



## Response to the CMA's Provisional Decision Report Submission

Note: Confidential redacted information is shown [X].

### Enhancing the service target regime

#### Background

1. In its response to the CMA's provisional decision report (the **Report**), the Home Office explained that, in the same way that Motorola's unilateral market power provides it an ability to charge prices that are above the competitive level, it also has the ability and incentives to lower service quality, to maximise its profits, by reducing its expenditure and investments in Airwave. Moreover, Motorola's incentive to do so could be exacerbated through a pure charge cap.<sup>1</sup>
2. The charge control targets the issue of excessive prices and excessive profits on a forward-looking basis but does not protect service standards and the existing "service target" and "service level" regimes, set out in the Framework Arrangement negotiated two decades ago, do not reflect the more demanding requirements of today's modern emergency services. The current contractual monitoring and incentives regimes are not sufficient to deter Motorola from reducing service quality. This is because, the financial implications to Motorola of lowering standards (in terms of Service Credits under the service level regime) are likely to be far smaller than, and outweighed by, the financial benefits of cost-cutting (in terms of costs not spent). At present, breaches of service availability targets do not lead to Service Credits. Service Credits are only due if site outages are not fixed within [X] hours, and the values of Service Credits payable are very modest relative to the potential risks and harm to users (e.g. police in the field without connectivity) and when compared to the revenues that Airwave generates.<sup>2</sup>
3. Looking forward to the future, the Home Office also wishes to ensure confidence in, and the security of, the Airwave network for period from 2022 to [X]. This is particularly important since Motorola intends to withdraw from ESN after 2024. The Home Office therefore wishes to protect against Motorola running-down Airwave prematurely, and to ensure that Motorola continues to invest in appropriate service levels until the ESN transition completes.<sup>3</sup>
4. The Home Office's response to the Report set out its proposals for amending the service quality regime in relation to Police. The measures proposed in the Report, as enhanced

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<sup>1</sup> Home Office (2022), 'Home Office's Response to the CMA's Provisional Decision Report', 22 November, paras 1.14 and 7.47 to 7.78.

<sup>2</sup> Ibid, paras 7.53 to 7.54.

<sup>3</sup> The Home Office is also conscious of the comments in Motorola's [X] letter of 25 October 2022

in this submission, are aimed at maintaining standards of service that are generally being achieved.

5. As can be expected, the service levels being achieved are somewhat higher than what is contractually required in the original service agreements, which were negotiated over 20 years ago.<sup>4</sup> The Airwave network has generally proved stable and resilient<sup>5</sup>, allowing the operational levels of service to increase, and allowing the increasing operational needs of its users, which have changed significantly over the last 20 years, to be met. However, the fact that the Home Office has not benefited from improvements in the contractual levels of service due from Motorola, for example, through higher availability targets, is consistent with Motorola's position of unilateral market power, which has limited the opportunity to negotiate improvements in prices or terms from those agreed in the original PFI contract.
6. The Home Office welcomes the CMA's proposal not to reduce the value of service credits payable when service performance falls short, as a result of the introduction of its proposed charge control remedy.<sup>6</sup> This is an important safeguard; however, some additional proportionate changes are also required.
7. To recap on the context explained in the Home Office's response to the Report, the existing service credit regime deals with outages at a site level and incentivises Motorola to fix issues quickly. The service levels specify a downtime (or Service Unavailability) threshold for sites, measured in minutes. For example, in the case of police, if Airwave fails to meet the designated contractual service levels for police Radio Voice Services, the affected police force is entitled to payment from Airwave in the form of pre-specified service credits. For Radio Voice Services (**RVS**) for Police, service credits accrue in three stages, according to site downtime: SC1 [~~3~~] hours in a 24hr midnight to midnight period), SC2 [~~3~~] hours in three months) and SC3 [~~3~~] hours in three months).<sup>7</sup>
8. In terms of the existing service level regime, the Home Office accepts the current standards imposed (in terms of unavailability time thresholds) but recommends that the CMA increases the value of service credits that applies when these are not met. Specifically, the Home Office considers that the service credit value should be increased by a factor of three relative to prevailing levels, or 5.4 taking account of the reduction in Airwave charges following the introduction of the CMA's proposed charge control.<sup>8</sup>
9. The above service level regime applies to sites and thus applies to the 'micro' and 'input' aspects of Airwave's performance. The current service target regime currently focuses on a different metric (availability of RVS) and serves a slightly different purpose: it seeks to ensure the provision of a reliable and resilient network, one that police users and other users can be reassured is generally always available, including in a moment of critical need or unexpected operational challenges. Therefore, the current service target regime relates to the 'macro' and 'output' aspects of Airwave performance. Currently, these targets<sup>9</sup> apply to all forces across Great Britain individual at a force level, and are monitored monthly and quarterly at both a force level and at national (GB) level;

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<sup>4</sup> Ibid, paras 7.52 – 7.63.

<sup>5</sup> Although last year, including with Storm Arwen, the number of interruptions were not adequate, with service availability below the prevailing target of [~~99~~] % in [~~99~~] % of the police-quarter observations (i.e. [~~99~~] quarters of 208).

<sup>6</sup> Ibid, para 7.57.

<sup>7</sup> Ibid, paras 7.48, 7.49.

<sup>8</sup> The details are discussed in Ibid, para 7.58.

<sup>9</sup> PSRCP Model Services Contract, [~~3~~]

however, there is no financial incentive for Motorola to meet these targets—no service credits are paid if a target is missed.

10. In its response to the Report, the Home Office proposed that the service target regime should be modified as follows:<sup>10</sup>
  - a. To update targets for Police which are currently at [%<] (and which is below what police forces rely on), to those currently required for Fire and Ambulance of [%<] and ensure that service levels are set at a level that is appropriate for today. [%<] is lower than what is currently being achieved in most months across services which is generally closer to [%<].<sup>11</sup>
  - b. To keep the assessment period (i.e. three-month in the case of Police, or one-month in the case of Fire and Ambulance) unchanged.
  - c. To upgrade all service targets to a service level, with an associated service credits payable in the event that the targets are not achieved. For Police, this would be assessed on a force-by-force basis, with payments made to the relevant force when the target is not met.
11. The Home Office proposed that the new (macro-level) service target regime should have a “sliding scale” service credit, where the value of the service credit increases the further the percentage availability figure is below the new [%<] target for Police force services. For example, for each 0.01% loss of availability below [%<], the service credit value could be related to the current total value of all Stage 1 RVS service credit (SC1) payments payable to all forces, which is £[%<].
12. In its response, the Home Office noted that the details of this mechanism were being explored and that further information would follow. This is set out below, and an example of how this would work is provided in an accompanying spreadsheet.<sup>12</sup>

### From a service target to service level and service credit regime

13. [%<] ‘PSRCP Model Services Contract, Service Levels’ currently specifies the operation of the service level and service target regimes. As acknowledged by the CMA, [%<] recognises the need for adequate incentives on the part of Airwave to deliver the critical service. It states:<sup>13</sup>

“The service level and service credit regime is intended to reflect the private finance initiative ethos of ‘no service – no payment’ with service credits designed to reinforce the service level structure and not intended to be implemented in a punitive way. However, in order to reflect the customer’s concerns, certain network services benefit from the service credit regime in a manner that is disproportionate to the associated contract charges being charged by the contractor. **In particular, to provide an appropriate incentive to the contractor, any failure to provide radio voice services beyond a specified**

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<sup>10</sup> Ibid, para 7.59.

<sup>11</sup> See Figure 7.1 of the Home Office response to the PDR. Between September 2021 and September 2022, Police Service Availability was at or above [%<] in [%<] of the 13 months.

<sup>12</sup> Accompanying file: ‘[%<]’.

<sup>13</sup> PSRCP Model Services Contract[%<]‘Service Levels’. The CMA also refers to this in CMA (2022), ‘Mobile radio network services, Provisional Decision, Appendix B: Additional background information’, para 75.

**time threshold will generate service credits, which significantly exceed the charge that the customer pays for that service”. [emphasis added]**

14. The intention therefore is that such service credits, while not unduly punitive, should significantly exceed service charges in order to provide the correct incentives. As noted above, the Home Office is of the view that to generate such incentives, as things stand, the existing service credit regime needs to be strengthened to incentivise an appropriate level of service that reflects the modern demands of the emergency services. Appropriate incentives would be expected to result in fewer outages than currently prevail.
15. Updating radio voice network targets to the level forces expect, and provided to the Fire and Ambulance services, of [X]%, and the inclusion of financial incentives should these targets be missed, would provide the necessary strengthening of the existing regime.
16. Implementing such a regime should not require further administrative cost. In the current setting there is already an established service performance and problem management reporting system. Through these arrangements, Airwave regularly reports Police service RVS availability nationally, regionally, by force and by site.<sup>14</sup> This monitoring regime means that the implementation of a service credit regime for Police service RVS targets should be straightforward.
17. The financial incentives would need to be calibrated appropriately. From an economic incentive perspective, the gain in profits that Airwave might seek—including under the new charge control—puts at risk targets being missed and needs to be outweighed by the value of service credit applied to encourage service levels to be maintained and to provide a deterrent.
18. Calculating the optimal payment to balance these incentives can be challenging to undertake in practice. It can be difficult for an external party to predict the impact on outputs (e.g. service) from a change in inputs (e.g. OPEX) by a business. Therefore, a practical approach to incentivise a business to meet service standards is to benchmark contingent payments against the relevant turnover of the company concerned. Indeed, this is the approach in the original service level agreement; as noted above, [X] recognises the link between the charges that Airwave is paid and its incentives to provide a reliable service. This same approach can also be applied to determine the appropriate new Police RVS availability service credits and has been adopted by the Home Office in what is set out below.
19. There is also an opportunity to make the new regime more ‘continuous’ than the existing service level regime.<sup>15</sup> Currently, Motorola does not have a continuous incentive to fix an outage as quickly as possible. As noted above, service credits for Police RVS have three levels: SC1, SC2 and SC3, and if a continuous outage lasts [X]hrs [X]m in a quarterly measurement period, the value of the service credit is no greater than if it was fixed in [X] hours. Similarly, if a continuous outage lasts [X]hrs [X]m, the value of the service credit is no greater than if it was fixed in [X]hrs.
20. To improve on this, the new RVS service level regime should have a “sliding scale” service credit where the value of the service credit increases the further the percentage availability figure falls below the new [X]% level for Police force services. In particular, for each 0.01% loss of availability below [X]%, the service credit value should increase

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<sup>14</sup> See for example Airwave (2022), [X].

<sup>15</sup> i.e. with no break points, as exist in the current regime.

pro-rata and would be related to the current total value of all Stage 1 RVS service credit (SC1) payments payable to all police forces.

21. On this basis, the value of the service credit would be calculated on the value of the current total value of all Stage 1 Radio Voice Services service credits (SC1) payable to all forces, which is £[X]. This figure is derived from a single site outage of [X] hours in a 24-hour period in each force area totalled up. Credits would only be payable where the target is missed over a quarter. Table 1 provides more details of the proposed approach.

Table 1 Proposed service availability sliding scale (macro)

<b>Service availability percentage service level achieved (per quarter)</b>	<b>service credit value (per quarter)</b>	<b>Comment</b>
[X]	0%	service level achieved
[X]	£[X]	
[X]	£[X]	
[X]	£[X]	
[X]	£[X]	
[X]	£[X]	
[X]	£[X]	
[X]	£[X]	
[X]	£[X]	
[X]	£[X]	
[X]	£[X]	
[X]	£[X]	
[X]	£[X]	
[X]	£[X]	
[X]	£[X]	
[X]	£[X]	
[X]	£[X]	
[X]	£[X]	
[X]	£[X]	

Source: Accompanying spreadsheet '[X]'.

22. The £[X] figure is based on current contract charges (see above). Mirroring the CMA's statement in relation to the existing service credit regime, the Home Office would similarly expect the payments under the new regime to be based on prevailing charges (and not the reduced charges that will emerge under the new charge control). As such, the £[X] figure would be retained as the basis for setting these service credits and would increase in line with yearly indexation.
23. To avoid the current situation where the national service availability target percentage is achieved but it is not met for an individual police force, the service availability percentage service level would be on a per force basis, and service credits would be paid locally to each force where [X]% service availability is not met in each quarter.
24. It is recognised that certain extreme external events beyond Airwave's control might impact Airwave's performance however, the existing contractual arrangements provide

specific protections for Airwave in this regard (Force Majeure Events and Relief Events). Airwave would continue to have the option to pursue these routes in such exceptional circumstances going forward.

### **Proposed arrangements are proportionate**

25. In the accompanying spreadsheet the Home Office has modelled what the impact of the new macro service level regime might be over a year.<sup>16</sup> This analysis considers the frequency at which the proposed new availability service level ([<]%) has not been met, by quarter and by Police force, over the past four quarters (October 2021 to September 2022 inclusive).
26. During this period, service availability was below [<]% [<] times, or in [<]% of the force/quarter observations. The year's performance was affected by Storm Arwen, which hit in November 2021. Absent Arwen, the target would have been missed in only [<] instances, i.e., [<]% of the time.<sup>17</sup> Similarly, using the previous year's data (October 2020 to September 2021 inclusive), availability was below [<]% [<]% of the time.
27. Going forward, under the new regime, Airwave must have stronger incentives to maintain network resilience. The business should be able to achieve [<]% availability on a quarterly basis, Storm Arwen is not equivalent to a Force Majeure or alternative Relief Event. Where this service level is not met service credits should become payable—without exceptions being made.
28. Under the new regime, service credits applied as set out in Table 1 would have totalled £[<]m in 2022. These service credits would be in addition to service credits applicable under the existing regime for outages, which amounted to around £[<] last year. As explained above, the Home Office recommends the service credit value under the existing regime are multiplied by 3 to also improve Motorola's incentives to maintain service standards.
29. The total value of service credits that would have arisen last year under the new regime would have amounted to approximately £[<]m (£[<]m from service credits for failures on service availability + 3x £[<]m for failures in terms of delays in fixing outages).
30. These amounts strike the right balance between providing Motorola the correct incentives to maintain service standards at an appropriate level, without imposing an undue burden on Motorola. As the following table shows, the total service credit, considering both the new availability targets and the heightened micro regime, would amount to less than [<]% of Motorola's actual revenue last year, and [<]% of Motorola's allowed revenue next year based on the CMA's proposed charge control, or [<]% of OPEX.
31. Of course, if Motorola maintains services at an appropriate standard (above [<]%), no service credits would be paid.

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<sup>16</sup> Accompanying file: '[<]'.

<sup>17</sup> This was undertaken by using October 2021 monthly data as a proxy for the quarter, in place of the quarterly data.

Table 2 Proportionality assessment based on 2021-22 performance

	<b>Service credits for under performance in terms of radio voice services target</b>	<b>Total service credits, including credits for under performance in resolving site outages</b>
	£[X]	£[X]
<b>Relative to Police Contract Charges</b>	[X]%	[X]%
<b>Relative to allowed revenue under CMA charge control</b>	[X]%	[X]%
<b>Relative to OPEX under CMA charge control</b>	[X]%	[X]%
<b>Relative to Opening RAB</b>	[X]%	[X]%

32. Table 3 summarises the changes proposed to the existing service performance regimes.

Table 3 Existing and new service regime

	<b>Radio Voice Services target</b>	<b>Site outages</b>
<b>What does this intend to achieve?</b>	Incentives for Airwave to deliver the Airwave network that is almost always available  Macro/output measure	Incentives for Airwave to respond to site failures quickly  Micro/input measure
<b>Prevailing regime</b>	Target of [X]% availability No service levels or service credits apply	Service credits of increasing severity depending on time taken to resolve problem  <ul style="list-style-type: none"> <li>- SC1 paid out if a site outage lasts longer than [X]h in 24 h</li> <li>- SC2 if site outages that last longer [X]h within 3 months</li> <li>- SC3 if site outage lasts longer than [X]h within 3 months</li> </ul> Service credits are linked to airwave charges
<b>CMA proposal as per PDR</b>	No change	No change to approach  Service credits should stay of same magnitude, despite price cap reducing allowed revenues
<b>Home Office proposal</b>	Increase target to [X]%, which also becomes a service level	No change to thresholds

	<ul style="list-style-type: none"> <li>- Continue to apply at a force level, on a quarterly basis</li> </ul> <p>Introduce a new service credit</p> <ul style="list-style-type: none"> <li>- (prevailing) SC1 (£[&lt;]) to be awarded for each 0.01 percentage point below target</li> </ul>	<p>Increase the value of service credits so they are 3x current level. Implemented either as:</p> <ul style="list-style-type: none"> <li>- 3x current value of a police SC1 payment<sup>18</sup></li> <li>- 5.4x new national value of 24h worth of Contract charge</li> </ul>
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8 December 2022

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<sup>18</sup> The current SC1 payments (i.e. not 3x) range, for example, between £[<] for each of Wiltshire and West Mercia Constabularies, £[<] for Lancashire Constabulary, £[<] for Greater Manchester Police and £[<] for the Metropolitan Police.