Home Office

Remedies: Charge control and transparency

Introduction

1. Further to the Home Office's Submission and response to the CMA's working papers, this submission provides a further response to the charge control and financial transparency sections of the CMA's Potential Remedies working paper.[1] In doing so, the Home Office has used the CMA's Questions for consultation to structure its response.[2]

Charge control as an effective remedy

CMA: Our current view that if we find an AEC on the basis of Airwave Solutions having unilateral market power then a charge control remedy (ie limiting the prices Airwave Solutions is allowed to charge its customers) would be an effective remedy to mitigate the risks of any (pricing) harm to customers.

2. The Home Office agrees with the CMA that a charge control remedy would provide an effective remedy to control the current pricing harm to customers and to mitigate the risks of pricing harm until the Airwave network is replaced. The CMA's preliminary profitability modelling provides evidence that Airwave Solutions is currently able to exploit its position of market power and to earn super-normal returns.[3]

3. As previously submitted[4], the Home Office considers that there are market features that give rise to adverse effects on competition (AECs), in line with those provisionally identified by the CMA in its Issues Statement[5], that arise from Motorola's unilateral market power in the provision of the Airwave services and its dual role in the provision of the Airwave services and the development and delivery of ESN. Consequently, a range of remedies are required to effectively address these features; in particular the excessive pricing of Airwave services,

[1] See paragraphs 3, 215 and 221 of Home Office (2022), 'Confidential: Mobile Radio Network Services Market Investigation. The Home Office's Submission and response to the CMA's working papers: (1) Profitability modelling and results; (2) Cost of Capital; (3) Issues relating to benchmarking; (4) Approach to Assessing Motorola's Dual Role, (5) Airwave Network Contracts; (6) The role of the 2016 change control negotiations; (7) Scope for Competition and Market Definition; (8) Potential Remedies; and (9) Transfer Charges', 24 May.
[2] CMA (2022), 'LMR Network Services Market Investigation: Potential remedies', 16 May, paragraph 84.
[3] Ibid, paragraph 24.
[4] Home Office (2022), 'The Home Office's Response submission to the CMA's Issues Statement', 10 January.
[5] CMA (2021), 'Mobile radio network for the police and emergency services: Issues Statement', 13 December 2021.

information asymmetry and the lack of incentive for Motorola to deliver its ESN obligations (or, alternatively, the lack of effective interworking for other third party MCPTT[6] service providers due to the existing Motorola proprietary interworking interface).

4. In particular, the Home Office submits that an effective price control remedy and accompanying transparency obligations are imperative if the excessive charges are to be reduced for the existing Airwave service to the competitive level, thereby reducing the harm caused to the consumers of emergency services communications and, in turn, UK citizens and taxpayers.

5. The question then concerns the appropriate regulatory design to ensure that the remedy is effective and proportionate. The following questions raised by the CMA are discussed below:

- the services that such a charge control should apply to;
- whether only charges should be regulated or whether service quality incentives should also be introduced;
- how such a control is calibrated;
- the form of the charge control; and
- its duration and arrangements for review.

To which services a charge control should apply

CMA: Our current thinking is that a charge control should cover all Airwave Solutions business activities with the exception of Ambulance Bundle 2 services, PRONTO and CCCRS, and radio terminals except where provided as part of a managed services contract. However, we invite interested parties to make submissions as to whether the scope of services set out above for inclusion in a charge control is appropriate or whether other services should be included or excluded, respectively.

6. The Home Office agrees with the CMA's assessment that the charge control remedy should apply to those services in which Airwave is likely to have and be able to exploit market power, and that services subject to a reasonably effective competitive constraint may be excluded.[7]

7. The Home Office agrees that the charge control need not apply to: (i) PRONTO, given the nature of the product, and (ii) radio terminals, given the extent of competition, for example, with Sepura Limited (a supplier of TETRA handsets), except where handsets are provided as part of a managed service. For CCCRS, the services that are provided—unlike PRONTO—are much more closely

[6] Mission-critical push to talk.
[7] CMA (2022), 'LMR Network Services Market Investigation: Potential remedies', 16 May, paragraph 30.

connected to the provision of the Airwave services and, as such, the Home Office would ask the CMA to reconsider whether these services should be included in the charge control.[8] The Home Office considers the Ambulance Bundle 2 contract is a matter for the Department for Health & Social Care to comment on.[9]

8. In addition, the Home Office considers that the charge control should apply to the interworking services.[10] Motorola's ownership of Airwave Solutions provides it with market power in terms of the delivery of interworking services in the same way as it provides it with market power in terms of the delivery of the original core services of the PFI agreement—nobody else has control and direct access to the Airwave infrastructure and, therefore, nobody else can provide interworking services, a service which is therefore vital where transition involves a third-party MCPTT application.

9. Irrespective of the exact services to which the CMA ultimately decides to apply a charge control, the services excluded from the charge control are likely to share common costs and assets with the core services included in the control. This will need to be taken into account in the transparency requirements and in applying the charge control (in terms of setting an appropriate method of cost allocation and the proportion of common costs allocated to the included services).

Service quality measures

CMA: Our current thinking is that – aside from in relation to transparency issues and potentially interworking services – any charge control arrangements that may be introduced should focus only on charge levels, and that we should treat the specification of service requirements, and provisions in relation to service quality, as addressed adequately through existing contractual provisions.

10. As noted by the CMA, the existing contractual provisions between the Home Office and Airwave Solutions have not led to significant concerns regarding service quality to date.[11] It is likely that these provisions—service level objectives (SLOs) with the service level agreement (SLA)—will be sufficient going forward, albeit potentially with some modifications. As such, it is unlikely that service level requirements will need to be regulated within the charge control (unless at some future point there was a significant deterioration in service and for which the control may need to be reopened).

[8] The Home Office is additionally concerned that Motorola may have the incentive to unfairly use its position and supplier relationship, as provider of CCCRS and handsets, to unfairly encourage Airwave user organisations to delay their transition to ESN, or otherwise cause delay to transition, by, for example, delaying upgrades to control rooms or discounting Airwave handsets.

[9] It is assumed by the Home Office that the CMA proposes to exclude only the Ambulance Bundle 2 contract from the charge control, and that the charge control would apply to the Ambulance Bundle 1 contract.

[10] CMA (2022), 'LMR Network Services Market Investigation: Potential remedies', 16 May, paragraph 34.

[11] Ibid, paragraph 36. Please note that this is the case for the delivery of the Airwave service only, not delivery of ESN.

11. Notwithstanding this, within the reporting requirements there will need to be greater transparency around service performance and capital expenditure (see transparency—below). In addition, any form of charge control should avoid the risk of Airwave Solutions resting on its laurels and failing to ensure good stewardship of its assets (by cutting maintenance and renewals, which could store up future problems—see form of control, below).

Calibration of the charge control

CMA: Our current thinking that a charge control would need to be calibrated on the basis of an assessment of Airwave's costs associated with the provision of the relevant LMR and ancillary services, and of how those costs might evolve over time.

12. The Home Office agrees with the CMA's view that setting Airwave charges by reference to market evidence of charges for similar services would not provide a feasible or reliable basis for setting a charge control—due to the absence of like-for-like comparators and the limited extent to which information needed to make such an assessment is available.[12]

13. The Home Office agrees with the CMA that a charge control would instead need to be calibrated on the basis of an assessment of Airwave's reasonable costs associated with the provision of the relevant LMR and ancillary services, and of how those costs might evolve over time. This would include the following inputs:[13]

- Operating expenditure (OPEX) requirements;
- Capital expenditure (CAPEX) requirements;
- An appropriate opening capital value;
- An appropriate approach to allowing for depreciation (and residual asset values); and
- An appropriate return on capital.

14. The revenue allowance for each year would then be the sum of OPEX, depreciation, and a return on capital.[14] Issues considered in other working papers would feed into this assessment.[15] The Home Office also would note:

[12] CMA (2022), 'LMR Network Services Market Investigation: Potential remedies', 16 May, paragraph 39; Also, paragraph 82 of Home Office (2022), 'Confidential: Mobile Radio Network Services Market Investigation. The Home Office's Submission and response to the CMA's working papers: (1) Profitability modelling and results; (2) Cost of Capital; (3) Issues relating to benchmarking; (4) Approach to Assessing Motorola's Dual Role, (5) Airwave Network Contracts; (6) The role of the 2016 change control negotiations; (7) Scope for Competition and Market Definition; (8) Potential Remedies; and (9) Transfer Charges', 24 May.
[13] CMA (2022), 'LMR Network Services Market Investigation: Potential remedies', 16 May, paragraph 40.
[14] Ibid, paragraph 41.
[15] Ibid, paragraph 42.

- This approach is standard in assessing forward-looking ex ante charge caps—the 'RAB/WACC building block' charge control (referred to by the CMA in its Issues Statement as a 'bottom up' price control[16]). This model has been adopted in Great Britain for the regulation of telecoms, energy and water networks.

- The approach is also relevant to cost of service approaches to regulation—in assessing allowed returns, current and future expenditure needs, and in assessing ex post (once charges are set and costs are incurred) whether in each year charges are sufficient to cover outturn costs while allowing for a target rate of return.

15. The precise form of control, and charge cap versus cost of service regulation, is discussed below.

The form of charge control

CMA: [We invite interested parties to provide their views on] the advantages and disadvantages (including those highlighted above) of:

- *Adopting a charge cap approach;*
- *Adopting a cost of service (or rate of return) approach;*
- *Using cost sharing incentives, and the use of different cost sharing incentive rates;*
- *Applying a different approach to OPEX and CAPEX allowances, and in particular, setting a fixed OPEX allowance while applying a cost of service or cost sharing approach to CAPEX; and*
- *Including conditions on the eligibility of costs for recovery through charges (as a means of guarding against the risk of inefficient capex levels).*

[We invite interested parties to provide their views on] whether a charge control should determine charging outcomes or act as a backstop.

16. The Home Office welcomes the CMA's discussion of charge control options. This highlights key features of different regulatory options and their advantages and disadvantages.

17. The Home Office submits that there are three ultimate objectives in designing such a control:

    - Airwave charges—to reduce Airwave charges (reduce profitability, encourage OPEX efficiency, encourage prudent CAPEX);

[16] CMA (2021), 'Mobile radio network for the police and emergency services: Issues Statement', 13 December 2021, paragraph 67(a).

- Airwave service—to ensure delivery of what is an essential service for the remainder of its life (in particular through ongoing CAPEX); and

- ESN delivery—if possible, to encourage the transition to ESN (a cheaper alternative with greater functionality and better service).

18. The Home Office also notes that any form of charges regulation should take into account the specific context in which the control will be applied. In this regard, the CMA draws attention to two particular challenges that the CMA has identified in applying a charge control to Airwave:[17]

    - Uncertainty over the impact that obsolescence and reliability issues might have on future CAPEX requirements; and

    - Uncertainty over how long the Airwave network may need to remain operational (including whether equipment post-shutdown will have a residual value).

19. As a starting point the CMA draws a contrast between two forms of regulation:[18]

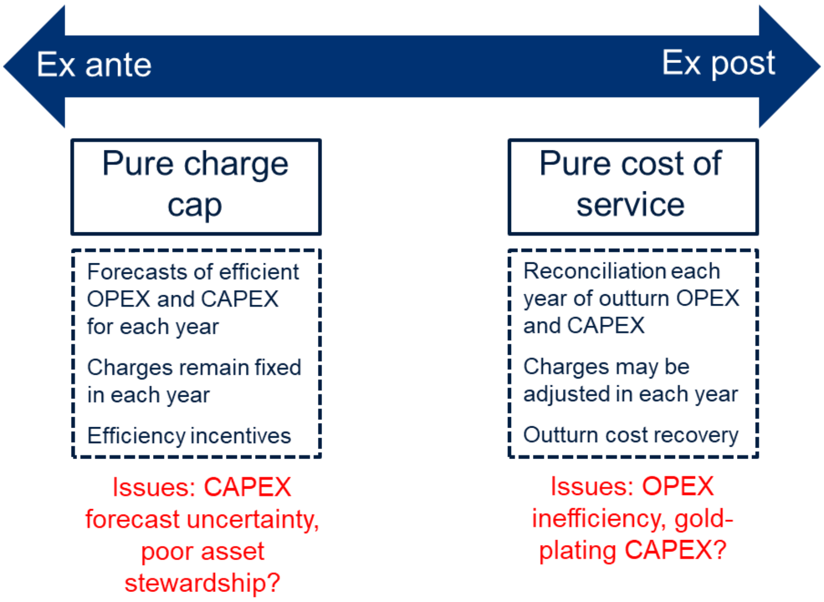
    - A charge cap approach—in which prices or revenues are set out in advance for a given period, whereby Airwave Solutions bears outturn cost out- or under-performance risk; and

    - A cost of service approach—in which indicative charges are set, but outturn charges will depend on outturn costs (as opposed to up-front assessments).

20. These two extremes are presented in Figure 1 below. The pure charge cap, on the left-hand side, is an ex ante approach. As the CMA notes, this has desirable cost efficiency incentive properties while requiring limited ongoing administration once charges have been set.[19]

[17] CMA (2022), 'LMR Network Services Market Investigation: Potential remedies', 16 May, paragraph 43.
[18] Ibid, paragraph 49.
[19] Ibid, paragraph 50.

Figure 1 Charge caps versus cost of service regulation



21. The charge cap approach is transparent and, once charges have been set, is lighter touch than cost of service regulation. However, and as raised by the CMA, the charge cap approach does require a reliable assessment of future costs (including future CAPEX). The CMA is concerned that uncertainty regarding future CAPEX may lead to a CAPEX allowance that is set too high—meaning higher charges than otherwise.[20]

22. An alternative form of regulation considered by the CMA is the cost of service approach (on the right-hand side of Figure 1). Here, outturn costs are passed through to charges—for example, based on annual regulatory reviews of Airwave profitability. As noted by the CMA, a downside of this approach is that this risks inefficiency and of gold-plating the assets.[21, 22]

23. As such, the CMA considers alternatives to a pure charge cap and pure cost of service approach. Before discussing these, however, the Home Office notes three further considerations.

24. First, given that the preliminary profitability analysis identifies the actual Airwave returns to be above the competitive level, either form of control would from the outset reduce Airwave charges significantly (eliminating monopoly profits, and bringing charges down in line with a competitive level). Therefore, either form of charge control discussed above would satisfy the first objective discussed in paragraph 17, above—that the charge control should reduce Airwave charges.

25. Given this reduction, the question then emerges of the funding and incentives for Airwave to fulfil the second objective—to sustain what is an essential service for

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[20] Ibid, paragraph 51.
[21] Ibid, paragraph 54.
[22] For example, through Airwave buying in unnecessary services from Motorola or prematurely purchasing replacement equipment from Motorola, in order to maximise Motorola group returns

the remainder of its life. Under the charge cap approach, Airwave Solutions will have powerful incentives to reduce its costs in order to increase profitability. However, there is a difference between reducing costs through genuine efficiencies, and reducing costs through:

- Cutting service levels, which may have an immediate adverse impact on performance and quality; and/or
- poor stewardship of the assets, which may not have an immediate impact but could lead to service failures in future.

26. Service standards are specified in the Airwave contract (as discussed in paragraph 10 above) and may deal with the first issue adequately. However, the second issue is more complicated to deal with. Under the current contractual approach (which has upfront pre-determined charges[23]), Motorola has historically made significant CAPEX underspend.[24] Under a new charge cap, which would significantly reduce Airwave charges, there may be even greater incentive for Motorola to underspend on assets. Additional protections would therefore be required to ensure that the remainder of the Airwave capital programme is carried out (such as through CAPEX monitoring).[25] The issue that asset condition improvements may need to be pre-specified is also raised by the CMA.[26]

27. This potential for poor stewardship may actually be a greater concern than that of CAPEX forecasting uncertainty (see paragraph 18, above):

- poor stewardship—Motorola is the manufacturer of a significant proportion of the Airwave equipment. Under an ex ante approach, the company might seek to delay the replacement of failing or end of serviceable life equipment as much as possible, whereas under an ex post approach it would (as the equipment manufacturer) wish to replace the assets, to generate further future earnings.
- forecasting uncertainty—The main CAPEX items going forward relate to ensuring ongoing service beyond the retirement of the BT MegaStream services (which have a hard stop in 2025). Airwave have commenced the planning, surveys and discussions with suppliers for the work to be undertaken in the period to 2026, and so should have a better view of the costs compared to what they provided during discussions with the Home Office in 2021. There does however remain uncertainty around if and when certain investments would be required (e.g. possible TFL London Underground system change costs).

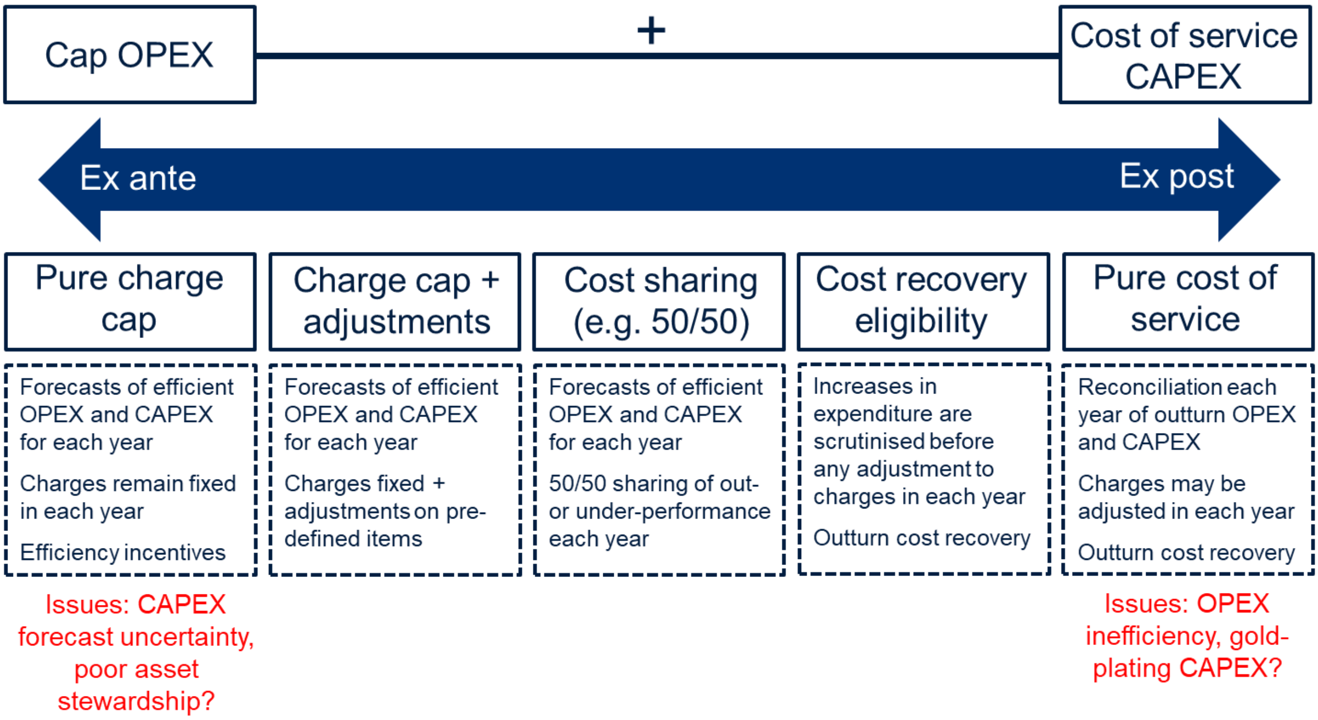
28. Third, under either a charge cap or cost of service form of control, the reduction in charges mentioned above provides greater incentive for migration than under

[23] Ibid, paragraph 50.
[24] See paragraph 46 below.
[25] See paragraphs 54 and 56 below.
[26] Albeit in the CMA's discussion of a cost sharing approach. See: CMA (2022), 'LMR Network Services Market Investigation: Potential remedies', 16 May, paragraph 58.

the status quo. That said, the Home Office considers it is unlikely that any charge control would be able to sufficiently reduce the Airwave charges to such a level as to remove all incentives for Motorola to delay ESN.

29. The CMA considers a variety of alternatives that fall on the spectrum between charge cap and cost of service regulation. Figure 2 below shows those alternatives (plus an additional 'Charge cap + adjustments' option that the Home Office proposes for consideration).

Figure 2 Alternative charge control models



30. Cost sharing is one option discussed by the CMA, and is presented in the middle of Figure 2. Here, the charges are fixed up-front as in the pure charge cap. However, out- or under-performance on costs against charge control assumptions is shared (for example) 50/50 between Airwave Solutions and the Home Office.[27]

31. Cost sharing provides some protection to Airwave Solutions given cost uncertainty, while also providing some efficiency incentives. However, in the Home Office's view this provides inadequate disincentives to engage in poor asset stewardship, similar to the pure charge cap.

32. Indeed, the CMA notes that under the cost sharing approach the asset condition requirements associated with the CAPEX forecasts may first need to be set out. The CMA notes that this may not be too an important issue if shutdown occurs

[27] See: CMA (2022), 'LMR Network Services Market Investigation: Potential remedies', 16 May, paragraph 56.

in 2026 but could be an issue if the service was to be provided beyond 2026—since CAPEX needs after that point will be affected by earlier capital spending decisions.[28] In effect, if the outturn CAPEX before 2026 is too low, and the service needs to remain operational beyond this point, this could necessitate an increase in CAPEX.

33. An alternative approach to cost sharing set out by the CMA is one in which a charge cap is applied to OPEX (where there is greater certainty of future costs) and a cost of service approach is adopted for CAPEX (where there is less certainty).[29] This is illustrated at the top of Figure 2. While on paper this may look attractive, the Home Office shares the CMA's concerns as to the possible undesirable incentives this could generate in relation to cost categorisation (as OPEX or CAPEX) and cost decisions (being potentially biased towards CAPEX solutions).[30]

34. The Home Office instead favours the third option considered by the CMA—cost of service regulation with conditions on which costs are eligible to be recovered. The CMA notes that this type of charge control would include a requirement for engagement by Airwave with the Home Office on material changes to CAPEX plans, plus a guard against allowing inefficient or wasteful expenditure to be recovered.[31]

35. Arguably, such an option is less automatic than a 50/50 cost sharing mechanism, and would generate a higher administrative burden each year. As with all of the options, it relies on being accompanied by transparency requirements around cost reporting, assurance and transfer charges (see below), in order for the regulator to undertake the assessment. However, this option offers the benefit (as is offered across all options) of an initial charges reduction, does not provide Airwave Solutions with an incentive for poor stewardship, provides some control over cost escalation, allows Airwave Solutions to recover its costs (subject to the assessment of prudence) ex post, and importantly, from the Home Office's perspective it is the least risky in terms of continuity of supply and quality of service, balancing value for money.

36. As such, this 'cost recovery eligibility' option is the option currently preferred by the Home Office, although such measure would necessarily need to include a mechanism for resolving disputes.

37. An alternative to this option could be to implement a charge cap but with 'specified adjustment provisions' for specific types of scheme, such as:

- CAPEX reopeners—cost allowances for schemes that are uncertain as to whether they will be needed and/or where cost outturns are beyond the control of Airwave Solutions may be excluded from the charge cap. Where such schemes are then subsequently required (or where the costs become

[28] Ibid, paragraph 59.
[29] Ibid, paragraph 61.
[30] It is noted that the CMA also mentions a split OPEX/CAPEX approach in which CAPEX is subject to cost sharing. See Ibid, paragraph 84.
[31] Ibid, paragraph 63.

known), and where there is a material impact on Airwave Solutions' revenues, there would be scope to re-open the charge control to accommodate the costs.

- charge control deliverables—in respect of large discrete renewals projects, CAPEX monitoring in each year would determine whether revenues stay along the determined profile or whether adjustments would be made, e.g. reflecting any potential delays in capital programmes that are not reflective of genuine efficiencies. This approach would ensure that the remaining Airwave capital schemes are delivered and delivered to schedule.

38. This option shares some similarities to the 'cost recovery eligibility' approach.

39. The CMA discusses the potential for a charge control to be a default (backstop) option, but with flexibility for the Home Office and Airwave Solutions to agree alternative arrangements. The charge control would then only apply if no such alternative arrangements have been agreed.[32] However, the Home Office is of the view that the negotiation process would still be affected by asymmetric bargaining power in Motorola's favour given its monopoly position. As such, the Home Office is not in favour of the backstop approach. Instead the charge control should be introduced in the first instance.

Duration and review

CMA: [We invite interested parties to provide their views on] the duration of a charge control and review arrangements.

40. The Home Office agrees that the charge control provisions could be re-opened in 2026, in the event that Airwave services continue beyond this point. As noted by the CMA, the CMA might undertake this review or this might be transferred to another regulatory body.[33, 34] Advance notice, for example of one year, would assist Airwave in adjusting its CAPEX programme to keep the network operational beyond 2026.

41. It is difficult to say at this stage how the approach might be modified in 2026, but this review should (as the CMA suggests) consider a narrow range of issues (such as past expenditure reconciliations, rolling forward of the asset base, updated forecasts of OPEX, CAPEX, residual value, as well as an updated view on the appropriate rate of return).

42. There are also two further issues to be considered: (i) Recoupment of excess historical profits; and (ii) the treatment of residual value.

    i. As the Home Office expects the CMA to find that Airwave's charges have been excessive, the Home Office considers that at the point of any review of the charge control there should be a reconciliation regarding excess profits in the public interest, given that the charges have been

[32] Ibid, paragraph 66.
[33] Ibid, paragraph 72.
[34] The Home Office intends to make further submissions on this point.

funded by the public purse. At the very least, this should cover the period from 1 January 2020 onwards, i.e. the period beyond the initial 20-year term of the PFI agreement when Motorola continued to provide Airwave services at the same charges during the extended period, even though its investment in assets had been fully recovered and amortised. As a result, the internal rate of return (IRR) of the cash flows to Airwave from 2020 until the expected end of Airwave's operations should be aligned with the weighted average cost of capital (WACC).[35]

ii. Upon switch off, once migration is complete, the Airwave assets will have a terminal (residual) value. This redeployment value would stay with Airwave Solutions, as the owner of the assets, and it would be up to Airwave Solutions to realise the value (i.e. re-use or sell the assets). For the design purposes, the value should be assumed as a positive cash flow to Airwave Solutions when checking that the IRR is equal to WACC. In terms of the decommissioning costs, the key principle is that the Home Office should not pay twice for them. Since decommissioning was expected to be required at the end of the original PFI agreement, the Home Office considers that the corresponding costs have been paid for, unless Motorola provides evidence showing that the estimate has increased because of the extension of the agreement.

Transparency remedies

CMA: Our current thinking that information transparency remedies – when viewed on a stand-alone basis – would not provide an effective means of addressing the adverse effects of an AEC

43. The Home Office agrees with the CMA that informational remedies alone are insufficient to address an AEC, were it to be found, and that a charge control is needed.[36] As submitted in the Home Office's response to the Issues Statement, transparency remedies may only go so far; where a company has unilateral market power and is earning excessive profits, as is likely to be the case with Motorola, there is a need for additional measures. The charge control is one such measure.

44. However, better transparency will assist in implementing the charge control. As noted in the Home Office's response to the Issues Statement, one of the reasons for Motorola's unilateral market power in renegotiations with the Home Office thus far is the asymmetry and lack of information available to the Home Office as to the costs of operating and maintaining the Airwave network.[37]

[35] Different WACC estimates could be used for the period before and after the start of the charge control – e.g. WACC as of 2018 negotiations to assess the period from 2020 until the start of the charge control and WACC based on the latest market data for the period after the start of the charge control.
[36] CMA (2022), 'LMR Network Services Market Investigation: Potential remedies', 16 May, paragraph 78.
[37] See Home Office (2022), 'The Home Office's Response submission to the CMA's Issues Statement', 10 January, paragraphs 11(e), 24(c) and 47.

45. Currently, the Home Office has access to little more information than can be obtained from Airwave's statutory accounts. The Home Office therefore does not have the means to effectively challenge Motorola as to whether it is running its operations efficiently, nor whether the costs being recovered truly relate to the operation of the Airwave network. Therefore, the Home Office is unable to determine whether the Airwave network is providing value for money for the UK taxpayer whilst allowing a reasonable margin for Motorola.[38]

46. For example, as explained to the CMA previously, from Airwave Solutions' statutory accounts it is difficult to assess why administrative expenses and headcount increased between 2018 and 2019.[39] It is also unclear as to why Motorola's investment over the period 2018-20 was one third lower than that forecast in 2018.[40]

47. In addition, there is a lack of transparency regarding the charges made by the parent (Motorola) to the Airwave Solutions subsidiary for various inputs (services and goods—including directors' payments, intellectual property licensing, hardware and support). This lack of transparency is a cause for concern for the Home Office as there is a high risk that, as a result of an inherent conflict of interest, Airwave Solutions may be overpaying for these inputs—which, to the best of the Home Office's knowledge, are not negotiated at arms' length, market-tested or price benchmarked. In turn, as the CMA notes in its profitability methodology working paper,[41] any such inefficient input costs may artificially understate Airwave Solutions' reported profitability (with excess profits effectively being disregarded yet paid to the parent business). This outcome is made possible due to the unilateral market power of Motorola and its dual conflicting roles, coupled with the lack of transparency and risk of effective challenge. The Home Office (albeit not being able to review the details) welcomes the CMA's assessment of the transfer charges.

48. Transparency ('open book') requirements, in terms of Airwave Solutions' accounting and reporting, would have a variety of benefits, including:

- addressing the asymmetry of information between Motorola and the Home Office, which currently prevents the Home Office from challenging the exercise of Motorola's market power in negotiations;
- ensuring that cost allocation between the parent company and Airwave Solutions is reflective of the cost drivers, and that intercompany transactions between the parent company and Airwave Solutions are set at the competitive level without any unfair or hidden advantage;
- measuring Motorola's profitability, in terms of whether this is commensurate with a competitive market return;

[38] Ibid, paragraph 47.
[39] Home Office (2022), 'Home Office's response submission to the CMA's Profitability methodology working paper', paragraph 35.
[40] Ibid, paragraph 34.
[41] CMA (2021), 'Land mobile radio network services. Profitability methodology approach', 13 December, paragraphs 51–52.

- monitoring CAPEX variation on Airwave Solutions against forecast, and challenging OPEX escalation of Airwave costs; and
- supporting the construction of and reporting against a potential charge control.

49. There are various transparency precedents imposed by regulators in other sectors, including those required by Ofcom, Ofwat and Ofgem. Such measures include requiring companies to submit returns consistent with Regulatory Accounting Guidelines (or Regulatory Accounting Principles) and other specific reporting requirements. While there is generally an annual reporting cycle that regulated companies need to adhere to, regulatory bodies can require more frequent reporting when concerns arise in specific areas (e.g. service interruptions).[42]

50. Any transparency requirements should be effective and proportionate. The scope and amount of reporting required will also depend on the nature of the charge control introduced alongside the measure.

51. Ofcom, in regulating wholesale product markets in which BT has significant market power (SMP), continues to apply transparency remedies even when, over time, it has withdrawn charge controls for the affected products (such as in the Wholesale Broadband Access market).[43]

52. As part of its transparency requirements, BT has an obligation in each year to prepare and publish regulatory financial statements.[44] The financial reporting requirements are specified by Ofcom for various activities and markets.[45] The full requirements placed on BT by Ofcom are far reaching and may be disproportionate in the case of Airwave Solutions, given the difference in the scale of operations.

53. The Home Office is of the view that any transparency remedy in the current instance should be focussed on key issues of interest. Nonetheless, regarding the issue of proportionality, the value of the Airwave contract is such that the financial cost of any transparency and charge control remedy (paid for by Airwave Solutions through potential regulatory fees and in turn by the Home

[42] For example, Ofgem requires National Grid Electricity System Operator (NGESO) to undertake six-monthly incentive scheme value for money reporting. Ofgem (2022), 'RIIO-2 Electricity System Operator Price Control - Regulatory Instructions and Guidance', 14 April, paragraph 5.4.

[43] See, for example, Ofcom (2018), 'Wholesale Broadband Access Market Review 2018', Final statement, July. The justification for Ofcom's removal of price controls is that sufficient infrastructure-based competition has grown sufficiently such that competitors are no longer reliant on the service-based product concerned. Clearly the situation is different in the case of Airwave, since there is no prospect of infrastructure-based competition against the Airwave network. As such, it would be expected that the transparency remedy would be accompanied by a charge control.

[44] See, for example, BT (2021), 'Regulatory Financial Statements 2021'.

[45] See Ofcom (2019), 'BT Regulatory Financial Reporting Regulatory reporting directions covering the wholesale local access, narrowband and wholesale broadband access markets for 2018/19 and following years, March; and Ofcom (2019), 'BT Regulatory Financial Reporting Regulatory reporting directions covering the physical infrastructure and business connectivity markets from 2019/20', July.

Office and UK taxpayer) would, if appropriately constructed, be far outweighed by the financial benefits of the measure.

54. The Home Office considers that a transparency remedy placed on Motorola in relation to Airwave could operate as follows:

- A requirement for Motorola to provide information to the regulatory body and the Home Office in relation to Airwave—including provision of a business plan, its forecasts, and in reporting outturns;

- The requirement to adhere to Regulatory Accounting Guidelines/Principles, accompanied by specific reporting requirements—including cost allocation principles, treatment of overheads, reporting of profitability and the treatment of transfers between Airwave Solutions and the rest of the Motorola business, and publication requirements;

- Publication of an annual (or more frequent – e.g. quarterly) performance report—to include revenues, OPEX (split by category) including variation against forecast with commentary, CAPEX (split by category) including variation against forecast with commentary, profitability and other financial metrics (assets, debt, etc) and key service performance metrics; the reporting should provide sufficient granularity and details about applied methodologies and should specify some historical data for comparison;

- A requirement that reporting is subject to independent audit and assurance, and must provide a reconciliation back to the statutory accounts. The regulator (and Home Office) would have the right to request supporting information or more detail if there are queries on the numbers.

55. There are two ways in which Airwave Solutions, from an accounting perspective, may have artificially high costs that understate its true profitability and overstate the revenue allowances required under any potential charge control: cost allocation between the parent business and Airwave Solutions, and intercompany transactions between the parent and Airwave Solutions. As mentioned above, the principles that Airwave Solutions follows in setting those allocations and transactions need to be defined by the regulator.

- On cost allocation, guidance should be given on how central costs (e.g., CEO costs, HR costs) are to be allocated between the parent business and Airwave Solutions. The allocation of costs to business segments should be based on cost drivers and should not be assessed in proportion to segment revenues.[46] For example, HR costs should be allocated based on the number of staff in each business segment rather than the segments' revenue. No mark-up would be added to the costs when they are allocated between business segments.

- Intercompany transactions are also of particular importance. Airwave Solutions should pay charges for inputs from the parent business that reflect

[46] See Oxera (2003), 'Assessing profitability in competition policy analysis', A report prepared for the Office of Fair Trading by Oxera, Economic Discussion Paper 6, July, section 6.

what would be paid in a competitive market. Based on UK precedents (Ofwat, Ofgem and Ofcom), within the Regulatory Accounting Guidelines, Airwave Solutions should be required to demonstrate that transfer charges and transactions with related parties are at arm's length using one of the following principles: (a) competitive tendering; (b) comparison against published list prices; (c) third-party evaluation; (d) benchmarking; or (e) a cost-based approach.[47] In addition to the charge control, additional remedies may be required to ensure that these intercompany / intragroup transactions replicate competitive arms' length transaction, for example, protections against cross-subsidisation, information sharing, and conflict management.

56. On CAPEX, Motorola currently undertakes both routine continual maintenance activity as well as more uneven replacement activity. A breakdown of this CAPEX activity (actual and forecast) by type should be provided. The commentary on variances against forecast should explain whether these can be explained by forecasting error, deferrals, non-delivery or efficiency. There should also be a requirement for advance notice to be provided to the regulatory body of anticipated material increases in costs—accompanied with an explanation and adequate justification.

57. As noted in the Home Office response to the Issues Statement, Motorola has agreed to regular (quarterly) reporting in the case of the ESN contracts.[48] There is no practical reason why this could not be introduced in the case of Airwave.

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[47] See, for example, Section 8 of Ofwat (2017), 'RAG 5.07– Guideline for transfer pricing in the water and sewerage sectors', November.
[48] Home Office (2022), 'The Home Office's Response submission to the CMA's Issues Statement', 10 January, paragraph 48 (a).