VERSION, THE CONFIDENTIAL VERSION WILL TAKE PRECEDENCE. THIS DOCUMENT IS FOR THE INTERNAL USE OF TELKOM ONLY AND ITS EXISTENCE AND DISCLOSURE DO NOT CONSTITUTE A STIPULATION FOR THE BENEFIT OF ANY PARTY OTHER THAN TELKOM.

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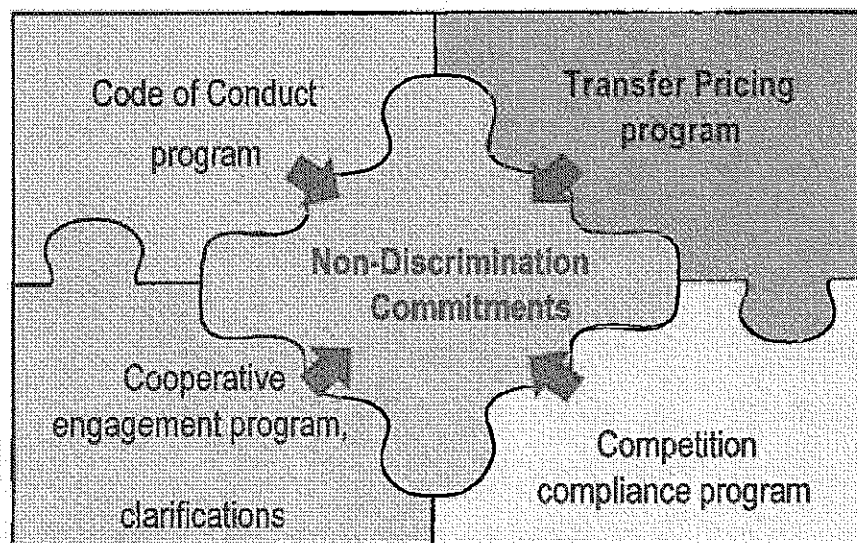
## Background

A number of complaints have been lodged with the Competition Commission alleging contraventions of the Competition Act by Telkom SA SOC LTD ("Telkom"). These alleged contraventions relate mainly to the manner in which Telkom has provided telecommunication services to wholesale customers in relation to its own retail customers.

As part of the Settlement Agreement, Telkom has committed to implement a programme (see Figure 1) to deliver a series of non-discrimination commitments, which will include a number of initiatives such as Transfer Pricing-, Code of Conduct-, a Competition Compliance- and a Cooperative engagement programme.

This document focuses on the commitment to introduce a Transfer Pricing Programme which will regulate transactions in the provision of Electronic Communications Services (ECS) / Electronic Communications Network Services (ECNS) between Telkom's Wholesale & Retail business divisions.

*Figure 1: The Transfer Pricing Programme as an initiative of the Non-discrimination commitments*



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### Introduction to transfer pricing programme

Telkom Group is structured into four companies: Telkom South Africa (TSA) SOC Ltd, Telkom International, Trudon and Swiftnet.

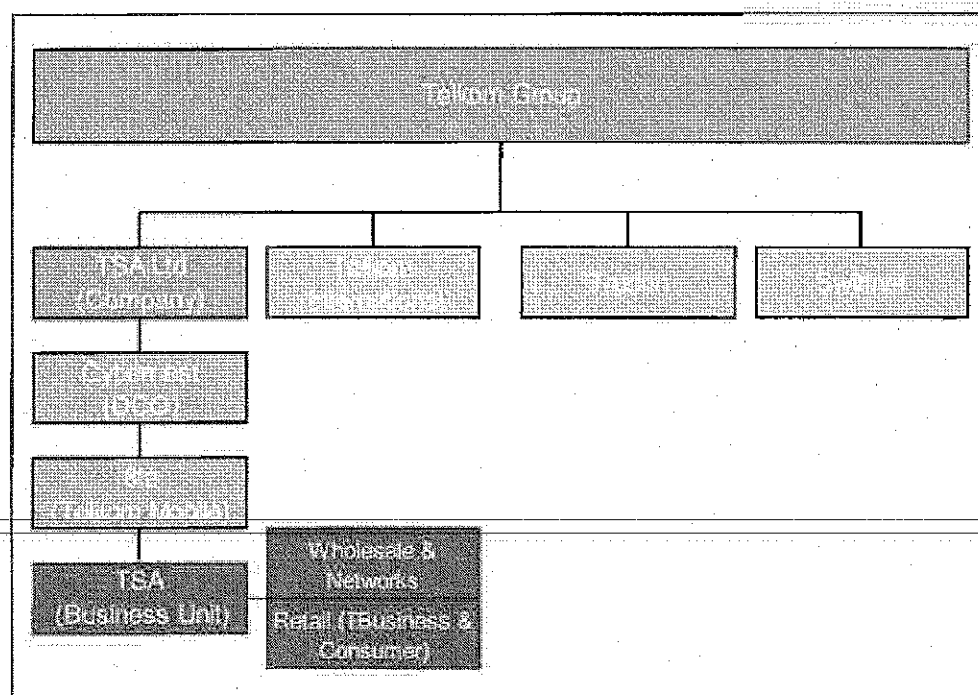
Telkom SA SOC Ltd is structured into three businesses: Telkom South Africa Business Unit (TSA), Cybernest, and 8ta.

The TSA Business unit's operations are organised between Wholesale and Retail divisions:

- The wholesale and network division (Wholesale) is the network 'factory' that provides network services to Other Licences Operators (OLOs) as well as to the Retail divisions of Telkom SA;
- The Consumer division provides services to retail customers, typically residential customers;
- The Telkom Business division provides services to retail customers, typically corporate and business customers;

This structure is illustrated below.

Figure 2: High-level Telkom structure



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Given the separate nature of the 8ta-branded Telkom Mobile division, it is not considered to be in scope of the Transfer Pricing programme.

The transfer pricing programme will operationalise a system whereby a set of 'fixed network products' are traded internally from the Wholesale division to the Retail divisions, and a set of transfer prices are applied to these products. Transfer prices will be determined based on cost, as calculated by Telkom's regulatory cost reporting systems, or – where there are corresponding wholesale products sold to external customers – by reference to the pricing structure applicable to external customers. As such, transfer pricing is at the heart of Telkom's commitment to providing a transparently non-discriminatory approach to the pricing of services provided to Other Licensed Operators (OLOs).

### **Telkom's approach to Transfer Pricing**

The primary purpose of the Transfer Pricing programme is to demonstrate the absence of discrimination in the determination of the prices at which Telkom's Wholesale divisions sells network services to external OLO customers and internal retail customers. As such, the focus of the analysis is on the determination of the cost of the network products provided by the Wholesale division and the consumption of these products by internal and external customers. However, in order to fully capture the costs of providing these products, it is necessary to consider the costs of the activities of all of the Telkom divisions that support the production of network services including Telkom's Cybernest and 8ta divisions and the central corporate functions such as HR and finance.

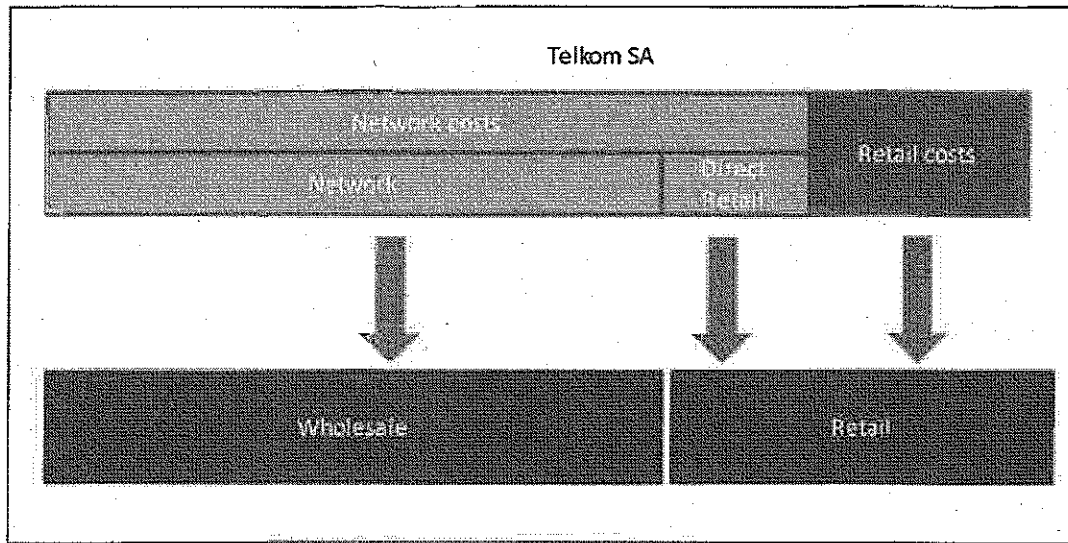
Given the consolidated nature of the GL, it is critical to the proposed Transfer Pricing programme that the costs of each division are separately identifiable, such that only the costs that are directly or indirectly attributable to the provision of network products are included in the determination of transfer prices.

Costs of Telkom SA will be allocated between the Wholesale and Retail divisions. Network costs will be allocated, via network components, to the network products produced by the Wholesale division and retail costs are allocated, via retail activities, to the retail products sold by the Retail divisions. Overheads and other common costs are allocated between divisions using [confidential].

*Figure 3: Allocation of Telkom SA cost to wholesale / retail business units*

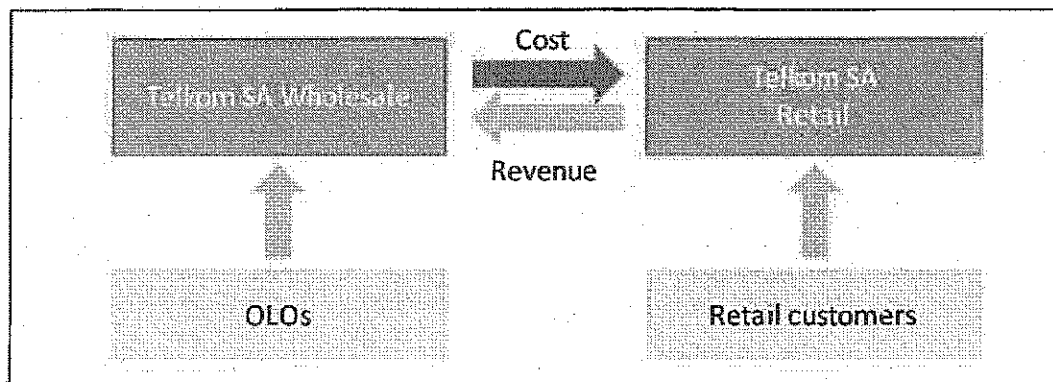


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The Wholesale division will then sell fixed network products to the Retail divisions, receiving a unit revenue for each product sold, which is in turn a unit cost to the Retail divisions. The wholesale business division also receives revenues from OLOs, whilst the Retail divisions receive revenues from retail customers.

Figure 4: Transfer charges between wholesale and retail



#### Derivation of transfer prices

In order to provide a transfer pricing regime that is transparent, consistent and objective, Telkom proposes to derive transfer prices for each network product.

Cost-based transfer prices will be determined by reference to the annualised capital cost, including depreciation and a return on capital employed, plus the annual operating costs, including direct costs and an allocation of overheads.

However, where internal network products correspond closely with wholesale products already sold to third party OLOs, Telkom will apply a transfer price based on the relevant wholesale price list to third party OLOs. Therefore Telkom's Retail divisions will pay the same price per unit as those paid by third party OLOs.

*Calculation of wholesale to retail transfer charges based on product volume multiplied by transfer price.*

The final calculation of transfer charges will be based on the multiplication of internal network product volume by the unit transfer price; the total value of transfer charges will be recognised as an internal revenue in a profit and loss statement for the Wholesale division, and the charges will be recognised as an input cost[confidential].

#### Development of the transfer price product catalogue

The definition of the network product catalogue will set out the products that are to be sold, at the same price, to Telkom's retail divisions and to OLOs. Network products will be defined such that they provide a transparent and consistent basis for consumption by both external wholesale and internal retail customers.

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The internal fixed network products for which transfer prices will be calculated and applied are [confidential]. Please note that this list is subject to refinement based on Telkom's analysis during the operationalisation of the transfer pricing programme. However, the programme will definitely be applied to the products directly implicated in the complaints addressed by the Settlement Agreement, namely IPLCs, HBTLs, IP Connect and leased line access services for a period of five years.

The transfer pricing methodology requires a wholesale / retail product matrix, so that for each external wholesale and retail product it is possible to identify the network product inputs that are needed in order to provide the external product. An example matrix for the Diginet product portfolio is provided below, with illustrative transfer prices (It is emphasised that this is only an illustrative example and has not bearing on the factual situation):

Figure 6: Wholesale/Retail product matrix for the Diginet product portfolio

		External Products											
		Retail Products						Wholesale Products					
		Fixed Diginet Local - 1000	Fixed Diginet Local - 10000	Fixed Diginet Local - 20000	Fixed Diginet Local - 100000	Fixed Diginet Local - 1000000	Fixed Diginet Local - 10000000	Fixed Diginet Local - 100000000	Fixed Diginet Local - 1000000000	Fixed Diginet Local - 10000000000	Fixed Diginet Local - 100000000000	Fixed Diginet Local - 1000000000000	Fixed Diginet Local - 10000000000000
Internal Fixed Network Products	Transfer Price												
	R100												
	R10												
	R20												
	R50												
	R100												
	R200												
	R400												

Transfer pricing in practice

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In addition to the calculation of transfer prices as outlined above, the operationalisation of transfer pricing will also involve a series of changes to the way in which Telkom's Retail and Wholesale divisions operate.

- Firstly, Telkom Wholesale will formalise the process by which the Retail divisions are informed of the prices of network products, and the processes by which any revisions to these prices are calculated and published.
- Secondly, these processes will be reflected in updates to the process by which Telkom Wholesale provides similar information to OLOs.

### **Monitoring and assurance**

Telkom understands the importance of demonstrating that the methodologies and systems used to operationalise transfer pricing are robust, transparent and objective. Hence, once transfer pricing is operationalised, Telkom will be in a position to provide to the Competition Commission a transfer pricing statement, which for externally available wholesale products, sets out the price at which each internal network product is transferred from the Wholesale to the Retail divisions and a comparison of the prices at which corresponding products are sold on a wholesale basis to third party OLOs. Telkom believes that this report will serve to demonstrate non-discrimination in the pricing of products provided to internal and external customers by the Wholesale division.

### **Transfer pricing for specific products**

The set of complaints that is being settled in respect of the Settlement Agreement directly implicate a number of Telkom Wholesale products that are alleged to have been subject to differential pricing in the past. These products will be subject to the Transfer Pricing policy for at least five years and will be dealt with on the following basis.

Telkom Wholesale's pricing of Diginet access lines used in the provision of IP VPNs and / or Internet access will be on a non-discriminatory, transfer price basis as per the general Transfer Pricing Policy. More specifically, diginet access lines will be priced in the following manner:

- Telkom Wholesale currently charges customers of Telkom Retail and OLOs identically for the customer end set (incl. port, NTU and local lead). This will continue to be the case;

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- Telkom Wholesale will charge the OLOs (and/or their customers) for the inter-exchange component on precisely the same basis as it charges Telkom Retail, including the same price structure and level of prices;
- Telkom Wholesale will by way of its CHIPAC solution charge the OLOs and Telkom Retail in precisely the same manner for the ports and network terminating units (NTUs) used in connecting from the exchange equipment to their respective ISP/VPN routers in their Points of Presence;
- Telkom Wholesale's pricing for non-common facilities / components utilised by OLOs will be not more than their cost plus a reasonable return. Non-common facilities / components (namely facilities such a Telkom Hand-Over Facility (HOF)), are those which are ordinarily required by OLOs only in order to access Telkom's network for the provision by the said OLOs of IP VPN or Internet access services similar to those provided by Telkom Retail (i.e. IP VPNs or Internet access via Diginet or ADSL) and which cannot be provisioned by the OLO itself or obtained by the OLO from persons other than Telkom. For non-common facilities / components (but specifically excluding network elements, such as the HOF or HOC, which of necessity are part of Telkom's network infrastructure and which are only constructed by Telkom to enable OLOs to access Telkom's network and or services provided over such network) which feasibly can be provisioned by the OLO itself or obtained from persons other than Telkom, Telkom will not restrict such self-provisioning or supply by persons other than Telkom (e.g. high bandwidth leased lines between the ISPs Points of Presence and the nearest Telkom exchange).
- Telkom Wholesale's pricing for non-common facilities / components utilised by Telkom Retail will be not less than their cost plus a reasonable return.

To the extent that the Telkom Wholesale diginet product is replaced or augmented by alternative leased line access products from Telkom Wholesale within the five year period, the same principles of non-discrimination and transfer pricing outlined above will apply.

Telkom Wholesale's pricing for access to ADSL lines through IP Connect will be non-discriminatory and comply with the general Transfer Pricing policy. In particular:

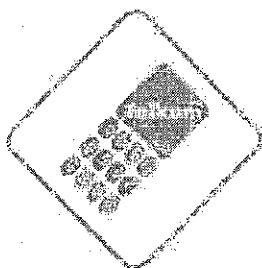
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- This entails that the price structure and level of prices for Common Components used by the OLOs and Telkom Retail will be exactly the same.
- Non-common components will similarly be priced at no more than cost plus a reasonable return for those non-common components utilised by OLOs and no less than cost plus a reasonable return for non-common components utilised by Telkom Retail. There will also be no restriction on self-provisioning the non-common components utilised by OLOs where technically feasible.

Telkom Wholesale's pricing for HBTLs and IPLCs will be non-discriminatory and comply with the general Transfer Pricing policy. In particular:

- This entails that the price structure and level of prices for Common Components used by the OLOs and Telkom Retail will be exactly the same.
- Non-common components will similarly be priced at no more than cost plus a reasonable return for those non-common components utilised by OLOs and no less than cost plus a reasonable return for non-common components utilised by Telkom Retail. There will also be no restriction (but specifically excluding network elements, such as the HOF or HOC, which of necessity are part of Telkom's network infrastructure and which are only constructed by Telkom to enable OLOs to access Telkom's network and or services provided over such network) on self-provisioning the non-common components utilised by OLOs where technically feasible.



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**Annexure B:  
Retail Pricing Policy**

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## **Background**

The complaints that are being settled as part of the Settlement Agreement relate to margin squeeze in the provision of IP VPNs and Internet access (via leased line or ADSL). The Transfer Pricing Programme commitment ensures that Telkom Wholesale will put in place non-discriminatory transfer prices for Telkom Retail that are the same as those prices charged to other licenced operators (OLOs). This is an important component of ensuring that no margin squeeze occurs in future again. However, as margin squeeze can also entail the pricing of the retail business below true transfer costs, a full commitment to cease such conduct also requires a commitment at Telkom Retail concerning its pricing policy for the IP VPN and Internet Access services. Specifically Telkom Retail undertakes that it will behave in the manner outlined in this annexure in order to ensure that no margin squeeze occurs now or in future.

## **Retail pricing commitment for IP VPNs/Internet Access**

When Telkom Retail costs bundled solutions for the provision of IP VPNs or Internet access (via leased line or ADSL), it shall ensure that it allocates the costs of the input elements referred to below, and sets retail prices for such services, in a manner that ensures that the following conditions are always met:

### **IP VPN solutions via leased line**

#### *Leased line access component*

Telkom Retail shall ensure that its total input cost allocation in respect of the leased line access component (Diginet or alternative leased line access products) for all IP VPN services rendered in a given financial year shall be based on actual lines utilised at the non-discriminatory transfer price for common components and cost-based prices for non-common components utilised by Telkom Retail from Telkom Wholesale as outlined in the Transfer Pricing Policy.

#### *Core component*

Telkom Retail shall ensure that its total input cost allocation in respect of the HBTLs used in the core component for all IP VPN services rendered in a given financial year shall be based on actual HBTLs utilised at a non-discriminatory transfer price (i.e. same price structure and level as priced to OLOs) from Telkom Wholesale. To the extent that IPLCs are utilised in IP VPN solutions for international connectivity, the cost allocation at Telkom Retail will occur on the

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same basis as HBTLs. This is outlined in the Transfer Pricing Policy. Other costs associated with the core component (such as routers, staff, NOC, etc) will be allocated based on the actual costs incurred.

### *Margin*

Telkom Retail shall not set prices for its bundled IP VPN services using leased line access lines at levels which are less than the sum of the costs referred to in its access and core network components and its other costs of rendering those services (e.g. sales effort, marketing, etc), as aggregated for a given financial year. Prices for individual contracts may vary from the average to the extent that the price concerned is an act done in good faith to meet a price or benefit offered by a competitor of Telkom. This should not detract from compliance with total revenues exceeding total costs for IP VPN products across all customers.

### *Internet services via leased lines*

#### *Leased line access component*

Telkom Retail shall ensure that its total input cost allocation in respect of the leased line access component (Diginet or alternative leased line access products) for all bundled Internet services solutions rendered in a given financial year shall be based on actual lines utilised at the non-discriminatory transfer price for common components and cost-based prices for non-common components utilised by Telkom Retail from Telkom Wholesale as outlined in the Transfer Pricing Policy.

#### *Core component*

Telkom Retail shall ensure that its total input cost allocation in respect of the HBTLs and IPLCs used in the core component for all Diginet based Internet services rendered in a given financial year shall be based on actual HBTLs and IPLCs utilised at a non-discriminatory transfer price (i.e. same price structure and level as priced to OLOs) from Telkom Wholesale. This is outlined in the Transfer Pricing Policy. Other costs associated with the core component (such as routers, staff, NOC, etc) will be allocated based on the actual costs incurred.

### *Margin*

Telkom Retail shall not set prices, for its bundled Internet services using Diginet access, at levels which will result in it recovering less than the costs referred to in its access and core network components and its other costs of rendering those

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services (e.g. sales effort, marketing, etc), as aggregated for a given financial year. Prices for individual contracts may vary from the average to the extent that the price concerned is an act done in good faith to meet a price or benefit offered by a competitor of Telkom. This should not detract from compliance with total revenues exceeding total costs for IP VPN products across all customers.

### **Internet services using ADSL**

#### *ADSL access component*

Telkom Retail shall ensure that its total input cost allocation in respect of the ADSL access component for all Internet services rendered in a given financial year shall be no less than the total prices that Telkom Wholesale would have charged to OLOs for the provision of ADSL access services of similar capacities and quantities. This is outlined in the Transfer Pricing Policy.

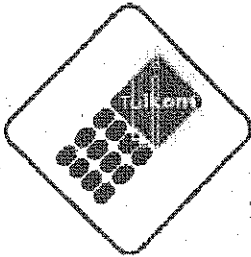
#### *Core component*

Telkom Retail shall ensure that its total input cost allocation in respect of the HBTLs and IPLCs used in the core component for all ADSL based Internet services rendered in a given financial year shall be based on actual HBTLs and IPLCs utilised at a non-discriminatory transfer price (i.e. same price structure and level as priced to OLOs) from Telkom Wholesale. This is outlined in the Transfer Pricing Policy. Other costs associated with the core component (such as routers, staff, NOC, etc) will be allocated based on the actual costs incurred.

#### *Margin*

Telkom Retail shall not set prices, for its bundled Internet services using ADSL, at levels which will result in it recovering less than the costs referred to in its access and core network components and its other costs of rendering those services (e.g. sales effort, marketing, etc), as aggregated for a given financial year. Prices for individual contracts may vary from the average to the extent that the price concerned is an act done in good faith to meet a price or benefit offered by a competitor of Telkom. This should not detract from compliance with total revenues exceeding total costs for IP VPN products across all customers.

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of the following document:**

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**Annexure C:**

**Code of Conduct**

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### **Background**

As part of the Settlement Agreement entered into between Telkom and the Competition Commission relating to alleged anti-competitive behaviour perpetrated by Telkom in the past, Telkom has undertaken to make certain commitments regarding its behaviour in the marketplace so that such allegations do not materialise in future. To this end, as part of the commitments made under the Settlement Agreement, Telkom has undertaken to develop a Code of Conduct for employees. This Code of Conduct ("the Code") sets out Telkom's expected behaviours for its employees and internal procedures. The Code acts as a guide for employees in how they interact with each other when dealing with specific Telkom services and how they interact with other licensees procuring wholesale services from Telkom. This Code also clarifies how Telkom employees share information with each other and external parties. The services this Code relates to, and our obligations are explained in the Code.

A key aspect of these obligations, covered in this Code, is that Telkom must treat itself and other licensees who want to use Telkom's services in a similar manner when providing specified services (i.e. Telkom must not discriminate in the provision of services). These behaviours are designed to ensure that Telkom does not act in an anti-competitive manner and that wholesale pricing is transparent and consistent.

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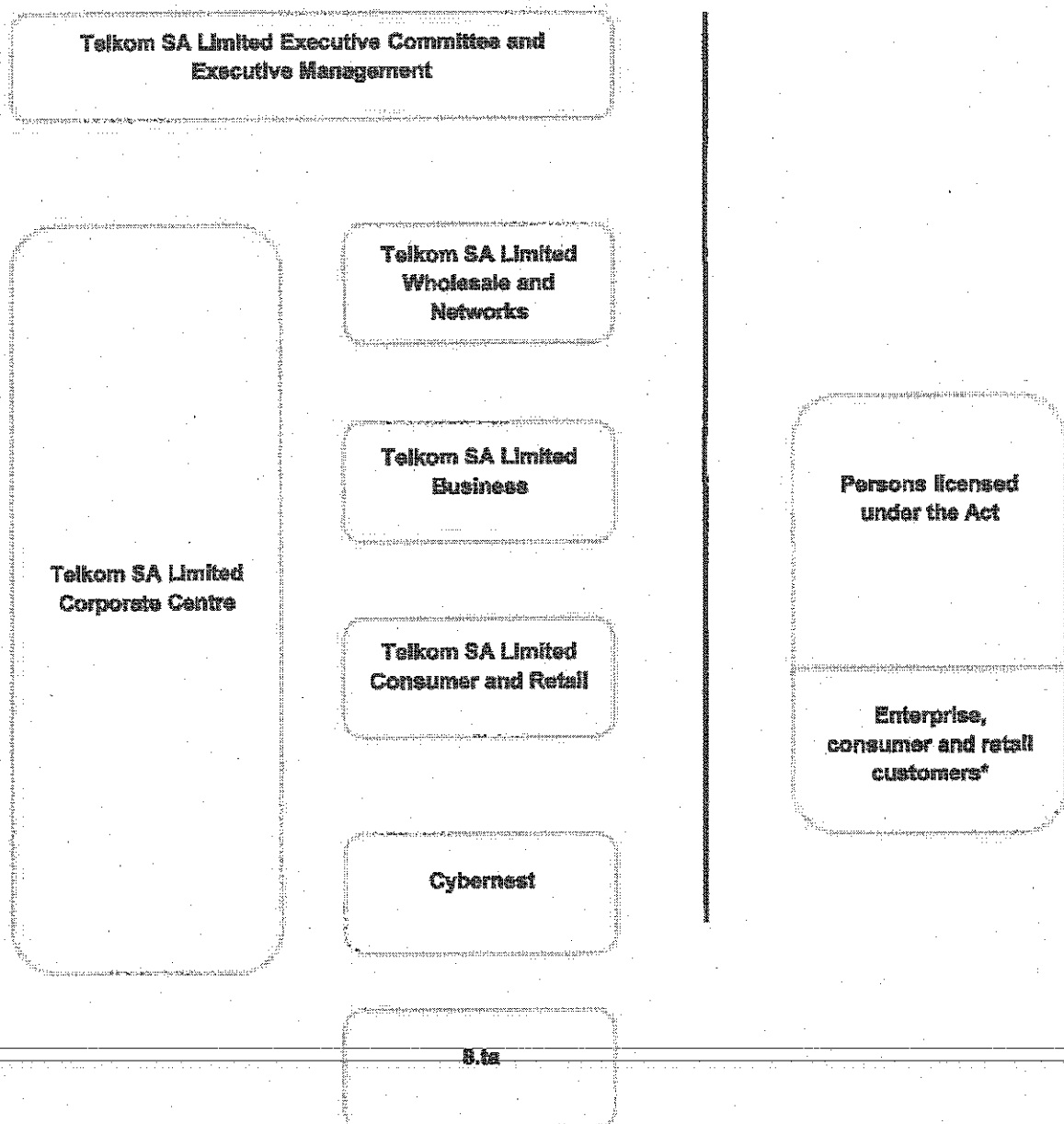
Telkom Group has the following subsidiaries: Telkom International (Pty) Limited, Q-Trunk (Pty) Limited, Intekom (Pty) Limited, Trudon (Pty) Limited and Swiftnet (Pty) Limited. Further, Telkom is comprised of the following operational business units:

- Telkom SA Limited Wholesale and Networks (referred to in this document as "Wholesale and Network") is the network 'factory' that provides network services to Other Licences Operators ("OLOs") as well as to the Retail divisions of Telkom SA;
- Telkom SA Limited Business provides services to enterprise retail customers, typically businesses;
- Telkom SA Limited Consumer and Retail (referred to in this document as "Retail") provides services to smaller retail customers, including residential customers;
- Cybernest comprises of Telkom's data centres; and
- 8.ta is Telkom's mobile electronic communications services business unit.

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In addition to these business units, Telkom operates a number of support functions which act across all operations. This structure is illustrated below.

*Figure 1: High-level Telkom structure*





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This Code covers acting in a non-discriminatory way, dealing with customer confidential information and dealing with commercial information. These issues govern the way Wholesale and Network provides certain services and how Telkom treats customer confidential and commercial information. The majority of the obligations in this Code are focused on the behaviour of the Wholesale and Network business unit. They control and manage the fixed access network and provide wholesale services to other licensees, including Retail. However, this Code also applies to staff in Retail, in particular the interactions between Retail and Wholesale and Network, as Retail employees must ensure they do not require the Wholesale and Network business unit to treat them in a way that is substantially different from how another operator would be treated.

### Purpose of the Code

The purpose of the Code is to provide guidance to Telkom employees regarding their behaviour, through their interactions amongst each other and other licensees, in a fair, transparent and non-discriminatory manner. This will enable Telkom to abide by its undertakings made under the Settlement Agreement with the Competition Commission. The Competition Act and the Electronic Communications Act, 2005 provides general prohibitions against both price and non-price discriminatory behaviour. However, this Code is specifically designed to provide guidance to employees on the application of the non-discrimination principle in relation to those services that are set-out in the Code and the operation of information sharing rules. Adherence by Telkom employees to the Code will help to ensure that all customers of Telkom's Wholesale and Network business unit, whether they are Telkom business or other companies, are treated in a substantially similar manner, with due regard to Telkom's rights and obligations in law.

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In order to operationalize the Code, Telkom will ensure that employees read and trained to understand the Code, as well as any obligations they have under it. Telkom will also ensure that sanctions exist for instances of employee non-compliance with the Code.

### Relevant services

This Code applies to all Telkom staff working on the provision of the services which Telkom is required by regulation to provide to other licensees ("regulated services") and those offered on a voluntary basis ("unregulated services") that have recently been subject to the undertakings made by Telkom with the Competition Commission set-out in the Settlement Agreement. These services are listed below. Other than these, the Code does not apply to any other of Telkom's services.

Table 1 details the Wholesale and Network regulated services to which this Code applies.

**Table 1 Regulated services covered by the Code of Conduct**

Service description	Service category	Source of legal obligation
Wholesale fixed termination	ECNS and ECS	Regulation
Carrier pre-selection	ECS	Regulation
Co-location	ECNS and ECS	Regulation
Facilities leasing	ECNS and ECS	Regulation
Number portability	ECS	Regulation

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Table 2 below details the Wholesale and Network unregulated services to which this Code also applies.

**Table 2 Non-regulated services covered by the Code of Conduct**

Service description	Service category	Status
IPLCs	ECS	Current voluntary commercial offer
Leased line access (Incl. Diginet)	ECS	Current voluntary commercial offer
VPN	ECS	Current voluntary commercial offer
HBTLs	ECS	Current voluntary commercial offer
IP Connect	ECS	Current voluntary commercial offer

### Non-discrimination

Like other licensees, Telkom Retail uses Telkom Wholesale and Network inputs to build some of the services they offer to end users. This means the obligations set out in the Code apply to any interactions between Retail and Wholesale and Network in respect of the services covered by this Code.

Non-discrimination means treating similar customers in a similar manner when provisioning the services covered by this Code. Acting in a non-discriminatory

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manner does not mean the service experience must be exactly the same for all licensees and for Retail. Non-discrimination does allow Telkom to do different things for different customers (including Retail) where those differences reflect the different requirements of the customer or for other objectively justifiable reasons. The principle of non-discrimination is a well understood concept that has been well-founded in jurisprudence under the Competition Act, 1998 and the Electronic Communications Act, 2005.

In summary, Telkom will endeavour to provide a reasonably 'level playing field' for all customers. This does not mean that Telkom must provide all services in exactly the same way but, when Telkom is delivering these services to customers they will make the provisioning experience as similar as possible for Retail and other licensees.

### Wholesale and Networks

Wholesale and Networks will not share customer confidential information which has been provided to them by their customer with Retail unless this information is required to deliver a service to this customer. In these circumstances Telkom may disclose the customer confidential information to an employee or duly appointed representative of Telkom as required.

### Retail

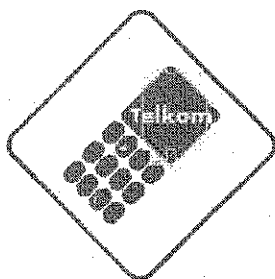
If you are an employee of Retail, you are also forbidden to request customer confidential information belonging to another licensee from Wholesale and Networks. This is to ensure that customer confidential information obtained by Wholesale and Network is only used in a manner that is consistent with the purpose intended by the customer.

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In summary, Telkom will not disclose customer confidential information to any third party without the prior consent of the customer.

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**Wholesale and Network will not disclose customer confidential information to Retail unless this information is required to deliver a service to this customer or otherwise permitted by the customer.**



# **Telkom SA SOC Limited**

## **Non-confidential version of Annexure D: Price Reductions**

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