

The impact of regulation on competition in telecommunications and piped gas¹

Heather Irvine and Lara Granville²

1. Introduction

The South African experience over the past 14 years since the Competition Act³ came into force demonstrates the difficulties inherent in sector regulators exercising concurrent jurisdiction over competition matters in key sectors of the economy. Uncertainty about which authority has jurisdiction has impacted on the ability of both the competition authorities and the sector regulators to deal with anticompetitive pricing and other forms of conduct in key sectors of the South African economy, such as telecommunications and energy.

This paper examines the *ex post* exercise of jurisdiction by the competition authorities in the telecommunications sector in the Telkom case, as well as subsequent attempts by the Legislature to clarify matters following the decision of the Supreme Court of Appeal in that case.

We also analyse the *ex ante* powers to regulate competition bestowed on the Independent Communications Authority of South Africa (ICASA) and National Energy Regulator of South Africa (NERSA) in terms of the Electronic Communications Act⁴ (ECA) and the Gas Act⁵ and their recent exercise of these powers in the mobile and piped gas industries.

We also analyse recent proposed amendments to the ECA, which will impact on the exercise of these powers by ICASA if they come into effect.

We conclude that significant legislative amendments are required in order to align the relevant legislation and enhance competition in these regulated sectors.

2. Exercise of jurisdiction by the competition authorities in regulated sectors – the Telkom case

In South Africa, one of the first cases to tackle the respective roles of competition authorities and sector regulators, and jurisdiction over anticompetitive conduct in a regulated sector, was the *Telkom* case.⁶

A complaint was made against the incumbent fixed line operator, Telkom, by a number of parties which relied on access to Telkom's lines in order to offer their services. In May 2002,

¹ DRAFT FOR DISCUSSION PURPOSES ONLY, NOT FOR PUBLICATION

² Norton Rose Fulbright South Africa

³ Act 89 of 1998.

⁴ Act 36 of 2005.

⁵ Act 48 of 2001.

⁶ *Telkom SA Limited v Competition Commission of South Africa and Another* (11239/04) [2008] ZAGPHC 188 (20 June 2008) (the **High Court decision**);

Competition Commission of South Africa v Telkom SA LTD and Others (623/2009) [2009] ZASCA 155; [2010] 2 All SA 433 (SCA) (27 November 2009) (the **SCA decision**); and *Competition Commission and Telkom SA Ltd Case No 11/CR/Feb04* (003855) (the **Tribunal decision**).

the South African VANS Association (SAVA), the Internet Service Providers Association (ISPA) and 18 value-added network services providers (VANS) lodged a complaint in relation to alleged anticompetitive conduct by Telkom. In August that year, Omnilink and Internet Solutions lodged a further complaint, which the Commission consolidated into a single investigation with the SAVA complaint.⁷ In February 2004, the Commission referred various aspects of these complaints to the Competition Tribunal for adjudication. In summary, the Commission's referral alleged that Telkom's refusal to provide telecommunications facilities to VANS, to 'peer' with VANS and/or to lease access facilities directly to VANS, constituted an exclusionary act in terms of section 8(c) of the Competition Act, and/or a refusal to provide access to an essential facility in terms of section 8(b) of the Competition Act, and/or price discrimination in terms of section 9 of the Competition Act.

Telkom applied to review and set aside the Commission's decision to refer these complaints and the referral itself. Telkom also sought an order declaring that the Commission did not have the power to refer the matters forming the subject matter of the referral to the Tribunal for adjudication, and that the Tribunal similarly lacked any power in law to adjudicate on this conduct.

The key issues raised by Telkom related to the competition authorities' jurisdiction to evaluate anticompetitive conduct in the telecommunications industry at all. To understand the basis on which the Competition Commission did make its referral, it is necessary to consider the powers granted to the competition authorities in terms of the Competition Act. Although the relevant provision had gone through numerous iterations, at the time of the determination of the Telkom case – as it is now – the governing provision was Section 3(1A) of the Competition Act. This section reads:

(a) In so far as this Act applies to an industry, or sector of an industry, that is subject to the jurisdiction of another regulatory authority, which authority has jurisdiction in respect of conduct regulated in terms of Chapter 2 or 3 of this Act, this Act must be construed as establishing concurrent jurisdiction in respect of that conduct.

(b) The manner in which the concurrent jurisdiction is exercised in terms of this Act and any other public regulation, must be managed, to the extent possible, in accordance with any applicable agreement concluded in terms of section 21(1)(h) and 82(1) and (2).⁸

The wording of this section provided a gap for Telkom to contend that the Commission had no jurisdiction at all to refer this complaint for adjudication by the Tribunal. Section 3(1A) only established concurrent jurisdiction 'in so far as' the Competition Act applies – if it does not apply, then section 3(1A) finds no purchase, and no concurrent jurisdiction is established. Whether the Competition Act applies is therefore a question of law, which has to be

⁷ In terms of Rule 17(2) of the Rules.

⁸ The Competition Commission had entered into a Memorandum of Agreement with ICASA, which came into effect from 16 September 2002 (the **MOA**) (see GG 23857; GN 1747 of 2002. memorandum of agreement entered into between the Competition Commission and ICASA, available at www.icasa.org.za or www.compcom.co.za). The MOA provided for co-operation between the Competition Commission and ICASA in relation to both merger reviews and complaint investigations and dealt with aspects such as the exchange of confidential information, the sharing of resources, the establishment of a joint working committees, the manner of consultation, as well as the participation by one regulator in the proceedings of another. However, what the MOA did not do (and indeed, it would not have had the power to do) is to determine where the jurisdiction of one regulator ends, and the other begins – this is something which must be determined with reference to the legislation.

answered independently of section 3(1A).⁹

Telkom argued that the conduct which formed the subject of the complaint fell within the exclusive jurisdiction of ICASA and outside of the jurisdiction of the competition authorities, because it was either authorised in terms of the Telecommunications Act,¹⁰ and/or by the sectoral regulator in terms of Telkom's licences¹¹; or related to the scope of Telkom's licences and Telkom's powers and obligations to VANS providers in terms of the Telecommunications Act. Since these matters were by their nature disputes between different kinds of licensees, Telkom argued, they fell within the exclusive purview of ICASA, the sectoral regulator entrusted with the task of determining such dispute and interpreting the Telecommunications Act. It argued that the legislature had clearly created a regulatory regime to deal with the dispute which was the subject of the complaint referral, and had appointed ICASA as the regulatory body to resolve this dispute.¹² Since the conduct complained of is contemplated by the relevant telecommunications legislation and/or the licences, the legislature could never have contemplated that the competition authorities would have the authority to condemn this conduct as anticompetitive. Accordingly, Telkom argued, the Competition Act did not apply to this conduct at all.

Telkom also argued that the referral was invalid on a number of other grounds, including that the Commission's reliance on a report supplied by an external service provider had created a reasonable apprehension of bias, and that even if concurrent jurisdiction did exist, the Commission had failed to adhere to peremptory provisions prescribed by the Memorandum of Agreement between it and ICASA.

The Commission argued that the alleged contraventions of the Competition Act by Telkom were not authorised by the Telecommunications Act, ICASA or Telkom's licences. It also raised the point that, since the Tribunal and the Commission are specialist bodies, and these complaints raised complex competition issues, the High Court should not deprive the Tribunal of the authority to determine whether these complaints involved possible contraventions of Chapter 2 of the Competition Act.

The High Court's decision was not based on the issue of jurisdiction – it ruled that the referral was invalid on the basis that the Commission was biased towards the complainants as it had relied heavily on a report by Link Centre, a research body in the field of information and communications, which had strong ties to the complainants. The High Court accordingly set aside the Commission's decision to refer the matter and ordered the Commission to pay Telkom's costs. Both parties applied for, and were granted, leave to appeal the High Court's decision.¹³

The Supreme Court of Appeal (SCA) rejected Telkom's argument and confirmed that the

⁹ This is in line with the interpretation of the repealed section 3(1)(d) in the Nedcor/ Stanbic case (Standard Bank Investment Corporation and The Competition Commission 2000 2 SA 797 (SCA)), in which Schutz AJ noted that concurrency only arises where another statute regulated what he termed

'*monopolistic acts*'.

¹⁰ Act 103 of 1996.

¹¹ The distinction between conduct which a party is 'obliged' to perform and that which is 'authorised' by other legislation, is raised by the Commission in its Heads of Argument filed in the Supreme Court of Appeal – it acknowledges that the competition authorities have no competence to condemn conduct which a party is obliged to perform or refrain from performing (and that an attempt by the competition authorities to exercise such jurisdictional competence would be unlawful and reviewable), but denies that the conduct which forms the subject of the complaint falls within this class.

¹² Telkom noted that the issues raised in the complaint referral had been referred to ICASA on a number of occasions.

¹³ The Commission appealed on the basis that the High Court had erred in granting the review relief, whilst Telkom cross-appealed on the basis that the High Court ought to have granted not only the review relief, but should have declared that the competition authorities had no power to investigate (in the case of the Commission) and adjudicate (in the case of the Tribunal) on the conduct forming the subject matter of the complaint.

Competition Act applies to all economic activity within South Africa, including Telkom's conduct. The SCA concluded that the Commission had jurisdiction to deal with the complaint and where its jurisdiction overlapped with that of ICASA's, the Commission had sufficiently cooperated with ICASA in accordance with the Competition Act. The SCA found that the Telecommunications Act did not oust the jurisdiction of the Commission to investigate competition matters in the telecommunications industry.

The SCA's decision is an important one, because it confirms that the competition authorities can enter into regulated sectors and exercise their powers, and indeed, that the 'competition authorities not only have the required jurisdiction but are also the appropriate authorities to deal with the complaint referred.'¹⁴

However, it only deals with the exercise of concurrent competition jurisdiction by the Commission. This decision did not clarify whether the jurisdiction of the competition authorities can potentially be entirely excluded by sector specific legislation. For example, in the gas industry, if NERSA is granted the power to approve maximum prices for piped gas, does this mean that the competition authorities lack jurisdiction to investigate and refer complaints about excessive pricing?

2.1. Legislative amendments after the Telkom case

The SCA's judgment was based on the law as it existed in February 2004, when the Competition Commission referred the complaint to the Tribunal. At that time, the Telecommunications Act was the applicable law. However, the ECA came into force on 19 July 2006 and repealed the Telecommunications Act.

The Convergence Bill (the Bill that preceded the ECA) proposed to expand the powers of ICASA in relation to competition matters in the electronic communications sector. In particular, the Bill proposed that ICASA would be empowered to direct a licensee to refrain from engaging in acts likely to substantially prevent or lessen competition, and to prescribe regulations defining relevant markets and market segments, so that pro-competitive conditions could be imposed upon licensees having 'significant market power'.

In their submissions on the Bill, the Competition Tribunal and the Competition Commission argued that the jurisdiction over competition matters granted to ICASA in the Convergence Bill should be removed. They argued that the exercise of concurrent jurisdiction over competition by the Commission and the regulator 'was meant as a temporary measure and [was] not ideal'.¹⁵ They pointed out when the Telecommunications Act was enacted, it was only necessary for the regulator to have the power to tackle anticompetitive behaviour because the Competition Act had not yet been enacted. Given that the Competition Act had now come into force, they argued, there was no longer a need for ICASA to regulate competition at all. Therefore they submitted that while the Commission and sector regulators should evaluate prohibited practices issues together, the final decision should be made by

¹⁴ The Commission appealed on the basis that the High Court had erred in granting the review relief, whilst Telkom cross-appealed on the basis that the High Court ought to have granted not only the review relief, but should have declared that the competition authorities had no power to investigate (in the case of the Commission) and adjudicate (in the case of the Tribunal) on the conduct forming the subject matter of the complaint.

¹⁵ Competition Commission and Competition Tribunal 'Submission of the Competition Commission and the Competition Tribunal on the Convergence Bill (B9-2005) for consideration by the Portfolio Commission on Communications' available at <http://www.compcom.co.za/policyresearch/Comments%20on%20the%20Convergence%20Bill%20April%202005.doc>

the Commission.¹⁶

Unfortunately, the approach advocated by the competition authorities did not prevail. When it came into effect in July 2006, the ECA expanded the powers of ICASA in relation to competition matters in the electronic communications sector. In particular, section 67(1) and (2) allow ICASA to direct a licensee to cease or refrain from engaging in an act that is likely to substantially prevent or lessen competition by giving undue preference to or causing undue discrimination against any other licensee or a person providing a service pursuant to a licence exemption. ICASA is required to prescribe regulations to describe what would be considered as giving undue preference or causing undue discrimination in this case. Regulations detailing procedures for complaints and the monitoring and investigation of such complaints, as well as prescribing penalties for failure to comply with written notice are also to be promulgated by ICASA. These provisions were retained despite the competition authorities' submission that these are issues over which the competition authorities should have exclusive authority.¹⁷

Section 67(10) of the ECA recognises that 'the authority is, for the purposes of the Competition Act, a regulatory authority defined in section 1 of that Act', and subsections 10 and 11 provide that ICASA and the Commission can ask for and receive assistance or advice from each other in relation to their proceedings. However, section 67(9) went a step further than simply endowing ICASA with concurrent jurisdiction in relation to competition in the sector. It provided that: *subject to the provisions of this Act, the Competition Act applies to competition matters in the electronic communications industry.*

In effect, this provision *excludes* the application of the Competition Act where conduct is specifically authorised or addressed by the ECA. Accordingly, if the SCA were to decide the Telkom case today, in respect of a referral that took place after July 2006, the outcome may well have been different, despite the principled basis of enabling a regulator with experience in competition matters to exercise jurisdiction over those matters.

Realising this, prior to the handing down of the SCA decision, the Legislature introduced proposed amendments to the Competition Act, which culminated in the passing of the Competition Amendment Act in 2009.¹⁸ The Department of Trade and Industry claimed that its primary motivation in amending the Competition Act was to elevate the status of competition law principles by recognising their importance for the South Africa's economic development and growth. To this end a new object was to be inserted into the Act, which states 'to provide for consistent application of common standards and policies affecting competition within all markets and sectors of the economy'. To achieve this, an amendment to Section 3(1) of the Competition Act seeks to 'overrule' any other legislation by providing that 'despite anything to the contrary in other legislation' the Act will apply to all economic activity in or having an effect within South Africa. There are, however, a couple of provisos to this section, one of which relates to the situation where the Competition Act applies to any conduct arising within an industry or sector of an industry that is subject to the jurisdiction of another regulatory authority in terms of any other legislation. In this situation, the regulator in question and the competition authorities will have concurrent jurisdiction.

¹⁶ Submission on the Convergence Bill (footnote 13) at paragraph 3.1.1.

¹⁷ Submission on the Convergence Bill (footnote 13) at paragraph 3.1.1.

¹⁸ Submission on the Convergence Bill (footnote 13) at paragraph 3.1.1.

Interestingly, however, the amendments introduce the concept of 'primary authority' in circumstances where there is concurrent jurisdiction. In such cases, the sector regulator is charged with primary authority to 'establish conditions within the industry that it regulates as required to give effect to the relevant legislation in terms of which that authority functions as well as the policies and principles of this Act', while the Competition Commission must exercise primary authority to 'detect and investigate alleged prohibited practices within any industry or sector and to review mergers within any industry or sector'.

The Amendment Act also proposed to effect an amendment to the ECA, to remove the offending 'subject to' wording in section 67(9) and replace it with a '*despite*', thus leading it to read: 'despite the provisions of this Act, the Competition Act applies to competition matters in the electronic communications industry'.

In essence, the Competition Amendment Act aims to clarify jurisdiction by distinguishing between *ex ante* jurisdiction (i.e. – the power to adopt 'before the fact' rules and regulation which are aimed at creating conditions in the sector that enable it to facilitate competitive outcomes) and *ex post* jurisdiction (the power to evaluate (allegedly anticompetitive) conduct 'after the fact') (except in so far as competition authorities maintain *ex ante* regulation in respect of merger evaluation).¹⁹

And indeed, the structure of the ECA allows for such division of labour. The provisions of section 67 envisage ICASA using *ex ante* power to set conditions in the market to facilitate competition. Section 67 requires ICASA to prescribe regulations defining relevant markets and market segments, so that pro-competitive conditions may be imposed upon licensees having 'significant market power', in circumstances where ICASA determines such markets or market segments have ineffective competition.²⁰ Subsection 7 sets out examples of such pro-competitive terms and conditions.

However, it is unfortunate that the ECA retains section 67(1) and (2) which relate to *ex post* evaluation of conduct engaged in by participants in the industry.²¹ This creates problems because, while ICASA's primacy over competition matters in the electronic communications industry will end when the Competition Amendment Act comes into force, it is not clear when that will happen. The Amendment Act has not come into force since it was signed into law in 2009, and now, five years later, the prospect of the Amendment Act ever coming into force is uncertain (although one of its provisions – the market inquiry provision – was brought into

¹⁹ See also Fungai Sibanda 'Of concurrent and exclusive jurisdiction in the ICT sector' Mail and Guardian 21 July 2009, available at: <http://www.mg.co.za/article/2009-07-21-of-concurrent-and-exclusive-jurisdiction-in-the-ict-sector>.

²⁰ It defines what "significant market power" is, and subsection 6 provides the methodology for determining the effectiveness of competition in market segments.

²¹ The background to such *ex post* power is this: As noted above, the ECA replaced the Telecommunications Act. The Telecommunications Act set up a telecommunications regulator, the South African Telecommunications Regulatory Authority (SATRA). The Telecommunications Act was amended in 2001, and, with the promulgation of the ICASA Act, SATRA was replaced by ICASA. This legislation established ICASA and gave it wide powers to regulate broadcasting and telecommunications in the public interest and in pursuance of the objects set out in the Telecommunication Act, the Independent Broadcasting Authority Act 4 of 1999 and the Broadcasting Act 103 of 1996. At this point, both technical and economic regulatory tasks (such as licensing) were allocated to the sector regulator. In particular, Section 36(1)(d) conferred on ICASA certain powers in relation to competition in the sector. It provided

"Where it appears to the Authority that Telkom, in the provision of its telecommunications services, is taking or proposing to take any step which confers or may confer on it an undue advantage over any person who may in the future be granted a licence in competition with Telkom, the Authority may direct Telkom to cease or refrain from taking such step, as the case may be."

Section 53(1) provided: *"If it appears to the Authority that the holder of a telecommunications licence is taking or intends taking any action which has or is likely to have the effect of giving an undue preference to or causing undue discrimination against any person or any category of persons, the Authority may, after giving the licensee concerned an opportunity to be heard, direct the licensee by written notice to cease or refrain from taking such action, as the case may be"*. It is this latter provision which was translated into section 67(1) – (3) of the ECA, which confers on ICASA *ex post* jurisdiction to deal with complaints of anti-competitive conduct in the sector.

force in March 2013²²). Accordingly, if the competition authorities wish to evaluate allegedly anticompetitive conduct *ex post* in this industry, there may still be challenges to its jurisdiction, which raise the same severe delays as experienced in the *Telkom* case.

3. The exercise of competition jurisdiction by regulators

While the *Telkom* case and the intended amendments to the Competition Act will go some way to clarifying the extent to which the competition authorities deal with competition issues in competition sectors, an equally pressing question has arisen in recent years regarding the manner in which sector regulators should deal with competition issues in regulated sectors.

As noted by the ICN,²³ the justification for the existence of sectoral regulations designed to promote competition, when there is already a general competition law applicable to all sectors, is that, in sectors which are just being exposed to competition, competition cannot yet work and there is a need to monitor the gradual development of competitive forces.

These concerns are addressed through ‘economic regulation’ by sector regulators. Moodliyar and Weeks²⁴ explain the distinction between the terms ‘economic regulation’ and ‘competition policy’ and note that the term ‘economic regulation’ has been used to describe the regulatory response to natural monopolies and other phenomena which result in outright market failure.²⁵ Motta explains that the term ‘competition policy’ ‘applies to sectors where structural conditions are compatible with a normal functioning of competition (whether the market functions well in practice or not is another matter).’²⁶

Economic regulation is applied *ex ante*, and requires long-run and continuous involvement on the part of the regulator for purposes of conducting monitoring and ensuring compliance.²⁷ On the other hand, competition policy interventions are meant to address anticompetitive conduct in markets that would otherwise tend towards effective competition and are applied *ex post*.²⁸

In South Africa, certain sector regulators are explicitly granted the power to examine the state of competition in markets within their sector, and where they find that competition is weak, to address this through appropriate regulation. For instance, NERSA is, in terms of the Gas Act, required to regulate pricing in the industry ‘where there is inadequate competition’. Similarly, Chapter 10 of the ECA provides that ICASA ‘must prescribe regulations defining the relevant markets and market segments, as applicable, that pro-competitive conditions may be imposed upon licensees having significant market power where the Authority determines such markets or market segments have ineffective competition.’

These provisions raise a key issue highlighted by Moodliyar and Weeks – that ‘an important

²² Proclamation 5 of 2013, GG36221.

²³ International Competition Network, Antitrust Enforcement in Regulated Sectors Working Group Subgroup 2: Enforcement experience in regulated sectors, Report to the Third ICN Annual Conference, Seoul, April 2004.

²⁴ K Moodliyar & K Weeks, ‘A framework for promoting competition in electronic communications: clarifying the role of the Competition Authority and the sector regulator’ available at: <http://www.compcom.co.za/presentations-third-annual-competition-conference>.

²⁵ Moodliyar & Weeks, page 2 (footnote 22 above).

²⁶ Moodliyar & Weeks, pages 2-3 (footnote 22 above).

²⁷ Moodliyar & Weeks, page 3 (footnote 22 above.)

²⁸ Moodliyar & Weeks, page 3 (footnote 22 above.)

area of convergence between economic regulation and competition policy is in the application of competition analysis for purposes of diagnosing the market power problem and identifying appropriate remedies'.²⁹

In the section below, we examine the ways in which ICASA and NERSA have recently exercised these powers in the mobile and piped gas industries.

3.1. ICASA - Section 67 of the ECA

As explained above, a key aspect of ICASA's economic regulatory powers was introduced by section 67(4)-67(8) of the ECA. This brought the ECA in line with developments in Europe relating to guiding economic regulation with competition analysis.³⁰ Guidance provided by the EU notes that the framework for economic regulation and competition law in electronic communications is based on three concepts: ³¹

- (a) That the degree and intensity of regulatory intervention must be proportional to the competition problem at hand: where markets are already, or are in the prospect of becoming effectively competitive, existing regulatory measures will be withdrawn or made lighter;
- (b) That markets need to be analysed following competition analysis principles, from the very definition of the market, to the assessment of market power, to the identification of remedies to address the competition problems observed; and
- (c) That there is a need to consider products and markets on the basis of economic value rather than on their physical or technological or regulatory characteristics.

4. The ECA

The provisions of the ECA follow this approach and incorporate some of these principles. Section 67(4) requires ICASA to apply competition law principles to identify market power problems and determine whether there is ineffective competition, which then justifies the imposition of pro-competitive terms and conditions, which are required to be proportional.

The structure of such assessment is as follows: ICASA is first to determine the relevant market. A determination of the market definition (section 67(4)(a)) must include:

²⁹ Moodliyar & Weeks, page 4 (footnote 22 above.)

³⁰ Moodliyar & Weeks note that bringing competition law principles into economic regulation has been a key objective of the European Union in its directive on a common regulatory framework for electronic communications networks and services (referred to as the "Framework Directive"). They explain: "*Prior to the Framework Directive National Regulatory Authorities (NRAs) in Europe applied ex-ante regulation on the basis of a Significant Market Power ("SMP") designation applied to firms with a market share of 25% or more. Although NRAs also took into account factors such as turnover relative to the size of the market and control of access in deciding on remedies, no comprehensive analysis of market power and competition was undertaken in order to justify the need for interventions or determine their proportionality given the nature of the market power problem.*

The Framework Directive however provides direction to NRAs by indicating markets that are likely to be susceptible to ex ante regulation. Such markets will be characterised by high and non-transitory entry barriers and will be unlikely to be subject to effective competitive constraint due to the presence of bottleneck facilities (or some other impediment). The NRAs are then required to carry out market analyses (applying the principles of competition analysis) to assess whether or not competition is effective in the relevant markets and designate providers with SMP to which specific obligations may be applied. (See Moodliyar & Weeks, page 4-5 (footnote 22 above.)

³¹ International Competition Network, Antitrust Enforcement in Regulated Sectors Working Group, Subgroup2: *Interrelations between Antitrust and Regulatory Authorities*, Report to the 4th ICN Conference, Bonn. (Quoted in Moodliyar & Weeks, pages 5-6 (footnote 22 above).

- A consideration of the non-transitory (structural, legal or regulatory) barriers to entry; and
- A consideration of the dynamic character and functioning of the market/s. (67(6)(a))

Then, ICASA must determine which firms in that market have “significant market power” (SMP) (Section 67(4)(d)). This should include:

- A consideration of who is dominant in the defined market;
- A consideration of who has control of essential facilities in the defined market; and
- A consideration of who has a vertical relationship that may harm competition in the defined market. (Section 67(5))

There is also a requirement to determine whether the defined market/s have effective competition or whether there are market failures (Section 67(4)(c)). This assessment includes:

- an assessment of relative market share of the various licensees in the defined market/s (Section 67(6)(b)(i));
- a forward looking assessment of the market power of each of the market participants over a reasonable period in terms of at least (Section 67(6)(b)(ii)):
- actual and potential existence of competitors;
- the level, trends of concentration, and history of collusion, in the market;
- the overall size of each of the market participants;
- control of essential facilities;
- technological advantages or superiority of a given market participant;
- the degree of countervailing power in the market;
- easy or privileged access to capital markets and financial resources;
- the dynamic characteristics of the market, including growth, innovation, and products and services diversification;
- economies of scale and scope;
- the nature and extent of vertical integration; and
- the ease of entry into the market, including market and regulatory barriers to entry.

There is then a requirement to impose pro-competitive measures that would remedy those market failures (Section 67(4)(c)). There is no explicit indication in the ECA of the considerations that are relevant for determining the pro-competitive conditions, except what is contained in Section 67(4) (c) – that such conditions must ‘remedy’ the market failures in the markets found to have ineffective competition. Section 67(7) sets out what such pro-

competitive terms and conditions may consist in. They include, among others:

- a prohibition against discrimination in relation to certain matters (access, provisioning of services, interconnection and facilities leasing);
- an obligation requiring the licensee to publish information for the purpose of ensuring transparency;
- an obligation to maintain a separation for accounting purposes;
- price controls, including requirements relating to the provision of wholesale and retail prices.

Section 67(8) then provides for a review of the pro-competitive conditions. This requires:

- A review of the 'market determinations' made on the basis of earlier analysis (Section 67(8)(a)(i));
- A determination of whether, the licensees to whom pro-competitive conditions apply, still possess SMP (Section 67(8)(b));
- A determination of whether there are changes in the competitive nature of the defined market/s that require changes to the pro-competitive conditions. This requires, according to Section 67(8)(b):

An assessment of whether the pro-competitive conditions previously applied are proportional, or whether they need to be modified to ensure proportionality.

Whether the remedies or conditions are still proportionate to the identified market failure is thus at the heart of the review process.

4.1. Mobile interconnection rate regulation by ICASA

ICASA promulgated call termination regulations in 2010 and it then conducted a review of the pro-competitive conditions imposed in terms of those regulations and promulgated new call termination regulations in 2014.

Under Chapter 7 of the ECA, ICASA has the power to regulate interconnection and it may regulate interconnection rates in terms of Section 41 of that Chapter. Interconnection is the physical linking of networks to one another so as to enable the transmission of calls from one network to the other network on which the called number can be found. For example, an MTN subscriber wishing to make a call to a Cell C subscriber, is likely to be unaware that the two networks are 'interconnected' because the call transfers between the two in a seamless manner. However, it is common practice for the network that receives (or 'terminates') the call to charge the network that sends (or 'originates') the call, a fee for termination. This is referred to as an interconnection rate or a 'termination rate'. In mobile electronic communications, the rate is referred to as the 'mobile termination rate' or 'MTR' and in fixed electronic communications the rate is referred to as the 'fixed termination rate' or 'FTR'.

Interconnection is a critical part of the electronic communications sector, without which operators cannot enable their subscribers to call other subscribers on other networks. However, interconnection is often an area in which market failure occurs, because

interconnection rates are often used as a tool by incumbent operators to exacerbate market failure, particularly in concentrated markets. It is recognised internationally that one of the challenges faced by new or late entrants into electronic communications markets, and one aspect of the market which enables the entrenchment of existing market power, is the charging by incumbents of high interconnection rates to late or new entrants. These rates form a 'floor' for the prices that are charged to consumers. When an operator decides what retail price to charge consumers for calls which terminate on another network ('off-net calls'), it must start its calculation from the interconnection rate. For example, when the MTR was R1,25, operators had to charge consumers a retail price higher than this in order to make any profit.

Scale is an important component of the ability to compete in this industry. In order to compete for customers, new or late entrants must provide national coverage, at a high quality, at reasonable prices, together with other value-added services. Given these features of the market, a new or late entrant's total investments and operator costs will be almost as high as those of existing operators. Late entrants obviously earn less revenue and therefore have a smaller scale, because their ability to attract and retain new subscribers is limited by the market power of the incumbents which have easier access to capital markets, large subscriber communities, ongoing subscriber contractual commitments, and sunk costs advantages.

Maintaining high interconnection rates is a strategy which can be employed by the incumbent super-scale operators to exacerbate this effect, and eliminate the likelihood of a late entrant gaining sufficient scale to compete effectively. Without regulatory intervention, a smaller operator cannot on its own achieve reasonable scale in this environment.

For these reasons, there are a number of regulators internationally that have decided to regulate interconnection rates. In addition, numerous regulators in other jurisdictions have recognise that there is frequently a positive relationship between market share differences and cost differences. Symmetric rates imposed on operators with low market shares may have adverse effects on profitability. Accordingly, asymmetric rates (that enable smaller operators to charge higher interconnection rates to their larger competitors, than those competitors are entitled to charge them) may be justified, for example to encourage the development of a new entrant that suffers from a lack of scale due to late market entry.

The historical position in South Africa provides an illustration of the use of interconnection rates to stymie the ability of new entrants to compete in the market. When Vodacom and MTN entered the market in 1994 and 1995 respectively, they were given the benefit of an asymmetrical interconnection rate with the then dominant fixed operator, Telkom. At that stage, Telkom, Vodacom and MTN were the only three communications operators in the market. Vodacom and MTN could charge R1.00 more than the fixed termination rate vis-à-vis Telkom. This enabled them to grow their businesses and to obtain the necessary scale benefits.

When Cell C launched in 2002, it similarly benefited from asymmetry with Telkom but ICASA did not at that time regulate mobile termination rates. Vodacom and MTN operated without regulatory scrutiny in this area since their launch until the 2010 Regulations were

promulgated – a period of 17 and 16 years respectively during which MTRs were unregulated.

In anticipation of Cell C's entry to the market, Vodacom and MTN increased interconnection rates between 1998 and 2001 by a staggering 515%. In 1998, the interconnection rate was R0.20. The agreement between Vodacom and MTN to increase the interconnection rate to R1.25 per minute was taken a few weeks before Cell C was set to open its doors.

This prevented the growth of Cell C into an effective competitor as it was restricted in its ability to compete vigorously in the face of high MTRs. This impacted directly on Cell C's ability to build significant market share with proportionate value share. A fourth mobile operator, Telkom Mobile, entered the market in 2010. While it benefited from having interconnection rates regulated at the time of its entry, it has also struggled over the last four years to gain the necessary scale to compete effectively with Vodacom and MTN, illustrating that the regulatory intervention may not have been aggressive enough.

This is an area well-suited to *ex ante* economic regulation, and ICASA accordingly has special powers to regulate interconnection under Chapters 7 and 10 of the ECA. Unfortunately, ICASA had not exercised this power at the time that Cell C entered the market. By 2006/07, ICASA began to appreciate that there was significant market failure within the industry and so it started the process, designed under section 67 of the ECA, of analysing the market, identifying market failure, and considering what remedies were appropriate to correct that market failure. This process included an 'inquiry' into call termination rates under section 4D of the ICASA Act in 2006/7, resulting in the 2007 Findings document;³² and draft regulations on each of the components set out in section 67(4) in 2008.³³ Given the time that had passed since its 2007 Findings document, on 9 October 2009, ICASA released a request for information from all licensees to facilitate up-to-date evidence-based evaluation of the effectiveness of competition in the call termination market in South Africa.³⁴ On 8 March 2010, it released a 'Guideline for Conducting Market Reviews' in order to provide stakeholders and licensees with clarity as to how market reviews in terms of section 67 were to be conducted, including the public consultation process, the relevant powers of information gathering and the types of information which may be requested.

This process eventually culminated in the Draft Call Termination Regulations being published on 16 April 2010,³⁵ and final Call Termination Regulations being published in October 2010.³⁶ Pro-competitive remedies imposed by ICASA under the 2010 Regulations provided for a reduction in

interconnection rates and asymmetric MTRs. Asymmetry enabled Cell C and other licensees to charge higher MTRs to Vodacom and MTN than MTN and Vodacom could charge them.

ICASA explained that such remedies were aimed at addressing failures in the each of the mobile and fixed markets. In section 2.4.5(6) of the explanatory notes to the 2010

³² Publication of the findings pursuant to section 4C of the ICASA Act of an inquiry conducted in terms of section 4B of the ICASA Act, GN 1627 of 2007, Government Gazette, No.30449.

³³ Intention to define relevant wholesale call termination markets in terms of section 67(4), 29 January 2007, GG 29568; Draft Regulation pursuant to section 67(4)(a-e), 6 March 2008, GG 30850.

³⁴ ICASA, 2009 "Submissions to questionnaire", 9 October 2009, Government Gazette No. 32628.

³⁵ Draft Call Termination Regulations, 16 April 2010, Government Gazette No. 33121.

³⁶ Call Termination Regulations, 29 October 2010, Government Gazette No 33121.

Regulations, ICASA stated that:

the application of asymmetric rates for a transitory period will benefit total social welfare by stimulating increased competition in the respective markets, thereby benefiting end users. However, asymmetric (higher) termination rates may only be justified on certain criteria to ensure that only those licensees that are dedicated to the goal of reducing retail prices through competitive forces qualify for such asymmetry.

ICASA also indicated, at paragraph 3 of the explanatory notes to the 2010 Regulations, that it expected the imposition of these pro-competitive terms and conditions on operators in the relevant markets to achieve the following:

- a more efficient and effective access regime;
- a more dynamic retail pricing environment; and
- continued access and investment in electronic communications networks in SA.

In addition to the existence of section 67(4) of the ECA, the 2010 regulations also provided for a 'schedule of review' of the regulations. ICASA began this process in July 2013 when it launched its Cost to Communicate programme, and noted in that notice that it would review the call termination regulations of October 2010 and 'the review will not consider revisions of either the market definitions or SMP determinations as these will not have changed'.³⁷

Such a review led to the release of draft call termination regulations in October 2013,³⁸ and final regulations on 4 February 2014.³⁹ This review concluded that the market definitions had not changed, and that there was still ineffective competition in these markets and still a need to impose pro-competitive remedies. Indeed, ICASA concluded that far more extensive cuts in call termination rates were called for, and more expansive asymmetry. This conclusion is supported by the fact that none of the intended outcomes of the 2010 regulations had been achieved yet and that market shares in the downstream retail market (based on revenue share) have remained largely stagnant, reflecting that the smaller operators, and late entrants have not been given a sufficient leg-up to achieve the scale necessary to compete with the incumbents.

There have therefore been regulations in place for three years, designed to create the conditions for competition to emerge. As explained in the explanatory memoranda to both the 2010 and the 2014 regulations, these pro-competitive measures are not intended to be in place forever. Once the market can be controlled by competitive forces, it should be possible to reduce the degree and intensity of regulatory intervention, as proposed by the EU guidance.

However, it seems that in South Africa, we are still far away from that, in both the space of interconnection, and in numerous other spheres in telecommunications and broadcasting. It is unfortunate that the only time ICASA has exercised its section 67 powers is in relation to

³⁷ ICASA General Notice of intention to implement a cost to communicate programme, 4 June 2013, Government Gazette No. 36532.

³⁸ Draft Call Termination Regulations, 11 October 2013, Government Gazette No 36919.

³⁹ Call Termination Regulations, 4 February 2014, Government Gazette No. 37295.

interconnection rates, where such interventions are required in other spheres.

It is, for example, a great pity that there have not been such investigations into markets in the broadcasting sphere. ICASA has published a Discussion Document on Broadcasting Transmission Services⁴⁰. But there are no final regulations in this regard, nor have there been any active interventions in relation to the dominance in the subscription television market. Broadcasting appears to be an area where ICASA has been so late in the day in intervening that the incumbent players have benefitted for years from a lack of thorough regulation that they can easier entrench their dominance. For instance, in the area of subscription broadcasting services, Top TV, a subscription broadcaster, was licensed in 2008 and launched service in 2010 but at the end of 2012 went into business rescue. Although there are doubtless also other reasons for this, one of the

contributing factors was publicly acknowledged to have been the challenge that Top TV faced in competing for subscribers with DStv and MNet (both owned by Multichoice), who had been entrenched in the market for 14 years and almost 23 years respectively.

ICASA's lack of intervention in this area can be compared with many years of regulatory work by Ofcom in the UK in addressing the market power of BSkyB in the subscription television market.

There is now regulation in place which provides that third parties can access Sky's set top box (i.e. broadcast their own services via Sky's infrastructure so that customers need not install separate satellites or set top boxes to view the services of competing broadcasters). Not only do third parties have access to the Sky set top box, but those third parties can also enforce conditional access on end viewers (e.g. BT Sports can ensure that only Sky subscribers who pay a bit extra are allowed to watch the BT Sports channels, as delivered over the Sky STB). Similar interventions in South Africa would assist in encouraging competing broadcasters to enter the market and be sustainable in that market.⁴¹

4.2. Amendments to the ECA

As we have illustrated above, there is a precise step-by-step process set out in section 67 of the ECA on how to engage in a competition analysis for the purposes of economic regulation. Of course, assistance from the competition authorities in engaging in such evaluations, would provide further assistance to the regulator to successfully implement these steps. But even in the absence of such support, the legislation provides helpful guidance to ICASA on conducting these assessments.

There is therefore some concern that proposed amendments to the ECA aim to reduce the considerations that ICASA should take into account in assessing the effectiveness of

⁴⁰ ICASA discussion document on regulatory framework for broadcasting transmission services, 15 June 2011, Government Gazette no. 34371.

⁴¹ The EU Communications Directives (2002) is the latest set of EU-wide directives setting out the regulatory requirements on electronic communications networks. Among the five directives contained within this framework (Framework, Access, Authorisation, Universal Service, and Privacy), Access Directive deals with the obligations on operators to provide access to other service providers. Specifically within the Access Directive, Article 6 (along with the accompanying Annex 1) deals with the accessibility of conditional access systems. The UK Communications Act (2003) adheres to Article 6 and Annex 1 Part 1 of the Access Directive by requiring the UK regulator, Office of Communications ("Ofcom") to ensure that all broadcasters have access to conditional access systems as prescribed by the Access Directive. Oftel, "The regulation of conditional access", 24/07/2003. http://www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/2003/condac0703.pdf sets out the conditions of operation for Sky. Other technical broadcasting services, such as access control services (interactive functionality in digital television) and electronic programme guide (EPG) listings, are also regulated in the UK.

competition in the market.

In this regard, proposed amendments to the ECA are introduced by the Electronic Communications Amendment Bill, B17B-2013. On the one hand, they appear to respond to criticism of ICASA's holding of *ex post* competition jurisdiction, but deleting section 67(1)-(3) of the ECA. The Amendments appear to propose the removal of ICASA's powers to evaluate and remedy past anti-competitive conduct engaged in by participants in the electronic communications sector. This appears to be a positive move, since the Competition Commission is better suited to exercise *ex post* competition jurisdiction.

Unfortunately however, some *ex post* jurisdiction appears to be retained through the addition to be Section 67(4)(f) of the amended act. The new provision provides that ICASA must:

prescribe regulations defining relevant markets and market segments and impose appropriate and sufficient pro-competitive licence conditions on licensees whether there is ineffective competition, and if any licensee has significant market power in such markets or market segments. The regulations must, amongst other things -...

(f) provide for monitoring and investigation of anti-competitive behaviour in the relevant market and market segments.

This addition seems to undermine the goal of removing ICASA's *ex post* jurisdiction and indeed, appears to complicate matters by placing such powers within the scope of the provisions that address its *ex ante* economic regulatory role. Moreover, there are no amendments proposed to subsections 67(8)- (12), and accordingly subsection (9) remains and continues to read 'Subject to the provisions of this Act, the Competition Act applies to competition matters in the electronic communications industry.' It is concerning that the addition of 67(4)(f) and the failure to amend subsection (9) may retain space for forum shopping and disputes over jurisdiction.

Of further concern are the proposed changes to section 67(4)-(6). The amendments propose the addition of Subsection 64(4A), providing for the analysis of the effectiveness of competition in the relevant markets. This new section contains far fewer factors to consider in evaluating competition in the market. The amendments propose the consideration of (among other things not specifically identified): barriers to entry and the dynamic functioning of the markets (including market share). Excluded are the current 67(6)(b) considerations such as: the existence of competitors; the level and trends of concentration; the degree of countervailing power in the market; and economies of scale and scope; and many others.

We are of the view that the considerations in the current ECA assist the Authority with the assessment of the market by directing it to consider issues normally considered by competition authorities when examining the adequacy of competition in a market. These considerations can help the Authority to reach the correct conclusion in light of well-established and relevant factors. The factors now left in subsection (4A)(a) and (b) do not seem like sufficient guidelines to direct ICASA in making this assessment.

A further notable amendment is the proposed section 67(4)(d) which provides that the Regulations must:

impose appropriate pro-competitive licence conditions on those licensees having significant market power to remedy the market failure.

In some ways, this wording is better and clearer than the current provision. It introduces the concept of appropriateness, proportionality and the requirement to tailor the remedy to the market failure. However, it suggests the only pro-competitive remedies that can be proposed must be contained in licence conditions. This seems unnecessary and cumbersome, if licences will need to be amended to accommodate new regulations.

It is hoped that the final version of the Amended ECA will take into account the success of ICASA in promulgating the Call Termination Regulations, and how the provisions of section 67 provided the requisite guidance which enabled it to engage in economic regulation with reference to competition analysis. The amendments should not remove such guidance.

4.3. Maximum price regulation of piped gas by NERSA

The regulatory framework for piped gas is set by the Gas Act, 2001, which established a National Gas Regulator and provided for the 'orderly development of the piped gas industry'.⁴²⁴⁰ The functions of the Gas Regulator are set out in section 4 of the Gas Act and include the power to 'regulate prices⁴³ in terms of section 21(1)(p) in the prescribed⁴⁴ manner'; and to 'monitor and approve, and if necessary regulate, transmission and storage tariffs and take appropriate action when necessary to ensure that they are applied in a non-discriminatory manner as contemplated in section 22'.

Section 21(1) of the Gas Act deals with conditions of licences, and provides that the Gas Regulator may impose licence conditions within a stipulated framework of requirements and limitations, including, in terms of the subsection:

*maximum prices for distributors, reticulators and all classes of consumers must be approved by the Gas Regulator where there is inadequate competition as contemplated in Chapters 2 and 3 of the Competition Act, 1998 (Act No. 89 of 1998).*⁴⁵

⁴² Section 2 of the Gas Act sets out a wide range of objectives are to promote the efficient, effective, sustainable and orderly development and operation of gas transmission, storage, distribution, liquefaction and re-gasification facilities and the provision of efficient, effective and sustainable gas transmission, storage, distribution, liquefaction, re-gasification and trading services; facilitate investment in the gas industry; ensure the safe, efficient, economic and environmentally responsible transmission, distribution, storage, liquefaction and re-gasification of gas; promote companies in the gas industry that are owned or controlled by historically disadvantaged South Africans by means of licence conditions so as to enable them to become competitive; ensure that gas transmission, storage, distribution, trading, liquefaction and re-gasification services are provided on an equitable basis and that the interests and needs of all parties concerned are taken into consideration; *promote skills among employees in the gas industry; promote employment equity in the gas industry; promote the development of competitive markets for gas and gas services; facilitate gas trade between the Republic and other countries; and promote access to gas in an affordable and safe manner.*

⁴³ The term "price" is defined in section 1 as "the charge for gas to a distributor, reticulator or a final customer".

⁴⁴ The term "prescribed" is defined in section 1 as "prescribed by regulation or by rules".

⁴⁵ The provisions of section 21(1)(p) must be read together with Regulation 4 of the Gas Regulations, which provide as follows:

- "(3) The Gas Regulator must, when approving the maximum prices in accordance with section 21(1)(p) of the Act-
- a) be objective i.e. based on a systematic methodology applicable on a consistent and comparable basis;
 - b) be fair;
 - c) be non-discriminatory;
 - d) be transparent
 - e) be predictable; and
 - f) include efficiency incentives.
- (4) Maximum prices referred to in subregulation (3) must enable the licensee to –
- (a) recover all efficient and prudently incurred investment and operational costs; and
 - (b) make a profit commensurate with risk.
- (5) The Gas Regulator must approve maximum prices for gas for each distribution area or group of distribution areas as indicated in Annexure A for the following classes of customers:
- (a) residential; and
 - (b) commercial and industrial."

However, In terms of section 36 of the Gas Act, its provisions were subject to the provisions of the Mozambique Gas Pipeline Agreement (MGPA) between the Minister of Minerals and Energy, the Minister of Trade and Industry and Sasol Limited concerning the introduction of natural gas by pipeline from Mozambique into South Africa. This agreement endured for a period of 10 years after natural gas was first received from Mozambique, until 25 March 2014. Its purpose was to compensate Sasol for the investment it was required to make in order to extract natural gas from the gas field in Mozambique and to construct a gas transmission pipeline from Mozambique to South Africa. In exchange for supplying 120 million GJ pa of natural gas from Mozambique to South Africa for 25 years after the date upon which natural gas was first sold and delivered on a commercial and continuous basis to pipeline customers in South Africa (clause 4), Sasol was permitted to charge external customers a price for the gas which was determined⁴⁶ in accordance with a Market Value Pricing (MVP) formula.⁴⁷ This effectively allowed Sasol to charge monopoly, and in many cases discriminatory prices for natural gas and effectively shielded Sasol from complaints in terms of the Competition Act, for example, based on excessive pricing in contravention of section 8(a).

In anticipation of the MPGA coming to an end, NERSA released a consultation document on 21 October 2010 dealing with the 'Methodology to approve maximum prices for piped-gas' in terms of section 21(1)(p) of the Gas Act. NERSA noted that its responsibility to approve maximum prices required there to be 'inadequate competition' as contemplated in Chapters 2 and 3 of the Competition Act⁴⁸ and this implied that 'NERSA should encourage competition and seek to replicate competitive market outcomes in approving maximum prices'.⁴⁹ NERSA explained further that the regulated maximum price for the gas energy component of the maximum price should shadow the hypothetical price that would occur if competition were not limited. NERSA stated that 'On this basis, the maximum regulated price for gas energy will fall somewhere in the envelope bounded on the low end by the cost of production of gas, and on the high end by the opportunity value for consumers (their cost of a reasonable alternative fuel).'⁵⁰ NERSA observed that 'This latter outcome (which may result in Market Value Pricing), is inefficient, and results in a deadweight loss to the economy as a whole.'⁵¹ NERSA concluded that: 'The best regulatory option is to seek to replicate market outcomes and set the maximum price for gas energy as closely as possible to the marginal cost of supply.'⁵² NERSA went on to state, however, that the marginal cost approach may not encourage competition because it may not leave any surplus for a potential competitor to enter the supply market. NERSA also expressed the view that marginal cost is also difficult to calculate.⁵³ NERSA also dismissed international benchmarking as an inappropriate basis for piped-gas pricing in South Africa on the grounds that the South African gas market is

⁴⁶ In terms of clause 8.4.

⁴⁷ This referred to "determining the gas price by comparison with:

- (a) *the cost of the alternative fuel delivered to the customer's premises or anticipated place of use (in the case of Greenfields Customers); plus*
- (b) *the difference between all the operating costs of the customer's use of the alternative fuel and the operating costs of using natural gas; plus*
- (c) *the difference between the Nett Present Value (NPV) of the capital costs of the customer's continued use of the alternative fuel and the NPV of the capital costs involved in switching to natural gas, as would be reflected in the customer's accounts."*

⁴⁸ Page 7 of the Consultation Document.

⁴⁹ Page 16 of the Consultation Document.

⁵⁰ Pages 25-26 of the Consultation Document.

⁵¹ Page 26 of the Consultation Document.

⁵² Page 27 of the Consultation Document.

⁵³ Page 30 of the Consultation Document.

unique.⁵⁴ On this basis, NERSA proposed that the price of alternatives is 'arguably the more appropriate option'.⁵⁵

In June 2011, NERSA released a 'Draft Methodology to Approve Maximum Prices of Piped-Gas in

South Africa'. NERSA stated in that document that 'In the absence of a transparent gas market price in South Africa, the maximum price for gas energy (at the point of its first entry into the transmission/ distribution system) shall be determined by reference to energy price indicators.'⁵⁶ NERSA recognised that, in order for it to approve maximum prices of piped gas, it had to be of the view that there existed market conditions or market features indicating inadequate competition in line with the provisions of chapters 2 and 3 of the Competition Act. NERSA proceeded to set out an assessment of the current piped gas market conditions that indicated, in its view, inadequate market competition, and hence the need to approve maximum piped gas price in the prescribed manner.⁵⁷ Those included:

- (1) a monopolistic market structure in terms of which Sasol (pursuant to the MVP model) references the price of natural gas to *the costs of an alternative energy source available to an individual customer*. NERSA noted that '*This is a perfect price discrimination scenario by a monopolist*';
- (2) gas prices that are higher than those charged in perfect competition or in a competitive market; and
- (3) significant entry barriers, lack of countervailing power, lack of product differentiation, discriminatory pricing and a high degree of vertical integration of Sasol in the gas market.⁵⁸

In September 2011, NERSA produced a discussion document relating to the 'Determination of the Inadequate Competition in the Piped-Gas Industry as Contemplated in Chapters 2 and 3 of the Competition Act, 1988'. In that document, NERSA repeated the views it had expressed in its Draft Methodology on Maximum Pricing of Gas regarding the inadequacy of competition in the South African gas industry.⁵⁹

NERSA also recognised that 'given the costs of fuel conversion, once the decision to use gas has been made, the customer is effectively captured by the gas supplier, and in the absence of multiple gas suppliers the customer is no longer open to competitive threat'.⁶⁰ NERSA noted in this regard that 'the adoption of energy price indicators related to other fuels

⁵⁴ Page 30 of the Consultation Document.

⁵⁵ Page 30-31 of the Consultation Document. It stated in this regard that:

"The level of the alternative fuel cost can be managed by using a basket of alternative fuels and:

- recognizing that no single fuel is a perfect substitute for gas; and*
- allowing regulated prices to be determined at a level that reflects the balance between encouraging new entry and sharing economic surplus between consumers and producers."* (p 29)

⁵⁶ Section 3.1 of the Draft Methodology.

⁵⁷ Page 31 of the Draft Methodology.

⁵⁸ Pages 32-33 of the Draft Methodology.

⁵⁹ Para 2.9, page 5 and Para 2.17, page 7 of the Determination of Inadequate Competition.

⁶⁰ Para 3.9, page 10 of the Determination of Inadequate Competition.

is a pragmatic approach to determine what a competitive energy price should be. It is not evident that alternative fuel types provide adequate competition for gas. NERSA does not support the view that the market is defined as a broad “energy market”, but instead considers the relevant market to one for piped-gas including (mobile) storage.’⁶¹

In October 2011, NERSA released the final ‘*Methodology to Approve Maximum Prices of Piped-Gas in South Africa*’ along materially the same lines as the Draft Methodology, and that was approved by NERSA on 28 October 2011. NERSA explained in its final methodology that it would approve a single maximum price per licensee, based on which different customer category maximum prices would be approved, as per the customer categories listed in Annexure A to the Gas Regulations. A licensee would therefore be required to apply for maximum prices for each customer class and each customer category’s price would have to be below the maximum price as approved by NERSA for that licensee.⁶² NERSA again recognised in its decision that the requirement to approve maximum prices and hence to implement this methodology was contingent on NERSA determining that there was inadequate competition as contemplated in Chapters 2 and 3 of the Competition Act. It stated that this determination formed part of a separate assessment by NERSA that would be performed from time to time.⁶³

On 8 February 2012, NERSA approved the determination of inadequate competition in the piped gas market as contemplated in Chapters 2 and 3 of the Competition Act, 1998, as envisaged in section 21(1)(p) of the Gas Act.

In early 2013, NERSA received two applications from Sasol Gas Limited (Sasol) requesting:

- approval of a maximum gas prices for the period 26 March 2014 to 30 June 2017, and a trading margin for the period 26 March 2014 to 30 June 2015 (the **maximum gas price application**); and
- approval of a transmission tariff for the period 26 March 2014 to 30 June 2015 (the **transmission tariff application**).

These applications were published on NERSA’s website on 4 February 2013 for stakeholder comments and input. In accordance with NERSA’s procedure for the processing of maximum prices and tariff applications, NERSA reviewed and made a preliminary assessment of the maximum prices of gas to be applied by Sasol as well as a preliminary assessment of the proposed gas transmission tariffs on 6 February 2013, which were published on NERSA’s website on 8 February 2013 for public comment and input.

Detailed written submissions to NERSA were submitted in respect of Sasol’s applications on behalf of several large industrial users of gas, who argued that both the methodology and the process adopted by Nersa were flawed.

On 25 March 2013, the Piped-Gas Sub-Committee of NERSA met and recommended approval of Sasol’s applications and on 26 March 2013, Sasol’s maximum gas price

⁶¹ Para 3.10, page 10 of the Determination of Inadequate Competition.

⁶² Para 5, page 24 of the Final Methodology.

⁶³ Para 14, page 4 and Para 42, page 11 of the Final Methodology.

application and transmission tariff application were approved by the Board of NERSA. Reasons for approving Sasol's maximum gas price application and transmission tariff application were issued by NERSA on 24 April 2013.

An application for the review of NERSA's decision in relation to these pricing applications was filed by a group of large industrial users of gas in the North Gauteng High Court on 18 October 2013. The application alleges that NERSA's decision suffered from serious procedural errors, and that it utilised an approach to gas pricing, in particular, using a pricing methodology, that is fundamentally inconsistent with the underlying objective of the statutory powers granted to NERSA in terms of the Gas Act, which is to ensure that suppliers charge prices that are reflective of those they could charge in competitively priced markets (as opposed to uncompetitive or monopoly prices). They argue that NERSA's pricing decision will have the perverse effect of entrenching Sasol Gas' monopoly pricing structure, and allow it to charge prices which are significantly higher than the average prices it currently charges customers of piped gas (in market in which pricing was and still is significantly warped by the fundamentally anticompetitive Mozambique agreement). At the time that this paper was written, answering papers had yet to be filed. It may be some time before the Court rules on the application.

There is also concern (although this is not one of the grounds of review) that NERSA appeared to choose to regulate prices before conducting the inadequate competition assessment, since such an assessment is a jurisdictional pre-requisite for regulation. More importantly, the inadequate competition assessment itself did not contain a thorough analysis of competition in the market, and it appeared to display a lack of understanding of key competition law and economics principles. For instance:

NERSA seems to have included products within the market definition purely because of the terms of the Gas Act, rather than the question of substitutability. (See for instance the fact that CNG is viewed as part of the piped-gas market because of the definition in the Gas Act.

Despite the manner in which NERSA set the Methodology to approve pricing (by including a basket of alternative fuel sources' pricing), it did not consider that alternative fuels are in the same market as piped gas because of the high cost of switching.

NERSA makes its geographic market definition conditional on:

- suppliers being willing to build the infrastructure;
- a pipeline available to connect the customer;
- willingness of the customers to pay a connection and transportation costs; and
- sufficient gas to supply the customer.

It concludes that the relevant geographic market is South Africa. Although NERSA is correct in stating that if these factors are present then a customer can access gas anywhere in the country, a comprehensive market definition requires the actual undertaking of an analysis of whether these factors are present.

NERSA concludes that the relevant functional market is the market for the supply of gas to the wholesale and retail market which includes distributors, traders, and reticulators, without a undertaking a functional market definition exercise. NERSA seemingly reaches this conclusion on the basis that Sasol Gas is active on all levels of the supply chain. But of course there are functional distinctions between these levels and parties that operate on only one of those functional levels.

NERSA made no determination of what the term 'inadequate competition' means, and unfortunately, this term is not defined with reference to the Competition Act. Using section 7,8, 9 and 12A(2) of the Competition Act, NERSA was able to identify key issues that impede more effective and adequate competition, namely: structure of the market, entry barriers, exercise of market power, anticompetitive conduct such as price discrimination and high prices and market allocation. However, these considerations are all based on Sasol's position in the market as well as Sasol's conduct which was, in any event, permissible in terms of the MPGA.

NERSA states that it has used sections 7, 8 and 9 of the Competition Act in its analysis. However, while section 7 sets out when a firm is considered to be dominant, section 8 and 9 deal with abuses of dominance. It is important to note that the mere fact that a firm is dominant and has market power is not viewed as anti-competitive by the Competition Act. It is only the abuse of that dominance in the ways set out in section 8 and 9 of the Competition Act that is considered anti-competitive and is therefore prohibited in terms of the Competition Act. A mere assertion of dominance and market power by NERSA is therefore insufficient to show inadequate competition in terms of chapters 2 and 3 of the Competition Act.

5. Recommendations

5.1. Legislative amendments are required

As the *Telkom* case demonstrates, uncertainty about which authority has *ex post* jurisdiction to deal with complaints about anti-competitive conduct has seriously hampered enforcement by both the competition authorities and the sector regulators. In the telecommunications sector, for example, the Telkom complaint took some 11 years to reach finality, during which time, complainants were effectively deterred from pursuing complaints about anti-competitive conduct to either ICASA or the Commission. Despite the fact that the Commission identified telecommunications as a priority sector for investigation,

As the recent experience described above indicates, *ex ante* regulation by ICASA and Nersa has also proven to be problematic in several respects. For instance, in the case of the ECA, legislative gaps have allowed for forum shopping and make it unclear which authority should exercise primary jurisdiction over which area of regulation.

In the case of the Gas Act, there are also proposed amendments in the pipeline. The Gas Amendment Bill proposes to change section 21(1)(p) so that it will provide: 'maximum prices and tariffs for distributors, reticulators, and all classes of customers must be set in the prescribed manner'. It therefore contemplates a far more interventionist regulation of pricing – to 'set' rather than just 'approve' licensees' maximum prices. Most worryingly, however, the

pre-requisite to determine whether there is inadequate competition in the market before exercising its pricing regulation power, has been removed in the Bill.

Furthermore, there is an amendment which provides that NERSA must monitor the application of the prices and tariffs and take appropriate action where necessary to ensure non-discrimination. This appears to be the imposition of *ex post* regulatory power on NERSA.

Legislative amendments are clearly required to address these issues. It is of concern that the proposed amendments to the ECA seem to diminish the level of guidance to ICASA, while in the case of the present Gas Act, a lack of particularity in the requirement that there be 'inadequate competition' has failed to provide the regulator with sufficient guidance on how to conduct economic regulation. The proposed amendments to the Gas Act suggest that there be no assessment of the levels of competition before pricing regulation is imposed. These concerns should be addressed so that the final version of the legislation provides for thorough, *ex ante* economic regulation through the application of a competition analysis.

5.2. The sector-specific legislation should be clear and consistent with the Competition Act

NERSA has no general powers in terms of the Gas Act to monitor gas prices and to initiate a process to regulate pricing. It can only 'approve' a maximum pricing application once it receives one. There is also no provision for Nersa to initiate a review of its decisions on maximum pricing, in the event of a material change in market dynamics, and no means for buyers of gas to trigger such a review.

Moreover, section 21(1)(p) does not provide adequate guidance to NERSA on what process it should follow in order to assess whether inadequate competition exists (and therefore, whether it should regulate prices, and if so, how). Although the section clearly implies that Nersa must assess the nature and extent of inadequate competition *before* regulating prices,⁶⁴ the Gas Act does not set out a clear series of steps to be followed to identify the relevant market and then evaluate the competitive conditions in that market.

NERSA's power to regulate prices is triggered in terms of section 21(1)(p) 'where there is inadequate competition as contemplated in Chapters 2 and 3 of the Competition Act'. This general reference is to the prohibited practices sections of the Competition Act (Chapter 2, dealing with price-fixing and market allocation by competitors, as well as restrictive agreements between customers and suppliers and abuses of dominance) and the merger regulation provisions (Chapter 3). There is no specific guidance, as set out in section 67 of the ECA. It would be far more helpful if the Gas Act would set out, as section 67(4) of the ECA does, that what Nersa must do is define the relevant markets and set out a methodology for determining whether there is inadequate competition in these relevant markets, which could include, for example, the factors set out in section 12A(2) of the Competition Act which are commonly used in traditional economic analysis to assess the nature and level of competition in a relevant market- such as the actual and potential level of import competition in the market; ease of entry into the market, including tariff and regulatory barriers; level and trends of concentration, and history of collusion, in the market; degree of

⁶⁴ One of the grounds on which NERSA's determination of Sasol's applications is being reviewed is that NERSA determined its methodology *before* making its finding of inadequate competition.

countervailing power in the market; dynamic characteristics of the market including growth, innovation and product differentiation; and the nature and extent of vertical integration in the market.

5.3. The legislation should make provision for mandatory coordination and interaction between the competition authorities and sector regulators

Regulators are expected to apply competition analysis to create conditions that would foster competition, without much experience of competition law and competition economics, or the techniques used by competition authorities to regulate.

Accordingly, there needs to be cooperation between the competition and sector regulators so that there is appropriate knowledge sharing. This can be done in the case of both ex post or ex ante regulation, to the extent that there is concurrent regulation. Accordingly, sector specific legislation should tie up with the provisions of the Competition Act that provide for MoUs to be entered into between the parties. Such Memorandums of Understanding should set out practical and particular steps on engagement in each instance that there needs to be the application of ex post regulation in a regulated sector or the application of competition analysis in relation to ex ante regulation.

5.4. Adequate provision for appeals

Neither the Gas Act, nor the ECA, provide for any appeals in relation to the exercise of competition regulation by independent regulators. Parties aggrieved by decisions by NERSA and ICASA in the course of exercising their powers have to bring an application to the High Court to review these decisions.

At the time that this paper is being written, Vodacom and MTN have launched applications to review ICASA's 2014 Call Termination Regulations, and requested interim relief from the High Court in the form of an order suspending the implementation of the Regulations until the review is decided. The parties are alleging numerous defects in the regulations and ICASA's process. As explained above, similar review is being pursued against NERSA in relation to its maximum pricing regulation.

While we present no views regarding the validity of NERSA's or ICASA's processes which led to these reviews or indeed the substantive 'correctness' of the regulation which resulted from these processes, we note that reviews like these take many years to complete. In the review of the call termination regulations, if the regulations are suspended pending the outcome of the review process, the market will suffer from a further period without pro-active intervention of economic regulation, thereby delaying the prospect of creating the conditions necessary for the market to function without regulation.

This problem highlights the advantages of the competition authorities' process. In this regard, if the Competition Commission regulates, its decisions primarily lead to referral to the Competition Tribunal. There is thus an investigation process during which the Commission can take into account stakeholders' submissions. However, the Commission's decision is then subject to further oversight and decision by the Tribunal, and the Tribunal process provides for the exchange of pleadings of the relevant parties and opportunities for testimony and cross examination of both factual and expert witnesses.

It is for this reason that the High Court has found that a referral by the Competition Commission does not amount to administrative action, because it does not have a direct, external effect on the rights of the affected parties.⁶⁵⁶³ The decision of the Tribunal will affect parties' rights, and this decision will only be taken after a comprehensive fair hearing process. Such Tribunal processes can be completed in shorter periods than High Court litigation.

It would accordingly be helpful if the ECA and the Gas Act provided for some internal review processes, before resort to High Court review is required. For instance, the creation of an 'economic regulation tribunal' may enable questions of both legal procedural process and substantive technical regulation to be considered by an expert body that can adjudicate complaints regarding sector regulators' regulation. A single economic regulation body could play this role (there needn't be one for telecommunications, one for gas, one for airlines, one for broadcasting, etc.), since the principles underlying economic regulation, with the application of competition analysis should be consistent across industries.

Such a Tribunal's decisions may or may not in turn be subject to review in the High Court, but its existence should be designed to provide for more efficient and speedy assessment of reviews of economic regulation, and can be staffed by persons familiar with economic regulation and competition regulation, so that account is taken of the specific needs of economic regulation, so that for instance, minor gaps in process can be weighed against the substantive outcomes of such process. If the High Court does in turn review this body's decision, it should provide for significant deference to the body, in light of the expertise thereof, as happens in relation to the Competition Tribunal.

6. Conclusion

The experience of regulation by sector regulators and the competition authorities over the past 10 years demonstrates the challenges inherent aligning competition law enforcement and efficient regulation of the telecommunication and gas sectors.

It is clear that legislative amendments are required to define roles and responsibilities more clearly and enhance the ability of NERSA and ICASA to work with the competition authorities to achieve pro-competitive outcomes which ultimately deliver lower prices and improved products and services to South African consumers. Such legislation should be consistent with the Competition Act, and provide for the application of competition analysis in relation to ex ante regulation. There should also be legislative and mandatory provision for interaction between competition authorities and sector regulators to ensure knowledge transfer, as well as effective regulation.

However, amendments of this nature can only be successfully effected if there is a clear consensus in government about the role of competition in the economy. It is not merely about who should regulate what, but also, whether competitive markets can be trusted to deliver the best results for consumers in the long term.

⁶⁵ Telkom SA Limited v Competition Commission of South Africa and Another (11239/04) [2008] ZAGPHC 188 (20 June 2008).

