Draft Mobile Radio Network Services Market Investigation Order 2023

Response to the CMA's Consultation

16 June 2023

1. INTRODUCTION AND SUMMARY

(1) This is Airwave and Motorola's response (the "**Response**") to the CMA's consultation on the Draft Mobile Radio Network Services Market Investigation Order 2023 (the "**Draft Order**"). The Response is without prejudice to Airwave and Motorola's position that the CMA has not established that there is any adverse effect on competition within the meaning of section 134 of the Enterprise Act 2002 ("**EA2002**").

(2) Airwave and Motorola[1] have applied for review by the Competition Appeal Tribunal of the legality of the CMA's Final Decision (the "**CAT Application**"). Since the deadline to respond to the 30-day consultation on the Draft Order expires on 16 June 2023, this Response must assume, which neither Airwave nor Motorola do, that the CMA's proposed remedies will be implemented. This Response should therefore not be read as acceptance of the remedies or other substantive findings set out in the Final Decision but instead focuses on the extent to which the Draft Order effectively implements the price control remedy set forth in the Final Decision.

(3) Airwave makes the following high-level observations:

(i) The Draft Order makes clear that network investment made by Airwave would not necessarily be recovered to the extent incurred. The Airwave network has always been maintained to the highest standard on a 'whatever it takes' basis, in return for the agreed price. The Draft Order abandons that contractual principle, and it should be for the Home Office, not Airwave, to assume the risk and consequences of underinvestment in Airwave.

(ii) The Draft Order assumes that Motorola remains the owner of the Airwave network. The CMA should 'future proof' the Draft Order by referring to Airwave's parent company in generic terms and/or make provision for a scenario where Airwave is no longer controlled by Motorola.

(iii) For the reasons explained in detail at Section 3, there are considerable uncertainties as to how the Draft Order is intended to operate, such that the proposals are unworkable as currently drafted.

(iv) The Draft Order ignores the fact that Airwave has approximately [✂] billing customers, i.e operates pursuant to many contracts, and instead treats the supply of the Airwave service as if it occurs under a single Home Office contract. The CMA's approach masks a vast array of practical and contractual issues that are bound to arise, and for which the Draft Order makes no provision.

(4) This Response has been structured as follows:

(i) **Section 2** outlines the issues underlying the approach to valuation of the assets for the purpose of establishing the initial value of the regulatory asset base ("RAB") in the Draft Order.

(ii) **Section 3** explains how a number of technical and practical uncertainties within the Draft Order make it unworkable and provides suggestions as to how these issues can be rectified.

[1] For convenience, the term "Motorola" is used to refer to both Motorola and Airwave, except where the context is otherwise clear.

(iii) **Section 4** outlines a number of more specific observations on the framing of the terms of the Draft Order.

2. GENERAL COMMENTS ON THE PRICE CONTROL REMEDY

2.1 Principles for constructing a RAB

(5) The CMA has chosen to adopt a RAB-based charge control. Determining the initial value of the RAB is a key step in setting up any RAB-based regulatory mechanism. Any error made in establishing the proper value of the assets of the regulated firm affects the entire charge control as well as longer term incentives. At the same time, establishing a reliable estimate of the value of the assets of the regulated firm is not a straightforward task. There are a wide range of methodologies that can be used to value an asset, and these produce different results, depending on their outlook. For example, the price paid for an asset in the past, the asset's current replacement cost, and the value of future cash flows produced by the asset are not necessarily the same.

(6) In order to establish the current value of the assets in a market under competitive conditions, a Current Cost Accounting ("CCA") approach is generally considered to be appropriate. For example, the International Telecommunications Union notes that "*the role of regulators should be to take the necessary steps to replicate a competitive market where, for example, interconnection charges should be based on current costs to reflect Build-Buy decisions faced by new entrants.*"[2]

(7) This approach involves a current cost revaluation of the historical (partially depreciated) book values to arrive at the starting asset base for the RAB. There are different methodologies to undertake a current cost revaluation, but all seek to arrive at the same asset value in principle – the (depreciated) current cost value of the historical assets. Different methods include absolute valuation, modern equivalent asset ("MEA"), expert appraisal, or indexation (using asset-specific indices).

(8) The following examples illustrate some approaches taken to the implementation of price controls in the UK telecoms sector. Airwave notes that, while Airwave has never been a regulated entity since it is a PFI construct, significant parts of its network are similar to those of a commercial telecommunications operator. Airwave has regular engagement with Ofcom in relation to aspects of its operation (for example, core transmission and backhaul).

2.1.1 BT

(9) BT has a longstanding history of applying the CCA approach. In 1984, BT provided its report in both Historic Cost Accounting ("HCA") and CCA terms, with the HCA estimates being made consistent with the estimates used in BT's statutory financial information, and the CCA estimates reflecting the values of the assets to the business (i.e. the net replacement cost ("NRC")).[3]

[2] ITU Regulatory Accounting Guide, Telecommunication Development Bureau, March 2009, page 24 (https://www.itu.int/ITU-D/finance/Studies/Regulatory_accounting_guide-final1.1.pdf).

[3] Critique of BT's response to Ofcom's LLU and WLR price control consultation, Frontier Economics, January 2012 (https://www.ofcom.org.uk/__data/assets/pdf_file/0022/63625/bt_duct_valuation_re1.pdf).

(10) To date, BT continues reporting most of its assets' values as equivalent to their NRC in BT's Regulatory Financial Statements ("RFS").[4] Although (indexed) historical cost methodology is used across multiple asset types (i.e. land and buildings, access (copper, fibre and backhaul), transmission, and other non-current assets), BT's ducts are subject to the CCA with Regulatory Asset Value adjustment methodology. For ducts, Ofcom has made a special provision such that:

(i) pre-1997 assets (i.e. built up to 31 July 1997) are valued with indexing forwards historic costs with RPI from 1 April 2005; and

(ii) post-1997 assets (i.e. built after 31 July 1997) are valued with CCA.

(11) Any discrepancies between HCA and CCA transactions are recorded as CCA adjustments (for example, disposals and write-offs to reflect the revalued NRC). Additionally, BT employs the same accounting policies and processing in both HCA and CCA valuations (for example, the same useful economic lives).

(12) This CCA valuation (based on indexation) has been recently noted by BT in its 2022 RFS: "*Retail Price Index (RPI) increase during the year was 8.96% compared with an increase of 1.47% during 2021. This led to a material increase in the asset valuation, primarily on copper, duct and pole assets which are indexed on the basis of RPI. The resulting holding gain is recognised as reduction in costs leading to higher returns.*"[5]

2.1.2 Ofcom

(13) At present, Ofcom uses the current cost-based estimates of the fully allocated costs of BT's assets base which are reported and audited in BT's RFS. Ensuring enough incentives for Openreach to improve efficiency and continue its investment in fibre deployment, particularly in areas where the fibre build competition is low, is one of Ofcom's key objectives, and to this end, Ofcom sets its charge controls in line with its expectation on how much Openreach will recover during the forward-looking period.

(14) Ofcom's approach to regulating charges for ISDN30 services provides an analogous cross-check to the CMA's approach in the Draft Order. When Ofcom set the charge control, ISDN30 services were becoming obsolete and were provided using assets that were heavily depreciated and were not being replaced because of the legacy nature of the service. However, Ofcom recognised that the appropriate charge would have to reflect the economic value of these assets, which was determined by assuming that the services would be provided in a steady state rather than being run down.

(15) In order to achieve this, Ofcom valued assets at 50% of their Gross Replacement Costs (i.e. essentially discounted MEA) even though NRC based on the depreciated book value amounted to only 8-13% of Gross Replacement Cost[6] and the net realisable value ("NRV") of these assets (ISDN line cards and access electronics) would presumably have been close to

[4] See BT Accounting Methodology Document Relating to the 2020 Regulatory Financial Statements, page 18 (https://www.bt.com/bt-plc/assets/documents/about-bt/policy-and-regulation/our-governance-and-strategy/regulatory-financial-statements/2020/accounting-methodology-document-2020.pdf).

[5] BT's Regulatory Financial Statements For the Financial Year ended 31 March 2022, page 2 (https://www.bt.com/bt-plc/assets/documents/about-bt/policy-and-regulation/our-governance-and-strategy/regulatory-financial-statements/2022/regulatory-financial-statements-2022.pdf).

[6] Ofcom's Wholesale ISDN30 price control, 12 April 2012, paragraphs 3.15 and 3.31-3.43 (https://www.ofcom.org.uk/__data/assets/pdf_file/0027/73908/isdn30_final_statement.pdf

zero. Ofcom did **not** take the position that customers would effectively now be 'paying twice' – or any number of times.

2.2 Application to the Airwave RAB

(16) Without prejudice to the CAT Application, the following sections comment on how the CMA can amend the Draft Order to better reflect the principles in the Final Decision, in particular the principles of the Byatt Report which the CMA considered to be appropriate for this case.

(17) According to the CMA:

> "*[t]he charge control will limit the price of the Airwave Network services at a level that the CMA considers would apply in a competitive market*."[7]

(18) This suggests that the CMA should apply a CCA approach in line with standard regulatory practice for establishing the RAB. Indeed, the CMA refers to the 1986 Byatt Report, which addresses asset valuation in terms of CCA and, consistent with competition principles,[8] explains that asset valuation should be based on:

> "*… what it would be worth paying* ***to bring replacement assets into use now*** *in the normal course of business, taking account of practical constraints, eg on the rate at which the latest equipment could be introduced*."[9] (Emphasis added)

The Byatt Report goes on to note:

> "***What it would be worth paying depends on the remaining service potential of an asset****, ie its net value after depreciation*."[10] (Emphasis added.)

(19) Applying these principles to an opening asset valuation of the Airwave network means starting from the modern equivalent asset value (for example, the £[✂] million estimate prepared by Analysys Mason) and then discounting that number by the Airwave capex requirements to run Airwave to 2029. This approach reflects the choice a prospective new entrant would have between (i) building its own infrastructure and (ii) acquiring the existing Airwave assets to serve the Home Office's needs after the end of the PFI period.

2.3 The CMA's Approach in the Draft Order

(20) The Draft Order calculates the opening asset value as if the PFI Agreement had terminated and the assets were not used to provide the Airwave service after 2019, which of course is not the case. Based on this approach, the CMA ascribes a value of just £[✂] million to Airwave's assets at the end of 2019, which is then augmented by the (depreciated) capex undertaken since 2020 in order to arrive at an opening value.

(21) The CMA's approach to valuing Airwave's assets is therefore implemented in the Draft Order on the basis that the Airwave service essentially becomes an operating and maintenance contract, with the existing Airwave assets treated as if they had transferred to the customer at scrap value. UK Government guidance expressly recognises however that assets will not

[7] Draft Explanatory Note, paragraph 8.
[8] Annex 2 of Volume 2 of the Byatt Report explains how Byatt's asset valuation principles are consistent with competition principles.
[9] Byatt Report, Volume 1, paragraph 12.
[10] Depreciation here is economic, not accounting. See Byatt Report, Volume 1, paragraph 13.

necessarily transfer to the customer at the end of a PFI contract.[11] Consistent with the UK government's recognition that assets do not necessarily transfer at the end of a PFI contract, the Home Office has a contractual right to acquire the assets at fair market value upon termination (which has not yet occurred) of the PFI Agreement.

(22) If the CMA insists on implementing a price control remedy in the form of the Draft Order, the CMA should make an Order that reflects the CMA's Final Decision that the Byatt Report principles are "appropriate"[12] for this case.

(23) Motorola notes that, by implementing the Final Decision in terms set forth in the Draft Order, the CMA's approach would conflict with the approach taken by all other UK regulators to asset valuation. Indeed, applying the CMA's logic, prices to consumers should all have dropped once water, electricity, gas, telephony/internet, etc. assets were 'paid for' since consumers should be treated not only as buying a service but 'effectively' as paying for the assets needed to serve their premises. If one applies the CMA's economic logic to the housing market, landlords who own Victorian properties should be required to charge nominal rents to tenants on the basis that the capital cost of the asset (the property) has been recovered. This cannot be the CMA's intention, and accordingly Airwave respectfully submits that the Draft Order be amended accordingly before it is finalised.

(24) If the CMA seeks to implement its 'not paying twice' concept, such action will not comply with sections 134(4) and (6) of the EA2002 as it will go beyond the CMA's power to remedy an AEC, improperly changing the fundamentals of the PFI Agreement.

(25) In fact, the Draft Order goes further by implicitly treating the Home Office as if it were effectively the owner of the assets at the end of the charge control period, and not just the beginning. Subtracting the NRV of the assets in the calculation of final settlement charges means that the Home Office is entitled to claim any residual value that the Airwave assets might have after shutdown. The Draft Order is therefore drafted in terms such that the Home Office is effectively gifted the benefit of Airwave's assets at scrap value at the end of 2019 as well as whatever value Airwave might be able to realise from its assets at the end of the charge control period. The Draft Order therefore goes beyond what is necessary to address the adverse effect on competition that has been identified by the CMA in the Final Decision.

(26) Airwave notes that the NRV for the final settlement charges is to be based on an independent assessment, and respectfully suggests that the same level of independence be brought to bear on the question of the opening asset value, both as a matter of principle and as regards the practical steps that need to be taken to calculate the RAB (see below).

3. THE DRAFT ORDER IS LACKING CRUCIAL DETAILS AND THE RESULTING PRICE CONTROL REMEDY IS UNWORKABLE AS DRAFTED

(27) As an overarching comment, the charge control contemplated in the Final Decision would not be implemented effectively through the Draft Order. We set out the reasons for this below together with detailed suggestions on how this can be rectified from (35) to (65). In

[11] See, for example, HM Treasury Guidance on Standardisation of PF2 Contracts (2012). This Guidance observes (for example) that where assets are unlikely to transfer to the Authority on termination, it is in the interests of the Contractor to properly maintain the assets.

[12] Final Decision, paragraph 6.96.

our view, many of the issues identified below should properly be the subject of specific consultation before the Order is finalised.

(28) The CMA states that:

> "*while the description of how the charge control has been designed and calibrated raises a range of issues that have required detailed assessment (and that have been considered in section 8 and in this appendix), the operation of the charge control should be relatively straightforward. In particular, its implementation (as described in paragraph 67), will require the fixed percentage adjustment to be made to core and police menu charges to be calculated and applied in each year of the control. No other adjustments to charges will be required.*"[13]

(29) The Draft Order fails to deliver such a charge control regime. It omits essential calculations and estimates that are necessary for a robust and workable RAB-based charge control regime and, as presently drafted, the Draft Order would give rise to a level of uncertainty for Airwave and its customers that is impractical.

(30) Developing and implementing RAB-based regulation is a very significant undertaking, which requires various stages of consultation on principles and implementation, as well as valuation and auditable processes. The CMA must undertake this work to arrive at an agreed methodology with the newly regulated company, so that the regulatory regime can be implemented in operational systems and ultimately audited without uncertainty/risk of subsequent disagreement with the CMA or audit failure. In other telecoms markets with RAB-based regulation, developing these details has taken a year or more, as indicated in the table below.

Timescales required to develop RAB-based regulation in other telecoms markets

Country	Duration	Details
Finland	22 months	Survey[14] on most suitable methodology for fixed access cost modelling published in April 2015 and the final documentation[15] for the fixed access model issued in January 2017
Ireland	11 months	Consultation[16] on cost modelling of reusable civil passive engineering assets published in July 2015 and final decision[17] issued in May 2016
New Zealand	26 months	First consultation[18] on setting the initial RAB for fibre fixed line access services ("FFLAS") published in September 2020 and final decision[19] issued in October 2022

[13] Appendix K, Final Decision, paragraph 157.
[14] Analysys Mason's "Final Report for FICORA: Survey of the suitability of a bottom-up LRIC+ model for Finland," 30 April 2015 (https://www.traficom.fi/sites/default/files/media/regulation/Final-report-for-Traficom-20150430.pdf).
[15] Analysys Mason's Report for the Finnish Communication Regulatory Authority, Documentation of FICORA's v1.0F model, 20 January 2017 (https://www.traficom.fi/sites/default/files/media/regulation/Documentation-v1-0-model-20-01-2017.pdf).
[16] Commission for Communications Regulation's Consultation and Draft Decision, "Eircom's Wholesale Access Services: Further specification and amendment of price control obligations in Market 4 and Market 5 and further specification of price control obligation in Market 2," 3 July 2015 (https://www.comreg.ie/csv/downloads/ComReg1567.pdf).
[17] Commission for Communications Regulation's Response to Consultation and Decision, "Pricing of Eir's Wholesale Fixed Access Services: Response to Consultation Document 15/67 and Final Decision," 18 May 2016 (https://www.comreg.ie/media/2017/12/ComReg_1639.pdf).
[18] Commerce Commission New Zealand, "Fibre information disclosure and price-quality regulation: Proposed process and approach for the first regulatory period," 15 September 2020

(31) As a further reference point, as described above Ofcom's design of the price control on BT's legacy ISDN30 service had to value assets that were almost fully depreciated in accounting terms but which had a positive economic value and which were deployed in the provision of a service that was anticipated to be nearing the end of its life. This process took about two years from the first consultation in May 2010[20] to the final decision in April 2012.[21]

(32) The time needed for the implementation of these price controls is explained by the fact that, for a RAB-based system to work as it should, a thorough assessment of costs and detailed consideration of reporting requirements is needed to support the monitoring of compliance and ensure that the regulated firm can discharge its obligations confidently, reliably, and robustly.

(33) The sheer volume of material created as part of the introduction of a price control regime to an ongoing business acts as a useful proxy for the level of detailed work that needs to be undertaken to implement a RAB-based charge control. The broadly drafted obligations in the Draft Order to calculate allowed revenues and ensure compliance are not an indication of simplicity but a major source of concern.

(34) Airwave has identified at paragraphs (35) to (65) below the following (non-exhaustive) list of issues that have not yet been properly addressed in the Draft Order. Airwave considers that the CMA will need to have regard to these in order to deliver a workable RAB-based price control.

3.1 How the allowed revenue translates into charges

(35) The Draft Order defines the charge control in terms of a maximum allowed revenue, from which the maximum revenue that Airwave is permitted to recover from core and police menu services is derived. This structure highlights the fact that the nature of the contractual arrangements between Airwave and its customers is not properly provided for in the Draft Order. Currently, Airwave core and menu fees are charged to and paid by the respective authorities (the Home Office, the Fire Services, the Department of Health and the individual police forces). The CMA needs to articulate exactly how the new charge regime will apply to each of these separately funded authorities.

(36) Once the disaggregation of allowable revenues has been accomplished (which as a matter of procedure requires the involvement of the relevant contractual counterparties), the CMA needs to address the fact of separate contracts with the different customers in relation to the calculation and application of service credits, which in the CMA's approach are treated as a single item. Each of the Police, Fire and Ambulance contracts have differing sets of KPIs against which service credits are calculated. It is commonplace that a service affecting event may result in service credits being paid under, for example, the Ambulance contract but will not necessarily result in service credits being payable under the Police contract due to the

(https://comcom.govt.nz/__data/assets/pdf_file/0012/225012/Fibre-information-disclosure-and-price-quality-regulation-Proposed-process-and-approach-for-the-first-regulatory-period-15-September-2020.PDF).

[19] Commerce Commission New Zealand's Final Decision Reasons paper, "Chorus' initial regulatory asset base as at 1 January 2022," 6 October 2022 (https://comcom.govt.nz/__data/assets/pdf_file/0029/294284/ChorusE28099-initial-regulatory-asset-base-Final-decision-Reasons-paper-6-October-2022.pdf).

[20] Ofcom's "Review of retail and wholesale ISDN30 markets: Consultation on the proposed markets, market power determinations and remedies", 4 May 2010 (https://www.ofcom.org.uk/consultations-and-statements/category-2/isdn30).

[21] Ofcom's "Wholesale ISDN30 price control", 12 April 2012 (https://www.ofcom.org.uk/__data/assets/pdf_file/0027/73908/isdn30_final_statement.pdf).

differing KPIs. Further, the application of those differing service penalty 'points' must then be applied to the revenue specified in that particular contract. As the CMA has effectively 'conformed' the pricing into a single charge, further detail is needed in the Draft Order to explain how Airwave should calculate these service credits moving forward.

3.2 How service changes are to be accommodated

(37) The Draft Order does not address the possibility that the scope of services provided under the headings covered by the cap could change. For example, the Home Office has commenced discussions with Airwave about potential significant changes to the service, including expanding coverage to [✂]. Under the Draft Order, Airwave would seem unable to levy any charges for such additional services or, if it can, it is unclear as to the basis on which such charges should be calculated. Accordingly, detailed provisions on how such service changes should be costed and priced are required for the cap on total charges to be workable. Such an omission will obviously affect both Airwave's commercial incentives and the service levels that Airwave can reasonably be expected to operate to.

(38) Similar considerations apply to special events, control room moves and other user requested activities for which Airwave is currently entitled to charge a fee, many of which are of critical importance (including special events for which bespoke arrangements are required, for example the Queen's funeral and the recent coronation of King Charles III). Under the three main Blue Light contracts, Airwave is obliged to provide such services and is only permitted to remove or amend services under very specific circumstances (obsolescence or having identified a better way of providing them).

(39) Last, the charge control mechanism as set out in the Draft Order does not envisage any modification of the Airwave service, for example an evolution towards a hybrid solution through a combination of the Airwave network and other networks more geared towards data services. The charge control provisions for an early termination of the Airwave service are insufficient for this case and if such a development were treated as early termination, the associated rules for the calculation of any final settlement may well give rise to unnecessary disputes.

3.3 Mitigation of foreseeable market distortions

(40) As drafted, the Draft Order may be expected to have significant distortive effects. For example:

(i) There would appear to be no limit on the extent to which individual customers could demand additional equipment or services at no extra cost to them regardless of the cost implications for Airwave, unless Airwave were entitled to decline such requests. This is unsustainable and unfair both on Airwave as well as its competitors in relation to the competitive elements of the Airwave service.

(ii) Under the revenue cap, the Amber Light users (some of which are UK registered charities) will effectively subsidise the Home Office's use of the Airwave service. Airwave cannot see any justification for such an approach and would find it difficult to explain to its non-Blue Light customers why the revenues Airwave collects from them should go towards funding lower charges for the Home Office under core and police menu services.

(iii) The proposed charge control does not expressly deal with any transition to ESN, which might well start within the period of the control. The CMA should clarify that while all or part of the Airwave service is being provided, the allowable revenues

should not be affected. Absent such clarification, transition issues may lead to unnecessary disputes, for example if the Home Office refused to pay the contractually agreed flat fee for provision of an Airwave service for any ESN transition groups that are delayed in completing their transition to ESN in the period until the Airwave network is switched off in its entirety. This was a key flexibility concession obtained by the Home Office in the 2016 change of control negotiations; the concept of providing a partial or regional service while accommodating national users is extremely challenging technically, which is not dealt with at all in the Draft Order. For context, in other 'migratory' situations, Ofcom has applied a different model entirely, looking at the *total* costs of service provision to provide a reasonable glide path towards new technology, as mentioned by Motorola during the CMA's market investigation.

3.4 There is no explanation of a suitable asset valuation approach for setting the RAB

(41) Quite aside from the issue of how, in principle, the Draft Order should approach the setting of the RAB, the CMA's very use of the figure of £[✂] million is inconsistent with the practical calculations and assessments required for setting the RAB. The estimate of £[✂] million used by the CMA was provided by Motorola as an approximate indication of the value of sites that are potentially attractive to other users at that time, in response to a request made by the CMA during the market investigation. This estimate cannot be used as a substitute for a proper forensic valuation of the assets that should make up the opening RAB, which would need to cover all of Airwave's assets and not just sites.

(42) Accordingly, and consistent with the approach taken by all other regulators establishing a RAB for the first time, the CMA needs to consult on and subsequently determine what will be the most suitable methodology for properly valuing Airwave's assets. Significant further consultation is required beyond that already conducted as part of the CMA's market investigation as the CMA's market investigation did not delve into the necessary level of detail for this determination to be made. For example, at the very least, any reasonable approach to asset valuation requires physical surveys of Airwave's actual assets. This includes engineering condition reviews as Airwave's critical assets include both indoor electronics and outdoor tower sites located all over the UK. Their capital and maintenance needs are fundamental to maintaining the services for an unknown duration at least until 2029 if not beyond.

(43) Setting up the revenue cap will require detailed processing of Airwave's internal accounts based on the RAB modelling requirements:

(i) Airwave's fixed asset register ("FAR") will need to be carefully reviewed to devise a suitable mapping of assets in the accounts to asset categories to be considered in the regulatory model; and

(ii) Airwave's general ledger ("GL") will need to be reviewed in detail to devise a suitable mapping of opex items to relevant opex categories to be considered in the regulatory model.

3.5 The Draft Order needs to clarify various issues regarding the RAB roll-forward process

(44) The terms of the Draft Order contain no provisions for adjustments of additional spend beyond that contemplated in current plans that Airwave might justifiably have to incur

between now and the review period, as envisaged by the Final Decision.[22] If the intention is that such spend is reviewed and, where justified, recovered through higher revenue allowances post the 2026 review, it is unclear as to how this would be dealt with (and how recovery of legitimately incurred cost would be ensured) if the service terminated earlier than at the end of 2029.

(45) The terms of the Draft Order also contain no provisions for adjustments of over-spend that Airwave might justifiably have to incur between now and the review period. Even if Airwave were allowed to recover expenditure that exceeds the allowance within the charge control over the next few years through higher revenue allowances post-review, it is unclear as to how these would be dealt with (and how recovery of legitimately incurred cost would be ensured) if the service terminated earlier than at the end of 2029.

(46) *Future Capex*. This issue is particularly concerning given that, so far as Airwave can ascertain, the CMA appears to have struck out many of the already foreseeable capex requirements that will be necessary for the network to function to 2029 (and potentially beyond) from the capex allowances.[23] Again, so far as Airwave can ascertain, the Draft Order seems to have effectively 'stitched together' elements of various capex plans to arrive at allowable capex. This being the case, and having ignored the capex plan to keep the network operational to 2029, the Draft Order needs to clarify how these additional costs will be handled.

(47) More specifically, the Draft Order is silent on:

(i) the process between the CMA and Airwave to agree on the forecast capex to be included in the regulatory model (including how disputes are to be resolved);

(ii) the compliance mechanics for monitoring actual capex against forecasts; and

(iii) how new (types of) assets are allocated to the RAB.

(48) *Disposals* (or any other changes in Airwave's accounts). The Draft Order is silent on how disposals (or any other similar changes) in Airwave's accounts are to be accounted for in the RAB.

(49) *Depreciation*. The Draft Order is silent on key aspects of the depreciation calculation to be used for setting and rolling-forward the RAB, in particular:

(i) the depreciation method(s) to be used;

(ii) the asset lifetimes to be used, and how remaining asset lifetimes should be estimated; and

(iii) how capital additions should be depreciated, for different types of additions (for example, like-for-like replacement, new items, capex improvements/strengthening).

3.6 Opex considerations for roll-forward calculations

(50) The Draft Order is silent on:

(i) the process to agree the forecast opex that is included in the regulatory model;

(ii) the compliance mechanics for monitoring actual opex against forecasts; and

[22] Final Decision, paragraph 8.20.
[23] See Appendix G, paragraphs 84-87.

(iii) how new types of opex items that did not exist previously are allocated to the revenue cap calculation.

3.7 Airwave is required to project revenues for an extensive list of services

(51) An appropriate process needs to be settled that will facilitate revenue forecasting. Revenue forecasts are likely to be subject to a range of uncertainties, and therefore they may need to be updated frequently to avoid significant discrepancies with actual revenues. Relying on relatively stable revenues over the past is not a satisfactory replacement for undertaking reliable forecasts of future revenues, where these feed into the attribution of revenues to services that is relevant for the calculation of maximum allowable charges.

3.8 The proposed calculation of final settlement charges treats the Home Office as if it were the beneficial owner of the Airwave assets

(52) Airwave notes that the arrangements for final settlement charges treat the Home Office as if it were the owner of Airwave's assets. If one assumes that the RAB were fully depreciated, that no reconciliation adjustment were required and that there were no independent assessment or de-commissioning and redundancy costs, the formula in paragraph 12 of Schedule 1 the Draft Order implies that Airwave would have to pay the Home Office an amount equal to the value it is estimated to be able to realise from the sale of the assets, as determined by a third party. Subtracting the NRV from the closing value of the RAB and any costs incurred in closing down the network has the same effect of gifting any residual value to the Home Office. This is in Airwave's view beyond the scope of the remedies proposals in the Final Decision which are focused on controlling the prices that are charged and not the ownership of the assets.

3.9 Multiple ambiguities and technical issues in relation to various calculations

(53) There are a number of more specific areas where Airwave has difficulty understanding how the Draft Order is intended to operate. In particular, the reconciliation adjustment for the period t-1 has to be included in determining the revenue allowance for period t, which will in all likelihood have to be determined prior to the final reconciliation for year t-1 being possible (for example, because the final CPI and RPI figures will be published only at some point in year t). This does not appear to be possible.

(54) The provision in relation to the calculation of Service Credits is unclear and suggests that Service Credits should increase by 60% relative to their current level. Service credits are currently calculated with respect to KPIs and amounts billed under each of the Police, Fire and Ambulance service contracts. As the CMA have effectively merged all these individual pricing arrangements into a single charge it is unclear how Airwave is expected to calculate service credits.

(55) Proper attention needs to be paid to all issues that are bound to arise as part of final settlement. It should be made clear that Airwave will be able to recover all costs regarding decommissioning and redundancy, even though, for example, Airwave's redundancy arrangements exceed the statutory minimum.

(56) Airwave does not understand the arrangements in relation to the commencement of the charge control, for example in relation to issues already invoiced or in relation to services where the date on which the order is made falls within a particular billing period.

3.10 There is a lack of clarity on compliance requirements

(57) Internal and external audits stipulated in the Draft Order, along with the rest of the compliance process, will require a significant commitment of resources, including time, finances and people.

(58) There will be significant additional operational costs including all the elements to set up a new regulatory function including departmental staff, accounting systems, and audit and regulatory support. Setting up a new regulatory compliance function efforts has implications that extend far beyond the cost of setting up. Airwave is not a regulated entity, has not organised itself as such, and does not possess any regulatory capability or experience. To avoid unnecessary uncertainty and to minimise the risk of audit failure for Airwave, the CMA is asked to specify precisely the system and reporting requirements. In particular:

(i) *Capex*. Airwave is required to inform the CMA (and the Home Office) about any material deviation between its actual capex, the capex plans submitted, and the capex that has been allowed for. Given that the allowed-for capex has been set by the CMA based on high-level forecasts after making a number of unclear adjustments, Airwave does not understand what purpose could be served by a three-way capex reconciliation. Furthermore, it is unclear to Airwave what constitutes the relevant base line, or what would be considered 'material' changes. Such reconciliation requirements need to be far more precisely specified.

(ii) *Pro-forma returns*. Given the wide-ranging information requirements included in the Draft Order, it would be appropriate and helpful for the CMA to provide pro-forma returns to indicate exactly what information it expects to receive and in what format such information must be provided. Otherwise, there is a high risk of disagreement and lengthy debates about the appropriateness or otherwise of the information provided by Airwave. It would also enable Airwave to confirm that the information can be made available in the form requested and avoid disproportionate costs.

(iii) *Authorisation and approvals*. There should also be greater clarity on the process for reviewing and signing off compliance with the information provision requirements. It is not clear who is ultimately responsible for confirming that Airwave has complied with its obligations to provide information. Given the involvement of both the CMA and the Home Office, do both parties need to agree that an obligation has been complied with? What happens if one party is satisfied but the other is not? Within what time period should sign-off occur?

(iv) *Other compliance costs*. Contrary to the CMA's view that compliance costs should be limited to the cost of independent assessment, Airwave anticipates there will be very substantial compliance costs from having to change reporting systems and having resources simply to deal on extraordinarily short notice (see further at (72)-(73) below) with any queries from the CMA or the Home Office.

(v) *Reconciliation*. In relation to the calculation of revenues and the reconciliation of information with the information in Airwave's statutory accounts, it is not clear whether this should be done based on the cash position or the revenue accrual. For example, there may be services that are delivered over a multi-year period but invoiced and paid upfront. Similarly, there may be deferred payments for services where revenue has been accrued for accounting purposes, potentially reflecting the risk of non-payment.

(vi) *Independent assessors*. In relation to the selection and appointment of independent assessors, the Draft Order should be updated to clarify the selection criteria and the

approval process, for example, in terms of the time period within which such an approval has to be made. In particular, it should be made clear whether Airwave's auditors can provide such assessment or whether this has to be separate, which has implications for the statutory audit process.

3.11 There is no proper discussion of the approach to capturing inflation in relation to the RAB

(59) The Draft Order does not implement the RAB indexation aspect of the charge control envisaged in the Final Decision, which entails adjustments being made to the RAB and the depreciation charges to reflect inflation. Table K.8 states that "*[d]epreciation and return allowances would be adjusted to reflect the RAB being indexed to CPI from 2023*"[24]; a similar indexation is suggested within the spreadsheet supplied with the Draft Order. However, the Draft Order does not specify such indexation.

(60) Whilst the Final Decision notes that the "*CMA will consult on the precise way in which RAB indexation should be applied as part of the development of the Order implementing the remedies set out in this final report, and will consider the NPV-neutral approach referred to in the Home Office's submission in that context.*"[25] The Draft Order replaces such a charge control mechanism with one in which the allowed return is calculated with reference to nominal WACC, applied to the un-indexed RAB and depreciation charges. This approach differs from the approach set out in the Final Decision.

(61) This replacement happens without any consultation on this issue, contrary to the Final Decision. Instead, there is a statement that:

> "*[a] nominal percentage return on capital (ARett) should be calculated for each relevant year, and applied to the average nominal value of the RAB in that year. This differs in form from the indexation approach set out in the Report, which involved applying a fixed real percentage return on capital to the average real value of the RAB in the relevant year (ie it applied indexation to the RAB rather than to the percentage return on capital figure), but is simpler and to substantially equivalent effect. It is consistent with the decisions included in the Report*."[26] (Emphasis added).

(62) Airwave notes that this statement is incorrect, as the provisions in Schedule 1 apply the calculated nominal rate of return to the real rather than the nominal RAB. Leaving this inconsistency aside, the approach set out in Schedule 1 might be equivalent to applying the real WACC to the properly indexed RAB (combined with indexation of depreciation charges), but this would have to be demonstrated in combination with the application of non-indexed capital expenditure allowances to the RAB.

3.12 Appropriate compensation needs to be incorporated for Home Office changes

(63) There is precedent on major technology programmes for the Home Office expecting Motorola to undertake work at its own risk and cost and without appropriate contractual protection. In Motorola's experience such requests have typically arisen as a result of changing requirements by the Home Office. A compensation system therefore needs to be

[24] Appendix K, Table K.8.
[25] Appendix K, paragraph 147. The NPV-neutral approach suggested by the HO seems to be with reference to the approach used by Ofgem (see Appendix K, paragraph 145), which apparently comes from a Home Office email from 19 January 2023 (see footnote 863) rather than any formal submission.
[26] Explanatory Note, paragraph 51(e).

set up to ensure that Airwave does not pay the economic price of any cost-overruns, wasted work and projects which the Home Office may undertake or seek to undertake.

3.13 Steps required to address the issues identified above

(64) For the reasons given above, the CMA is respectfully invited to reconsider the practicality of its Draft Order. The list of issues identified in this section demonstrate that there are a number of points that need to be addressed, and which Motorola considers should be the subject of further consultation, before an Order could be made to the requisite standard.

(65) Airwave would also note that these comments are not intended to be exhaustive. It is clear from all comparable regulatory processes that Airwave has studied that the process is deliberately iterative and takes place over many months. The Draft Order also fails to address many other issues, including the volatility in charges that could occur year on year due to indexation, underspend (or overspend) on menu service requirements, unforeseen events like the decision in 2017 of BT to cease its Time Division Multiplex transmission solution, the potential termination of Airwave's long-term tenancy of its core switch sites, third party capex changes, and so on. There will be very substantial billing, collection, and budgeting issues that are simply not addressed. There is no consideration given as to how this remedy will affect, on a practical day to day basis, the many contracts that Airwave has, as well as customers' ability to procure budget funding.

4. SPECIFIC DRAFTING COMMENTS ON THE DRAFT ORDER

(66) Motorola also notes the following specific points in relation to the drafting of the Draft Order.

4.1 Scope for modification or amendment to the Draft Order

(67) Article 10.1 of the Draft Order states:

> *"Without prejudice to any provision of the Act providing for the review, variation or revocation of the Order, where Airwave Solutions, Motorola Solutions and the Home Office agree arrangements for the setting of charges for Specified Goods and Services that differ from the charge control methodology set out in Schedule 1 but do not result in a material weakening of the constraints that the application of Schedule 1 would otherwise put on the level of revenue Airwave Solutions and Motorola Solutions receive for Specified Goods and Services, Airwave Solutions and Motorola Solutions may apply to the CMA for the variation of the Order. The provisions of the Order shall nonetheless continue to apply unless and until the CMA varies the Order by the making of a further order in accordance with section 161(4) of the Act."*

(68) The contents of the Article, despite purporting to be subject to the provisions of the EA2002, appear to be a *non sequitur*. If the CMA does not intend to fetter its discretion through Article 10.1, then Airwave is unclear as to the purpose behind the CMA indicating the conditions under which it would be prepared to consider applications for review, variation or revocation of the Order. The Home Office and Airwave may wish to agree new services that may necessarily imply a "*material weakening*" of the revenue cap, or indeed a wholly new arrangement in light of future market developments, but Article 10.1 indicates that the CMA would be predisposed against such an arrangement.

4.2 Termination provisions

(69) Article 3.3 provides that the Draft Order may cease to have effect earlier than contemplated in Article 3.2 where "*the CMA is satisfied that the whole Airwave Network has been permanently shut down and the contractual obligations between Airwave Solutions and the Home Office have come to an end and that Airwave Solutions and Motorola Solutions have complied with all their obligations under the Order.*" This does not allow for the possibility of the Airwave contracts being terminated but the Airwave network continuing to operate. To remedy this, Airwave would suggest removing the words "*whole Airwave Network has been permanently shut down and the*" from Article 3.3. The remaining wording would, in Airwave's view, still achieve the CMA's intended objective as set out in the Final Decision.

4.3 Confidentiality and legal privilege

(70) Article 6 outlines the compliance information that must be provided to the Home Office and the CMA and provides that such information must be "*accompanied by a declaration in the form and meeting the requirements of this Article 6 and Schedule 2.*" Article 8.5 provides that *"[s]ubject to Part 9 of the Act, the CMA may publish any information or documents that it has received in connection with the monitoring or the review of this Order or any provisions of this Order for the purpose of assisting the CMA in the discharge of its functions under or in connection with this Order*." However, this provision (and Part 9) of the Enterprise Act only applies to the CMA; there does not appear to be any provision in relation to the obligations of the Home Office in relation to the confidentiality of this information.

(71) Article 8 outlines the information that the CMA can require be supplied to it under the Order. Article 8 should clarify that the CMA is not permitted to compel the production of privileged materials under the Order.

4.4 Time period for provision of information

(72) Article 7.1 provides that "*Airwave Solutions and Motorola Solutions must respond clearly, accurately and in full, and within 10 working days of the date thereof, to reasonable queries and requests from the Home Office or the CMA for further clarification and substantiation of the compliance information provided under Article 6. The CMA may, in exceptional circumstances, allow a longer deadline for responses to such requests*." This is unnecessarily prescriptive since the CMA might want information in circumstances that are not exceptional that would take Motorola, acting reasonably, more than 10 working days to produce. The formulation proposed by the CMA actually narrows the scope of its powers to request information (since what is a reasonable request would be interpreted by reference to the 10-working-day time limit).

(73) On that basis, Motorola and Airwave suggest that Article 7.1 be amended as follows:

> "*Airwave Solutions and Motorola Solutions must respond clearly, accurately and in full, ~~and within 10 working days of the date thereof,~~ to reasonable queries and requests from the Home Office or the CMA for further clarification and substantiation of the compliance information provided under Article 6. Airwave Solutions and Motorola Solutions must respond to such requests within the time period specified in the request, which must be no less than 10 working days of the date thereof. The CMA may, in exceptional circumstances, allow an extension ~~longer deadline~~ for responses to such requests.*"

5. FINAL COMMENTS

(74) For the reasons given above, there are a number of significant problems that need to be addressed appropriately before an Order could be made to the requisite standard. Accordingly, the CMA is respectfully invited to reconsider its Draft Order in its current form.

(75) Should the CMA decide to make an Order in the terms proposed in the Draft Order, the Draft Order will not properly implement the Final Decision and Motorola and Airwave would apply to the Competition Appeal Tribunal for a review of that decision in accordance with section 179 EA2002.

(76) For the foregoing reasons, the CMA is respectfully invited to revisit the proposal made by Motorola in January 2023 to resolve this issue on a permanent basis. Motorola has suggested above some improvements that could be made to the CMA's proposals. However, Motorola remains of the view that the Draft Order is more complicated than required to address the AEC identified by the CMA. Motorola invites the CMA to consider a simpler approach that would apply an appropriate flat percentage discount to the current contractual pricing. Such approach would avoid all of the ambiguities and complexities identified in this Response, and would allow the Airwave contracts to continue to function as drafted by the parties, unlike the terms of the Draft Order.

(77) Motorola and Airwave would otherwise welcome continued close dialogue and engagement with the CMA on the Draft Order.

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