Mobile Radio Network Services Market Investigation

Reimagining the Well-Functioning Market: the CMA's construction of a market that never existed

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(1) The CMA's analysis is driven by what, in its view, one might expect to happen in a 'well-functioning market', but without considering what such a well-functioning market would be in this particular instance. The CMA's starting point for looking at the workings of a competitive market is a model of free entry, referencing the Byatt report[1], which says:

> "In measuring the continuing costs of supply the relevant prices are those that would be paid for resources purchased now in the normal course of business in competitive markets. Such competitive market conditions may result from the actual existence of competing producers or, more generally, from the threat of competition from potential producers entering the market. Even where competitive markets do not exist, it is necessary to estimate the effects that competition would have in order to measure the value of the resources used. The assumption of free entry into a market defines the level of profit required to cover the cost of capital, since no-one will enter unless they expect to recover this cost. <u>The assumption of free entry also defines the value of existing assets to a business as equal to the amount a competitor would be prepared to pay for them in a competitive market</u>." (Emphasis added by the CMA)

(2) If we want to apply these principles, we first need to clarify what is the relevant supply. As the CMA also notes:

> "[T]he features of LMR networks – in particular, the very large, sunk costs associated with the development of such networks – are such that there is likely to be a single supplier and one or a small number of purchasers (who may group together). In this context, we would not expect to see LMR networks being developed speculatively but rather we would expect to see the main purchaser(s) effectively commissioning a supplier to develop and operate a network and, in return, the purchaser would provide a high-level of security to the supplier in terms of demand / remuneration for the services provided. Indeed, this was the case with the Airwave network where PITO signed a long-term agreement with Airwave for the provision of services, under which revenues were largely guaranteed."

(3) At issue here is the supply of services over what the CMA terms the 'extension period', i.e., the period of 2020-2026. There was however never the 'extension period' that has been constructed by the CMA to be assessed in terms of its functioning (or otherwise) as a 'market':

(i) there could not, for the reasons set out by the CMA, be a supply of LMR services over whatever extension period one considers, without the Home Office contracting for it; even in a free entry scenario, this would have involved inviting bids for such an extension period as LMR networks would not be developed speculatively;

(ii) the parties did not contract, or even ever discuss contracting, for an 'extension period' of 2020-2026;

(iii) the parties instead contracted for, and agreed, that Airwave would be provided as long as the Home Office needed it.

[1] Accounting for economic costs and changing prices: a report to HM Treasury, 1986. The Byatt Report.

Thus, the difference between what was contracted for at the time and what the CMA would like to pretend had been contracted for was not due to the 'market' not working well: it was simply not the service that the Home Office was seeking.

(4) It is nonsense to pretend that in a 'well-functioning market' the Home Office would have invited bids for a 2020-2026 Airwave service period: by 2016, the Home Office had procured ESN, which was expected to start functioning by 2019. There was therefore nothing irrational about the Airwave contract extension sought by the Home Office: it was a perfectly sensible contractual choice for the Home Office to seek to 'keep the lights on' with Airwave on an as-needed basis when the delay to ESN was unknown but might have been relatively short.

(5) For these reasons, the well-functioning market would not have, and therefore did not, seek bids for a 2020-2026 'extension period'. Indeed, in 2018, i.e., two years before the fictitious 'extension period' Motorola offered the Home Office [✂] that, had the Home Office chosen to take it, would have yielded [✂] for the Home Office to the end of 2026/7. **The Home Office therefore had options and this is precisely what a well-functioning market looks like.** The fact the Home Office chose the 'pay as you go' option which with hindsight turned out to have been the more expensive option reflects the uncertain nature of contracting and nothing more.

(6) It might be that the CMA's views are inspired by the provisions in the Public Contracts Regulations 2015 according to which "the underlying assumption is that such a contract would be competed at the end of the term, unless exemptions applied. (ie not simply extended as a matter of course)."[2] However, this ignores that as a result of the 2016 negotiations, the 'end of the term' was perpetual, i.e., there was neither a requirement for nor the possibility of competition without any further change of terms. Only now that the Home Office has sent a National Shutdown Notice has the term become fixed at 31 December 2026, which implies that the next point where competition may be required, or becomes possible, is 31 December 2026.

(7) It would be a gross misuse of the CMA's market investigation powers to construct a historic fictitious bidding market that for good reason never happened and then seek to penalise a company that simply complies with the terms of the contract extension that had been agreed instead. As it is, the CMA is essentially seeking to make Motorola pay for the delay to ESN being much longer than the Home Office had expected, since but for the failure to deliver ESN Airwave would already have been switched off.

(8) Indeed, the only 'market' that might not have been functioning well is the ESMCP, which the CMA has refused to investigate properly despite many requests by Motorola since the outset of this market investigation. This is even more extraordinary given that the CMA now defines the relevant market for the market investigation as including both Airwave and ESN. That is not a balanced market investigation, with the CMA limiting itself to only a highly superficial treatment of Motorola's 'dual role'. All of this is quite aside from the CMA's failure to address the Home Office's own dual role as purchaser.

(9) **The CMA's profitability analysis is therefore bound to fail, since it is premised on a model of a contractual arrangement that was never bargained for, and never would have been.**

[2] Paragraph 17 (f) of the Profitability Working Paper.

(10) In other words: competition for the market as defined by the CMA took place with the Home Office's decision to procure ESN, and Airwave simply provided the fallback solution to cover against the risk of delays. Although in theory that fallback service could have been procured, at this point, the thought experiment has lost all contact with reality: given the high demands of running the Airwave service no outside company would seek to come in and provide the highly demanding Airwave service - with all its legacy technology issues that would inevitably come out in due diligence - on a 'pay as you go' basis (bearing in mind that the Airwave network services can be [✄]) without receiving a significant risk premium.

(11) In reality, therefore, by the nature of the services, this fallback solution would not be provided by anyone other than the established network. The continued provision of services by Airwave is, as Motorola has repeatedly emphasised, simply a function of a contract that was entered into in 1999 and has since been adjusted to meet the Home Office's need for a flexible backstop solution to cover the case of ESN delays.

(12) It would have been completely inappropriate for economic and political reasons and irrational for the Home Office to tender for the continued provision of Airwave services for such an extended period of time. Having commissioned a replacement network only months before, there would have been no need for such services as soon as ESN became available.

(13) Nonetheless, if one wanted to entertain the fiction of what a well-functioning market for such a back-up service would have looked like, one would need to imagine a tender in which Airwave and anyone else who might be interested were invited to bid for the provision of an Airwave-like service for an unspecified number of years, [✄].

(14) Any bidder who would have won such a hypothetical tender would have had to make the investments set out in the Analysys Mason report and would have had to earn sufficient revenues to earn a reasonable return on such investment. Thus, the 'competitive price' for services over the extension period in a well-functioning market is defined by the revenues that such a bidder would have to be guaranteed. As the work undertaken by Analysys Mason demonstrates, even for an extension period of seven years such a bidder would have required a similar level of revenues to those agreed between the Home Office and Airwave. The idea that such an investment would ever have been undertaken for a shorter period on terms more favourable than were in fact agreed can reasonably be discarded as fantasy.

(15) Entirely in line with the last statement in the quote from the Byatt report, highlighted by the CMA, the MEA analysis undertaken by Analysys Mason would also define the value of Airwave's assets. Instead of making the investment in network infrastructure set out in the Analysys Mason work, any prospective bidder could also have reviewed Airwave's existing network assets. Of course, the willingness to pay for these assets would not be the same as the MEA value established by Analysys Mason, as the purchaser would not get a completely new network that required no further investment, but one that needed considerable maintenance capital expenditure to provide the services required over an unspecified period.

(16) Therefore, the amount that a competitor would be prepared to pay would be equal to the saved investment into a new network minus the additional capital expenditure that would be required to maintain the ageing infrastructure. The net effect would, however, be the same: the same level of revenues - determined through competition for the provision of Airwave-like services over the so-called extension period - would be required.

(17) As Motorola has recently explained[3], the probability-weighted average of the IRRs for the scenarios modelled by Motorola ***at the time of the acquisition*** is [✄]%. Using an alternative approach in which the IRR is calculated using probability-weighted average cash flows (which gives more weight to total returns that are larger in absolute terms) yields an IRR of [✄]**%**. To ground these anticipated investment returns relative to the vast uncertainties of operating an ageing mission-critical telecommunications network, in a 2014 land development project the UK Government indicated that bidders should target investment returns at 15-18% IRR.[4]

(18) Neither of Motorola's probability-weighted IRRs remotely justify intervention to rewrite the last years of a long-term contract. It would be biased, or at least give the appearance of bias, in the context of a market investigation to pretend that the Home Office had made an entirely different contractual choice six years ago, not least when the Home Office was specifically offered (in 2018) significant discounts in return for providing greater certainty to Airwave about the term over which services would be required.[5]

[3] Motorola's Third Supplementary Submission to the CMA's Oral Hearing on 10 February 2022.
[4] See Motorola's 18 August 2021 Submission, paragraph 44.
[5] See Motorola's First Supplementary Submission to the CMA's Oral Hearing on 10 February 2022.