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Mobile radio network services for the police and emergency services: Observations on the CMA's proposal to make a market investigation reference

Prepared for Motorola

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DotEcon Ltd
17 Welbeck Street
London W1G 9XJ
www.dotecon.com

Content

Introduction and summary

Our assignment

We have been asked by Motorola Solutions, Inc (Motorola) to provide an independent assessment of the CMA's proposal to make a market investigation reference for the "*market for the supply for the Airwave network in Great Britain*." The Airwave network "*is a secure private mobile radio communications network for organisations involved in public safety in Great Britain*", allowing "*the police, fire and emergency services staff to communicate securely with each other when in the field.*"

Our observations

In the remainder of this document, we briefly summarise the CMA's main points and then provide our observations on the views put forward by the CMA and on the evidence presented in the consultation document.

In summary, we consider that:

- The identification of a 'market for the supply of the Airwave network in Great Britain' that might not be working well is nonsensical from an economic perspective.
- The assessment of market power and detriment based on anecdotal evidence of failure to agree and ROCE calculations is fundamentally flawed.
- There is no evidence to suggest that the initial procurement process was uncompetitive.
- References to Motorola's incentives to delay ESN are speculative and there is no evidence to suggest that such behaviour took place.
- Relying on a market investigation instead of the appropriate contractual dispute resolution processes can be expected to limit the scope for efficient long-term contracting in future with the UK government.

Background

The Airwave network

The Airwave network was commissioned by the Home Office in 2000 under a Private Finance Initiative (PFI) framework arrangement. The contract was won by BT which set up Airwave Solutions (Airwave) to design, build, finance and operate the network. Airwave was sold as a standalone business to Macquarie Communications Infrastructure Group (with the then Office of Fair Trading having looked at and cleared the transaction). In 2016, Airwave was acquired by Motorola (with the transaction having been investigated and cleared by the CMA).

The original PFI contract was due to end in December 2019, at which point the network was expected to be shut down with users migrating to a different secure communications solution using a commercial mobile network. The invitation to tender for this different so-called Emergency Services Network (ESN) was issued by the Home Office in 2014 and the ESN was expected to become operational in time to provide services after the Airwave contract had expired, with transition from Airwave to ESN beginning at the end of 2017. Motorola won one part of this ESN tender, covering customer and service support and the development of new specialist public safety applications as well as providing some of the core network functions (Lot 2).

However, delivery of ESN is delayed and therefore the Airwave network continues to provide the secure communications platform for public safety and emergency services. With the current expectation being that the ESN will not be available before the expiry of the current Airwave contract, negotiations between Motorola and the Home Office over a further extension to the Airwave contract are on-going.

The CMA's concerns

The CMA's proposal to launch a market investigation is driven largely by "*increasing concerns about the delays to the roll-out of ESN and costs to the British taxpayer of the continuing operation of the Airwave network*". In April 2021, "*the Home Office, at the request of the Cabinet Office, wrote to the CMA, expressing concerns about Airwave Solutions' profitability and the extent to which this might impact Motorola's incentives in the roll-out of the replacement solution, ESN.*"

The CMA identifies "*significant detriment for customers, as evidenced by the persistently high and increasing returns achieved by Motorola in the 4 – 5 years to 2019*". The CMA estimates excess profits over this period to be around £700 m and indicates that a further £1.2 bn of excess profits might be

extracted by Motorola between 2020 and 2026, the latest expected shut down date for the Airwave network.

Specifically, the CMA claims that "*the market for the supply of the Airwave network in Great Britain is not working well for the following reasons*:

a. *the highly differentiated and bespoke nature of the Airwave network, requiring it to be designed, built and operated under a long-term exclusive contract,*
b. *the dual role of Motorola, as owner of Airwave Solutions and key supplier in the roll-out of ESN since 2016, with the incentives such a position creates,*
c. *the absence of competitive tension in the award of the original contract, with only one supplier taking part in the bidding process and the resulting likely uncompetitive pricing structure, and*
d. *delays in the roll-out of ESN that have necessitated the extension of the Airwave network by three years to 2022 and now require a further extension until the end of 2026, thereby prolonging the likely uncompetitive pricing structure well beyond the original term of the PFI Agreement."*

Potential remedies

The CMA has identified two potential remedies at this stage, namely

- a "*form of rate of return regulation typically employed by regulators setting price caps for natural monopoly networks*", which would address the adverse effects from the exercise of market power, and
- a divestiture of the Airwave networks, which would address the alleged incentive of Motorola to delay the launch of ESN in order not to jeopardise the excessive profits it earns from the operation of the Airwave network.

It is not clear whether these remedies are considered in the alternative, or whether they would be combined.

Alternative options for resolution

The CMA dismisses alternatives to a market investigation with reference to the wider powers that are available to the CMA. Specifically, the range of potential remedies is wider than that available to Ofcom compared with Ofcom's ability to impose SMP conditions (which would only cover Airwave's conduct, but not alleged problems related to Motorola's involvement in ESN). The option for the Home Office to rely on contractual dispute resolution processes or litigation is dismissed because this would not necessarily address all the concerns identified and

"may require a number of separate actions (with the added risk of divergent or inconsistent outcomes)."

Observation 1: There is no 'market for the supply of the Airwave network'

There is no "market for the supply of the Airwave network", which must be provided through a long-term exclusive contract

Our first observation is that, from an economic perspective, the CMA's identification of a "*market for the supply of the Airwave network in Great Britain*" that might not be working well is absurd.

The very first reason given by the CMA for why this supposed market might not be working well is the "*highly differentiated and bespoke nature of the Airwave network"* which requires it to be "*designed, built and operated under a long-term exclusive contract*".

This effectively says that the services provided by Airwave could not be bought and sold in a (spot) market where the customer could at different points in time choose between competing suppliers. By definition, the Airwave network can only be supplied by whoever has been contracted to design, build and operate the network.

The CMA correctly identifies that "*under such circumstances, one would expect competition to be for the market*" where "*the main competitive interaction occurs when contracts are awarded and/or extended*" and "*competitive constraints within the contract would be expected to be minimal at best*".

This, however, suggests that any competition concern would have to be considered in relation to such competition for the market, i.e. at the point at which competition for the contract takes place. Where contract delivery requires investments in highly specific assets (as in this case) contract extensions by definition will involve negotiations between the two contracting parties (see below) rather than a market transaction.

Despite having identified the correct frame of reference as being competition for the market, the CMA then notes that the "*effectiveness or otherwise of the historical policy and procurement decisions that resulted in the creation of the Airwave network*" only provides "*relevant context*". The CMA is trying to form a "*view on how competitive outcomes may have evolved since 2000*" and focuses on "*the potential for current market realities to give rise to adverse effects on competition*" (though the alleged "*absence of competitive tension in the award of the original contract*" is considered to be a factor that contributes to the alleged 'market for the supply of the Airwave network' not working well).

Given the CMA's acknowledgment that competition should be appropriately considered as competition for the market, looking at the evolution of competitive outcomes or current market realities is patently absurd. As the CMA acknowledges, the effectiveness of competitive constraints within the contractual arrangement is a foregone conclusion. Neither competitive outcomes nor market realities will change over time when the subject of the investigation is a highly differentiated and bespoke network that must be designed, built and operated under an exclusive long-term contract.

Considering services provided within an exclusive long-term contract as if they were a market jeopardises trust in contractual commitments

Pretending that services provided under such a long-term exclusive contract could be considered to constitute a 'market' in which one could assess the evolution of profitability over time, for example, is not only nonsensical but has potentially severe detrimental consequences for the incentives facing prospective contracting parties.

Any supplier of services under any long-term exclusive contract would potentially be vulnerable to becoming the subject of a market investigation if the customer – who had signed up to the contract – became unhappy with the terms to which it had agreed. The buyer would essentially be given an opportunity to renege on its original commitments by calling for a competition authority to intervene. This issue is especially pernicious where the Government is the customer.

When long-term exclusive contracts are tendered both buyer and seller need to form expectations about future events, including the prospect of an extension or a contract renewal. At this point, the buyer should expect that it will face a supplier who has invested in specific assets (both physical infrastructure and technology know-how) and who might therefore be in a strong bargaining position. Similarly, the supplier should expect that it might be equally difficult to identify an outside option for the use of such specific assets. This then creates a bilateral monopoly situation in which bargaining takes place. If the buyer does not want to rely on bargaining positions being largely balanced when it comes to re-negotiating terms, it can leverage its stronger position before the long-term contract is agreed, by including provisions governing the negotiation of extensions or modifications.

In any case, terms for an extension that are considered unacceptable or unfair must be treated as a contractual dispute that should be addressed through arbitration or litigation. There is no justification for affording one party – the buyer – the opportunity to seek competition remedies on the grounds that

the supplier now exploits its market power in an alleged market that is defined to comprise the services (and only the services) that have been contracted.

The prospect of a competition authority stepping in and wielding its extensive powers to obtain better terms for the buyer, even (or especially) if the buyer acts on behalf of the taxpayer, must be expected to destroy trust in contractual arrangements. Rather than benefitting the taxpayer, such an intervention will most likely result in long-term harm as the risk of being hauled before the CMA to face uncertain and potentially extreme "remedies" must be factored into the decision whether to bid for the contract in the first place. Where a supplier decides to bid that risk would need to "priced in", resulting in an increase in taxpayer exposure.

Observation 2: The assessment of market power and detriment is flawed

The CMA's case is that it appears that "*since 2010 Airwave Solutions has behaved in a way that is consistent with the exercise of unilateral market power (as would be expected …)*" given that competitive constraints within the contract are minimal at best.

The rather specific starting date for the alleged exercise of unilateral market power seems to be derived from the fact that the Government tried to negotiate a discount with Airwave around 10 years into the contract but failed to come to an agreement. Even though later negotiations between the Home Office and Motorola yielded a discount of 5%, the CMA considers this to be a "*modest price discount (relative to the level of the profits that are now being made)*".

Further evidence of the exercise of market power and the detriment suffered by the customer (and ultimately the taxpayer) is that Airwave has earned excessive profits (and must be expected to continue to do so until the ESN is ready, and the Airwave network can be switched off).

Failure to come to an agreement over modified terms is not an indication of market power

Considering the failure of contracting parties to come to an agreement over modifications of terms during the contract, or at the point at which an extension is agreed, as evidence of unilateral market power is entirely inappropriate.

There is no reason why a buyer should be entitled to price reductions over the course of a contract unless such reductions had been agreed (either explicitly or in response to changes in market conditions, neither of which seems to have been the case).

As the CMA notes, one reason for the failed negotiations between Airwave and the Home Office was that the Government was not prepared to offer an extension in return for lower prices. There was also a failure to agree the ownership of assets upon expiry of the original agreement. It is entirely unclear why failure to come to a resolution is construed as evidence of unilateral market power by Airwave given that there appear to have been discussions about multiple aspects of the contract that simply could not be settled on mutually acceptable terms.

It would be highly dangerous for contracting incentives if any failure of a supplier to agree to modifications of contractual

terms requested by the buyer in a long-term exclusive contract could be construed as an exercise of market power. If the Home Office wanting but failing to obtain a discount could be construed as an exercise of market power this would seem to create an implicit obligation on suppliers offering services under a long term contract to accede to demands from their customer to lower prices from the contractually agreed level. Such an obligation would clearly affect the incentives at the contracting stage.

The assessment of excessive returns is flawed

A key part of the CMA's argument is the "*apparent high level of profits that [Airwave] has been able to make in recent years and our reasonable expectation that it may be able to continue making profits well in excess of its cost of capital until the end of 2026.*" This claim is based on the CMA's calculations of return on capital employed (ROCE) and a calculation of economic profits based on an assumed Weighted Average Cost of Capital (WACC) of 10% ("*consistent with an Ofcom decision taken during the relevant period*").

Specifically, the CMA shows:

- ROCE being negative until 2006, below WACC until 2010, climbing to 50% by 2016 and having been as high as 240% in 2017;
- an average ROCE of 19%, twice the CMA's provisional estimate of WACC at 10%; and
- cumulative economic profits being negative initially, with a break-even around 2015 and being positive (and increasing) since then.

There are several problems with the CMA's analysis.

ROCE is inappropriate, and annual ROCE measures even more so

First, ROCE is not the appropriate measure in this instance and looking at annual ROCE developments is misleading.

The CMA states that "*where data permits, we use ROCE, as this can be computed annually and thus provides greater insights into trends over time and the drivers of profits above the 'normal' level.*" Whilst this may be helpful when looking at the evolution of competition in a properly defined market, taking such an annual view is inappropriate in this case.

It is generally accepted that the most appropriate measure of profitability is the internal rate of return (IRR), calculated over a reasonably long time period (ideally over the lifetime of a project). The reason why ROCE, specifically unaveraged annual ROCE figures, are not a robust metric of profitability is that ROCE is easily affected by changes in accounting practice, such

as the treatment of depreciation or the capitalisation of costs.[1] The enormous variation in the ROCE figures presented by the CMA since 2016 reveals the problematic nature of such calculations – it would be nonsensical to conclude from these variations that there were genuinely massive changes in Airwave's profitability. Focusing on differences between ROCE and the cost of capital for specific years is therefore potentially highly misleading.

In any case, the CMA's own guidelines state that "*[w]here investment is characterized by large one-off expenditure, or the industry has experienced a period of growth, it may be desirable to consider profitability over a relatively long period of time or on a project appraisal basis. For example, it may be appropriate to use a cash-flow-based model to compute a measure of the internal rate of return (IRR) where reliable data is available on this basis.*"[2] Obviously, a single project provided through a project company set up to deliver a long-term contractual obligation (which defines what is 'the industry') is a textbook example for this.

Indeed, the CMA appears to accept the advantages of using an IRR implicitly as it also states later in the document that "*[a]s we do not have cash flow information for the early years, i.e. we could not calculate the IRR, we have calculated the Airwave solutions ROCE.*" This suggests that the use of ROCE has been driven more by data availability than a view that ROCE is a better or more appropriate measure.

We acknowledge that the CMA gives an average ROCE over the entire period (2001 – 2019), and that long-run averages of ROCE can approximate (and even be equivalent) to the IRR, provided they are calculated correctly, but it is unclear whether

[1] For a discussion see OFT (2003), Assessing profitability in competition policy analysis, Economic Discussion Paper 6, OFT 657 or Grout, Paul A. and Zalewska, Anna, Profitability Measures and Competition Law (July 2006). Centre for Market and Public Organisation Working Paper No. 06/144

[2] Competition Commission, Guidelines for market investigations: Their role, procedures, assessment and remedies; April 2013. These guidelines have been adopted by the CMA.

the average ROCE given by the CMA provides such an approximation.[3]

It is inappropriate to assess returns on a project of this nature with the benefits of hindsight

Moreover, it is entirely inappropriate to look at returns on a project such as Airwave with the benefit of hindsight, after the uncertainty facing the parties when entering the contract has resolved.

Being able, ex post, to establish a break-even point does not mean that any profits earned by Airwave since then are excessive. It does certainly not justify an intervention to reduce such profits. From an economic perspective, the relevant benchmark should be the target return that resulted from a competitive tender, taking into account that costs and revenues were highly uncertain at that point.

It is the nature of risk that those who are taking it may enjoy an upside, e.g. in the form of greater profits because of lower costs, higher demand or a contract extension. There is no economic justification for considering any such upside (if, following appropriate calculation, it even exists) as an indication of market power in the form of excessive profitability.

Airwave might well have failed to break even (and we understand that there have been a number of very substantial debt write-offs over the course of its operation) without being entitled to ask for more money from the government. Thus, what the CMA identifies as excessive profit, is (if it exists) simply the realisation of an upside that was wholly uncertain when terms were agreed between the Home Office and BT. Airwave should be entitled to enjoy such an upside under these terms agreed.

[3] Although the correctly weighted average ROCE is equal to the IRR, this is of little practical help as the appropriate weights depend on the IRR and the information required to calculate these weights would permit direct calculation of the IRR (see OFT (2003); Grout and Zalewska (2006)). The formula for calculating the appropriate average ROCE has been derived by Kay (Kay, J.A. (1976), 'Accountants Too, Could be Happy in a Golden Age: The Accountant's Rate of Profit and the Internal Rate of Return', Oxford Economic Papers, 28).

Moreover, the correct asset valuations must be used (i.e. based on the value to the owner) and all changes in the book value of assets must flow through the profit and loss account (see OFT, 2003). The value of the asset to the owner is the lower of replacement costs (the 'modern equivalent asset' measure) and the higher of the present value of future earnings (excluding excessive profits) and the realisable value (i.e. the amount for which the asset could be sold); see OFT (2003).

In this context, it clearly does not make any sense to claim that it has become "*particularly clear in the last 4 or 5 years of the original contract duration*" that prices have been above the competitive level. Prices have followed the agreed path, and with Airwave making losses over a significant part of the contract, the CMA would also have to conclude that it was particularly clear in the initial period of Airwave's operation that prices have been below the competitive level. If the CMA were correct, any contract for services provided to the customer at relatively flat prices but requiring substantial investments by the supplier would show prices being below the competitive level for part of the contract and prices above the competitive level for the remainder, which defies economic logic.

The fundamental flaw in the CMA's analysis is that it treats the supply of services that can only be provided through an exclusive long-term contract by a supplier who has invested in very specific assets as if it were possible to buy such services in a spot market where one might expect competition to align prices and costs at any point in time. Within long term contracts, the terms agreed upfront determine how the risk associated with uncertainty that will resolve only over the course of the contract is shared and the supplier will accept initial losses in exchange for uncertain gains later.[4] The fact that a prospective upside materialises does not provide any justification for curtailing this upside ex post.

Also, as there would typically always be a prospect of the contract being extended or renewed (which was very much considered when Motorola acquired Airwave), it would equally be unjustified to demand lower charges because initial costs have been recovered or assets have been written off. The economic value of the underlying assets may be very different from their book value, and it is the economic value that should be used when establishing returns.

[4] That such risk-reward trade-offs were a central part of the negotiations becomes clear from the NAO report into the procurement of Airwave, e.g. in relation to the potential upside from gaining additional users and thus additional revenues. As the NAO notes, "*there is no provision in the contract for the police to share in the benefits from a higher than expected take-up of Airwave by sharers. O2 claims that, as no sharers were delivered up-front by PITO, O2 is in effect taking all the risk on this aspect of the deal and should reap all the benefits if it is successful.*" NAO, Public private partnerships: Airwave, Report by the Comptroller and Auditor General, HC 730 Session 2001-2002, April 2002.

Even the ROCE measures put forward by the CMA do not indicate excessive profits

Finally, even if one were to take the ROCE average calculated by the CMA as reasonable proxy for the return earned by Airwave, the level does not suggest excessive profits.

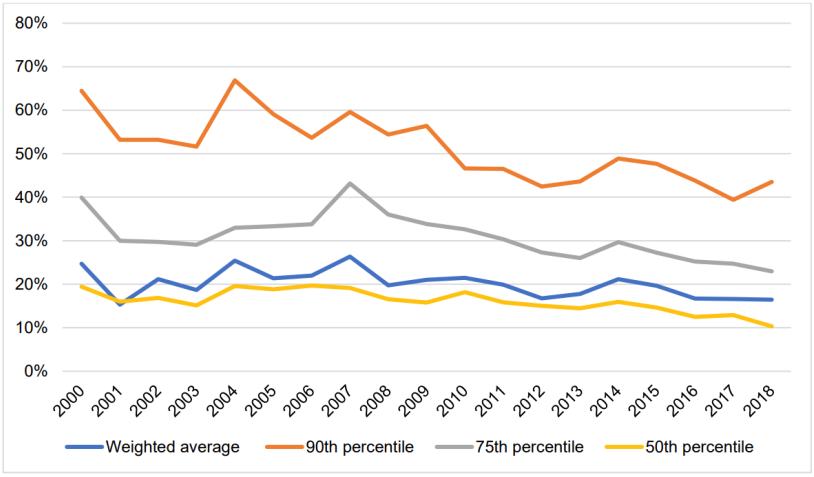
To start, the WACC used by the CMA is inappropriate. The Ofcom decision relates to the provision of wholesale line rental – an activity whose risk profile is very different from that of designing, building and operating the Airwave network, and which is only one of the activities carried out by the regulated firm. Given that Airwave was specifically set up to deliver this contract, it is entirely appropriate to use as a benchmark the hurdle rate or target rate that was used when preparing the tender and ultimately accepted by all parties when agreeing the initial contract. This is the required rate of return that reflects the risk associated with the project (a risk which was clearly acknowledged when the NAO examined the Airwave procurement process).

Moreover, while a gap between ROCE and WACC may indicate that a company earns excess returns, it does not by itself imply excessive returns or the exercise of market power.[5] For example:

- The recent CMA report assessing the state of competition in the UK shows weighted average ROCE figures for large companies around the 20% mark (see Figure 1). Although the CMA notes that this may indicate the presence of excess returns, it does not suggest that the UK is rife with monopolies exploiting their market power.

[5] As Grout and Zalewska state, "*the real concern is the distinction between excess returns and excessive return, and whether we can answer the questions: can we identify what 'excessive' means in a numerical sense, and given this, are the measures of profitability sufficiently useful to be of use in competition law? Our answers to the two questions are yes and yes; but just barely. We argue that, at the end of the day, profitability measures are useful in a competition law context but the analysis is far more of an art form and far less of a simple statistical procedure.*"

Figure 1: Percentile distribution of ROCE for large companies



Source: CMA analysis of FAME data

Figure 3.5 in CMA, The State of UK Competition, CMA133

- Using a historic dataset covering investigations by the Monopolies and Mergers Commission and then the Competition Commission (which eventually turned into the CMA), Grout and Zalewska (2006) look at Accounting Rates of Return (ARR, equivalent to ROCE) of cases with and without adverse findings.

Figure 2: ARRs in UK competition investigations with and without adverse findings

	All companies, %	Monopoly pricing cases only, %
Company level data		
Average ARR where adverse finding	51.0	102.6
Average ARR where no adverse finding	30.5	28.3
Case level data		
Average ARR where adverse finding	62.6	119.0
Average ARR where no adverse finding	39.9	50.4

Table 3 in Grout and Zalewska (2006)

From this, the authors conclude that the "*evidence suggests that the difference between an ARR for a market without any adverse activity and those where the CC have decided to make an adverse finding is around 20% generally, and over 70% where the abuse has involved monopoly pricing. These are additions to what the CC perceives as acceptable ARRs, which themselves are in the order of 20% plus. This evidence provides strong confirmation of the general point made in this chapter, namely, that profitability measures need to be extremely high before they can be taken as reliable evidence of excessive pricing.*"

In light of this, the gap between ROCE and WACC identified by the CMA appears to be insufficient to indicate the exercise of market power.

Observation 3: There is no evidence of a failed procurement process

The CMA explicitly states that it is concerned with current market realities giving rise to adverse effects on competition and considers the initial procurement only in so far as it provides relevant context. However, the CMA points to lack of competitive tension in the initial procurement, which supposedly is meant to indicate that the terms initially agreed were uncompetitive and that Airwave has obtained some undue benefits from this. It is difficult to see how an intervention on this basis could be anything other than an attempt to remedy a failure of the initial procurement exercise, even though the CMA claims this not to be its intention.

In any case, the CMA offers no plausible evidence to support any theory that the initial procurement exercise was unsuccessful and has given Airwave some undue advantage (which it might be exploiting going forward).

The number of bidders is evidence of the challenging nature of the project

The CMA emphasises that the procurement process attracted only one bid, claiming that "*there is currently no reason to believe that, in the absence of any outside option, PITO was able to negotiate a price that was at the competitive level*."

However, this appears to be an undue focus on the very last stage of the procurement exercise. As the CMA's summary of events indicates, there was initially interest in the project from 70 companies. The field of prospective suppliers then shrank as the requirements became clearer and the risks associated with delivering the project and the cost of preparing an offer[6] became apparent, leaving three bidding consortia after the publication of the project advertisement in January 1996. As the CMA states, the reason why only one consortium, led by BT, remained was that other "*potential bidders had dropped out for various reasons including that there were few companies committed to what was then an emerging technology and that only a few companies had the financial strength to take on such a large project*."

It is not uncommon in such large-scale projects that only a small number of suppliers eventually remains at the final offer

[6] See Annex B of the consultation paper; footnote 16 refers to the potential reimbursement of the costs of carrying out project definition studies by PITO, which however failed to maintain interest as there was no clarity about the funding that would be available.

submission stage. It would, on the contrary, be implausible to expect full offers from many prospective suppliers, given the specific requirements (in this case: the use of a particular, new and untested technology) and the substantial cost of preparing an offer, which will have to be written off by every unsuccessful bidder (and will need to be recovered through an appropriate mark-up over cost in the contract price).

In this case, he fact that ultimately only one provider was prepared to submit a bid speaks to the difficult nature of the project and the uncertainties that the supplier would face rather than an inherently uncompetitive procurement process. As the NAO in its initial assessment of the Airwave procurement states, the Home Office/PITO coped with these challenging circumstances reasonably well (though there were of course certain aspects that could have been improved, such as establishing earlier a definitive list of sharers).

Indeed, by comparison with many other large scale public procurement projects of a comparable nature[7], the Airwave project appears to be a success, being on time and on budget – which is more than can be said for the ESN project.

There is no reason to believe that BT/O2 would have had market power at the procurement stage

In any case, even with a single bidder, the Home Office and BT would have been in a bilateral monopoly situation, and there is no reason to presume that relative bargaining power was highly asymmetric. Put another way, there was no unilateral market power at the procurement stage; it was open to the customer to agree the terms with which it was satisfied.

The fact that 'doing nothing' was not an option in the face of existing systems not meeting requirements is not relevant in this case, as there would have been alternatives to procuring a national network for the emergency services, such as a continued provision of sub-national communications solutions (which, according to the 2002 NAO report, would seem to have been considered).

Indeed, even on the CMA's own analysis of economic profits (based on a WACC of 10%), the project was cumulatively loss-making for the first 15 years of its 19-year duration, which is hardly suggestive of uncompetitive pricing.

Moreover, we understand that the Home Office had the opportunity to, and did, exercise substantial negotiating power under certain change of control provisions which gave it an

[7] For examples, see https://www.computerworld.com/article/3412308/the-uk-s-worst-public-sector-it-disasters.html

unfettered right to block Motorola's acquisition of Airwave. It was out of these change of control provisions that a Deed of Recovery ultimately arose, which entitled the Home Office to compensation in case a delay to ESN was caused by Motorola. Accordingly, the potential for extensions was certainly understood, fully negotiated by all parties, and disclosed to the CMA at the time of its merger investigation.

Therefore, there is no reason to believe that BT or Airwave would have enjoyed unilateral market power at any point of the procurement process or in negotiations over contract extensions thereafter.

Observation 4: References to Motorola's incentives to delay ESN are inappropriate

Motorola's incentives to delay ESN should not be relevant for a market investigation

The CMA cites Motorola's incentives to engage in behaviour aimed at delaying the launch of ESN as another reason why the alleged 'market' may not be working well.

Leaving aside that such behaviour – if it existed – would seem to be more appropriately addressed through a thorough investigation of ESN, reference to Motorola's incentives seems to be no more than speculation.

First, concerns that such incentives might affect the roll-out of ESN were assessed when the CMA examined the acquisition by Motorola of Airwave. The CMA was satisfied that the safeguards, such as the Deed of Recovery (DoR) agreed with the Home Office, were sufficient to deal with these concerns. The Home Office (like Motorola) also appears to have regarded Motorola's acquisition of Airwave as benefit to the development of ESN, helping with the migration from Airwave to ESN.

There is no evidence for any attempts by Motorola to delay, despite the incentives having been in play for some time

Second, these incentives would have been at play for more than five years now. If the CMA were correct in its view "*that the DoR may not be effective in constraining the incentives that have been created by Motorola's ownership of Airwave Solutions and the Lot 2 Contract delivery*", one would expect that some tangible evidence of such behaviour exists.

As far as we are aware, there is no evidence to suggest that Motorola has tried, much less succeeded, to delay the roll-out of ESN. The problems with ESN appear to be more the result of the underlying structure of contracts and the lack of clarity about responsibilities of the parties. The 2019 NAO report[8] appears to lay the blame squarely at the Home Office's contract management and simply states – without any further discussion - that "*the Home Office needs to manage Motorola's contractual position carefully, given that it is both a main supplier to ESN and the owner of Airwave and may therefore benefit from programme delays.*" It does not point at any instance of Motorola having tried to delay the progress of ESN.

[8] NAO (2019), Progress delivering the Emergency Services Network, Report by the Comptroller and Auditor General

Airwave's ownership is irrelevant for extension terms

If the delays to the roll-out of ESN are not caused by Motorola, then the ownership of Airwave is irrelevant for the assessment of the terms and conditions offered by Airwave in negotiations over extensions of service provision. Motorola's involvement in the delivery of ESN cannot be a contributing factor to the alleged market for the supply of the Airwave network not working well.

There is no justification for a divestiture remedy

By implication, as there is no reason to suggest that Motorola would (if it in fact could) change its behaviour going forward, or any evidence that the safeguards put in place against attempts to delay are in fact ineffective (notwithstanding the CMA's view that they 'appear to be'), the proposed divestiture remedy is similarly inappropriate and disproportionate. It would in any case not take effect by the time the terms of an extension have to be agreed.

Observation 5: There is no justification for discarding other contractual dispute resolution mechanisms

It is not clear why the CMA dismisses alternative forms of resolution

The CMA points out that other routes might be available to the Home Office to address the concerns identified (namely excessive prices for the continued provision of Airwave services), such as contractual dispute resolution or litigation.

Given that the supply of the Airwave network is a contractual matter – governed by the initial PFI framework agreement and since then extended – this would from an economic perspective be the obvious way of dealing with any potential disagreements over terms and conditions. The CMA does not explain why such mechanisms are incapable of addressing all the concerns identified.

Proceeding with a market investigation (and even more so imposing remedies) puts at risk future efficient contracting

The only difference between a government customer pursuing contractual dispute resolution mechanisms versus securing competition intervention would seem to be that the latter carries a greater threat. It would be a matter of concern if this were the sole reason for using a market investigation instead of an appropriate contractual dispute resolution mechanism.

This is because the threat of using the additional remedies that are available under a competition intervention is likely to undermine trust in contractual arrangements. If one were to accept that services that are provided under an exclusive contract can be construed to constitute a market, this creates a threat of having contractually agreed revenues capped by a subsequent intervention on notional competition law grounds if circumstances turn out well for the seller, without any corresponding limitation to the downside risk. Any contractual commitment by a purchaser would cease to be credible, limiting the ability of the parties to agree an efficient sharing of risks and potentially limiting the range of contracts that sellers are willing to enter.

Conclusion

In conclusion, our observations clearly indicate that the CMA's analysis does not support making a market investigation reference in relation to the supply of the Airwave network. The services provided by Airwave to the Home Office (and sharer organisations) cannot be regarded as a market.

We therefore expect that a market investigation reference by the CMA in these circumstances would have a number of substantial adverse effects, including undermining incentives to enter into long-term contracts in future.

In the context of a long-term contract, any disagreement over terms for an extension should be regarded as a contractual dispute and should be addressed through appropriate commercial/contractual mechanisms. Otherwise, the threat of bringing competition law remedies to rewrite the commercial terms agreed between the parties will substantially weaken trust in those long-term exclusive contracts.