



Mobile Radio Network Services Market Investigation

Motorola's First Supplementary Submission to the CMA's Oral Hearing on 10 February 2022

4 March 2022

1. Introduction and Summary

- (1) At the CMA's oral hearing on 10 February 2022, Panel Members asked several questions concerning contractual negotiations during and after 2016. Given the limited time available during the hearing for this central topic, Motorola wishes to briefly supplement certain comments it made during that hearing.

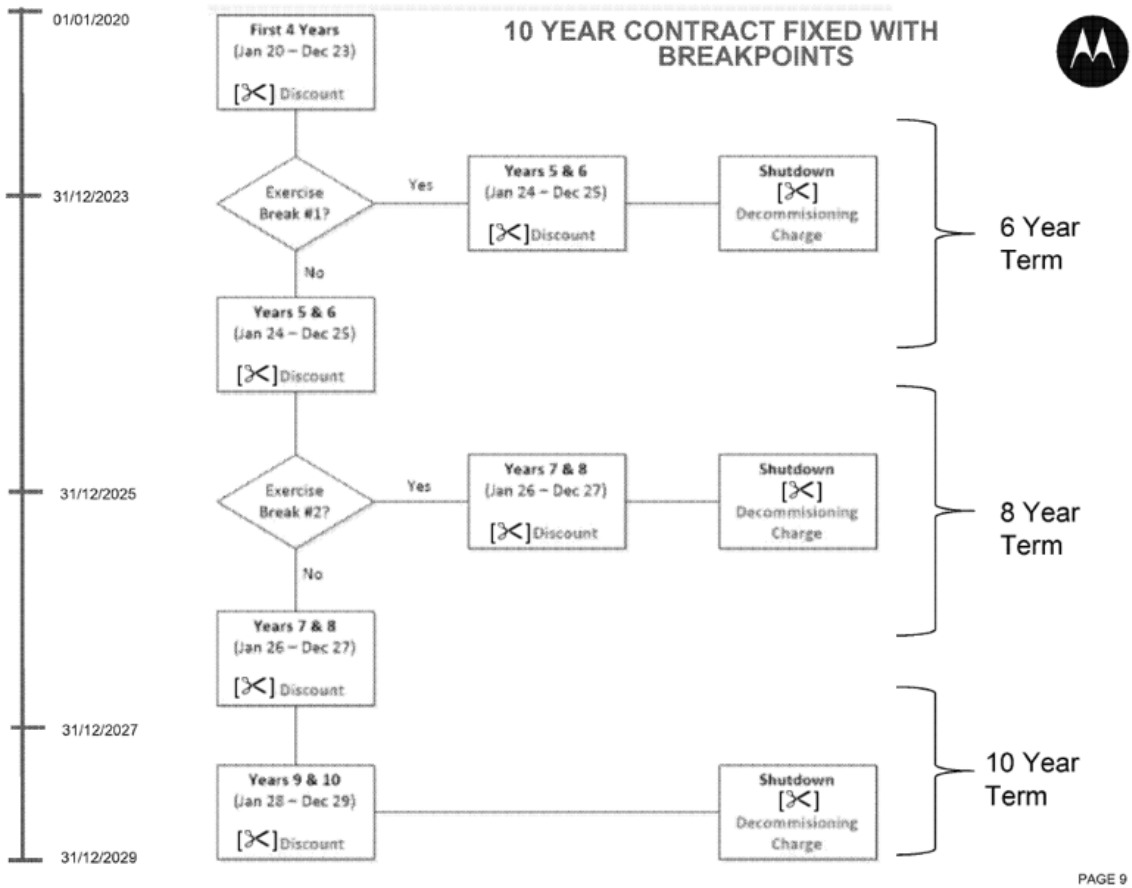
1.1 Contractual context

- (2) Since its inception in 2000, the Airwave service **has never been re-tendered**. This itself suggests that the 'market' contract has worked well in the view of the well-advised customer, at least until very recently. To ignore the fact that Airwave has never been re-tendered leads inevitably to conflating the questions of **how well a market is working** and **how well a contract is performing**. This is the reason for the CMA's guidance, consistent with decades of economic literature, that the correct approach in the context of markets characterised by bidding and tendering is to examine conditions of competition when competition *for the market* takes place.¹ Anything that the parties subsequently choose bilaterally by way of variation to an ongoing contract **does not reflect the operation of a market**. This is not a matter of legal construction of the contract but business and economic reality.
- (3) To repeat, competition for the Airwave service has never taken place since the original tender process. This is the reason Motorola has consistently referred to the Airwave service as a long-term contractual arrangement that should (if at all) be measured over its lifetime. To treat mutually agreed variations as new 'economic bargains' deserving of their own truncated analysis of returns makes no sense from an economic standpoint. It would also require, as a minimum at each stage, the modern equivalent asset value to be calculated and the relevant risk profile to be estimated at the time the new economic bargain was struck. The role of risk is especially important since this is directly linked to the terms that can be made available, as explained further below.
- (4) Although it may be tempting to look at economic bargains struck bilaterally along the way, doing so against the background of ongoing contractual obligations does not reveal anything about whether a market is working well. All this can reveal is that the parties concluded, at that point in time, that it was in both their interests to vary the existing contract. Of course, by complete contrast, the ESN tendering process involves fixed term contracts that are regularly competed for. This is not, however, how the Airwave service has been provided following the tender process that led to the contract award in 2000. The closest instance in which one can say this occurred was in 2016 when, by virtue of the acquisition of Airwave, the Home Office faced a choice between continuing with Airwave on the then current terms and choosing to consent to the proposed acquisition and (among others) vary the terms of the Airwave service.
- (5) As a matter of logic, if the Group were to depart from long-established economic principles to examine how the "market" (i.e. contract) is working during the lifetime of the contract as varied bilaterally, the Group would need to include offers that were **not** taken up, since these provide equally valid insight into how well the "market" is working. An offer that is not taken simply reflects customer choice.

¹ Competition Commission, "Guidelines for market investigations: Their role, procedures, assessment and remedies" (April 2013).

- (6) In 2018 the Home Office chose a shorter “pay as you go” option over a longer-term contract (reflecting the benefits of investment planning and contractual commitment) offered by Motorola, with defined break points. The fact that the Home Office requested a 10 year quote clearly shows that the Home Office understood that terms and a commitment to take the service for a longer period are necessarily linked.
- (7) The offer made by Motorola in 2018 was as follows:

Figure One: June 2018 Commercial Proposal²



- (8) To put this offer into context, according to Motorola’s best estimate capturing the spirit of this offer, this would have yielded a post-tax IRR of less than [Redacted]% for the period 2020-2026. The fact that the Home Office chose a different option – especially in face of all the evidence at the time that ESN would be delayed – does not detract from its relevance if the Group were to look at ‘economic bargains’ that were available to be had.
- (9) Using the Group’s own analytical framework (if that were to be adopted), the above offer demonstrates conclusively that the market is working very well. The above proposal guaranteed blue light customers savings of £[Redacted]m off a total baseline revenue of £3.5bn over 10 years, i.e. around [Redacted]%, in return for a higher degree of contractual certainty.

² [Redacted].

- (10) It would be wholly disproportionate – if not egregious – to impose a remedy on Motorola that required it to compensate the Home Office for a well-advised commercial choice that turned out to be a poor one.
- (11) It will also be clear from Figure One above that the only rational way to view the outcome of each agreed bargain was that, from the perspective of each party, *an improvement over existing terms was secured*.
- (12) Last, it will also be clear that if the ‘economic bargains’ approach were to be followed, it would make no sense to truncate the economic performance of the contract into 2000-2019, and then 2020-2026, since this truncation does not factor the economic bargains that were struck. The facts must ultimately drive the analysis: the parties agreed at various stages to amend a long-term contract that has demonstrated reasonable, but in no way excessive, returns, and certainly far better than the customer anticipated.

1.2 Airwave is now a fixed term contract

- (13) The framework for the economic assessment of the Airwave service has changed since the commencement of the market investigation. Airwave has evolved from a long term open-ended contract, to a contract with a fixed expiry date, not dissimilar to the arrangements in place for ESN. The Airwave contracts expire in December 2026 (subject to transition provisions).
- (14) Any assessment of economic returns of this tendered service (and the proportionality of any proposed intervention in the remaining term) can now be made with certainty: the start point is 2000 and the end point is 2026.
- (15) Beyond 2026, the Home Office will presumably be required to invite tenders for such a service. **This will be the first point at which competition for the supply of LMR services in Great Britain will take place since 2000.**
- (16) For the reasons explained in the response to the CMA’s remedies questions, this is the first point at which it would be proportionate for any remedies to apply, if the market was adjudged not to be working well at that point. To the extent to which any remedies were imposed prior to the expiry of the current contract, this would inevitably affect the risk profile of any contract after 2026. Absent regulatory intervention prior to 2026, Airwave would expect that any new contract would reflect the current approach to Government long-term contracting and that pricing would reflect those principles, including reflecting the risk profile of that future contract and the attractiveness to Airwave of obtaining a reasonable return on assets that will otherwise have to be decommissioned and written off.

1.3 What was agreed in 2016

- (17) To understand the extent to which it is appropriate to infer from the events in 2016 whether the market was working well, a distinction should be drawn between:
 - (a) the concessions that the Home Office were able to extract in return for granting consent to the acquisition by Motorola of Airwave; and
 - (b) the changes that the Home Office sought in relation to the Airwave contracts.
- (18) In the former category are key matters such as the resolution of ongoing litigation and the Deed of Recovery (putting *Airwave* revenues at risk in the event of Motorola delays on ESN). These matters reflect the *consent right*, as evidenced in the weight of the substantial contemporaneous evidence. In the latter category, the material changes sought by the Home

Office to the Airwave contract were a unilateral option to extend at the agreed price, and a reduction in price in relation to benchmarking.

- (19) There is no contemporaneous evidence available to Motorola even hinting that the Home Office was not satisfied with the Airwave terms (in fact it obtained what it sought); the only thing that has changed since the agreement of those commercial terms (which were essentially reconfirmed in 2018) is the Home Office's recent attitude towards those terms given the failure of ESN. This provides no justification for intervention.
- (20) In the event, Motorola did not have to make all the concessions it had envisaged in the worst-case scenario presented to the board in 2015, but at the same time the Home Office obtained what it considered to be important, including the right to require Airwave to continue providing services for as long as they were needed on the same terms that had been agreed under the PFI Framework Agreement. The Home Office could have tried to get better terms (and the Motorola worst case scenario included price reductions of [30]%), but it did not. At the same time, there was no long-term commitment from the Home Office (Airwave was expected to be shut down in 2019), and Motorola accepted the risk of having to make potentially heavy investments into an ageing network with a very uncertain period over which costs could be recovered.
- (21) This risk/certainty pricing trade-off was subsequently explored in negotiations, notably in 2018, as seen in Figure One above.
- (22) Finally, in passing, it should be noted in relation to the unilateral option that if this is to be regarded as a 'ceiling' (per comments made during the oral hearing) it should equally be regarded as a 'floor'. In other words, this was a contractually agreed price. Ultimately, the Home Office wanted – and obtained – contractual certainty with an indefinite option to set the Airwave shut down date with no possibility for a price increase prior to that date (except in relation to indexation). In December 2021 the Home Office exercised that very option.

1.4 2021 Negotiations

- (23) The failed negotiations in 2021, which were triggered by an unreasonable demand from the Home Office, demonstrate that the 'market' continued to work well: there was a default contract in place under which Airwave must provide services on agreed terms until the Home Office notifies Airwave of a national shutdown date (which, as stated above, occurred in 2021). These terms were agreed in 2016, when the Home Office held considerable bargaining power. There was nothing stopping the parties from exploring whether there were mutually beneficial variations, but if no such variations could be found at the time, the default terms would (and did) prevail.