The telecommunications market in the Czech Republic

The developments in the Czech telecommunications market in 2009 were marked by the declining economy, which translated in an across-the-board slump in revenues from telecommunications services. The decline was not as significant as in other sectors, but, compared to the previous period of growth, it was prominent. According to Company's estimates, the telecommunications market in the Czech Republic contracted by approximately 5% on the previous year.

Revenues from the fixed line market recorded a year-on-year slump of approximately 9%, while the mobile market revenues were down by approximately 6% – in stark comparison to a growth of approximately 3% in 2008. Fixed line penetration reached 36% as at the end of 2009, continuing the downward trend of previous years. Mobile penetration (measured by the number of registered SIM cards with a 13 month activity criterion), on the other hand, exceeded 130% (an accurate figure cannot be determined due to differences in the Czech operators' methodologies of accounting for mobile customers), which is among the highest penetration rates in Europe.

Among European Union member states, the Czech Republic has for a long time been in the upper echelon of countries with the highest volumes of voice traffic in mobile networks. This, however, did not stop the fixed-to-mobile substitution and the proportion of mobile voice traffic continued to grow also in 2009. According to Company's estimates, 83% of all voice traffic generated in 2009 was in the mobile networks, which translates into a 2 p.p. year-on-year growth.

The demand for data and internet services and for value added services also continued to grow.

Trends in the fixed line market

In 2009, the revenues from fixed lines reached approximately CZK 48 billion, which spells a year-on-year decline of approximately 9%. The fall of the voice revenues was partly offset by the growing revenues from broadband internet, IT services and business solutions.

The year 2009 was marked by a general economic recession and operators sought to respond to the market needs by focusing on products and services that let the customer save costs, economize and have a maximum control over expenditure.

In May 2009, Telefónica O2 presented a brand new concept of consumer services. It spelled the end of the previous concept based on combining voice and other services in pre-set bundles; in its stead, a flexible combination of broadband internet with other fixed line and mobile services came to the market. The new concept lets the customer choose only those services they really use, and save at the same time.

Combinations of mobile and fixed line services were offered also by Vodafone, as part of its OneNet corporate proposition, and T-Mobile – branded as ProfiNet.

The market of paid and free television was developing at full speed. The cable television market continued in its consolidation – a trend driven mainly by RIO Media a.s. and Nej-TV. Paid television operators added new channels to their portfolios, including HDTV programmes. The coverage of the Czech Republic by the terrestrial digital television technology DVB-T increased further during the year. Despite competitive pressures, O_2 TV has found its market and as at the end of the year it had 138 thousand subscriptions.

Several major changes occurred in the fixed line market in 2009: in April, T-Mobile Czech Republic, a.s. (T-Mobile) announced a take-over of consumer and small business clients of GTS NOVERA s.r.o (GTS Novera), which decided to focus exclusively on the corporate market and pulled out from the consumer and small business segments altogether. The take-over of customers was concluded in the autumn. T-Mobile simultaneously announced a deal with České Radiokomunikace a. s. (České radiokomunikace) for the take-over of its consumer client base. This transaction was concluded in December by T-Mobile taking over all assets in the small and medium enterprise (SME), small/home office (SoHo) and residential segments, including the relevant infrastructure and employees of České radiokomunikace who worked on the commercial and operating side in the aforementioned segments. The acquisition meant that T-Mobile could start offering services of the fixed line and become the largest alternative operator with a DSL proposition. České radiokomunikace announced that it wished to pursue the core areas of its business – television and radio broadcasting and operation of the broadcasting infrastructure, including wholesale and corporate telecommunications services.

At the end of the year, GTS Novera announced a deal with Centrum Holdings s.r.o. to transfer approximately 40 thousand email and web accounts of the Raz Dva service. České radiokomunikace also announced its plans to cover, by the end of 2009, 25 Czech towns with its wireless broadband internet service operated on the WiMAX platform.

WiFi internet connectivity continued to hold a strong position in the Czech Republic. As at the end of the year, the number of its customers (including FTTx) stood at approximately 780 thousand. Due to the high number of WiFi service providers, the quality of connection varied greatly. Some WiFi providers began to invest in the FTTx infrastructure.

The installation of a new cable distribution system, EuroDOCSIS 3.0, by UPC Česká republika, a.s. (UPC) in 2009 meant that the company could add new connection speeds to its existing portfolio. From September it started offering 50 and 100 Mb/s download speeds. Several weeks later it came out with a significantly slower 1 Mb/s option in an effort to capture new customers and light users with this economy alternative. UPC later began to offer this starter internet tariff for free to the subscribers of the cable television service. UPC also continued to expand its television channel portfolio, added High Definition (HD) channels and digitalised its television service.

Trends in the mobile market

The size of the mobile market in the Czech Republic measured by revenues reached approximately CZK 82 billion in 2009, which represents a year-on-year drop of approximately 6%.

Despite the recession of the Czech economy, all mobile operators recorded additions to its customer base in 2009. The net additions (of active customers in the case of Telefónica O2 and of registered customers in the case of T-Mobile and Vodafone) reached 299 thousand in 2009, compared to 406 thousand in 2008.

Telefónica O2 experienced a year-on-year increase of 3% in active users, whose number grew to the total of 4,945 thousand. The share of active customers in the total market cannot be determined as T-Mobile and Vodafone apply a different methodology of accounting for customers and publish only the figure of registered customers.

Operators responded to the market need by offering products which allowed cost optimisation and maximum control over expenditure. Telefónica O2 expanded the offer of its O_2 NEON tariffs by adding the new O_2 NEON L+ tariff, and increased the number of free minutes and simultaneously reduced the price per minute of call for its O_2 NEON XL tariff. The Company also introduced new tariffs for the pre-paid market: O_2 NA!PIŠTE and O_2 NA!HLAS, with calls and SMS priced only CZK 0.50.

In July, Telefónica O2 became the first Czech operator to offer a tariff free of all monthly fees and commitment in the form of its O_2 ZERO, which gave the customer full control over their expenditure.

As part of its economizing package, Vodafone started offering Výdaje pod kontrolou, a programme with services like FlexiStrop, FlexiLimit or Chytrý přehled.

The year 2009 saw also the success of unlimited or discounted communication within a pre-set group (e.g. O_2 Přátelé, O_2 Navzájem, T-Mobile Rodina, T-Mobile Přátelé v síti or Přátelé síť nesíť, Vodafone Přátelé ze všech sítí).

The developments of recent years in the mobile market confirm the trend of the growing demand for mobile broadband internet. All operators invested in the modernisation of their existing networks and deployed the UMTS/HSDPA technology in order to be able to offer the highest quality broadband internet connectivity. Telefónica O2 continued in the roll-out of its new generation mobile network (3G) operating on the UMTS/HSDPA platform. Before the end of the year, all 13 regional capitals, i.e. almost 30% of all Czech population, were covered with the service, and Telefónica O2 thus became the only operator in the Czech market to offer broadband mobile data connectivity with speeds of up to 3.6 Mb/s.

T-Mobile began the modernisation of its GSM network at the beginning of the year. The goal is to deploy the EDGE technology across the network, which should be completed in mid-2010. T-Mobile simultaneously announced that it was gearing up to accommodate the arrival of new technologies, such as the new generation networks or IP services. At the end of the year, T-Mobile announced the launch of its 3G network pilot operation, trialling the HSPA technology supplied by Nokia Siemens Networks. The pilot service was available in all locations in Prague and went live for all customers in January 2010. Its roll-out to the regional capitals of the Czech Republic is expected within the next two years.

In March 2009, Vodafone launched a commercial operation of its 3G network in parts of Prague 9 and 10. Huawei was chosen in July as Vodafone's new supplier for the construction of the 3G network and infrastructure and for an upgrade of the 2G EDGE network. According to Vodafone's statement, the company will focus on the construction of a 3G network in Prague and Brno as a priority.

Pre-paid services started emerging in the mobile broadband internet market in the Czech Republic towards the end of the year. The mobile operator MobilKom, a.s., whose services are marketed under the brand name of U:fon, introduced a pre-paid card; the customer paid for a USB modem and received a usage credit of a certain value. A fixed amount was subtracted from the credit for every day the customer went online, and when used up, the credit could be topped up. Vodafone came out with a similar offer at the end of 2009.

In December 2009, MobilKom announced a major turnaround of its strategy for the U:fon brand. It intends to start a wholesale operation and transform itself into a low-cost provider with a focus on mobile data. The new strategic focus also resulted in the closedown of U:fon brand stores.

Regulation

Several changes occurred in 2009 in the legislative environment which governs the field of electronic communications in the Czech Republic. The most material changes included the following:

1) changes in the legislation;
2) changes in the areas of relevant markets analysis and product regulation;
3) changes in the Universal Service provision and in the government's policy and support of broadband internet access.

Major changes in the legislation which governs the area of electronic communications include the following:

- commencement of the application of the European Parliament and Council (EC) directive on audiovisual media services in the national law (by way of an amendment to the radio and television broadcasting legislation and the enactment of a law on audiovisual media services);
- preparation of subsequent amendments to the Electronic Communications Act which concern the permission for use of radio frequency bands, Universal Service, priority connection in emergencies;
- issuance of a Government Regulation No. 228/2009 Coll., amending Regulation No. 154/2005 Coll., on the determination of the amount and method of calculation of the charges for using radio frequencies and numbers, as amended;
- issuance of a Decree No. 267/2009 Coll., amending Decree No. 117/2007 Coll., on the numbering plans of electronic communication networks and services, as amended by Decree No. 231/2008 Coll.;
- issuance of a European Commission and Council (EC) Regulation No. 544/2009, amending Regulation (EC) No. 717/2007 on roaming on public mobile telephone networks in the Community, and Directive No. 2002/21/EC on a common regulatory framework for electronic communications networks;
- issuance of a European Parliament and Council (EC) Directive No. 2009/214/EC, amending Council Directive No. 87/372/EEC on the frequency bands to be reserved for the coordinated introduction of public pan-European cellular digital land-based mobile communications in the Community;
- approval of a revised new regulatory framework on electronic communications by the European Parliament and Council (EC), taking the form of:
    i. issuance of a European Parliament and Council (EC) Directive No. 2009/136/EC, amending Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services, Directive No. 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector, and Regulation (EC) No. 2006/2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws;
    ii. issuance of a European Parliament and Council (EC) Directive No. 2009/140/EC, amending Directive 2002/21/EC on a common regulatory framework for electronic communications networks, Directive 2002/19/EC on access to, and interconnection of, electronic communications networks, and Directive 2002/20/EC on the authorization of electronic communications networks and services; and
    iii. issuance of a European Parliament and Council (EC) Regulation No. 1211/2009 establishing the Body of European Regulators for Electronic Communications (BEREC) and the Office.

Telefónica O2 raised comments on the European Commission's proposal for the review of the new EU regulatory framework for electronic communications services in the discussion of the European Parliament committees. The Company was also contributed to the preparation of the above legislative amendments through its involvement in the process of expert or public consultations, either directly – through industry associations of telecommunications operators, or through the parent company.

The passing of the new Payment Services Act also directly concerned the Company. The provision of these services – previously known as "third party services", of Telefónica O2, which allowed the customers to order and buy goods and services of third parties, was concerned primarily by the following laws:

— Act No. 284/2009 Coll., on the Payment System, which incorporates in particular the European Parliament and Council Directive 2007/64/EC on payment services in the internal market, European Parliament and Council Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, to be amended by the European Parliament and Council Directive 2009/110/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions,
— Act No. 285/2008 Coll., on selected measures against the legalisation of the proceeds from crime and terrorist financing.

Telefónica O2 previously provided the services based on a CTO licence under the Electronic Communications Act, and under the Civil and Commercial Codes.

Relevant markets analysis and product regulation
Telefónica O2 continued to meet its duties with which it was tasked based on the relevant markets analysis undertaken by the Czech Telecommunications Office (CTO) in 2006 and 2008.

During 2008 and 2009, the CTO analysed markets which the European Commission excluded from the list of the so-called relevant markets. The analyses resulted in a gradual cancellation of regulatory powers, especially in the retail voice markets.

In January 2009 the CTO published new regulated wholesale prices for call termination in mobile networks. Effective from February 2009, the price per minute of call went down from CZK 2.99 to CZK 2.65, and from 1 July 2009 it went down further to CZK 2.31.

The CTO commenced a second round of analysis of selected wholesale markets and the retail market of access to a public telephone network in a fixed point. In May the European Commission published a recommendation for the regulation of prices for call termination in fixed and mobile networks in the Community.

Regulation of international roaming
The European Parliament and Council passed a new regulation concerning the roaming regulation in the European Union. Retail prices for incoming calls went down from 22 cents to 19 cents per minute with effect from July; the price of an outgoing call went down from 46 cents to 43 cents per minute; the price of an SMS sent within the Community went down to 11 cents. The regulation at the same time promulgated the limit on wholesale prices for calls, SMS and data services.

Internet access
A CTO decision from 28 January 2009 introduced, with effect from May 2009, a new ADSL internet access service (the so-called naked ADSL), in which the end user does not need to subscribe to a fixed point telephone network access service for the purpose of using a publicly

available telephone service. Telefónica O2 took advantage of this opportunity and introduced the service as part of its new service concept for the consumer segment, which was launched in May 2009.

Imposition of duties related to the provision of the Universal Service

Telefónica O2 provided the following services during 2008 as part of meeting its duties imposed by the CTO in relation to the Universal Service provision:

a) the public payphone service;
b) access to the public telephone service, of the same quality as for other end users, for people with disabilities, namely by means of special terminal equipment;
c) special price plans for persons with disabilities, which are different from the regular price plans provided under the standard commercial terms and conditions
d) ancillary services to the service of access to the public telephone service at a fixed point of the public telephone network:
   — payment of the charge for connection to the public telephone network in instalments – consumers only;
   — free-of-charge selective blocking of outgoing calls;
   — free-of-charge itemised billing – consumers only.

Based on a CTO decision, services under point (d) were excluded from the scope of the Universal Service with effect from 30 July 2009. The services continued to be offered commercially, outside the Universal Service provision.

CTO issued an amendment to its earlier decision concerning services under point (a). The amendment has led to a significant reduction in the number of public payphones operated as part of the Universal Service in the second half of 2009 and onwards.

Universal Service

In the first half of 2009, CTO issued a decision concerning the amount of net costs for services included in the scope of Universal Service in 2007. The decision has not yet become final and legally conclusive as the other operators who have the duty to contribute towards covering for the losses incurred as a result of Universal Service provision appealed against the CTO decision.

During 2009, Telefónica O2 claimed with the CTO a payment for services included in the scope of the Universal Service in 2008. In the second half of 2009, the CTO reviewed documents supplied by Telefónica O2 in order to verify the amount of the claim.

On 17 December 2009, a CTO decision concerning the amount of loss incurred as a result of providing special price plans for persons with disability; the loss is compensated directly from the state budget. The loss was quantified at CZK 136,201,450 and reimbursed to Telefónica O2 on 23 December 2009.

Government policy and support in the area of broadband access

The government of the Czech Republic decided not to use funds earmarked by the European Union for the execution of the so-called European Economic Reconstruction Plan for the development of broadband internet infrastructure but for other activities in the sphere of rural development. In September 2009, the European Commission published Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks, which addressed the possibilities of using public funds for the development of ICT infrastructure.

Telefónica O2, both independently and as a member of various associations, participated in the discussion on the application of funds from the European Economic Reconstruction Plan and the text of the Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks.

The Company is constantly monitoring options offered to customers by structural funds, and modifies its products and services so that they are eligible for subsidies. Telefónica O2 has simultaneously been calling for observance of specific state aid rules in order to protect the market competition from undue distortion.