



MOTOROLA SOLUTIONS

Mobile Radio Network Services Market Investigation

Sundry Points Arising from the 10 January 2023 Hearing

3 February 2023

1. Introduction

- (1) This submission addresses in summary form certain points arising in the 10 January 2023 response hearing (the “Hearing”). The following should be read together with Motorola’s prior submissions on the relevant topics.

2. Charge Control

- (2) At the Hearing, Motorola expressed its concern with the calibration of the proposed charge control, which results in unsustainably low levels of revenue (ignoring that the proposed remedy itself is wholly unjustified, disproportionate and would impose unacceptable constraints on Motorola’s ability to make critical business decisions despite being responsible for service delivery).
- (3) Our first observation is that even if one were to accept that it makes sense to analyse Airwave’s profitability for the period 2020 to 2026 (which Motorola does not), the drop in revenue implied by the allowed revenue under the charge control bears no relationship to the supernormal profits that Airwave is allegedly earning. As the CMA notes, “the proposed charge control would be likely to result in allowed revenues for 2023 that were around £[redacted] million ([redacted]%) lower than revenues that Motorola forecast absent the charge control.”¹
- (4) Such reduction would exceed even the level of excess profits identified by the CMA in its base model, which is based on the irrational assumption of a negative opening value of assets (implying that Airwave, rather than having to pay for the assets that would enable it to continue with the provision of services after 2019, would have received money simply for carrying on with the business). According to this model, Airwave would allegedly earn excess profits of around £160 million annually (£1.1 billion over the seven years from 2020 to 2026 and £160 million p.a. thereafter), i.e. substantially less than the implied revenue reduction flowing from the charge control. The numbers simply do not add up even under the most absurd assumptions about the value of Airwave’s assets at the end of the PFI period.
- (5) Plugging the allowed revenues calculated from the charge control mechanism into the CMA’s truncated profitability model clearly demonstrates that the proposed charge control does not work. Replacing the figure for turnover relating to the Airwave network with annual revenues of £[redacted] million from 2020 to 2026 results in an NPV of profits (at a discount rate of [redacted]%) of –£[redacted] million in the base model. Using the inflated 2023 figure for the period would produce an NPV of –£[redacted] million. Using the CMA’s sensitivity case where the opening asset value is positive (though still unrealistically low), the corresponding figures are –£[redacted] million and –£[redacted] million respectively.
- (6) These distorted results flow directly from the unsustainable assumptions made by the CMA in calibrating the charge control. As Motorola has expressed at the Hearing, these assumptions consistently veer towards those that produce the lowest possible value for allowed revenues and Motorola strongly disagrees with the choices made by the CMA. Without limitation, Motorola makes the following observations:
 - (a) There is no justification for using the net realisable value of Airwave’s assets as the starting point for determining the value of the RAB. The assets would continue to be used in the provision of the service rather than being scrapped and any transfer would happen at fair market value. The only appropriate measure of fair market value is the replacement cost of the assets, adjusted for the fact that the existing network requires ongoing

¹ Provisional Decision, Annex K, paragraph 167.

maintenance capex and the investment necessary to deal with end-of-life inputs that would not be needed for a newly constructed replacement network. This value would be significantly higher than even the higher asset value considered in the CMA's profit sensitivity.

- (b) The CMA has no justification for adjusting Motorola's capex forecast by removing the risk provision and replacing Motorola's well-considered choice of the safest option for the replacement of the Megastream service with a less costly and more risky option that was considered but rejected by the business at the time and would in any case not be viable now going forward and not eliminate the need for further base station upgrades if the network were to continue to operate beyond 2026. Moreover, capex forecasts should be updated to reflect the substantial price increases experienced over the last year or so which would not have been reflected in the outturn costs of earlier forecasts.
 - (c) The replacement of RPI with CPIH as the basis for indexation is unjustified. Many of Airwave's supply contracts are indexed to RPI and Airwave will be faced with increases in input costs in line with RPI regardless of what is now considered to be a superior measure of inflation.
 - (d) It is appropriate to use a hurdle rate that reflects the uncertainty of future revenue streams (noting that the CMA is proposing to deal with this issue through lump sum payments reflecting unrecovered investments in case of an earlier than envisaged end of service provision). At the very least, Motorola considers that the cost of capital it uses internally (typically between [X]% and [X]%) should be used rather than the unreasonably low WACC calculated by the CMA on the basis of considering the Airwave business as being of a similar nature as regulated utilities.
 - (e) Motorola disagrees with the treatment of decommissioning costs which have been pushed into the pre-2020 period. These costs are incurred when the network is decommissioned and there is no reason to maintain that they have already been paid for through charges up to and including 2019.
 - (f) The assumption of opex pegged at 2021 levels, indexed at CPIH and subject to presumed efficiency improvements is arbitrary and unsupported. Motorola considers that any forward-looking remedy should start from the actual level of costs. Moreover, as the CMA is aware, Motorola strongly rejects the adjustments made to the allowable costs, in particular the exclusion of the costs for hardware and software support (MSI field engineers) and the attribution of administrative overheads to the out-of-scope AB2 service.
- (7) In addition, and in the case that any remedy were necessary to reduce the allegedly excessive prices charged by Airwave, Motorola agrees with the view expressed by the Home Office in its response to the Provisional Decision about the structure that any such intervention should take. A simple discount, applied equally across all services deemed to be within the scope of the control, would be strongly preferable to a charge control that directs the entire price reduction at the core contracts, which raises concerns about discriminatory treatment of users and adds complexity as a result of some revenues and costs being volume-dependent.

3. Is there scope to intervene when a contract is already in place?

- (8) In the Hearing, the CMA asked in various places² whether Motorola’s view was that the CMA has no power to intervene in relation to existing contracts in a market, referring to retail banking and the audit market investigation. The CMA clearly does have the power to regulate prices, and to require termination of an existing contract.³
- (9) The point is rather that a proper CMA intervention must be based on features of a market that cause the market to be distorted at the time the contract is entered into. When the contract accounts for 100% of supply in the market, this is the point at which competition for the market took place. This is the crucial difference between market investigations into, to cite the examples offered by the CMA, retail banking and into the audit market. In those markets, competition takes place every day, which is not the case where there is competition for the market – competition is extinguished at the point of bidder selection and will only come into existence again when a new tender is conducted (or the threat of a new tender can be leveraged in negotiations), but not during the term of the contract.
- (10) This is also the reason why the CMA’s new theory of competitive interactions between the Home Office and Motorola during the course of the Airwave contracts does not make sense. “Competitive” interactions do not take place across the two sides of the market. “Competitive” interactions are interactions in pursuit of a common resource, i.e. interactions on the same side of the market.
- (11) Motorola also notes that in the retail banking and statutory audit market investigations referred to by the CMA in the Hearing, the CMA’s remedies packages in those cases addressed the AECs by making provision for *future* arrangements. The remedies had no effect on existing contracts and/or arrangements (and so did not for example terminate or amend existing contracts). This is proportionate, consistent with the fundamental principle of legal certainty, and consistent with the forward-looking nature of remedies under a market investigation.
- (12) If the CMA seeks to impose a remedy in the current market investigation such remedy must, to be proportionate, address future competition in the market, i.e. once the Airwave contract has expired. It is disproportionate, and contrary to the CMA’s own examples given in the Hearing, to impose a remedy that would rewrite an ongoing, clearly expressed fixed price contract that was negotiated and agreed by two well-advised parties.
- 4. If the market worked well ESN would have been delivered on time and we wouldn’t be here**
- (13) The view expressed on several occasions at the Hearing appeared to be that the failure of ESN to become available on time is *itself* an indication of the market not working well.⁴
- (14) A market that is not working well may lead to a failed procurement process, but a failed procurement does not necessarily mean that the market is not working well. It is therefore wrong for the CMA to deduct from the failed ESN procurement outcome that the relevant market must not be working well. There can be many reasons why a procurement process does not result in a desired outcome. It is notable for example that October 2015 was the target date for awarding the main ESN contracts, yet by September 2016 certain of these contracts were still to be awarded. There is nothing to suggest that this delay was due to any market failure.

² See, for example, page 13, line 10 of the Hearing transcript.

³ Schedule 8, Enterprise Act 2002.

⁴ See, for example, page 16, line 12 of the Hearing transcript onwards.

- (15) In April 2017, the Home Office's Accounting Officer commissioned an independent review of ESN. The independent review identified causes of delay to the Programme including: (a) the failure of Kellogg Brown and Root to deliver planning and collaboration between the other ESN contractors; (b) the fact that Motorola and EE had prepared solutions based on differing technical standards;⁵ and (c) the late delivery of certain projects under the control of the Home Office, such as the handsets and vehicle equipment that the emergency services would use, providing ESN on the London Underground and providing an air-to-ground service for helicopters and aeroplanes.
- (16) Skipping forward to December 2019, the date by which transition was supposed to have completed, ESN was still not ready. The many well-documented reasons included (among others):
- the Home Office had neither completed coverage testing nor established the methodology to be adopted in relation to its commission of the 292 masts;
 - the Home Office had not awarded contracts for certain parts of the ESN system, such that air-to-ground, fixed vehicle devices, and handheld terminals were not available;
 - the Home Office had not produced plans to solve key issues such Direct Mode of Operation (DMO) capability.
- (17) None of these procurement failures can fairly be attributed to a feature that would have caused a distortion in the relevant market in which ESN was procured as a replacement and which continued to be supplied by Airwave until ESN became available.
- (18) To understand whether the market was not working well at the time of ESN procurement, it is necessary to understand (a) whether there are grounds to think that the ESN tender processes suffered from a market failure; and (b) whether *the market* could have delivered continued supply of communication network services for public safety after the end of the initial PFI term, i.e. instead of bilateral negotiation on a back-up basis.
- (19) All the relevant economic indicators, service levels, customer satisfaction scores etc. indicate that the relevant market (as served by Airwave) was working perfectly well. It is therefore a profound mistake to say that a misguided and ill-informed post-ESN tender contract award execution by the Home Office indicates a market not working well. Specifically, the Home Office could have:
- tendered for a replacement network on a technology-neutral and non-discriminatory basis, specifying the requirements that the solution would have to meet rather than the way in which it would have to be operated, which would in all likelihood increased the chances, if not guaranteed, that a working replacement would be available and user migration would be complete by the end of 2019 (or at least soon thereafter);
 - exercised its option under the PFI agreement to take over the Airwave assets and re-tender for the Airwave service on that basis, either by retaining ownership of the assets and inviting bids for operating and maintenance contracts or by transferring the assets to the winner of the tender; or

⁵ The Home Office subsequently admitted that it had been aware that there was a discrepancy in Motorola and EE's technical standards at the time, but that it had not appreciated the problems, and resultant delays, that this would cause. The Home Office also admitted that problems such as this could have been avoided with better integration and coordination between the different ESN suppliers.

- used the threat of pursuing either of these routes in order to negotiate improved terms with Airwave for the provision of the service after 2019.
- (20) Of course, the Home Office made a very different choice, which at the time was seen as very risky and potentially foolhardy. It is this choice rather than the lack of options available to the Home Office at the time or the market in some unspecified fashion not working well that is directly responsible for the way in which ESN has turned out.
- (21) By contrast, section 134(1) Enterprise Act 2002 requires the CMA to decide whether “any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom.” The failure of ESN is not a feature that prevents, restricts or distorts competition in the relevant market. The failure of ESN is instead an outcome of a procurement that has failed, not because features of the market precluded the Home Office from obtaining a working solution for the post PFI period, but because of the specific choices that the Home Office made. Had ESN succeeded, Airwave would not have been required.
- (22) It was of course entirely within the Home Office’s gift to choose an option that was challenging and highly risky (even though the Home Office appears to be acknowledging the aspirational nature of the project only now when it describes ESN in its response to the Provisional Decision as something that is breaking new ground and cannot guarantee to deliver a working solution within a reasonable timeframe). However, it would be entirely wrong to conclude with the benefit of hindsight from the fact that the project has not met the wildest expectations that the market has not been working well.
- (23) As the CMA puts it: the “aim of an investigation is to examine whether there is a competition problem caused by features of the market.”⁶ So the proper way to examine this is to investigate how such features might be considered to have caused a distortion of competition. In its Provisional Decision, the CMA considers the delay in the delivery of ESN as one of the features of the market that allegedly give Airwave unilateral market power and the ability to charge prices above the level that might be expected in a competitive market⁷. This is despite the fact that, by the time the delay manifested, Airwave prices had already been long set and so the delay cannot possibly have caused a distortion in competition.⁸

5. Profitability analysis from other contracts

- (24) In response to Motorola’s position that the proposed charge control remedy is unsustainable, the CMA has maintained that this remedy would merely reduce Airwave’s profitability to the returns Motorola is obtaining elsewhere⁹ or turn supernormal profits into merely handsome ones.¹⁰
- (25) Motorola has not seen the analysis on which these assertions are based, but can categorically state that the reduction in revenues that would flow from a charge control as proposed in the Provisional Decision would reduce returns far below those that Motorola earns across its

⁶ Provisional Decision, paragraph 9.

⁷ See, for example, paragraph 34(d) of the Provisional Decision.

⁸ Moreover, all of the other features that the CMA now says cause a distortion of competition (see Provisional Decision, paragraph 4.3) were already in place in 2016 at a point when (i) the CMA cleared the Airwave acquisition; and (ii) the CMA accepts the market was working well. The CMA does not explain how these features suddenly cause a distortion of competition after 2020.

⁹ See page 50, line 6 of the Hearing transcript onwards.

¹⁰ See page 10, line 16 of the Hearing transcript onwards.

business. According to our calculations, the loss of revenues would reduce Airwave's gross margin to around [REDACTED]% and would result in the accounts showing losses, contrary to the CMA's claims.