Mobile Radio Network Services Market Investigation

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

11 March 2022

1. Ensuring Due Account is Taken of Risk

(1) There was only a very limited discussion of profitability in the 10 February 2022 oral hearing, which focused on specific details rather than the broader context within which any assessment of profitability needs to be undertaken. This supplementary submission explains how business risk is to be factored into such assessment, taking as read all of Motorola's prior submissions on this topic:

- Motorola's Response to the CMA's proposal to make a market investigation, dated 18 August 2021, at paragraphs 5 – 9;
- Motorola's Response to the CMA's Request for Information dated 7 September 2021, dated 10 September 2021, at paragraphs 1 – 6;
- Motorola's Response to the CMA's Final Report and Decision on a Market Investigation Reference, dated 15 November 2021, at paragraphs 145 – 153;
- Motorola's Response to the CMA's Issues Statement, dated 10 January 2022, at paragraphs 87 – 90;
- Motorola's Response to the CMA's Working Paper on Profitability, dated 10 January 2022; and
- Motorola's Responses to Site Visit Follow Up Questions, dated 14 January 2022, at paragraphs 55 – 56.

(2) As shown below, it would be a serious mistake to undertake an *ex post* analysis of whether the 'market' is working well after 2019 (as implied by the CMA's truncated assessment) solely by measuring profitability without considering the *ex-ante* risks. This brief submission seeks to assist the Group in understanding the impact that uncertainty has on returns.

(3) As the Group is aware, at the time of acquisition, there was considerable uncertainty over the returns that the investment in Airwave could generate. Motorola undertook extensive sensitivity analyses, looking at the IRR under different assumptions about the level of discount from the current prices that would have to be offered, the cost of settling the benchmarking dispute, the upfront payment and the earnout and, most importantly, the length of time over which Airwave would be able to carry on supplying services before being shut down. As the extensive slide pack presenting these analyses (dated August 13, 2015; provided as MIRFI2Q26_00000982.pdf) shows, expected returns varied enormously across different scenarios, with the expected term over which Airwave services would be required being the main driver of variation. Expected returns covered a wide range of scenarios, from heavy losses in the worst case to attractive returns in the best case. **Overall, around half of the cases would result in a return below Motorola's cost of capital and the other half would produce returns above.**

(4) In the course of the acquisition negotiations with the Home Office, some of these uncertainties were resolved (e.g. in relation to the benchmarking dispute), but others remained. In particular, the Home Office did not commit to requiring Airwave's services beyond the end of 2019.

(5) As notified to the CMA at the time of the Airwave acquisition (and referenced in Motorola's earlier submissions), for the purposes of obtaining a fairness opinion Motorola management had instructed Motorola's financial advisers (Goldman Sachs) to model the implications of different durations, providing Motorola's view as to the probabilities of each of five possible

cases arising. These were the case where services would no longer be required beyond 2019 (which was subsequently set as the National Shut Down Target Date) and where the network would remain in operation until the end of 2020, 2022, 2025 or 2028. **At this point, the probability of operation beyond the end of 2022 was put at** [✂]**%.**

(6) Motorola has calculated the respective IRRs for scenarios modelled as shown below.

Service provided until the end of	IRR	Probability
2019	[✂]%	15%
2020	[✂]%	30%
2022	[✂]%	35%
2025	[✂]%	15%
2028	[✂]%	5%

(7) The probability-weighted average of these IRRs 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 [✂]**%**.

(8) Neither of these IRRs would remotely justify intervention to rewrite a long-term contract with just four years to run, where the economic value of the service being provided is unquestionably high, where risk has been allocated (the Home Office did not commit to anything beyond 2019) and where the price has been agreed. This is especially the case 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 (see First Supplementary Submission).

(9) It is patently not the purpose of a market investigation to essentially turn back the clock and pretend that one party had made a different contractual choice four years ago.