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Mid-term forecasting of electronic communication markets development in Croatia**

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1 Objectives of the project

The global objective of the project is to assure further strengthening of regulatory rules of the telecommunications market in Croatia (in compliance with the EU *acquis*), which will contribute to its further development.

In the Terms of reference there are two specific objectives mentioned:

To provide an overview of the entire telecommunications market in Croatia including both historical data and future projections in order to provide access to the information necessary for focusing research and development efforts and developing new products and business strategies.

To provide strategic assessment of the role of regulatory rules (laws, bylaws, decisions) in the telecommunications sector with the main focus on the role of competition in delivering benefits for customers.

Emphasis on broadband

In discussions with the beneficiary it was asked and agreed that the project would put emphasis on the broadband development as this is of vital importance to the development of the information society in Croatia.

2 Introduction

One of the tasks of the project was to give an overview of possible improvements of regulations with an aim to further enhance the capabilities of HAKOM to promote the use of telecommunications and especially broadband. In this report an overview is given of the present status of the regulations and some suggestions are given for further improvement. As a general remark the project notes that the present regulatory package as it is enacted now is in full line with the EU regulatory framework. The major needs for further improvement lie outside the scope of HAKOM. They concern matters like the speed of court procedures, the duct sharing and the costs of rights of way. Nevertheless HAKOM has a task to watch closely the developments and wherever possible to speed up the implementation process.

3 Implementation of provisions

The component 3 of the project CARDS 2004, Capacity building for the Croatian Telecommunications Agency, EUROPEAID/120454/C/SV/HR, has given a legal gap analysis and gave some proposals for texts to be included in the new Electronic Communications Act. This new law is now enacted and has been published in the Official Gazette nr 74 after approval by Parliament. We will not repeat the findings of that project, they are well documented in the deliverables of component 3. Nevertheless we have reviewed the implementation of the suggestions that were proposed. In the following we will shortly describe the status of their implementation.

3.1 Authorisations

The provisions for general authorization have been correctly implemented. The transitional paragraphs of the new law regulate the abolishment of concessions and the issuing of

general authorisations. There are no major legal steps envisaged here. The new regulatory package that is now being negotiated in Brussels will not influence this area.

3.2 Markets

HAKOM has now started the market analyses that are part of the new law. Of the 7 markets that are to be analysed according to the recommendation of the commission nr 2007/879/EC, the following 5 have been analysed and are now in the last phases of public consultation. The final decisions on these markets are now in preparation. These markets are:

Market 2: Call origination on the public telephone network provided at a fixed location.

Market 3: Call termination on individual public telephone networks provided at a fixed location.

Market 4: Wholesale (physical) network infrastructure access (including shared or fully unbundled access) at a fixed location.

Market 5: Wholesale broadband access.

Market 7: Voice call termination on individual mobile networks.

The two markets out of the recommendation that remain to be analysed are market 1: Access to the public telephone network at a fixed location for residential and non-residential customers and market 6: Wholesale terminating segments of leased lines, irrespective of the technology used to provide leased or dedicated leased lines.

The analysis for these Markets must use inputs from the analysis of market 4, so it is logical that these markets are put on hold until the present procedure is finalised.

According to the same recommendation regulators have the power to designate other markets for ex-ante regulation if these markets pass the 'three criteria test'. HAKOM has judged that this may be the case for four other markets: the market for the termination of SMS messages, the market for publicly available telephone services in mobile networks, the market for transit calls in fixed public communication networks and the market for access and originating calls from mobile networks. These markets have been analysed and draft decisions based on these analysis have been submitted for public consultation.

The conclusion is that HAKOM is already quite advanced in the market analysis area. The final test will come with the imposition of remedies and the opposition that this may arise from the operators that are designated as having significant market power.

3.3 Universal service

The transcription of the USO obligations in the new law is in line with the acquis. It is positive to note that only operators with a market share of more than 2% will have to contribute to a USO fund if such a fund should prove to be necessary. It must be noted that the acquis does not mention Internet access as part of the USO. Given the still high number of dial up customers in Croatia it is right that the Law specifically mentions Internet access, although by implication this is limited to dial up. Croatia is in the lucky position that broadband Internet increasingly becomes 'the norm'. If broadband development in some areas would seriously be hampered therefore in the future an extension of the definition might be sought in one of the public consultations as foreseen in the Law.

For the time being there is no need to interfere as the market is still developing. It must be kept in mind that if a fund would be set-up this would hinder the development in the sector in areas that are already served. If it would just take away some of the profits made in well developed areas, it may be justified to impose an extra burden on operators, however chances are that this would diminish the possibilities to further invest in developing the market. By doing that, this would hinder the future development of the sector as a whole also to the detriment of the less well served areas. The latter is likely to be the case for the non-

HT companies that are active on the market, as the financial situation of most of them is weak.

3.4 Interim Conclusion

The conclusion is very short, there is no need for extra regulatory input. The emphasis should be on the implementation and the further development of expertise within HAKOM.

4 Further steps

There are other areas where further actions of HAKOM are necessary. The most important ones are systematic regulatory accounting and the introduction of 'naked DSL'.

4.1 Regulatory accounting

The next step in the application of the European Regulatory Package entails detailed accounting of underlying costs.

As a first step price setting for wholesale services by using the 'retail minus' approach as is done by HAKOM is a good first step. The next step should be a total overview of real costs, based on the Long Range Incremental Costs (LRIC) principle, as this is the only objective means to set tariffs in a market that is still dominated, as it is, by one major telecommunications infrastructure and service provider. LRIC principles try to determine the cost an efficient operator would have if it would provide the services that are regulated. In LRIC calculations the part of the costs that a dominant operator always has because he does not have to be efficient are not accepted. Generally the network layout, as it exists, is accepted.

The foreseen following larger technical assistance project has as one of its main parts the development of regulatory accounting. This can only be effective if there is already staff available in HAKOM that will have regulatory accounting as its main tasks. Ideally they would be trained in the basics of regulatory accounting before they will under the guidance of the experts enter into the complex real life accounting.

4.2 Technologically independent regulation

In the interim report we made a remark about technology independent regulation. This was especially aimed at the existing licences for mobile telecommunications for T-Com mobile and VIP. In the meantime we have learned that these licenses will soon be renewed and made technologically independent. Thereby this issue should be solved.

4.3 Naked DSL

Naked DSL is another offering that would further develop the broadband market. It means that when a customer has an ADSL connection he should be able to have this connection without the obligation to have at the same time a standard telephone line. The customer could then choose to have a telephone connection over the ADSL line (VoIP) or simply use his mobile.

4.3.1 The need for Naked DSL

The consumer survey that was initiated by the project shows clearly that there may very well be a market for this service. In this consumer survey almost half of the interviewed people who have a landline said that they cannot do away with it because they need it for Internet.

The percentage of interviewed people who said this is 49%. That is not to say that they would all give up their fixed standard telephone line if they could get Internet without having a standard subscription, but they would at least consider it. In the same survey 21% of the interviewed people indicate that they would consider giving up their landline and manage with just a mobile phone. This percentage is even higher for the younger age groups. Therefore in the future it may be expected that this trend increases. In this respect it is interesting to mention that in Western Europe the interest for using VoIP over DSL has increased because of the economic crisis. By using this service the costs for users can decrease substantially.

4.3.2 Unjustified bundling

Another way of looking at this issue is that in the present offering where one has to buy both a PSTN line plus an ADSL line in order to be able to get ADSL line, this can be considered to be an unjustified bundling of services. It is sometimes argued that bitstream access is a form of unbundling because ADSL and PSTN can be bought from different companies, PSTN is available from the incumbent, the ADSL type services can be obtained from the alternative operator. Still, even if the customer wishes to have voice services dealt with by VoIP over ADSL line, he still is obliged to pay a subscription for PSTN, a service he does not want to use. Regulators should be very keen on this.

4.3.3 Legal approach

The new electronic communication act gives some openings for the regulator to enforce the incumbent to offer naked DSL. If this proves indeed to be possible the incumbent should be forced to offer naked DSL. The alternative approach is to wait until one of the competitors wishes to offer naked DSL and then start a procedure based on the analysis of market 4. But it is not certain at all if an alternative operator would do such on its own initiative. If this offer is to be done by the incumbent to individual subscribers it must first be established that the relevant market is susceptible to ex-ante regulation. This could perhaps be done in the analysis of market 1, which is the only analysis on retail level for fixed access. This analysis can start after the finalisation of the analysis of the markets that is now on its way. It is highly likely that the analysis will lead to the conclusion that the incumbent has SMP in this market. If not directly as the market description is about telephone lines that by implication using paragraph (5) of article 55 of the Law that says that SMP designation can be extended into closely related markets. Article 61 of the Law and especially its paragraphs (1) and (2) can be construed to impose the obligation of offering naked DSL. They read as follows:

(1) The Agency may, in accordance with provisions of Article 56 of this Act, impose obligations on operators with significant market power to meet reasonable requirements for access to and use of specific network elements and the associated infrastructure and associated facilities.

(2) The obligation referred to in paragraph 1 of this Article may be imposed on the operators by the Agency in particular where it considers that denial of access or any other unreasonable terms and conditions or restrictions having a similar effect would hinder the emergence of a sustainable competitive market at the retail level, or would not be in the end-users' interest.

In this case it can be argued that naked DSL is a reasonable requirement for access (1) and that it is in the interest of end users(2). The latter has been confirmed by the results of the public enquiry. Nevertheless a more in depth analysis will have to be made on the Croatian texts in order to estimate its validity.

4.3.4 Pricing for Naked DSL

It can be argued that pricing for naked DSL should be the same as for the reference ULL offer. Whether this is justified can only be judged when detailed examination has shown what cost elements have been accepted in the prices for ULL. It is outside the scope of the project to consider this now, but if the offer of the incumbent seems unreasonable a detailed regulatory cost accounting exercise is unavoidable.

4.3.5 Situation in Europe on Naked DSL

In Europe the approach towards naked DSL differs per country. In some countries it is offered as part of the standard offering of the incumbent, in others some pressure had to be put on the incumbent and in others this offer does not exist. There is no clear rule in this area and a judgement has to be made for every country separately. As indicated above, in Croatia the conditions, both from the legal point of view and from the market point of view exist to introduce this service.

In the end it is also in the interest of the incumbent to have a naked DSL offering as it must be expected that if it is not offered gradually users may be tempted to switch to other forms of broadband where there is more competition and then the incumbent could well remain empty handed. Examples are Wimax offerings and in the near future mobile Internet access offers.

4.4 Ducts

Although the problem with the status of the Ducts cannot be solved by HAKOM, HAKOM has the task to promote a solution to the problem because it may very well hinder the development of the telecommunications market and especially competition.

A solution might be found by an approach that favours a public private partnership. The ownership of duct could then lie with (local) governments but the right of use during a rather long period could be given to the private party that made an investment, with the obligation to give other parties access to it at reasonable conditions. It is outside the scope of the project to work this out but the direction as mentioned might help in bringing this problem closer to a solution.

4.5 Rights of Way Fees

In Croatia a new regulation is in place regarding the fees for right of way that operators have to pay when they wish to have cables on the territory. The charges vary from 4 to 10 kn/m² depending on the nature of the ground that is used to lay the cable. The amounts look rather small but 10 kn/m² equals 700€ per km per year or 14.000€ for one off payment as the yearly fee can be exchanged in a one off fee of 20 times the yearly fee. This fee could even be higher than the cost of a line and could effectively result in an extra tax for telecommunications. A charge of this size is certainly not in line with the aim to promote broadband.

The amount is in the higher range of what is charged in Western European countries if there is such a charge because there is no common position in the EU on the charges for right of way. Some countries do not allow any charges at all: examples are Belgium, Finland, Ireland, Luxemburg, The Netherlands and Sweden. In these countries most of the time a compensation may be charged for a possible decrease in value of the land and/or necessary costs to be made by the landowner. In other countries the municipalities determine the costs with or without a maximum set: examples are Denmark, Germany, Italy, and Portugal.

Other countries have specific regulations like the UK where a fee has to be paid to Ofcom and the operator may even be forced to buy the land involved. The most specific is FR that has given clear maximum amounts. It could be advisable that HAKOM tries to influence the regulation in place, it has not a direct role but it is affecting the telecommunications market and seems to contradict the wish to promote broadband.

5 Conclusion

The two main further steps in developing the regulation should be:

1. the start of a regulatory accounting according to LRIC principles.
2. the introduction of 'naked DSL'

On top of that from our studies it can be concluded that infrastructure competition for broadband access in the fixed network will not come about easily. As long as competition from mobile networks like LTE, cable and/or WiMax is not substantial a tough regulatory regime for broadband access over copper will have to remain in place.

Lastly a solution for the ducts should be sought actively and pressure should be exercised to try to lower the tariffs for right of way.