Mobile Radio Network Services Market Investigation

Motorola's Response to the CMA's Working Paper on Profitability

10 January 2022

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1. Introduction and Summary

(1) Motorola welcomes the opportunity to comment on the approach and the preliminary results set out in the CMA's Profitability Methodology Approach Working Paper of 13 December 2021. Given the central importance assigned by the CMA to the analysis of Airwave's profitability – in terms of both diagnosing an AEC as well as establishing the magnitude of any detriment – it is critical to ensure that the underlying approach is sound and that the assumptions that form the basis of the analysis are correct.

(2) It is a truism that the economic analysis must flow from a correct understanding of the factual underpinnings, since otherwise the assumptions as well as analysis of the opportunity for competition are almost bound to lead to incorrect conclusions. For the reasons explained elsewhere[1], given the factual underpinnings, it makes no economic sense to split the analysis of the Airwave service into a notional 'contract period' (2000-2019) and a separate notional 'extension period' (2020-2026). Chief among the reasons for this is the fact that the contract was never structured as an initial period of 2000-2019, at which point there was a full re-negotiation for the 'extension' period.[2] Any notional 'extension period' (a concept Motorola disagrees with) must have been set in 2016 when Motorola acquired Airwave; in economic or competition terms 2019 has no economic or competition relevance. Motorola never had the ability to walk away in 2019, and so it must be recognised that the very exercise proposed by the CMA is wholly artificial and its conclusions need to be treated accordingly.

(3) Moreover, this is a case where well-advised parties had agreed contractual terms with reference to an agreed fair internal rate of return (IRR) *for the life of Airwave*, whatever that would be. The hurdle rate for the Airwave project was negotiated, set between the parties at the outset, and is well documented and understood by the parties. There were no provisions that would protect Airwave from actual returns turning out to be lower than the hurdle rate agreed *ex ante,* nor any claw-back provisions that would require Airwave to reduce prices if actual returns turned out to be higher. All that can be established through an *ex-post* assessment of profitability is whether matters have turned out better or worse for a party than expected. For this, profitability will have to be assessed over the entire life of the project, i.e. 2001 to 2026.

(4) A project lifetime assessment is also the *only* profitability assessment that could in principle be appropriate for determining whether a 'market' that is synonymous with a project company is working well. The profitability exercise proposed by the CMA is, in substance, a measure of contractual, not market, performance. What follows is therefore entirely without prejudice to Motorola's position (i) that the provision of the Airwave service does not constitute a market in which an assessment of Airwave's profitability ex-post could indicate an AEC and (ii) that a truncated analysis makes no sense at all in relation to Airwave.

(5) Aside from the absence of a factual basis for a temporal profitability split, it will be self-evident that any two periods cannot in any event be examined in isolation: without the 'initial' contract for the design, construction and operation of the Airwave network, there could be no 'extension' and the only reason why the emergency services can continue to rely on Airwave to provide its vital services in the 'extension' period is because of the very substantial investment made into the Airwave network since its inception. The only sensible way to

[1] See Motorola's Response to the Decision to make a Market Investigation Reference, 15 November 2021 (the "MIR Decision Response").

[2] A contractual chronology is provided in the MIR Decision Response.

measure profitability is therefore over the entire period over which the services are being provided under the same contract.

(6) If one nonetheless were to attempt to split the contract period into sub-periods and try to calculate profitability separately for these sub-periods – e.g. a 'contract period' and an 'extension period', the key to obtaining any rational result would be the correct calculation of the closing value of assets at the end of the first sub-period, which would then determine the opening value of assets at the beginning of the second sub-period. Splitting the analysis temporally necessarily means that the results of any truncated IRR analysis are critically dependent upon the valuation of opening and closing assets.

(7) The CMA appears to understand the importance of this requirement and that the correct approach to establishing these values is to estimate their value to the business (VTB). However, the CMA erroneously and without any evidentiary support considers that the net book value (NBV) of the assets – calculated as the difference between accumulated capex and accumulated *accounting* depreciation between 2002 and 2019 – provides a 'reasonable estimate of the value to the business'. This is not the case and the results obtained from using NBV as a measure of VTB are meaningless.

(8) In summary, Motorola's view is that the ex-post analysis of the contractual performance of Airwave cannot be used to establish an AEC in a 'market' that is effectively synonymous with the provision of services under an exclusive long-term contract. At best, such an analysis can indicate whether actual returns have been better or worse than what had been agreed at the outset as a fair compensation for the risks taken (and on this basis, it is Airwave's customers for whom the bet has paid off). By extension, a truncated analysis provides even less insight into whether there is an AEC and should not be undertaken.

2. Scope of services

2.1 <u>Business activities</u>

(9) The CMA's profitability analysis focuses on Airwave's business activities, comprising the blue light contracts (police, ambulance and fire services) as well as the services provided to sharer organisations. The CMA invites comments on whether the analysis should include services that are provided outside of Airwave or whether certain services provided by Airwave should be excluded (paragraph 18 of the working paper).

(10) As Motorola has previously set out,[3] Airwave is a project company that would not exist without the initial PFI contract and whose sole purpose is to provide mission-critical communications services to the emergency services and designated sharer organisations. The CMA is therefore correct in focusing on Airwave's business activity.

(11) However, some parts of Airwave's activities go beyond the provision of LMR. Specifically, the two software business lines [✂][4] [5] are not integral to the provision of LMR. They are run separately by a different leadership team and their costs and revenues are also tracked separately. Motorola had already made adjustments to exclude these costs and revenues from the IRR model submitted to the CMA in August 2021. Similarly, costs and revenues associated with [✂] should be excluded as this contract covers the provision of control room services and terminals (including terminal support). The provision of these services is

[3] See section 3.2 of the MIR Decision Response.
[4] [✂]
[5] [✂]

outsourced to [✂] which itself (alongside other providers) offers such services directly to other Airwave customers. In fact, the [✂] requirements and awarded contracts to [✂] in 2016, [✂] in 2019, [✂] in 2021 and is looking to tender for [✂]. The [✂] contract with Airwave is set to roll-off in 2022-2023 once the new providers go-live.

2.2 Time period under consideration

(12) The CMA states that it proposes to assess the profitability of Airwave over the period 2000 – 2026, as suggested by Motorola, but that it will also divide this period into sub-periods for which profitability will then be assessed separately in order to understand "the levels of profitability resulting from the original negotiation of the PFI agreement and the subsequent negotiations to extend the Airwave Network beyond the original period"(paragraph 22). The CMA seeks comments on this approach.

(13) Motorola reiterates the point that there is no justification for looking at profitability within sub-periods, and certainly not where the periods chosen did not themselves arise from negotiations in which the parties had a walk-away option. Airwave is a project company whose economic life is tied to the period for which the Airwave service is required. The investments made by Airwave and the costs incurred over this period must be set against the revenues earned and it is inappropriate to introduce artificial splits.

(14) In this regard, Motorola strongly disagrees with the view that the various 'extensions' are not 'integral to the original PFI agreement', as the CMA claims (paragraph 21). The option for the Home Office of requiring continued provision of the Airwave service exists only because of the investments made under the PFI agreement, and the term 'extension' is itself a contractual misnomer.[6] The CMA's analysis proceeds from the incorrect basis that the periods are split from a contractual standpoint whereas there was no such 'break'. The Home Office had an intention to shut down Airwave at the end of 2019 but this was never contractually certain and, in the event, the Home Office required the service to be provided for longer on pre-agreed terms.

(15) The original contract[7] foresaw the possibility of extending service provision to other users (namely the ambulance and fire services, which were not part of the original contract) and addressed the issue of how any incremental revenues from such users should affect the terms under which the services were provided to the police. As the NAO in its initial report into the procurement of Airwave notes, "*PITO attempted to negotiate a clawback of part of any additional income earned by O2 but were unsuccessful as no sharers for the service could be guaranteed. O2 argued that it had assumed Airwave would be used by customers other than the police and had priced this into the deal. As it was taking all the risk on this assumption, O2 refused to share any future income that would result from the use of the system by other customers.*" Put differently, the purchaser accepted that Airwave may earn additional revenues from broadening the user base as compensation for bearing all the risk associated with the uncertainty over whether such additional users would materialise.

(16) Similar considerations apply to any temporal 'extension' of the PFI Framework Agreement. When Motorola acquired Airwave, Motorola certainly considered various scenarios for an extended provision of services, in terms of both a continuation of the Airwave service for an

[6] 'Extensions' is a colloquialism and a contractual misnomer, for the reasons explained in Motorola's Response to the Issues Statement, 10 January 2022.

[7] Public Safety Radio Communications Service Agreement between (1) Police Information Technology Organisation ("PITO", as the "Authority"), and (2) British Telecommunications plc (as the "Contractor"), dated 29 February 2000 (the "PFI Framework Agreement").

additional period that might be required by the Home Office while the development of ESN was being completed and a potential integration of Airwave with ESN as and when it would become available. Under any long-term contract for services that require substantive investments in highly specific assets, the possibility of continued supply beyond the initial contract period would naturally be considered by the parties. It would have been clear to the parties that the need for the services that Airwave was contracted to provide – secure and robust, mission-critical communication amongst the emergency services and potential sharer organisations – would not simply disappear and that therefore the Home Office would either have to procure a replacement or require Airwave to continue to provide the service.

(17) In any case, the terms on which the Home Office would require continued provision of service up to a national shut-down date (to be determined by the Home Office) were fully agreed in 2016 when Motorola acquired Airwave. At this point the Home Office did not specify an end date and so Motorola took on the entire risk associated with the uncertain duration over which Motorola would be required to provide Airwave, including making all requisite investments to ensure Airwave remained fit for purpose.

(18) For these reasons, Motorola considers that any assessment of profitability in sub-periods is entirely inappropriate and any split into sub-periods would be arbitrary. There is no good reason for splitting the analysis into different time periods in the present context.

(19) Any split of the economic life of Airwave into sub-periods and the subsequent use of a truncated IRR analysis does not affect profitability over the period overall. As the CMA acknowledges, a key challenge when using the truncated IRR methodology is to establish the correct opening and closing value of assets for the specific period under investigation. The opening value of one period would have to be the same as the closing value of the previous period. It will affect the profitability of both sub-periods in different ways (and, owing to the difference in length of the two periods, to a different extent). The table below shows how the results calculated from the CMA's August model vary with a change in the assumed opening value of assets for the second period (the highlighted line shows the CMA results based on the assumption that net book value of Airwave's assets provides an appropriate proxy for the opening/closing value, with which Motorola disagrees strongly, as explained further below).

Figure 1: Impact of Asset Valuation on Truncated IRR

Closing/opening value at 31 Dec 2019 (GBP million)	IRR* 2002 – 2019	IRR* 2020 - 2026	Agreed IRR*	Actual IRR* 2002 - 2026
100	[✂]	[✂]	[✂]	[✂]
120	[✂]	[✂]	[✂]	[✂]
140	[✂]	[✂]	[✂]	[✂]
160	[✂]	[✂]	[✂]	[✂]
180	[✂]	[✂]	[✂]	[✂]
200	[✂]	[✂]	[✂]	[✂]
220	[✂]	[✂]	[✂]	[✂]
240	[✂]	[✂]	[✂]	[✂]
260	[✂]	[✂]	[✂]	[✂]
280	[✂]	[✂]	[✂]	[✂]
300	[✂]	[✂]	[✂]	[✂]
320	[✂]	[✂]	[✂]	[✂]
340	[✂]	[✂]	[✂]	[✂]
360	[✂]	[✂]	[✂]	[✂]
380	[✂]	[✂]	[✂]	[✂]
400	[✂]	[✂]	[✂]	[✂]
420	[✂]	[✂]	[✂]	[✂]
440	[✂]	[✂]	[✂]	[✂]
460	[✂]	[✂]	[✂]	[✂]
480	[✂]	[✂]	[✂]	[✂]
500	[✂]	[✂]	[✂]	[✂]
520	[✂]	[✂]	[✂]	[✂]

* real post-tax IRR as per CMA analysis

(20) The obvious implication of this is the critical need to ensure the correct opening asset value since the notional extension period IRR is extremely sensitive to the change in this opening asset value. Whilst the IRR methodology provides a sound theoretical approach to assessing profitability and it may be possible to apply this methodology over segments of an activity's lifespan, as the CMA with reference to an OFT Discussion Paper prepared by Oxera[8] notes, the Oxera paper also makes clear that results will be very unreliable if the value of key variables cannot be established with sufficient precision. Without a need (let alone a justification) for applying a set of truncated analyses that depend on the correct estimation of opening/closing asset values at the split, Motorola strongly disagrees with the rationality of such an approach.

(21) Regarding any potential extension beyond 2026 (e.g. to 2029, as suggested by the CMA), [✂]. For this reason, Motorola considers it unnecessary to assess any longer duration [✂], subject to any further changes requested by the Home Office, which creates additional risks for Motorola that would need to be taken into account.

[8] Oxera, Assessing Profitability in Competition Policy Analysis, OFT Economic Discussion Paper No 6, July 2003.

3. Proposed approach

(22) Motorola generally agrees with the use of IRR measures to establish profitability instead of the ROCE approach used by the CMA in its Consultation paper.[9] However, as noted above, Motorola rejects the use of truncated analysis, which is not justified in this case.

(23) The CMA invites comments on the use of annual cash flow data, asking whether more granular cash flow data should be used to the extent that cash flows are not evenly distributed (paragraph 39). Motorola considers the use of annual data (or, more specifically, data matching the available accounting periods, which on some occasions have been longer or shorter than a year) is entirely appropriate. Given that historic cash flow data is not available on a more granular level at this point and may be difficult, if not impossible to obtain, it is doubtful that the use of more granular data would result in any additional insights. Given the existing challenges associated with the CMA's proposed analysis (in particular the need to establish opening/closing asset values at arbitrary points within the lifetime of the Airwave service in order to use a truncated IRR analysis), using any more granular data could at best provide spurious precision.

3.1 Asset valuation

(24) Regarding the approach to establishing these opening/closing values, Airwave agrees with the view that such a valuation must be undertaken on the basis of establishing the VTB using replacement cost on a Modern Equivalent Asset basis.

(25) As Oxera (at paragraph 4.12. of the Working Paper) states, the correct assessment establishes:

> "*the lowest cost of purchasing assets today [at the time for which the opening value is to be determined] that can deliver the same set of goods and services as the existing assets. The MEA is based on current best-practice technology and uses the optimal configuration of assets to deliver the costs and services as efficiently as possible.*"

(26) The CMA approach, by contrast, takes the accumulated capital expenditure over the previous period and subtracts the accumulated accounting depreciation to calculate NBV. There is no reason to believe that accounting depreciation accurately measures the changes in economic value of the assets (i.e. truly reflects economic depreciation). In the accounts, assets were depreciated linearly over a presumed economic life but also affected by an anticipated contract duration (as is clearly evidenced by the adjustments Motorola made in the August model supplied to the CMA, where depreciation charges initially determined in light of a putative 2019 end date were distributed over a longer period of time).

(27) The fact that the Airwave assets can continue to be used in the provision of services (albeit with heavy future capex[10] needed to deal with an ageing infrastructure where replacement is becoming increasingly difficult with fundamental changes in the underlying technology and spares no longer available) indicates that they still have economic value. Whilst for *accounting* purposes assets would have been written down to a low value by the end of 2019, their *economic* value in light of service provision to the end of 2026 is determined by the value of avoiding having to build a replacement network.

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[9] CMA, Mobile radio network for the police and emergency services, Proposal to make a market investigation reference

[10] Note that another significant future cost is the migration away from end-of-life services and products provided by third parties. This migration involves both a man-power cost (investigate including technology demonstrators, design, procure, install, cut-over and support) as well as the underlying third-party service/product itself.

(28) While it is easy to see why NBV as calculated by the CMA cannot be taken as an indication of the VTB of Airwave's assets, establishing the appropriate value of assets is a task that requires considerable thought, time and effort. It was impossible for Motorola to undertake a MEA valuation within the very limited time for comment provided by the CMA, but there are good reasons to believe that a proper measure of VTB would be substantially higher than the NBV calculated by the CMA. Motorola is working on a detailed MEA valuation of Airwave's assets and will share the results with the CMA in due course.

(29) In Motorola's view, the most meaningful approach to establishing the replacement value of Airwave's assets on an MEA basis would be to calculate the cost of a replacement TETRA network, potentially combined with a new core network, as this would be consistent with the MEA providing the same services and with not requiring users to replace their terminal equipment.[11] In this context, it is also worth pointing out that other European countries are still deploying and upgrading TETRA for LMR for public safety.

(30) Valuing assets on an MEA basis introduces further complications. Specifically, if the services were provided over an optimally configured replacement TETRA network, much of the forecast capital expenditure needed to keep the actual Airwave network operational and to maintain the level of service would not be necessary. At the same time, operating expenditure would be different, without it being clear whether it would be higher or lower than forecast. For example, operating expenditure may be lower if replacement components are more energy efficient, but on the other hand, the MEA design may involve a greater degree of sourcing of services from third parties (e.g. buying connectivity instead of constructing own network assets or renting tower space from established tower companies such as Cellnex, Cornerstone and WIG rather than constructing new towers).

(31) Overall, this means that in addition to establishing the opening value of assets on an MEA basis, one would also have to estimate future cash flows that are consistent with using the MEA replacement in the provision of services. This is not a straightforward task.

(32) In any case, this exercise effectively amounts to asking at what price a competing supplier, building a complete replacement for the Airwave network from scratch, might be able to supply the Airwave service from the CMA's date (1 January 2020) to 31 December 2026. In Motorola's view, one should be able to conclude without much detailed analysis that this price would be substantially higher than the Home Office pays for the Airwave service given that they would need to permit the competitor to recover the considerable investments in an alternative, equivalent network over a short period of time.

(33) By implication, the CMA's truncated IRR analysis, using a correct approach for establishing the opening value of assets, cannot find any excessive profitability. It is Motorola's firm belief that the replacement cost of assets at the beginning of the extension period considered by the CMA will be substantially higher than the NPV of cash flows, which would be confirmation according to the Oxera paper commissioned by the OFT that Airwave is not earning excessive profits.

(34) The CMA also invites comments on whether there are any assets not included on the balance sheet that Airwave requires to provide its services. In Motorola's view, this question becomes

[11] Motorola acknowledges that under a scorched earth approach alternative technologies might be considered, which could then also support a wider range of services than can be delivered over the Airwave network. However, consideration of such alternative technologies would seem inappropriate given that they would require complementary investments from users into replacing their terminals.

irrelevant when opening asset values are established on the basis of a proper MEA valuation looking at replacement costs rather than assets listed on the balance sheet.

3.2 Use of WACC as a comparator

(35) The CMA considers using a weighted average cost of capital (WACC) calculated based on the capital asset pricing model (CAPM) as a benchmark against which to compare the IRRs it calculates for the various sub-periods. In this context, the CMA asks for comments on various aspects that are relevant for the application of the CAPM, such as the appropriate risk-free rate, the cost of debt etc.

(36) In Motorola's view it makes no sense to use a WACC derived from a standard application of the CAPM to Airwave or Motorola. The Oxera paper is very clear that:

> (1) *"[i]n profitability assessments of realised rates of return, the relevant cost of capital is the ex ante cost of capital — i.e. the cost of capital that was used in assessing the project at inception. This is particularly important for risky projects that carried a high likelihood of failure. The ex ante cost of capital has to be adjusted upwards to capture the inherent risk (the result is commonly known as a hurdle rate). When a competition authority is assessing returns that have been realised, a comparison of the realised rate of return with an ex post cost of capital that does not reflect the risk of failure of the project could lead to an overstatement of profitability."* (paragraph 7.9; emphasis added).

(37) In relation to hurdle rates, Oxera notes that:

> (2) "*it is common to see companies marking up the cost of capital when setting 'hurdle rates' (i.e. required returns) to appraise individual projects or investment plans … This premium accounts for project-specific risks, which are not reflected in the company's cost of capital generated by the CAPM approach or other asset pricing models. One clear example where a mark-up is applied is for large investment projects with a high degree of asymmetric risk, i.e. when there is a relatively large downside risk of failure compared with the likelihood of success.* The CAPM and other models do not capture such asymmetric risk." (paragraph 7.28, emphasis added).

(38) In this case, there should be no dispute about the appropriate benchmark as the parties discussed and agreed on a target IRR at the outset, and one which – as previously explained – compares very favourably to other government projects for which data is available. Certainly, the CMA has not sought to suggest otherwise. The IRR agreed between the parties is set out in a financial model[12] put into escrow that would be used to assess the reasonableness or otherwise of potential future variations of charges. This model specifies a real, post-tax target IRR of [✂] (nominal pre-tax: [✂]).

(39) It is worth emphasising that this target rate does not provide a guarantee to Airwave. Rather, this was the rate that the parties agreed would be acceptable as generated on average across the potential ways in which uncertainty about technological viability and associated costs might resolve. A realised return below this level, as has in fact occurred to date, would not entitle Airwave to compensation or higher prices.

[12] This financial model formed the basis of the financial model provided to the CMA in August 2021, which retained the structure and some of the key assumptions such as a discount rate that the CMA has misconstrued as Motorola's cost of capital (see below).

3.3 Price or margin benchmarking

(40) The CMA also invites comments on the potential use of price/profit benchmarks from other countries and/or other telecoms services, though noting that there are limitations to the use of such benchmarks (paragraph 61).

(41) Motorola believes that the Group does not need to carry out such an exercise since there is no reason for the CMA to believe that Airwave is making excessive profits, when measured against the metric chosen by the parties which itself is recognised as an appropriate measure of profitability.

4. The CMA's preliminary analysis

(42) The CMA's preliminary analysis is based on financial information gathered from or provided by Motorola. Specifically, the CMA relies on information from cash flow forecasts prepared by Motorola[13] in relation to discussions with the Home Office about [✂] (the 'June' financial information) and information from a financial model provided to the CMA by Motorola specifically for the purpose of assessing the project IRR[14] (the 'August' financial information).

(43) Motorola wishes to ensure that the CMA properly understands the financial model provided to the CMA in August (with a small subsequent revision in September in response to a further Request for Information from the CMA):[15] The financial model was based on, and closely follows the structure of, the financial model prepared by BT as part of the PSCRCS Framework Agreement ("Police Contract") approved by PITO and placed in escrow in 2001. Motorola updated this model with actual cash flow numbers with minimal changes, so that the profitability of the Airwave service could be understood. Specifically, Motorola did not update variables, such as the discount factor that was used to calculate the NPV of post-tax real cash flows. This means that this figure must not be misconstrued as Motorola's view of the appropriate cost of capital, or even as a Motorola's internal estimate of its cost of capital, as the CMA insinuates.

(44) Cash flows for the period prior to the acquisition of Airwave by Motorola were constructed from the information in the statutory accounts as set out in the accompanying slide deck provided to the CMA[16]. A similar approach was followed for the post-2016 period where numbers were linked back to the statutory accounts, albeit with some adjustments.

(45) In relation to the differences between the June model and the August model, the CMA issued an RFI to which Motorola responded, setting out the reasons for differences in revenues (a potential contribution from the Home Office to additional capex was no longer under discussion in August) and costs (adjustments were made to reflect the costs that Airwave would incur if it were a stand-alone company that had to pay market prices for services obtained from Motorola at internal transfer prices, which were also reflected in the statutory accounts from 2020 onwards; depreciation charges were adjusted to correct for accelerated depreciation accounting for the initially envisaged end date). Therefore, Motorola strongly rejects the CMA's assertion that it did not explain the reasoning behind the changes in assumptions (paragraph 73). All these changes were fully explained in Motorola's response to the CMA's RFI, where Motorola also made some adjustments to the August financial model.

[13] A spreadsheet provided by Motorola in response to an RFI from the CMA [✂].

[14] IRR Model slide deck and accompanying spreadsheet.

[15] Response on behalf of Motorola Solutions, Inc., Motorola Solutions UK Limited and Airwave Solutions Limited to Notice 5 of the Competition and Markets Authority's Request for Information dated 7 September 2021

[16] IRR Model, 30 August 2021.

As these adjustments are present in the data presented by the CMA, the CMA is, moreover, fully aware of these explanations.

(46) For the reasons set out above, Motorola also fundamentally disagrees with the approach taken by the CMA to the calculation of the opening value of assets for the second sub-period. The VTB of the Airwave assets on a MEA valuation is simply not the difference between the sum of capital expenditure up to 2019 (at historic cost) and the sum of accounting depreciation (driven by assumptions about the economic life of assets that were affected by an anticipated end date of 2019). This means that none of the CMA's results carry any credibility and cannot be used as an indication of excessive profitability or used to establish the presence (let alone the size) of any detriment.[17]

(47) As regards the closing value of assets, Motorola is currently preparing a detailed response to this question as part of its reply to the CMA's request for financial information. On a preliminary basis, Motorola considers that the main source of residual value lies in the tower infrastructure and will provide more detail in its RFI response.

5. Conclusions

(48) In summary, Motorola considers that the assessment of Airwave's profitability will at best provide an insight into the contractual performance rather than any indication of an AEC in a properly defined market. At the core, this flows from the fact that the CMA is examining the provision of services within a contract rather than competition for the market, as explained in more detail in Motorola's response to the Issues Statement.

(49) Given Airwave's nature as a project company, which was created to deliver the original PFI contract and whose economic life will come to an end when the Airwave service is no longer required, any economic assessment will need to be carried out over the entire life of the project. On this basis, it is clear that actual returns remain substantially below the hurdle rate agreed between the parties, even with Airwave extended out to 2026 at agreed service rates.

(50) There is no justification for a truncated analysis of sub-periods, which in any case is extremely sensitive to the closing value of assets at the end of a sub-period, which is also the opening value of assets for the following sub-period (with the impact being greater the shorter the sub-period). In this regard, the CMA's preliminary findings of extremely high returns earned over a purported 'extension period' are an artefact of the presumed opening value of assets, which does not reflect VTB. To the extent that any weight could be given to such a truncated analysis (which Motorola strongly rejects), a more realistic valuation of Airwave's assets at the alleged cross-over point from the 'initial contract period' to the 'extension period' is bound to produce results that are more reflective of the returns earned by Airwave overall rather than an artificially inflated rate of return driven by the under-valuation of assets.

[17] As an aside, Motorola notes that the NPVs of discounted cash flows provided by the CMA in paragraph 92 for the 'PFI period' and paragraphs 93 and 94 for the 'extension period' are not comparable as the first number is in 2001 terms and the other numbers are in 2019 terms.