



## BUSINESS CONNECTIVITY MARKET REVIEW

### T1621G – WHOLESALE ON-ISLAND LEASED LINE PRICING – PROPOSED DECISION

#### EXECUTIVE SUMMARY

1. Sure (Guernsey) Limited (“Sure”) welcomes the opportunity to respond to the Guernsey Competition and Regulatory Authority’s (“the GCRA’s”) Proposed Decision<sup>1</sup> regarding remedies for the Guernsey business connectivity market (known as the Business Connectivity Market Review or “BCMR”). We are grateful for the opportunity to comment on the GCRA’s proposals.
2. As required by the GCRA in section 1.10 of its Proposed Decision, we have highlighted (by our use of yellow shading) all parts of this response that are commercially confidential. **Importantly, we request that prior to publication, the GCRA provides us with its proposed redacted version of this document, so that we can confirm that the items we have marked as confidential have been removed.**
3. We are pleased that the GCRA has published its proposed remedies for the wholesale on-island leased lines (“WLL”) market in Guernsey and are supportive of the GCRA’s desire to conclude this market review process in as timely a manner as possible. This BCMR process commenced in October 2019, almost four years ago, and we believe that conclusion of this process will bring much needed certainty to the WLL market. Given this, we do not wish to materially impact the completion timescales of the GCRA’s market review. Notwithstanding this, there are aspects of the GCRA’s proposed remedies which require attention, further discussion and, in our view, amendment by the GCRA. Where we have identified aspects of the Proposed Decision that should be amended, we have proposed alternative approaches and remedies that are pragmatic and simple to implement. Specifically:
  - a. **Methodological issues** – we believe that there are a number of errors and misunderstandings in the GCRA’s Leased Line Cost Model which have a material impact on the GCRA’s net present value (“NPV”) calculation. We have commented on and corrected these errors in a marked-up version of the Leased Line Cost Model and have provided a summary of these changes in our response below.

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<sup>1</sup> [t1480gj-business-connectivity-market-review-proposed-decision-wholesale-on-island-leased-line-pricing.pdf](https://www.gcragg.com/t1480gj-business-connectivity-market-review-proposed-decision-wholesale-on-island-leased-line-pricing.pdf)  
([gcragg.com](https://www.gcragg.com))

- b. **Pricing curve and product removal** – the GCRA’s proposal to prescriptively set prices on a ‘per product basis’ is disproportionate and unjustified and could have unintended consequences for the WLL market. Given the need for market certainty at this time, the proposed pricing curve may act as an appropriate starting point for Sure’s future pricing curve, so long as Sure is given adequate flexibility to update the curve going forward and the approach of prescriptively setting prices on a per product basis does not set a precedent for future market reviews. Similarly, we do not agree that requiring Sure to seek consultation and regulatory permission before changing prices or technical specifications of products is appropriate. Instead, we have proposed that the GCRA should impose transparency obligations similar to the ones used by regulators in the UK, Ireland, Isle of Man and Jersey.
  - c. **Weighted Average Cost of Capital (“WACC”)** – we believe that the GCRA was incorrect to remove the uncertainty premium from Sure’s WACC calculations. There is both good reason and well-established regulatory precedent for including the uncertainty premium in the WACC, and failing to do so could cause financeability issues for Sure in the longer run.
  - d. **Inflation** – the GCRA’s Leased Line Cost Model should be amended to take into account the updated actual and forecast inflation figures from the States of Guernsey. An additional short run inflation uplift should also be provided in light of recent comments from the Governor of the Bank of England which indicate that inflation will remain higher for longer in the short run.
4. We note that the GCRA has not asked respondents to answer any specific questions regarding its market analysis. As a result, we will not be commenting on every aspect of the GCRA’s analysis. We have instead focussed this response on the areas in which we believe further clarification or correction is required. Please note that the fact that Sure has not made comments on or representations regarding a point made by the GCRA should not be interpreted as Sure’s agreement to those points.

## METHODOLOGICAL ISSUES

5. In an email to Frontier on 10 February 2023 (and in which the GCRA included), we asked ‘is there still a plan for us to be able to sense-check Frontier’s assumptions, in case of any misunderstandings of the cost types or processes?’. This email was not answered by Frontier, nor the GCRA.
6. We have reviewed the GCRA’s Leased Line Cost Model. However, as explained to the GCRA on several occasions, due to a lack of team resource availability during this consultation period we have not been able to complete our review of the GCRA’s detailed model within the timeframe set by the GCRA. We therefore cannot guarantee that our list of proposed amendments is exhaustive.
7. Notwithstanding, upon review of the GCRA’s Leased Line Cost Model, it is apparent that our concerns about the GCRA’s assumptions and potential misunderstandings appear to have been valid. There are numerous errors and misunderstandings in the GCRA’s Leased Line Cost Model which have a material impact on the GCRA’s NPV calculation. We have listed these issues in Table 1 and provided the GCRA with a marked-up version of its Leased Line Cost Model for review.

**Table 1: Summary of proposed changes to the GCRA’s pricing model**

GCRA’s model tab	Cell or row ref.	Issue	Change(s) required
Results & controls	Cell D18	We believe that the GCRA should reinstate the uncertainty premium adjustment in its calculation of the nominal risk-free rate and reflect this in its final pre-tax nominal WACC. Based on our calculation, this would result in Sure having a WACC in the range of 8.52% and 9.52%, with a mid-point of 9.02%, with this rounded down to 9.0%.	We believe that the WACC rate needs to be adjusted from 8.8% to 9%.  Change applied and highlighted in yellow in Sure’s review version.  <b>In isolation, the revised WACC impacts the model’s NPV by</b> [REDACTED]
Results & controls	Cell D49 (Calculate button)	The button was intended to allow users to run a goal seek macro, to change the proposed leased line prices, such that the NPV value would be zero (cell D13). Unfortunately, the goal seek macro referred to a different row in the spreadsheet.	The macro needs to be updated to point to row 10 (rather than 11) of the Prices tab.  This has been updated in Sure’s review version.
Prices	Rows 18 - 26	Near the top of the spreadsheet, we noticed that rows 13-49 were hidden. Unhiding them revealed the section for wholesale copper broadband prices. We noted that the 2022 prices had also been used across the periods 2016-2021.	Historic copper broadband prices need to be updated.  The required changes are highlighted in yellow in Sure’s review version.  <b>In isolation, the revised pricing impacts the model’s NPV by</b> [REDACTED]

Demand	Row 14	<p>2 x 155Mbps circuits were included in every period, but these are not leased lines provided to customers. They are solely link bearers, used as network inputs for Reference Offer voice interconnect circuits.</p> <p>We appreciate that for the purposes of price control modelling, the revenue for own use leased lines would usually be recognised, but these two links are embedded in our core network and were not created as products in their own right. 155Mbps capacity circuits have never been made available for commercial use (at either wholesale or retail). Rather than them having been treated as own use they need to be excluded.</p>	<p>The assumed leased line revenue needs to be removed (Revenues tab, row 29: [REDACTED] across the 40-year period.)</p> <p>The required changes are highlighted in yellow in Sure’s review version.</p> <p><b>In isolation, the revised revenue/demand impacts the model’s NPV by [REDACTED] (if revenue removed), or [REDACTED] (if demand removed).</b></p> <p>Sure believes that the demand should be removed, as the circuits are not available as leased lines.</p> <p>Note: As customers cannot purchase a 155Mbps (legacy) leased line, the same and different exchange versions should also now be removed from the product list.</p>
Demand	Leased lines section (rows 6 to 54)	<p>The values are a consolidation of retail, wholesale, and own-use circuits, however many of the on-island own-use circuits relate to inputs for other core network services, rather than productised leased lines. In 2021 (the most recent year of actuals within the model), [REDACTED] of the 444 circuits were classed as own use.</p> <p>As per the point above, some types of these [REDACTED] circuits have never been available for use at a wholesale or retail level. They would never be purchased by an operator for any commercial use (in their own network or for resale to retail customers).</p>	<p>The model assumes that wholesale revenue is recognised for ALL leased lines, so the annual value is overstated for a subset of the [REDACTED] own-use circuits, in those instances where they do not exist as ‘productisable’ services.</p> <p>Sure will need to analyse the network use of each own use leased line and confirm to the GCRA how many need to be excluded.</p> <p>The model impact remains unknown, until the analysis is completed.</p>
Capex Forecasts	Cell E20 & cells R20:BA20	<p>The estimated lifetime for an ONT (&amp; associated connection labour) is shown as 20 years. Adtran, the manufacturer of Sure’s ONTs, has provided the following stats, showing the percentage probability of an ONT still being functional:</p> <p>[REDACTED]</p> <p>In addition:</p> <ul style="list-style-type: none"> <li>We know from JT that in Jersey it has begun replacing some of its ONTs at &lt;10 years.</li> <li>An industry expert (Jonathan Kingan) believes</li> </ul>	<p>If the model allows for 12 years (rather than 20), <b>in isolation, the revision impacts the model’s NPV by [REDACTED]</b>.</p> <p>Note: In Sure’s review version, we have also corrected a minor formula mismatch. The formulae in cells R20 to BA20 pointed to E19, rather than E20. As both E19 and E20 originally had the same value (20 years) this went unnoticed but changing the value in E20 from 20 to 12, highlighted the cell reference error.</p> <p>The changes are highlighted in yellow in Sure’s review version.</p>

		<p>that around 12 years would be more likely maximum period.</p> <p>There is no instance where Sure would wait 20 years (with Adtran's indicative failure rate of █% at that time), as that kind of failure rate would be operationally challenging, with a high level of customer dissatisfaction.</p> <p>Based on the above, we believe that, even generously, Sure should not be expected to go beyond 12 years before replacing our ONTs. After just 10 years the projected failure rate is already █%. We therefore request that the current 20-year timeframe is reduced to 12 years.</p>	
Other input data	Rows 48, 54 & 55	<p>At the time the model was created, it appears that the most recently published States of Guernsey (SoG) RPIX data related to Q3 2023. Since that time, the results for two more quarters have been released. The SoG has also updated its forecast inflation, with the latest being issued in May 2023: <a href="#">Forecast inflation Q22023.indd (gov.gg)</a></p>	<p>The model needs to be updated to reflect the latest RPIX actuals and forecasts.</p> <p><b>In isolation, the revised RPIX impacts the model's NPV by █</b></p> <p>The changes are highlighted in yellow in Sure's review version.</p>

8. As previously highlighted to the GCRA, due to Sure no longer maintaining its annual cost model for either regulatory or commercial purposes, Frontier has needed to make numerous significant assumptions, some calculated values of which have been compounded, as to how Sure's costs should be allocated. The use of Sure cost driver data from 2014 (the last year our regulatory model was run), remains a major concern for us, but within the timeframe allowed by the GCRA there were no means by which even Sure's main network-focussed cost drivers could be updated. The technical inputs required to do so are no longer captured by our business. Through no fault of its own, Frontier's model is therefore fundamentally flawed. However, it is clear that for the benefit of all wholesale on-island leased line users (at both the wholesale and retail level), the GCRA's market review should now be drawn to a close in as timely a manner as possible – that review having commenced in October 2019. We, however, reserves our right to conduct further detailed analysis of the model and Frontier's assumptions before the model can be used in other market reviews.

9. We do not wish to materially impact the timing of the remainder of the GCRA’s review process but believe that it is important for the changes set out in the table above to be reflected in the GCRA’s final version of its model (before any Final Decision is published). We are available to discuss any aspects of our proposed changes and to provide further clarifications.
10. Excluding the required own-use analysis, which still needs to be undertaken, Sure believes that the table below<sup>2</sup> reflects the minimum prices appropriate to the GCRA’s Proposed Decision.

**Figure 1: Revised minimum prices (indicative)**

Price controls	2024	2025	2026	2027	2028
<b>Price for Leased lines products</b>					
<b>On-island</b>					
Same Exchange Area, 2 Mbit/s	1,291	1,319	1,348	1,378	1,408
Different Exchange Areas, 2 Mbit/s	2,323	2,375	2,427	2,480	2,535
Lanlink 10 Mbit/s (Ethernet, RJ45)	2,067	2,112	2,159	2,206	2,255
Lanlink 25 Mbit/s (Ethernet, RJ45)	3,008	3,075	3,142	3,211	3,282
Lanlink 50 Mbit/s (Ethernet, RJ45)	4,578	4,679	4,782	4,887	4,994
Lanlink 75 Mbit/s (Ethernet, RJ45)	6,147	6,283	6,421	6,562	6,707
Lanlink 100 Mbit/s (Ethernet, RJ45)	7,717	7,887	8,060	8,238	8,419
Same exchange area, Lanlink 155 (PT, 1300Nm)	8,610	8,799	8,993	9,191	9,393
Lanlink 250 Mbit/s (Ethernet, RJ45)	9,025	9,224	9,427	9,634	9,846
Lanlink 500 (Ethernet RJ45)	10,334	10,561	10,794	11,031	11,274
Lanlink 750 Mbit/s (Ethernet, RJ45)	11,422	11,673	11,930	12,192	12,461
Lanlink 1000 (Ethernet, RJ45)	12,510	12,785	13,066	13,353	13,647
Lanlink 1000 (PT 850Nm/1300Nm)	12,510	12,785	13,066	13,353	13,647
Lanlink 10 Gbit/s (Ethernet, RJ45)	51,670	52,807	53,968	55,156	56,369
Fibre Channel 1 Gbit/s	12,510	12,785	13,066	13,353	13,647
Fibre Channel 2 Gbit/s	16,861	17,232	17,611	17,998	18,394
Fibre Channel 4 Gbit/s	27,739	28,349	28,973	29,610	30,261
Fibre Channel 8 Gbit/s	42,968	43,913	44,879	45,866	46,875
High Speed Ethernet 2Gbps	16,861	17,232	17,611	17,998	18,394
High Speed Ethernet 4Gbps	27,739	28,349	28,973	29,610	30,261
High Speed Ethernet 8Gbps	42,968	43,913	44,879	45,866	46,875
<b>Other on-Island</b>					
Guernsey - Herm, 2 Mbit/s	3,145	3,214	3,285	3,357	3,431
Guernsey - Alderney, 2 Mbit/s	10,523	10,755	10,992	11,233	11,480
Guernsey - Sark, 2 Mbit/s	10,523	10,755	10,992	11,233	11,480
Alderney - Sark, 2 Mbit/s	21,048	21,511	21,984	22,468	22,962
Guernsey - Herm 10 Mbit/s Ethernet	7,829	8,001	8,177	8,357	8,541
Guernsey - Alderney 10 Mbit/s Ethernet	15,937	16,288	16,646	17,012	17,386
Guernsey - Sark 10 Mbit/s Ethernet	15,937	16,288	16,646	17,012	17,386
Guernsey - Alderney 20 Mbit/s Ethernet	23,286	23,798	24,322	24,857	25,404

<sup>2</sup> Replicated from the contents of the table shown in Sure’s review version of the model (Results & controls tab).

## PRICING CURVE AND PRODUCT REMOVAL

11. The GCRA has proposed that its price control will be set on a ‘per product basis’ and that, if Sure wishes to change its prices or withdraw products, it must first ‘comprehensively consult’ with the OLOs before making a request for permission from the GCRA<sup>3</sup>. We comment first on the GCRA’s proposal to explicitly set Sure’s WLL prices on a per product basis, before turning to the issue of price changes and product withdrawal.

### *Pricing Curve*

12. Firstly, we consider that a regulatory approach where the GCRA effectively takes on the responsibility of Sure’s detailed product pricing strategy is disproportionate and unjustified and could be harmful to the market. This is because it fundamentally prevents Sure from remaining commercially and strategically engaged in that relevant market.

13. For example, we believe that the GCRA’s proposed pricing curve is too steep and are concerned that this could have a chilling effect on customers’ desire to move up the bandwidth ladder in the future. Whilst the rigid pricing proposed by the GCRA may be workable for 2023, it is unclear whether it will still be fit for purpose in 2028. We believe that Sure should have the freedom and agility to adjust its pricing curve to meet the changing demands of its wholesale customers, and we are concerned that the GCRA’s proposed pricing control does not facilitate this.

14. We understand that the GCRA would prefer that Sure’s prevailing pricing curve be more linear. However, our experience is that regulated and non-regulated entities do not ordinarily set their pricing curves simply to be linear and instead set prices to meet the needs/demands of their markets. An example of this can be seen in how Openreach prices its 10Mb and 100Mb wholesale leased lines products. Here the two prices are either the same or, in some instances, the 10Mb product is priced above the 100Mb product<sup>4</sup>. This type of pricing is part of product portfolio management where Openreach is trying to move its customers off the 10Mb product and therefore offering a 100Mb product at the same price or cheaper and thus significantly higher value for money. It should be evident from this example that deviation from a consistent price curve would not necessarily result in customers receiving less value for money, and we believe that Sure should have the freedom and agility to do so, where appropriate for the market.

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<sup>3</sup> Business Connectivity Market Review – T1621G – Proposed Decision – Wholesale On-Island Leased Line Pricing – para-5.7.

<sup>4</sup> [Product prices \(openreach.co.uk\)](https://www.openreach.co.uk)

15. Current regulatory best practice for price regulation in wholesale markets focuses on the principle of an economic replicability test and/or the identification of an ‘anchor product.’ Here, direct price regulation is applied to a given product, but other products in the portfolio are given greater pricing freedom, with the objective of ensuring minimum market distortion from regulatory intervention<sup>5</sup>. We believe it would be beneficial for the WLL market, and telecoms markets in Guernsey more broadly, if the GCRA were to move towards regulatory best practice in wholesale price regulation and we strongly encourage the GCRA to do so for future market reviews.
16. In recent years, we have been subject to a retail-minus price regulation regime for WLL, which we had understood to be very restrictive on our pricing freedom. This has resulted in Sure not changing its WLL pricing for an extended period. We welcomed and supported the GCRA’s proposed move to direct WLL price regulation because we believed that this would increase Sure’s commercial pricing freedom (within the parameters of a price control) and ability to meet the demands of the WLL market. Unfortunately, the price control proposed by the GCRA does not enable this and the GCRA has not provided any meaningful justification for why such an intrusive control is necessary.
17. Furthermore, we believe that the GCRA has restricted Sure’s commercial freedom by presuming the introduction of new ‘fractional’ products and designating speeds and prices to those products that may not have been in line with Sure’s intended pricing curve. The GCRA was made aware during the information gathering phase of this BCMR process that we intended to develop new ‘fractional’ WLL products for release into our portfolio. We had intended to consult with the OLOs to refine the speeds, technical scope and pricing of these new products in the weeks following the GCRA’s Remedies Final Decision<sup>6</sup>. Regrettably, the GCRA has taken information about our draft proposals for ‘fractional’ products, which were supplied in confidence and solely for the purpose of establishing forecast future demand, and effectively designed Sure’s new WLL portfolio, as well as setting prices

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<sup>5</sup> We note that the GCRA relies on a 2012 BEREC paper to support its proposed regulatory approach. We consider that significant changes have occurred in regulatory best practice over the past 10 years and that reference going that far back should be treated with caution. Additionally, we note that the GCRA appears to have modified the title and subject of that BEREC paper to “*wholesale on-island leased lines*” when the document in fact simply refers to “*wholesale leased lines*”. Whilst this modification is not material to the content of the BEREC paper, we are concerned that reference documents should be referenced in a transparent and accurate manner. Of further concern is that the GCRA in Annex 3 paragraph 1.4 appears to have modified text from the BEREC document and included that modified text within quotation marks which should indicate an exact quote from a reference document. We encourage the GCRA to observe standard good practice as it is important that all parties can put full trust and confidence in quotations from official documentation without having to physically check their veracity and accuracy.

<sup>6</sup> We have repeatedly stated to the GCRA that we had intended to make changes to the pricing levels and structure of our entire WLL portfolio. This had been the case since the conclusion of our ‘Request for Feedback’ from Other Licenced Operators (“OLOs”) in 2018. However, we also explained that we would only conduct a full price curve review once we have sufficient regulatory certainty, provided by the outcome of the ongoing BCMR.



for these 'fractional' products in a price curve and has done so without consultation or discussion with Sure, or, we assume, the OLOs.

18. The frequency of price changes varies considerably between different markets, and we believe the WLL market to be one of the most stable and least dynamic in this regard. Stability is valued in both retail and WLL markets, but it is still necessary for Sure to be able to innovate at both product specification and pricing levels in order that customers at all levels can benefit from technology innovation and related reductions in costs. Whilst the WLL market is relatively stable, so the commercial disruption of the GCRA's proposed very prescriptive price control is somewhat less than in other markets, where new investment and service/product innovation is happening at a much greater pace. An example of such a market is the wholesale broadband access market, where Sure considers that a price control as proposed by the GCRA for the WLL market could be materially harmful.
19. We therefore believe it would be in the interest of Sure's wholesale customers that the price control be less prescriptive. For example, it could be possible to allow Sure a margin of flexibility within the prescribed pricing curve, providing that the overall price control was still met. We believe this could be achieved with minimal additional complexity.

#### *Price and Product Changes*

20. In our view, we are concerned that the GCRA's proposal to require Sure to comprehensively consult and then seek regulatory permission to make amendments to its WLL portfolio is unduly restrictive and constrains Sure's commercial freedom to the detriment of its customers.
21. Firstly, we fully agree with the GCRA that withdrawal of any regulated service should only be done after full consultation with customers and sufficient notice to ensure that customers can migrate off the relevant product and ensuring that doing so would not leave those customers unable to compete effectively in the market. This is already standard practice for Sure and, as such, is not a concern.
22. However, our concern lies in the potentially unnecessary restrictions and delays resulting from a formal consultation and involvement of the GCRA in this process. A formal consultation process would take a significant amount of time to complete, with uncertain timescales. Sure would need to draft a consultation document, allow a reasonable amount of time for OLOs to respond, and then

provide further replies or comments to the OLOs' questions and conclude engagement. This process would need to take place *before* the GCRA could then conduct a review, rather than the GCRA conducting its review in parallel, where it had a concern, which would result in the process taking even longer. This prolonged process would be likely to act as a barrier for Sure when considering whether to making pricing or specification changes, or when seeking to remove legacy products. In our view, to follow such a process for every change to the WLL portfolio would be disproportionate and not an efficient use of the GCRA's limited resources<sup>7</sup>.

23. We also believe that the GCRA has overstated the risk that Sure would use pricing freedom to unfairly set wholesale prices in a manner that ultimately (albeit indirectly) discriminates against its rivals or discriminates in favour of its own downstream division. We are not aware of any evidence that Sure has, currently or in the past, set wholesale on-island leased line prices in a way that benefits its own downstream division. Sure takes its responsibility to act in a non-discriminatory manner seriously and would not wish to engage in behaviour that breaches its regulatory obligations.

24. Furthermore, whilst we recognise that such behaviour could occur in theory, we do not agree that it would happen in practice. The GCRA's argument that a SMP provider can use its pricing freedom within the basket to act in a way that negatively impacts its competitors is true of any SMP provider, not only Sure (which, for the avoidance of doubt, has not engaged in such activity). Were such an argument credible in practice, we would observe similar regulatory requirements to consult and obtain regulatory permission for price changes and product removal in other market reviews. We have reviewed the business connectivity market review decisions in the UK, Ireland, Isle of Man and Jersey (see Table 2), all of which suggest that such a risk is not a concern for other regulators in practice.

**Table 2: A comparison of transparency requirements across the UK, Ireland, and Crown Dependencies**

Regulator	Transparency Requirement	Required to consult?	Required permission?
Ofcom (UK)	Notify all customers with 90 days' notice of changes to prices, terms and conditions, and technical changes to products. Notify all customers with 28 days' notice for price reductions and associated conditions. Notify all customers with 28 days' notice for prices, terms, and conditions of new product introductions.	No	No

<sup>7</sup> We are conscious that the GCRA is a small and busy team and may not always have capacity to promptly consider requests for portfolio changes or concerns raised by an OLO. This could further delay the process on introducing new products and services.

	Notify customers with at least 12 months' notice of product withdrawals and, in some cases, 24 months' notice (focus on copper withdrawal).		
ComReg (Ireland)	Provide all customers with at least 3 months of changes to its leased line products and associated pricing. The notification must be provided to ComReg at least five days in advance of it being shared with customers.	No	No
CURA (Isle of Man)	Inform LOs at least 3 months before any changes to products, including prices. Notification to the Commission should occur one month before the notification to LOs.	No	No
JCRA (Jersey)	Publish changes to price and non-price terms and conditions for wholesale on-island leased lines one month before they come into effect. Notify OLOs and the Authority three months in advance of the launch of a new wholesale product (or removal of an existing product or service).	No	No
GCRA (proposal)	<i>Comprehensive consultation with all OLOs on changes to price, terms and conditions and product withdrawal Request permission from GCRA to make above changes.</i>	Yes	Yes

25. As can be seen in Table 2, Ofcom, ComReg, CURA, or the JCRA do not require regulated entities to specifically consult with OLOs or request explicit permission from the regulator before changing prices or withdrawing products. Rather, the regulated entities are required to provide the market with advanced notification of their proposal to amend their portfolio. The notification window provides wholesale customers with an opportunity to provide feedback to the regulated entity, if it has not already been provided, or raise concerns with the regulator about the competitive impact of the proposal. Should the proposed portfolio change result in an unfair or discriminatory outcome, then Ofcom, ComReg, CURA, or the JCRA can launch their own investigation.

26. Under the approach taken by other regulators in the UK, Ireland and Crown Dependencies, there is a presumption that the regulated entity has the freedom and permission to amend its portfolio in a manner it considers optimal for its business, which is only curtailed if the proposal is unfair, anti-competitive or in breach of the regulated entity's obligations. This sits in stark contrast to the approach proposed by the GCRA, which presumes that Sure does *not* have the freedom or permission to make changes to its portfolio and must first discharge some kind of evidentiary burden (i.e. that the proposal is not anti-competitive or unfair) before it is able to do so.

27. Whilst we recognise that the GCRA has considered the need to balance the risk of discriminatory behaviour against the risk of stifling commercial freedom, for which we are appreciative, we believe that the GCRA proposal is overly rigid and could have unintended consequences for Sure's ability to manage its product portfolio. The GCRA's conclusion is also skewed significantly towards the risk that Sure will act in a discriminatory manner, despite not providing any evidence that such behaviour is occurring or has occurred.
28. However, we believe that a pragmatic solution is possible. We propose that the GCRA removes the formal direction not to change prices or withdraw products without consultation and regulatory approval. Instead, we propose that the GCRA imposes transparency requirements on Sure, such as those imposed by Ofcom, ComReg, CURA and the JCRA. These notification requirements, such as providing 30 working days' notice of a pricing change or changes to the technical specification of a product and 3 months' notice for the introduction of new services, would provide OLOs with an opportunity to review the notification and raise concerns either with Sure or the GCRA. Should the GCRA have concerns, then it can investigate and/or prevent the price or specification change. However, if neither the OLOs nor the GCRA raises any concerns, then the proposed portfolio change can occur. For the avoidance of doubt, we would expect to demonstrate how the proposed change remains compliant with the price control in our notification to GCRA. Should the GCRA have material concerns with a future Sure proposal, then we would be prepared to stop implementation of the portfolio change until the GCRA's concerns had been suitably addressed.
29. In our view, a suitable transparency requirement is preferable to having a formal consultation and approval process. We believe the process will be quicker, more certain, more efficient, and will not place an unnecessary burden on the GCRA to review and approve a large number of portfolio changes.

## WEIGHTED AVERAGE COST OF CAPITAL (“WACC”)

30. On 9 January 2023, we submitted our WACC report to the GCRA<sup>8</sup>. This WACC report was produced by Oxera on Sure’s behalf, and we worked closely and carefully with Oxera to ensure that it was able to come to reasonable and well evidenced conclusions about a suitable WACC for Sure (Guernsey) Limited. We are grateful to the GCRA for giving Sure an opportunity to produce its own WACC report and for its careful consideration of our proposals.
31. We also welcome the GCRA’s decision to largely support our WACC proposal and its recognition that the parameters used are “reasonably well evidenced”<sup>9</sup>. We note, however, that there are two aspects of our proposal – the forward rate adjustment and uncertainty premium – that the GCRA rejects due to its view that Sure has not provided regulatory precedent or evidence for these adjustments. Whilst we do not agree that our proposals for a forward rate adjustment or uncertainty premium are “unsupported/unevidenced,” we are pleased to be able to provide the GCRA with further explanation and justification regarding these adjustments (primarily the uncertainty premium) to the risk-free rate.
32. Firstly, we don’t agree with the GCRA’s statement that there is no regulatory precedent for a forward rate adjustment or uncertainty premium. The principle behind both the forward rate adjustment and uncertainty premium is valid and has been acknowledged by economic/financial literature and adopted by regulators in the past, both explicitly and implicitly. It is therefore surprising that the GCRA dismisses these adjustments based on a lack of precedence alone. For example, the inclusion of a forward rate adjustment was historically well established in the UK, with Ofgem adopting such an adjustment in its RIIO-2 decision<sup>10</sup> and the Competition and Markets Authority (“CMA”) recognising that including a forward rate adjustment had become convention in its PR19 Final Decision<sup>11</sup>. Academic literature has long considered forward rates as unbiased predictors of future spot rates. Notwithstanding, we recognise that the forward rate adjustment is not always adopted and therefore recognise the GCRA’s conclusion that the forward rate adjustment may not be necessary in this current scenario.
33. Similarly, the Oxera report references at least 55 regulatory decisions in which an uncertainty premium has been applied (discussed further below). In our experience, such examples of other

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<sup>8</sup> 2023 Oxera Report, Estimating the WACC for Sure's Guernsey business, 9 January 2023.

<sup>9</sup> Business Connectivity Market Review – T1621G – Proposed Decision – Wholesale On-Island Leased Line Pricing – para-4.7.

<sup>10</sup> [RIIO-2 Sector Specific Methodology Decision – Finance \(ofgem.gov.uk\)](#) – see Table 6 on page 30.

<sup>11</sup> [Final report \(publishing.service.gov.uk\)](#) – see paragraph 9.233.

regulators utilising these adjustments would suggest that there *is* regulatory precedent that would support using them in the Guernsey context. We believe that there is both good regulatory precedent and good reason for including such an adjustment in Sure's WACC. As explained in the Oxera report, the uncertainty premium accounts for the risk that spot risk-free rates rise faster than that implied by the forward rate. That is, where the actual price payable for a risk-free instrument at a given future point in time (the spot rate) is higher than the forecast value for the same instrument at the point of purchase (the forward rate). Failing to account for this adjustment in regulated pricing can result in depressed permissible returns for the regulated entity, which in turn can hinder the regulated entity's ability to earn sufficient revenues in future to cover its operating costs, its debt interest payments and retain sufficient profit to attract equity investors (the financeability problem).

34. Whilst in most industries the financeability of an organisation is determined by market forces, regulated entities that are subject to economic regulation will see financeability determined by regulators. This is because regulators determine the revenues that an organisation may earn over the price control period. Given the risks that a regulated firm becoming unfinanceable as a consequence of the WACC determined by the regulator – unsuitable financial ratios, increased cost of debt and potentially financial distress – ensuring that regulated networks are sufficiently financeable is a key priority for economic regulators. The financeability issue would arise when the allowed for risk-free rate is set at a too-low level relative to the actual market risk-free rate – as recently demonstrated by sharp UK debt market volatility in the third quarter of 2022—an uncertainty premium adjustment is therefore, in our view, entirely appropriate.
35. As evidence for the validity of an uncertainty premium adjustment, Oxera explains that it has observed such a premium being applied to the risk-free rate in at least 55 separate regulatory decisions in the UK<sup>12</sup>. In its analysis of these 55 regulatory decisions, Oxera found that there was ordinarily an unexplained difference between the allowed for risk-free rate and the yield on 10-year gilts, with the allowed for risk-free rate set above contemporaneous rates due to uncertainty at the time (see Figure 1). In other words, regulatory precedence for the uncertainty premium has typically been an implied premium adopted by regulators to address uncertainty, rather than an explicit one that is included in the summary of estimate. Once further adjustments had been made to the sample data to remove outliers and to account for the convenience and forward premiums, Oxera found that an uncertainty adjustment of between -40bp and 50bp was apparent, with a mid-point value of 10bp. As can be seen in Figure 1, Ofcom, Ofgem and Ofwat decisions<sup>13</sup> on the allowed for risk-free

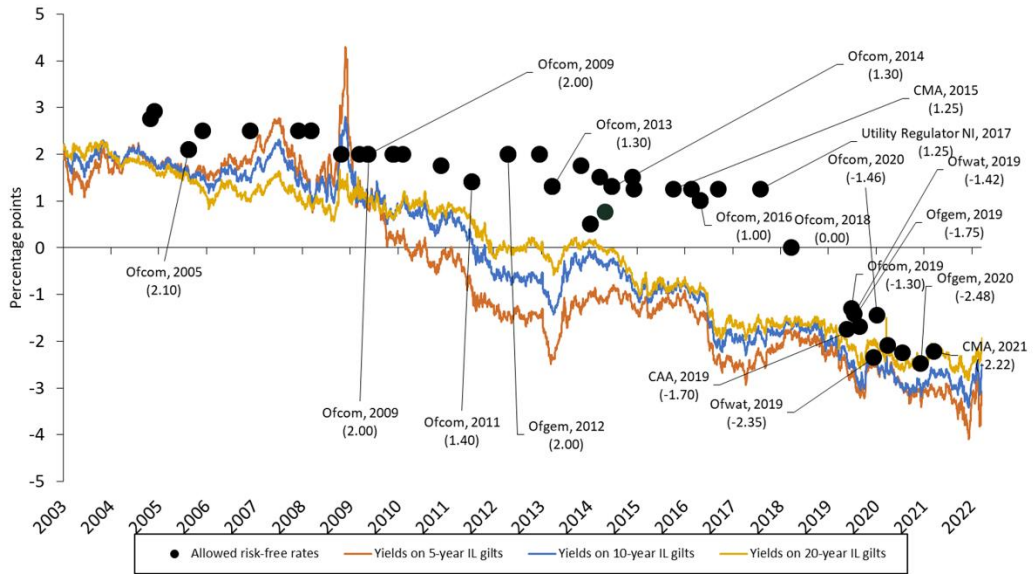
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<sup>12</sup> 2023 Oxera Report, Estimating the WACC for Sure's Guernsey business, 9 January 2023 – sec. 2.4, page 11.

<sup>13</sup> For example, see Ofcom (8 Jan 2020) Market review 2021–2026, Ofcom (28 June 2019) Business connectivity market review (BCMR), CMA (4 Mar 2015) Bristol Water determination, Ofgem (24 May 2019) RIIO-2 Methodology, and Ofwat (16 Dec 2019) PR19 Final determination.

rate have routinely included an ‘unexplained’ positive difference between the RfR and 10-year gilts, which in our view and the view of Oxera, can be considered an implied uncertainty premium.

**Figure 2: Past regulatory determinations where the risk-free rate sits above yields on ILGs.**



36. Given the evidence and explanation provided above, we believe that the GCRA should reinstate the uncertainty premium adjustment in its calculation of the nominal risk-free rate and reflect this in its final pre-tax nominal WACC. Based on our calculation, this would result in Sure having a WACC in the range of 8.52% and 9.52%, with a mid-point of 9.02%, with this rounded down to 9.0%. The working for this updated WACC calculation can be found in the table below.

**Table 3: WACC analysis summary**

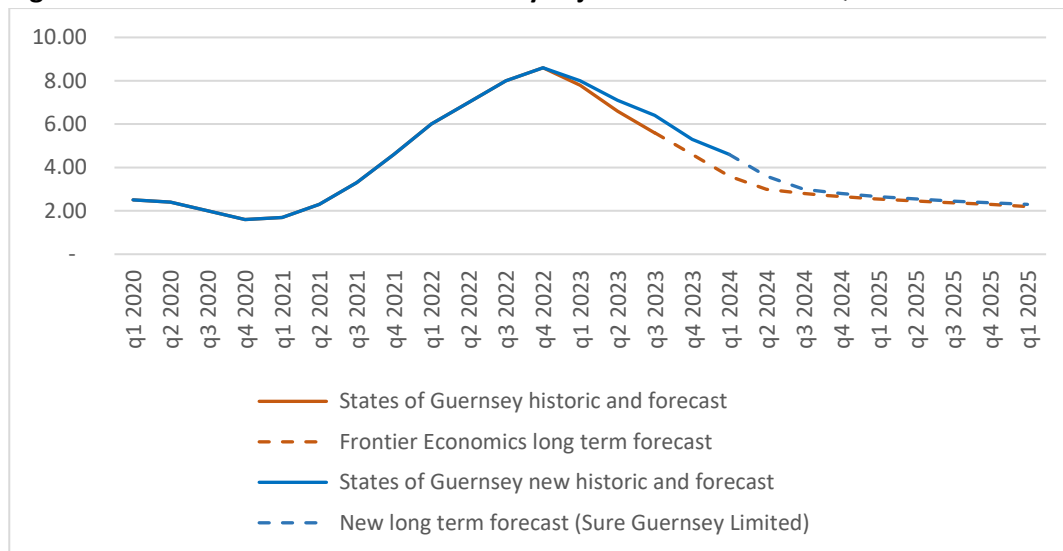
Parameter		Low (%)	High (%)
Gilt yields (nominal)	[A]	3.62	3.62
Convenience premium	[B]	0.50	0.50
Uncertainty premium	[C]	0.25	0.50
RfR (nominal)	[D]	<b>4.37</b>	<b>4.62</b>
Equity beta	[E]	0.53	0.76
TMR (nominal)	[F]	9.23	9.32
ERP (nominal)	[G] = [F] - [D]	4.86	4.7
CoE (nominal)	[H] = [D] + [E]*[G]	<b>6.95</b>	<b>8.19</b>
Guernsey risk premium	[I]	0.85	0.85
Adjusted vanilla CoE (nominal)	[J]=[H]+[I]	7.8	9.04
Tax rate	[K]	20	20
Adjusted pre-tax CoE (nominal)	[L]=[J]/(1-[K])	9.75	11.3
iBoxx bond yields	[M]	6.05	6.05
Borrowing costs	[N]	0.38	0.38
Uncertainty premium	[O]	0.25	0.50
CoD pre-tax (nominal)	[P]=[M]+[N]+[O]	6.68	6.85
Gearing	[Q]	40	40
WACC, pre-tax (nominal)	[R]=[Q]*[P]+(1-[Q])*[L]	8.52	9.52
WACC, pre-tax midpoint (nominal)		9.00%	



## INFLATION

37. The GCRA proposes to utilise the inflation forecast from the States of Guernsey Strategy and Policy Unit to inform its inflation rate for 2023 and early 2024, and a Guernsey RPIX average of 2.2% from 2016 – 2019 to inform its long-run inflation target. We believe that this is a sensible approach and in line with best practice.
38. While we broadly support the GCRA’s proposed approach, we believe that the GCRA’s model should be updated to reflect the States of Guernsey’s Quarter 2 2023 Inflation Forecast, which was issued in May<sup>14</sup>. The GCRA’s model assumes an annual inflation rate (RPIX) of 6.15% for 2023 and 3.01% for 2024. However, the States of Guernsey’s Quarter 1 Inflation Bulletin and Quarter 2 Inflation Forecast now suggest that RPIX will sit slightly higher. The annual change in RPIX for the year ending March 2023 was 8% (compared with the GCRA’s forecast of 7.8%)<sup>15</sup>. Similarly, the States of Guernsey now forecasts that inflation for 2023 will be 6.7% in Guernsey (compared against the GCRA’s forecast of 6.15%).

**Figure 3: GCRA’s forecast RPIX for Guernsey adjusted to reflect the Q2 Inflation Forecast.**



39. This deviation in actual and forecast RPIX can be seen in Figure 3 above. The updated RPIX forecast suggests that inflation will remain slightly higher for longer in Guernsey, with RPIX sitting slightly above the GCRA’s forecast until early 2025.

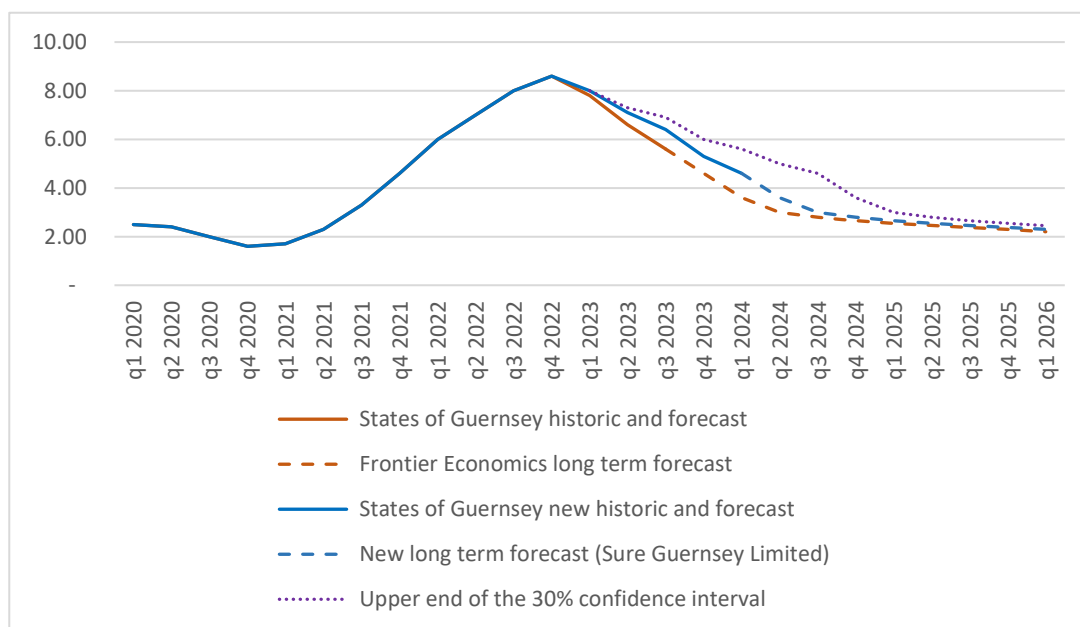
<sup>14</sup> We recognise that this Inflation Forecast was published after the publication of the GCRA’s Proposed Decision and completion of its modelling work.

<sup>15</sup> [Forecast inflation Q22023.indd \(gov.gg\)](#)

40. Furthermore, the States of Guernsey’s adjustments in its Quarter 2 Inflation Forecast is supported by recent public comments made by the Governor of the Bank of England. On Wednesday 17 May, he explained that ‘the likelihood of inflation topping its projection is skewed significantly to the upside’ and that this had been caused by “second-round effects” of inflation. The Bank of England has suggested that these second-round effects are being driven by internal factors, such as pay growth and domestic price rises, and has now increased its medium-term CPI forecast to 5.1% by the end of the year from its original 3.9% February projection. As explained below, RPIX ordinarily sits above CPI, suggesting that the RPIX in Guernsey at the end of 2023 could be higher than the 5.3% RPIX forecast by the States of Guernsey. We believe that the GCRA should make allowance for these recent reports and align its inflation assumptions with the States of Guernsey Quarter 2 Inflation Forecast, along with an appropriate uplift to reflect the uncertainty around short-run inflation rates in the UK.

41. In our view, an appropriate course of action would be for the GCRA to apply an uplift to the short-run rate of inflation by setting RPIX at the top end of the 30% confidence interval of the States of Guernsey RPIX forecasts. Doing so would apply a small but appropriate uplift to the forecast inflation for Guernsey to take into account the low level of confidence that the Bank of England has in quickly declining rates of inflation for the UK.

**Figure 4: GCRA’s forecast RPIX for Guernsey with 30% confidence interval included.**



**Sure (Guernsey) Limited**

19<sup>th</sup> May 2023