WHOLESALE BROADBAND MARKET

T1652G – PROPOSED DECISION – WHOLESALE BROADBAND ACCESS PRICING

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[1] in relation to its Wholesale Broadband Market Review ("WBMR"). We are grateful for the opportunity to comment on the GCRA's proposals. We recognise and value the involvement of Frontier Economics[2] ("Frontier"), the GCRA's external advisors, for the financial and economic aspects of this review.

2. As requested by the GCRA, 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 note that the GCRA has not asked respondents to answer any specific questions regarding its proposals. 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.

4. We have carefully reviewed the GCRA's proposals and are grateful to the GCRA for providing sufficient time to conduct a review. We welcome the GCRA's focus on ensuring fair broadband prices and agree with its pragmatic approach to determining Sure's WACC and accounting for inflation in its cost model. Notwithstanding our support for the GCRA's pragmatic approach regarding those aspects, we have some significant concerns about the GCRA's approach to this remedies consultation and its conclusions. Specifically:

    I. **Market definition and market power assessment** – we strongly disagree with the GCRA's decision to proceed directly to an assessment of remedies, without undertaking a timely and appropriate market definition and market power assessment. As we have previous explained

[1] t1652g-proposed-decision-wholesale-broadband-access-pricing.pdf (gcra.gg)
[2] Frontier Economics | Frontier Economics (frontier-economics.com)

to the GCRA, this approach is not in line with regulatory best practice and has resulted in the GCRA failing to take account of important market developments. We are concerned that, due to this lack of timely market analysis, the GCRA's decision could be open to challenge and could risk setting a precedent for how the GCRA should undertake future market reviews.

II. **Cost orientation –** The GCRA appears to have applied a narrow interpretation of 'cost orientation', without consideration of the more recent developments in the EU, such as the increasing use of economic replicability tests in place of traditional cost-based regulated charges. We remain concerned about the GCRA's further reliance on Sure's 2014 cost driver data, but in the absence of separated accounts, we feel compelled to accept its inclusion within the GCRA's model.

III. **Cost model methodological issues** – in assessing the GCRA's cost model, we have identified a number of potential errors and modelling issues, which need to be addressed. This includes the estimated lifetime of Optical Network Terminals ("ONTs") and general project costs, demand volumes for fibre installations and discounts being recognised as additional revenues. These methodological and modelling issues have a material impact on whether Sure is able to make a reasonable return on its investment, and therefore must be considered and amended.

IV. **Compliance framework** – The GCRA is proposing a very basic framework for the measurement of Sure's compliance with an annual weighted average price cap. For numerous reasons, not only do we believe that the framework would be unworkable, we consider that it would be materially unfair to our business. We are therefore proposing the use of a standard prior year volume / current year price mechanism, which is much more fit for purpose in the fast-moving Guernsey broadband market.

V. **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 inappropriately cause financeability issues for Sure in the longer run.

VI. **Inflation** – the GCRA's cost model should be amended to take into account the updated Q2 2023 actual and Q3 2023 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 Bank of England, which indicate that inflation will remain higher for longer in the short run.

5. As always, we remain ready to engage with the GCRA on these issues and can provide further information as and where required. We are keen to work closely with both the GCRA and Frontier, to ensure that we are not penalised as a result of any modelling-based misunderstandings.

MARKET DEFINITION AND MARKET POWER ASSESSMENT

6. The GCRA is proposing to impose remedies on Sure in the Guernsey wholesale broadband market based on a significant market power ("SMP") review that was undertaken in 2018, with reference to 2017 market data. The GCRA's position was formalised in March 2019[3] and it has repeatedly stated that it does not intend to conduct another market definition or market power assessment, in connection with its currently proposed remedies, which are intended to cover the 2024-28 period. The GCRA reinforced its view in its 10 October 2022 industry round table[4].

7. In response to this industry round table, we wrote to the GCRA to express our support for the GCRA's proactive and productive engagement, but also to set out some significant reservations about the GCRA's decision to simply review Sure's wholesale broadband pricing, without conducting a full review of the wholesale broadband access market[5]. In that letter, we explained that the GCRA's proposed approach was not in line with regulatory best practice, as endorsed by the GCRA[6]. We also explained that the proposed approach risked overlooking important ongoing and future developments in the broadband market in Guernsey.

8. Regrettably, the GCRA does not appear to have considered nor responded to our concerns. Rather, in paragraph 2.10 of its Proposed Decision, the GCRA seems to conclude that despite significant changes in the market since its last review, including the launch by Sure of a £37.5m project to build out a fibre to the premises ('FTTP') network across Guernsey and Herm and the granting of a fixed telecommunications licence that permits Starlink to provide satellite based broadband services, no developments have occurred that would change the market assessment. Instead, the GCRA simply

[3] t1358gj-broadband-market-statutory-notice-of-a-final-decision-final-decision.pdf (gcra.gg)

[4] The GCRA and Frontier Economics hosted an online industry round table, in which Sure, JT, Airtel Vodafone and other interested stakeholders were invited to hear about the GCRA's proposed approach to both the Wholesale Broadband Access and Business Connectivity market reviews.

[5] Letter from Chris Durnell to Michael Byrne on 28 October 2022.

[6] Report for CICRA Wholesale Broadband Access Market Review: Market Definition and SMP Assessment – 25 July 2018 – Section 3.1. We also note that the Authority adopted the European framework in its review of the Business Connectivity Market in 2022.

presents a very high-level summary of market developments ***that have already occurred*** and concludes that Sure would retain SMP at the wholesale level for this review period.

9. This approach is disappointing and concerning, for a number of reasons. Firstly, as set out in our 28 October 2022 letter, a significant amount of time has now elapsed since the last broadband market review and regulatory best practice dictates that a full review of the market definition and SMP designation should be conducted *at least* every five years (note, five years have now elapsed since the GCRA conducted its last analysis of the wholesale broadband market in 2018).

10. Secondly, we are puzzled about how the GCRA concluded that the aforementioned market developments are immaterial, without conducting an empirical assessment following the Hypothetical Monopolist Test. The purpose of conducting a market definition and market power assessment is to understand which products (existing or future) competitively constrain the focal product and whether these constraints are sufficient to mitigate against significant market power. Whether one product constrains another (i.e. can be identified as a substitute) can only be determined by assessing how customers of the focal product react to a change in price (and occasionally non-price terms). This is necessarily an empirical exercise – how else could the GCRA establish whether Starlink's broadband services or new 5G services (both expected to become widespread over this review period) competitively constrain broadband services, without first identifying whether customers consider these products as substitutable[7]? Whilst it may appear to the GCRA that no material changes have occurred in the market in the last five years, nor will occur over the next five, it is widely recognised that such superficial analysis is inappropriate as a basis for regulatory decisions that influence major investment decisions and the availability of state-of-the-art telecoms infrastructure to consumers and businesses in the market.

11. We are concerned that the GCRA does not appear to have made any effort to determine whether the wholesale broadband market remains unchanged since 2018, nor whether it is likely to change over the period for which this decision will apply (2024-28). The GCRA's analysis and decisions regarding market definition and market power assessments must be forward-looking and empirically driven – a point that it acknowledged in its 2019 SMP finding[8].

12. For example, the introduction of FTTP across Guernsey and Herm and the withdrawal of copper-based services will undoubtedly materially impact the market. It may be that the market for leased

[7] Regulatory best practice and European competition law dictates that this can only be established using the Hypothetical Monopolist Test, otherwise known as a SSNIP (small but significant non-transitory increase in price) Test.
[8] Section 3.26.

lines of certain speeds will no longer be distinct from the FTTP broadband market, especially if the FTTP service offerings start to include symmetrical variants, with high service SLAs applicable to business customers. Similarly, whilst Starlink's broadband service has not yet attracted a sizeable number of customers, it has only had a licence for 12 months. There is a chance that Starlink's market share could increase substantially during the review period. Again, whilst 5G services have not yet been commercially deployed in Guernsey, both Sure and JT have made clear that they expect to provide island-wide high speed, low latency 5G networks and services before the end of this review period, both of which could act as a suitable substitute for broadband services.

13. If the wholesale broadband market definition is potentially set to change during the period where the proposed remedies are to be applied, then the GCRA ought to assess that and subsequently reassess whether Sure retains SMP in the newly defined market. Only systematic and methodical analysis of substitutability will determine whether the market definition should be changed for the relevant period. It is not possible to do this through what appears to be the 'finger in the air' review described by the GCRA in Section 2 of its Proposed Decision. The GCRA's decisions must be based on thorough and transparent analysis, on which stakeholders have had the opportunity to comment. A policy position of proceeding straight to a decision on wholesale broadband remedies, without appropriately revisiting the market definition and SMP determinations, sets a risky precedent, which could result in reduced investor confidence for future significant telecoms investment in Guernsey.

14. As the GCRA has refused to engage in a new market definition and SMP assessment exercise, it is not possible for us to determine whether the market would remain unchanged; nor is it appropriate for us to submit data and analysis on that matter, in response to this Proposed Decision. It is the responsibility of the GCRA that its decisions are based on relevant analysis, using up-to-date data and are forward-looking in terms of anticipated market developments over the relevant period.

15. We are therefore keen to prompt the GCRA to commence a new market definition and SMP assessment for stakeholders to comment on. In order to not cause undue delays to the GCRA's introduction of the new remedies (and assuming that the GCRA is confident that it will result in an unchanged market with an SMP determination for Sure), the market assessment could be conducted in parallel with the conclusion of the GCRA's review of proposed remedies, leading to a Final Decision.

COST ORIENTATION

16. In the cost modelling section of the Proposed Decision[9], the GCRA states that cost orientation is a key principle in the EU regulatory framework.

17. Cost orientation can be interpreted widely, but the GCRA appears to interpret it as the setting of regulated prices based on the modelling of the regulated operator's costs of providing that service. Whilst that approach was certainly recommended for many years, more recent decision-making has seen a move away from cost-based regulated charges in favour of imposing non-discrimination remedies, such as economic replicability tests. In some contexts economic replicability tests are referred to as 'cost oriented pricing', but it differs significantly from the setting of specific regulated charges to reflect the cost of wholesale service provision. Instead, it focuses on the existence of economic space between wholesale and retail pricing.

18. This change has happened specifically in response to the need for regulated providers to invest in FTTP infrastructure and to allow them to set wholesale access prices to support that investment, providing it would be possible for the access seekers to replicate the regulated operator's retail broadband services using the regulated wholesale access services.

19. In some instances, an anchor pricing approach is used, whereby a single (popular) legacy product is subject to cost-based pricing, but the new FTTP-based services are not. The principle of this is that the regulated provider cannot profitably demand excessive premiums for FTTP services over and above the regulated legacy service price.

20. In the current draft EC Gigabit Recommendation[10], this move away from cost-based access pricing has been further strengthened, with NRAs effectively needing to justify where cost-based prices are imposed for wholesale access products other than access to physical infrastructure. The Gigabit Recommendation refers to a 'demonstrable retail constraint', such as products offered by other providers or a legacy product (like the anchor product example explained above).

21. In the Gigabit Recommendation, the focus of cost-modelling is on the setting the pricing of access to physical infrastructure to enable competitors to build new networks, without the need to replicate the physical infrastructure, such as ducts and poles.

22. The GCRA proposes to use a discounted cashflow model, calculating the future cashflows generated by the regulated products, based on forecasts for the relevant costs and revenues from those

[9] Page 11.

[10] https://digital-strategy.ec.europa.eu/en/library/gigabit-connectivity-recommendation

products. However, the opening position is based on known (historic) revenues and costs, with 2021 and 2022 being periods in focus for Frontier.

23. As a general principle, an operator's statutory accounting information does not facilitate the allocation of revenues and costs, required for cost accounting purposes. As highlighted to the GCRA on numerous occasions[11], 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.

24. Reliance on Sure's cost driver data from 2014 (the last year our activity-based costing model was run), remains a major concern for us, but within the timeframe allowed by the GCRA for submission of our data, 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 materially flawed.

25. Unfortunately, Sure has little option but to accept this position, as a reestablishment of our activity-based costing system would necessitate a minimum preparatory period of 20 months, but in reality, more likely around 24 months, based on our previous experience of the establishment and population of a suitably detailed costing system. As explanation, this would consist of 8-12 months of model design and creation, followed by 12 months of data collection (which should, for reconciliation with Sure's statutory accounts, align with the calendar year). These timeframes are way in excess of those sought by the GCRA for the purposes of price-setting for wholesale on-island leased lines and wholesale broadband services, hence our hesitant acceptance of the use of certain 2014 cost allocation data.

COST MODELLING

General Comments

26. We note that some of the cost modelling data used by the GCRA in its WBMR and Business Connectivity Market Review ("BCMR")[12] analysis is inconsistent. In our BCMR response, submitted to GCRA on 19 May 2023, we drew the GCRA's attention to a number of errors and omissions, but these were not corrected in the WBMR framework or associated model, which was provided to us on 23

[11] Most recently, in Sure's response to the GCRA's BCMR Proposed Decision, submitted 19 May 2023.
[12] In relation to wholesale on-island leased lines.

May 2023. We had proposed to the GCRA[13] that it held off publishing its WBMR proposals until it had considered our concerns and alternative proposals. It chose not to do so. As of today, we do not know whether the GCRA intends to formally accept our BCMR related proposed changes, but in the Methodological Issues & Proposed Changes section, below, we have listed those key proposals, along with those that have come to light during our review of the associated WBMR model.

27. Whilst we had the opportunity to review the WBMR model in more detail than our resources allowed for the BCMR version, we note that there are certain aspects that we were unable to validate. A key spreadsheet cell in the WBMR model that could not be validated was the 2023 value of the reference product (Fibre 30/3). Rather than being a value driven by a formula, it displayed the pasted result of a calculation, which appears intended to reflect the GCRA's headline story regarding its proposed 11% price constraint on Sure's wholesale broadband charges[14]. This was likely done to avoid a circularity within the model.

Methodological Issues & Proposed Changes

28. In an email to Frontier on 10 February 2023 (with the GCRA copied in), 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. And further, there is no mention of it by the GCRA in what it referred to as the 'detailed account of interactions and exchanges with parties relevant to the information gathering and modelling process', set out in Annex 4 of its Proposed Decision. Had Sure been given the opportunity to review the modelling assumptions and proposed treatments of revenues and costs, some of the incorrect assumptions would have been identified before the GCRA issued either of its Proposed Decisions (BCMR and WBMR). This would have been beneficial to all stakeholders, as market expectations for the pricing of wholesale on-island leased lines and wholesale broadband services have now been set, based on the GCRA's published proposals.

29. On a more positive note, we are grateful to the GCRA for providing us the Frontier cost models used to underpin the financial elements of the BCMR and WBMR, based on the source data that we had provided. It appears that the two models have been designed to exist in isolation, but with each drawing its base data from a single underlying source (perhaps a Frontier master model). However, from the information available to us, whilst we cannot readily see any benefit in having separate models, we can certainly see some risks. During recent weeks, the GCRA and Frontier have helpfully enabled us to query various aspects of the models and it has become apparent that most of the

[13] In our email of 19 May 2023.
[14] gcra-proposes-to-lower-cost-of-wholesale-broadband-services-by-11.pdf

informally agreed changes[15] need to be applied in both models. Unfortunately, due to the GCRA's preferred timings, where the WBMR Proposed Decision was issued beyond the close of the consultation period for the BCMR Proposed Decision, we have no direct visibility of the impact that those agreed changes could have on the pricing of on-island wholesale leased lines (within the BCMR).

30. In Table 1, below, we have listed the key issues that we have identified, along with our other proposed changes to improve the models' outputs. Some of these changes have a noticeable impact on the Net Present Value ("NPV") calculation[16] within each model and hence the GCRA's proposed annual price cap values. **We have associated our proposals below with the WBMR model, but in almost all instances the change would also need to be reflected in the BCMR model (where not already actioned as a result of our 19 May 2023 BCMR response).**

Table 1: Summary of proposed changes to Frontier's models

GCRA's model tab	Cell or row ref.	Issue	Changes required. Note: Financial impacts shown in relation to WBMR.
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%. **In isolation, the revised WACC impacts the model's NPV by** [redacted]
Revenues	Row 9	The 'recurring fee discount' appears to have been recognised as additional revenue, rather than as a reduction of revenue.	**In isolation, the revision impacts the model's NPV by** [redacted]
Demand	Row 102	Cell Q14 on the Costs tab of all versions (1-9) of the Excel template that we submitted[17], we included the note 'Free migration from copper to fibre. Services at new premises charged at £128.35'. Within the GCRA's model, forecast revenues for one-off broadband activities (e.g. connections) have been overstated. The GCRA's model applied the new premises charge to all 30,001 migrations from copper to fibre, rather than the relevant much lower actual/forecast installations figure of [redacted] across those years (2021-26).	On the Demand tab, the values shown on row 102 need to be replaced. Our forecasts can be seen in our updated version of the GCRA's WBMR model and our spreadsheet 'Guernsey landline installations (Jan 2022 – May 2023)', both of which accompany this submission, but are confidential. **In isolation, the revision impacts the model's NPV by** [redacted]

[15] We understand that any informal acceptance of a point cannot be relied upon until the GCRA's formal position has been confirmed via the publication of its separate Final Decisions (BCMR and WBMR).
[16] The NPV modelling approach is explained by the GCRA in the third bullet point on page 11 of its Proposed Decision.
[17] Spreadsheets entitled 'Guernsey Price Review – template – Sure v[X]'.

		Even where installation and reconnection charges are applied, they relate to landline, not broadband services, with the exception of a £12.75 copper broadband relocation fee (for a house move). For fibre broadband, no relocation charge applies. From each spreadsheet template that we populated, we could not ascertain that the GCRA's intention was to associate installation and relocation charges with broadband, rather than line rental. However, we acknowledge that our wholesale broadband price list is ambiguous in that regard.	
Capex Forecasts – FTTP rollout specific	Rows 20 to end of section. With rows proposed for inclusion, would now end on row 27.	The estimated lifetime for an ONT (& 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: At 10yrs: 95.6% At 20yrs: 91.3% At 30yrs: 87.2% In addition: • We know from JT that in Jersey it has begun replacing some of its ONTs at under 10 years old. • An industry expert (Jonathan Kingan) believes that around 12 years would be more likely maximum period (rather than 20). There is no instance where Sure would wait 20 years (with Adtran's indicative failure rate of 8.7% at that time), as that level of failure would be operationally challenging, with a high degree of customer dissatisfaction. In addition, ONTs are active network equipment, with built-in software, which will require multiple upgrades over its lifetime. Adtran is highly unlikely to still support software updates on ONTs that are anywhere approaching 20 years old. 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 4.4%. We therefore request that the current 20-year timeframe is reduced to 12 years. As a result of more recent correspondence with Frontier, Sure has also reviewed the likely future capex requirements for the Other Equipment category. All of our Capex related proposals are detailed in our submission to Frontier (with the GCRA copied in) on 06/07/23. They are also shown in the relevant model, as part of this submission.	**In isolation, the revisions impact the model's NPV by [redacted]**

Other input data	Rows 44, 49 & 50	At the time the model was created, it appears that the most recently published States of Guernsey (SoG) RPIX data related to a Q3 2022. 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: Forecast inflation Q22023.indd (gov.gg)	The model needs to be updated to reflect the latest RPIX actuals and forecasts. It should be further updated once the Q2 actual and Q3 forecast become available (due 25 July 2023) **In isolation, the revised RPIX impacts the model's NPV by [redacted].**

31. We do not wish to 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 draft version of its models (before the final decisions for both BCMR and WBMR processes are confirmed). **We are keen to discuss any aspects of our proposed changes and would request that we are actively involved in that final review of the models, to help minimise the risk of calculation errors or misinterpretations.**

COMPLIANCE FRAMEWORK

32. We recognise and appreciate that a basket style price cap would allow us the commercial flexibility to set our own wholesale pricing curve and product definitions – both of which may well need to change over time as the Guernsey fibre market develops. We broadly welcome the GCRA's desire to give Sure the flexibility it needs to remain active and engaged in the market. However, we are concerned about the GCRA's lack of focus regarding an appropriate compliance framework. In section 6.5 of the Proposed Decision, the GCRA refers to a compliance-checking process similar in nature to the current process for monitoring Sure's adherence to the retail minus approach on wholesale leased lines. This is extremely concerning.

33. As we have repeatedly informed the GCRA, most recently by email on 18 April 2023, that this basic approach to compliance does not provide a fair outcome. It also uses a fixed measure for compliance, based on a per-product margin, whereas the framework for any upcoming price cap for wholesale broadband services needs to account for an average price based on a basket of services, with fast-paced product volume movements. There are materially different market behaviours between wholesale leased lines and wholesale broadband services (the latter intensified during Sure's rollout of FTTP) and this must be recognised in any price control mechanism. We are therefore concerned about what appears to be a lack of understanding on the GCRA's part. We would recommend that it seeks advice on this matter, rather than ploughing ahead with a broadband compliance framework

that has materially different characteristics and requirements to the wholesale leased lines framework. If no changes were made to the existing proposals, Sure would be almost guaranteed to fail.

34. We note that the GCRA issued a proposed Direction to us on 13 July 2023 about what it considers to be non-compliance with Sure's wholesale leased lines price control, but it has not so far been able to answer certain fundamental questions – either those recently asked (18 April 2023) or those, more importantly, asked in 2015, when the framework was established. The current framework is fundamentally flawed and unfit for purpose. It does not even appropriately allow for new and/or ceased services within the period, but instead tries to account for volumes on a net basis at the period close. As a minimum, for any broadband price cap, we would want a monthly volume measure (within an annual compliance period), rather than a single annual measure.

35. The vast majority of the island's wholesale broadband services are provided by 'Sure Wholesale', with them being sold at the retail level by OLOs and 'Sure Retail'. Sure Wholesale, rightly, has no control over the volume of broadband services sold by each retailer, their retail prices, or the likes of special offers (including duration and timing within the year). As such, any broadband price cap framework that were to require Sure Wholesale to comply on a live 'within period' basis, as currently proposed by the GCRA, would be inappropriate.

36. Were a retailer to run a major promotion in the latter part of a year, particularly with any incentive for customers to upgrade to a faster speed (with an underlying higher wholesale charge), based on a 'within period' current-year-only annual price cap, a compliance breach is almost unavoidable. That is because Sure would be unable to calculate year-to-date compliance, adjust wholesale charges, compliantly notify the market, apply those revised charges, and suitably influence the retail market to increase our chance of wholesale compliance – all within a dwindling timeframe of the remainder of the year.

37. Looking at this issue in more detail, Sure has a requirement within its licence to provide 30 days' notice of proposed wholesale price changes, in cases where it holds SMP – wholesale broadband being one of them[18]. This requirement is set out in Condition 31.5 of our Fixed Licence and reflects the wording of a statutory notification of 2012[19]. Although not stated in either document, we understand that the GCRA considers that Sure is required to provide 30 clear working days' notice. In this context, the count of clear working days starts on the first working day following the day on

[18] t1358gj-broadband-market-statutory-notice-of-a-final-decision-final-decision.pdf (gcra.gg)

[19] CICRA 12/03: www.gcra.gg/media/4062/t12g-statutory-notification-amendment-to-cable-and-wireless-guernseys-fixed-telecoms-licence.pdf

which we publish the notification and finishes on the 30th working day. The publication would take effect in the market on the following day.

38. Taking 2024 as an example, being Year 1 of proposed price cap, and working back from the year-end (the point at which compliance would be measured):
    - **01/12/24:** The latest date on which Sure Wholesale could appropriately apply wholesale broadband price changes to influence the weighted average price, for compliance purposes.
    - **19/10/24:** The latest date to compliantly notify the market (with 30 clear working days).
    - **30/09/24:** The most recently available monthly charging/reporting data that Sure Wholesale could access to calculate its year-to-date weighted average price. We would then need to estimate how many retail sales, and of which product variants, the three retail broadband providers would be likely to make during October, November, and December – even though we would have no visibility of their Christmas campaign plans.

    In summary, our year-end compliance capability would be out of our control – as it would for any wholesale operator in that scenario. The chances of compliance, in that context, would be nothing more than pot luck.

39. In previous price controls of this type, where a flexible basket of services has been regulated, the GCRA's price cap framework has allowed for prior year volumes to be used in the compliance calculation, alongside current year prices. This is good practice and would avoid the risks associated with the above scenario. This standard historic volume / current price framework would also avoid the danger of unfairly penalising Sure for any material impact of retail promotions that one or more retailers might choose to offer, in the run up to Christmas. Were the GCRA minded to consider this much more fit-for-purpose framework, we would request the inclusion of a carry-over facility. This would incentivise us to smooth out wholesale broadband price changes and would avoid the risk of significant pricing swings, which would clearly benefit all retailers and their end users. Worryingly, under the GCRA's current proposals, major price changes would be an unfortunate likelihood, as there would be a year-end dead-stop. Whilst the risk could be mitigated through the setting of an artificially low weighted average price, solely to guarantee compliance, it would be entirely inappropriate for us to have to do that. We must ensure that the appropriate payback for our Guernsey Fibre project is achieved, so that we can maintain its financial viability through to its planned conclusion in December 2026.

40. In summary, for the GCRA's proposed price cap to be effective, it has to be fair and therefore achievable. We therefore urge the GCRA to establish a standard prior year volume / current year

price cap compliance framework, with a carry-over facility. We would be amenable to creating a draft framework of this type, for the GCRA's consideration. Please let us know if you would like us to do so. Indeed, we had intended to include a proposal, as part of this submission, but time pressures meant that this has not been possible.

WEIGHTED AVERAGE COST OF CAPITAL ("WACC")

41. On 9 January 2023, we submitted our WACC report to the GCRA[20]. It 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.

42. We also welcome the GCRA's decision to largely support our WACC proposal and its recognition that the parameters used are "reasonably well evidenced"[21]. 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 ('RfR').

43. Firstly, we do not 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 elsewhere, 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[22] and the Competition and Markets Authority ("CMA") recognising that including a forward rate adjustment had become convention in its PR19 Final Decision[23]. Academic literature has long considered forward rates as unbiased predictors of future spot rates. Notwithstanding, we acknowledge that the forward rate adjustment

[20] 2023 Oxera Report, Estimating the WACC for Sure's Guernsey business, 9 January 2023.
[21] Business Connectivity Market Review – T1621G – Proposed Decision – Wholesale On-Island Leased Line Pricing – para-4.7.
[22] RIIO-2 Sector Specific Methodology Decision – Finance (ofgem.gov.uk) – see Table 6 on page 30.
[23] Final report (publishing.service.gov.uk) – see paragraph 9.233.

is not always adopted and therefore recognise the GCRA's conclusion that the forward rate adjustment may not be necessary in this current scenario.

44. 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 regulators utilising these adjustments would suggest that there *is* regulatory precedent that would support their use 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, any debt interest payments and retain sufficient profit to attract equity investors (the financeability problem).

45. 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.

46. 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[24]. 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, below). 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 WACC analysis summary. Once further adjustments had been

[24] 2023 Oxera Report, Estimating the WACC for Sure's Guernsey business, 9 January 2023 – sec. 2.4, page 11.

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[25] on the allowed for risk-free 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.

47. During our engagement with Frontier and the GCRA as part of the BCMR, Frontier stated that it did not believe that an uncertainty premium was required in the Oxera WACC model because an implied premium has been included in the RfR due to the use of 2022 spot rates to determine the RfR rather than 5-year average yields.

48. In response to Frontier's comments, we re-engaged Oxera to better understand why it had used 2022 spot rates and why a further uncertainty premium was required. Oxera explained that its decision to use spot rates, rather than average yields, was underpinned by the need to adequately reflect current market evidence and to reflect the cost of new debt relevant to Sure more closely.

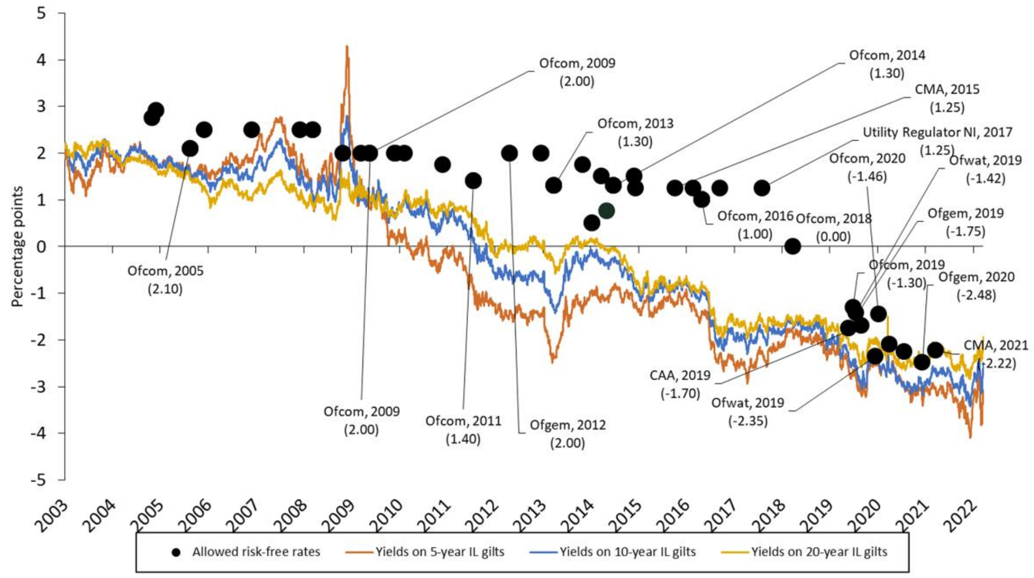
49. Adopting a focused current indicator, such as a spot in this context, provides a more accurate reflection of actual market evidence, which is especially important in a period where yields and rates have changed significantly. For example, at the time of our report, the spot rate was 3.62%, compared to the 5-year average RfR of 1.11%. It is not credible that any company would be able to finance itself anew at the 5-year average rate, especially in the case of Sure, which is debt-free.

50. Sure also currently has a net cash position. In view of our plan for considerable expansion, we expect to incur debt financing for the first time. Thus, this means that the parameters used in estimating the WACC should reflect the cost of new debt only. It would be inappropriate to use a 5-year average parameter, as we would reasonably expect to pay current market rates when it goes to market. The reason that several other precedents apply the 5-year average, is due to the consideration over embedded debt, i.e. debt raised previously, at past market rates. For example, a regulated company that has raised fixed-rate debt in the past (at lower rates), should not be permitted a materially higher cost of debt allowance now, based on spot rates alone, as this may over-compensate the company. Similarly, not reflecting spot rates in the regulatory control (when rates are higher) may mean that the allowed cost of debt is insufficient to cover the actual cost of new debt, and investors would not be able to recover costs, i.e. the company is not financeable.

[25] 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.

51. Given the above, Oxera's presented estimation does not therefore include an 'implied premium' due to the use of spot rates. Rather, the use of spot rates is to ensure that the RfR estimate reflects updated current market evidence and is consistent with the estimation of cost of debt, as Sure does not have embedded debt, and faces only the cost of new debt. The uncertainty premium put forward is thus necessary, as it captures the risk that spot rates may rise faster than suggested by forward rates. The current period where interest rates have increased rapidly is a good example, especially as rates have risen faster than expected since our report—if no uncertainty premium is considered within the regulatory control, there is a higher risk that the RfR would then be under-estimated (reflecting outdated, too-low market estimates), and result in a depressed WACC, leading to a financeability problem.

Figure 1: Past regulatory determinations where the risk-free rate sits above yields on ILGs.



52. 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 Table 2, below.

Table 2: 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]**	**4.37**	**4.62**
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]**	**6.95**	**8.19**
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%**	

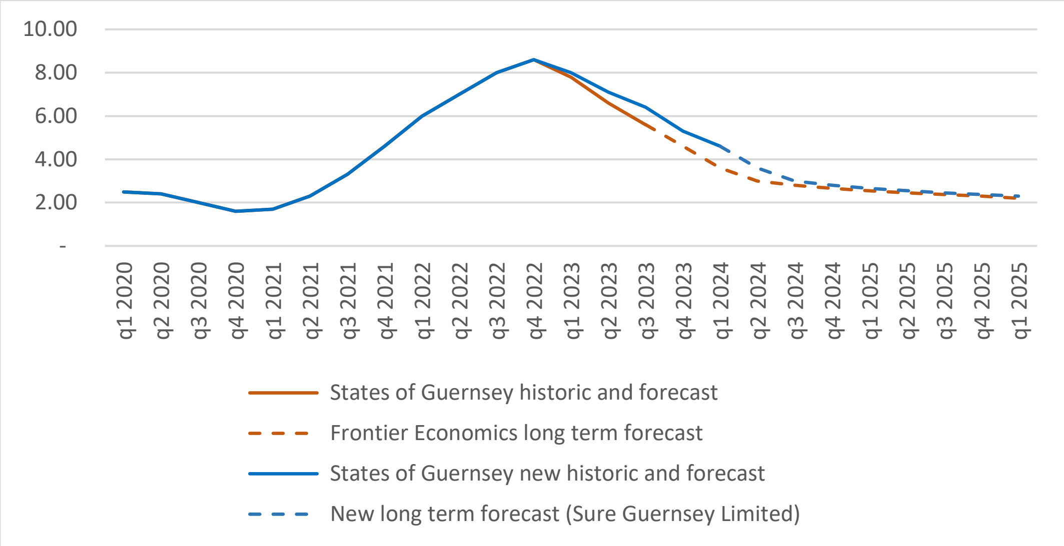
INFLATION

53. 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.

54. Whilst 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 Inflation Bulletin and Quarter 3 Inflation Forecast, both of which will be issued in July 2023. The GCRA's model assumes an annual inflation

rate (RPIX) of 6.15% for 2023 and 3.01% for 2024[26]. However, the States of Guernsey's Quarter 1 Inflation Bulletin and Quarter 2 Inflation Forecast has already made clear that RPIX is likely to sit higher, and inflation developments in the UK suggest that inflation at the end of 2023 could be even higher than forecast in the Quarter 2 Inflation Forecast. The annual change in RPIX for the year ending March 2023 was 8% (compared with the GCRA's forecast of 7.8%)[27]. Similarly, the States of Guernsey now forecasts that inflation for 2023 will be 6.7% in Guernsey (compared to the GCRA's forecast of 6.15%).

Figure 2: GCRA's forecast RPIX for Guernsey adjusted to reflect the Q2 Inflation Forecast.



55. This deviation in actual and forecast RPIX can be seen in Figure 2, above. The updated RPIX forecast for Quarter 2 2023 suggests that inflation will remain higher for longer in Guernsey, with RPIX sitting slightly above the GCRA's forecast until early 2025. Note, however, that further deviation between the GCRA's forecast rate of inflation (as stated in its model) and the States of Guernsey's updated assessment is likely to occur when the Quarter 2 Inflation Bulletin and Quarter 3 Inflation Forecast are published, on 25 July 2023.

56. The States of Guernsey's adjustments in its Quarter 2 Inflation Forecast has been supported by public comments made by the Governor of the Bank of England. For example, on 17 May 2023, 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

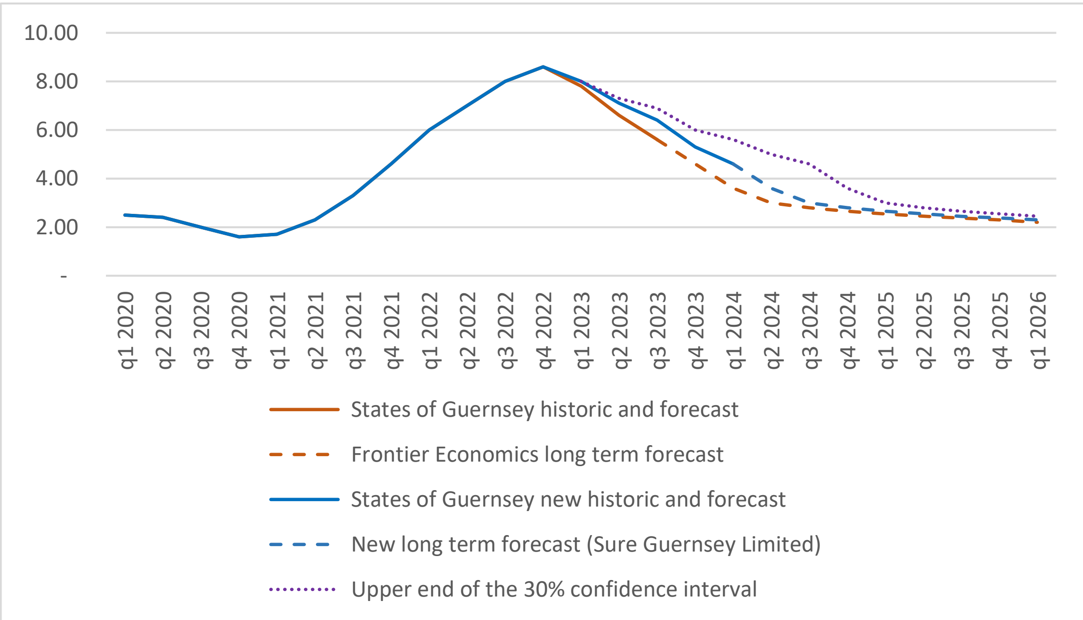
[27] Forecast inflation Q22023.indd (gov.gg)

its 3.9% February 2023 projection. More recently, further developments and public comments have been made, suggesting that inflation will remain higher for longer in the short run, as inflation data over the past few months has repeatedly defied expectations and stayed higher than predicted. In May 2023, the rate of inflation in the UK remained broadly unchanged (CPI of 8.7%), despite predictions that it would fall significantly. Core inflation continues to rise, despite the headline rate remaining static or reducing slightly. This has prompted the Bank of England to raise interest rates to 5% in June 2023, with many now believing that the end of year inflation (CPI) could sit around 6%, as opposed to the 5.1% forecast in the Bank of England's May Monetary Policy Report.

57. RPIX ordinarily sits above CPI, suggesting that the RPIX in Guernsey at the end of 2023 is likely to 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 3 Inflation Forecast, along with an appropriate uplift to reflect the uncertainty around short-run inflation rates in the UK.

58. 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. Please note, Figure 3 below reflects the 30% confidence interval included in the States of Guernsey's Quarter 2 Inflation Forecast, so will need to be adjusted to take into account further developments included in the Quarter 2 Inflation Bulletin and Quarter 3 Inflation Forecast, when they become available.

Figure 3: GCRA's forecast RPIX for Guernsey with 30% confidence interval included.



Sure (Guernsey) Limited

14 July 2023