APPENDIX E

Evidence and analysis on competitive constraints

Introduction

E1 This appendix considers the existence and strength of the competitive constraints faced by Stansted Airport Limited (STAL) in the market for airport operation services to passenger airlines.[1] This consideration covers the situation as it currently stands as well as that reasonably expected over the period 2014 to 2019 (the Q6 period). The examination of these issues will help the CAA assess whether the competitive constraints are sufficient to prevent STAL from having market power.

E2 In doing this, the CAA has considered:

- The ability and likelihood of airlines switching marginal services away from Stansted as a reaction to a price increase or a decline in service standards.
- Whether the extent of such substitution would be sufficient to constrain STAL's behaviour, including with respect to pricing.

E3 The conclusion to this appendix considers the individual and cumulative effect of all constraints on STAL, whether they arise from inside or outside the relevant market defined in appendix D.

E4 The analysis that is undertaken in this appendix is structured as follows:

- Section 1 outlines the legal framework under which the CAA has conducted its analysis.
- Section 2 outlines the position the CAA presented in 'The Stansted market power assessment: Developing its 'minded to' position' (the minded to Consultation).[2] It also summarises the CAA's provisional view from the Stansted Market Power Assessment: consultation on relevant market developments (the additional Consultation).[3, 4]

1 STAL's airport operations to cargo airlines will be the subject of a separate determination.

2 This document is available on the CAA's website: http://www.caa.co.uk/default.aspx?catid=1350&pagetype=90&pageid=14395.

3 Together these two consultations are referred to as the Consultations.

4 This document is available on the CAA's website.

- Section 3 outlines the responses to the Consultations.
- Section 4 outlines the CAA analysis and its responses to the various issues that have been raised by stakeholders.
- Section 5 outlines the CAA's overall conclusion on competitive constraints.

Section 1: Legal framework

E5 This section seeks to assess, in aggregate, the competitive constraints from both within and outside the relevant market that would prevent STAL from having substantial market power (SMP).

E6 Market power can be defined as *'a position of economic strength enjoyed by a firm, which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of consumers*'.[5] It is the ability, profitably, to sustain prices above the competitive level or restrict output or quality below competitive levels.

E7 The assessment of market power involves an analysis of the competitive constraints faced by the operator to see whether they are strong enough to prevent it from harming the process of competition.[6] Market power is not an absolute term but a matter of degree which varies according to the individual circumstances of the case.

E8 A single product market has been defined for STAL's airport operator services to passenger airlines (see appendix D), STAL currently has a limited amount of full service carrier (FSC) traffic (which, at present, tends to prefer to use Gatwick or Heathrow). However, because FSCs account for so little traffic at Stansted, the constraint from this source is unlikely to represent a significant part of the current cumulative constraints on STAL. This may, however, change if STAL is successful in attracting more FSCs.

E9 The focus of this appendix is therefore on low cost carriers (LCCs) and charter airlines (charters) which have different geographical substitution possibilities than FSCs. For example, the CAA considers that there is no constraint from such airlines switching to Heathrow as it is currently unsuitable for the LCC model, is capacity constrained and it is unlikely to

[5] Case 27/76 United Brands v. Commission [1978] ERC 207.

[6] Office of Fair Trading (OFT), Assessment of market power guideline (OFT 415), paragraphs 3.1 to 3.3.

be profitable for HAL to change its offer to attract LCCs. Passenger substitution between Stansted and Heathrow is considered in appendix F.

E10 The CAA has sought to identify the existence and assess the combined strength of all competitive constraints affecting Stansted to assess the degree of market power it may have. For presentational purposes, the CAA's reasoning on each issue has been set out under each heading. However, this does not mean that each issue has been considered in isolation. The CAA has considered the cumulative effect of competitive constraints in reaching its final conclusion.

Countervailing buyer power

E11 Countervailing buyer power (CBP) is broadly defined as a purchaser's ability to leverage its importance to a seller’s business to gain preferential terms. For example, an airline may be able to constrain an airport operator’s pricing power by leveraging the importance of its operations to the airport operator during negotiations to gain better terms. As stated in the Guidelines:

Buyer power exists where buyers have a strong negotiating position with their suppliers, which weakens the latter's potential market power. The CAA considers that assessing the existence and degree of buyer power may be an important aspect of an airport competition assessment and agrees with the OFT's [Office of Fair Trading’s] view that "the strength of buyers and structure of the buyers side of the market may constrain the market power of a seller. Size is not sufficient for buyer power. Buyer power requires the buyer to have choice.[7]

E12 The Guidelines also note that:

The evidence that the CAA may consider in assessing the degree of buyer power could include but might not be limited to:

- *The alternatives available to airlines operating at the airport;*
- *The net switching costs of airlines operating at the airport;*
- *Whether other airlines would be likely to take up airport capacity freed up ban an airline that switched some or all of its operations away from the airport;*

7 The CAA's April 2011 Guidance on the assessment of airport market power (the Guidelines) is available at: http://www.caa.co.uk/docs/5/Final%20Competition%20Assessment%20Guidelines%20-%20FINAL.pdf.

- *Indicators of the importance of a given airline to the airport in question; and*
- *Information on the level of previous airline switching and possible future switching.*[8]

E13 A buyer's bargaining strength might, for example, be enhanced if the following conditions hold:

- The buyer is well informed about alternative sources of supply and could readily, and at little cost to itself, switch substantial purchases from one supplier to another while continuing to meet its needs.
- The buyer could commence production of the item itself or 'sponsor' new entry by another supplier (e.g. through a long-term contract) relatively quickly and without incurring substantial sunk costs.
- The buyer is an important outlet for the seller (i.e. the seller would be willing to cede better terms to the buyer to retain the opportunity to sell to that buyer).[9]

E14 The European Commission's (EC) Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings' (2004/C 31/03) explain CBP as:

The competitive pressure on a supplier is not only exercised by competitors but can also come from its customers. Even firms with very high market shares may not be in a position, post-merger, to significantly impede effective competition, in particular by acting to an appreciable extent independently of their customers, if the latter possess countervailing buyer power. Countervailing buyer power in this context should be understood as the bargaining strength that the buyer has vis-à-vis the seller in commercial negotiations due to its size, its commercial significance to the seller and its ability to switch to alternative suppliers.[10]

E15 The Competition Appeal Tribunal (CAT) considered the existence of CBP in Hutchinson 3G v Ofcom in relation to a finding that Hutchinson 3G had significant market power. The CAT explained that the degree of buyer power was important:

For these purposes the right question is not the binary one of whether CBP exists or not. In other words, it is not enough to ask whether there is

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8 The Guidelines, chapter 6: Airline buyer power.

9 OFT, Assessment of market power guideline (OFT 415), p. 24.

10 EC Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings (2004/C 31/03). Those factors are not exhaustive or conclusive – see *Hutchinson 3G v Ofcom* [2005] CAT 39, paragraph 111.

CBP, and if so to hold that there cannot be SMP. CBP is the power of counterparties to offset the powers of the party whose allegedly superior powers are under consideration, and the important question is what degree of CBP is there, and (bearing in mind all the circumstances) does it operate to a sufficient extent so as to mean that there is no SMP? CBP is not an absolute concept in terms of its strength. It is a concept which embodies a possible range of strengths.[11]

And:

…*Various factors will contribute to, or detract from, the power of the buyer, and they will have various strengths depending on the market in question*.[12]

E16 Accordingly, the assessment of CBP is an assessment of how the market actually operates (or is likely to operate) on the true facts to see whether an airline has a real and effective bargaining position that is sufficient to counter the factors which would otherwise point in favour of an airport operator having SMP.

Barriers to Entry

E17 The scope for entry by new airports and expansion by existing ones is also considered because of the potential for competition from these sources. Where entry barriers are low, it might not be profitable for an airport in a market to sustain prices above competitive levels because this would attract new entry which would then drive the price down, if not immediately, then in the long term. Barriers to entry in the form of planning permission and processes are relevant in the airport market, while in the downstream market for air transportation, acquiring slots can be a barrier to entry.

Section 2: The Consultations

The minded to Consultation

E18 In the minded to Consultation, the CAA considered that STAL may have SMP. However, over the Q6 period, the CAA considered that the competitive constraints faced by STAL would weaken as capacity becomes tighter across the main London airports. Consequently, the CAA concluded that STAL would be likely to acquire SMP.

11 *Hutchinson 3G v Ofcom* [2005] CAT 39, paragraph 110.

12 *Hutchinson 3G v Ofcom* [2005] CAT 39, paragraph 111.

E19 In coming to this decision, the CAA estimated that STAL's loss of revenue following increases in airport charges of 5 and 10 per cent would not exceed the critical loss[13] required to make a price increase unprofitable.

E18 The CAA also considered that while easyJet had a degree of buyer power Ryanair did not, due to the lack of alternative London airports, to which it could switch.

E19 The CAA also outlined that likely future developments in the market, including the imminent divestment of Stansted, and the potential implications of that would form a key part of its final decision. The CAA acknowledged that one potential implication would be if the new owners of Stansted established different behaviours and relationships with the airlines.

Additional Consultation

E20 Following the release of the minded to Consultation there have been a number of significant market developments, including:

- In February 2013, with the approval of the Competition Commission (CC), Manchester Airports Group (MAG) acquired STAL.
- MAG, soon after the acquisition of STAL, commenced and reached long-term bilateral agreements with some of its passenger airlines, including easyJet and Ryanair (which together account for over 90 per cent of traffic at Stansted – see appendix G for more information).

E21 In October 2013, to gain a better understanding of the implications of these market developments, the CAA issued the additional Consultation. In the additional Consultation the CAA set out a provisional view that Test A would be failed in light of easyJet and Ryanair agreeing long term deals on airport charges. These deals involved prices that the CAA considered were within the range of prices that could be competitive.

E22 As part of the additional Consultation, the CAA asked stakeholders for their views on the implications of these deals, including whether easyJet and Ryanair have a sufficient level of buyer power to constrain STAL. The responses to additional Consultation have been considered by the CAA in reaching its conclusion on the market power assessment for STAL.

[13] See: appendix F for a description of the critical loss and its calculation.

Section 3: Stakeholders' views

The minded to Consultation

E23 The CAA received seven responses to the 'minded to' Consultation, six of which were relevant to the STAL passenger airline market:[14]

- easyJet;
- Gatwick Airport Limited (GAL);
- MAG (two submissions);
- Ryanair; and
- London Southend Airport Company Limited (LSAL).

E24 The principal points made in these responses are summarised below.

Airport operators' views

E25 MAG, in response to the minded to Consultation, made the following points on competitive constraints:

- The scope for airline switching is sufficient to constrain STAL's pricing. In particular, MAG considered that the grounding of aircraft can constitute a considerable form of switching.[15]
- The CAA had not taken into account the constraint on STAL from other European airport operators, and had failed to gather appropriate evidence such as airline route yields.[16]
- The CAA had not taken into account the constraints on STAL from other London airport operators and the impact of their spare capacity.[17]
- The CAA had adopted a novel concept of strategic constraints without evidence.[18]

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14 The responses to the minded to Consultation are available on the CAA's website: http://www.caa.co.uk/default.aspx?catid=1350&pagetype=90&pageid=14395.

15 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', p. 76.

16 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', p. 34 and p. 29.

17 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', pp. 44 to 50.

18 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', p. 81.

- The CAA had failed to analyse competitive constraints at the margin, and the analysis undertaken did not assess the cumulative constraint from other UK airports.[19]
- The CAA had disregarded Ryanair's buyer power, although it agreed with the CAA's view that easyJet has buyer power.[20]
- The CAA had failed to analyse the implications of the change in ownership and this made the CAA analysis static instead of forward looking.[21]

E26 GAL considered that the CAA had erroneously concluded that STAL had SMP. GAL identified various concerns/omissions with the CAA's approach, including those associated with competitive constraints, due to:

- Market developments since the release of the market power assessment, in particular Stansted's sale and the new owner's indication that it will compete more actively than it did under BAA. GAL also considered that STAL's behaviour under BAA ownership was now irrelevant to the CAA's assessment.[22]
- Lack of consideration of the cumulative impact of constraints.[23]
- Selective use of evidence and undue weight given to historic views and historic behaviour of airlines. GAL also suggested that more weight had been given to airlines' views over those of the airport operators.[24]

Airline views

E27 easyJet, in its response to the minded to Consultation, supported the CAA's finding that the market power test (MPT) was met at Stansted and that continued economic regulation was justified.[25] It also noted that, with new ownership at Stansted, it was unclear whether the same approach that the previous owners adopted would be used going forward.[26]

E28 easyJet also considered that:

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19 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', p. 73.

20 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', p. 67.

21 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', p. 13.

22 GAL, CAA Stansted market Power Assessment – Response from Gatwick Airport, p. 1.

23 GAL, CAA Stansted market Power Assessment – Response from Gatwick Airport, p. 5.

24 GAL, CAA Stansted market Power Assessment – Response from Gatwick Airport, p. 4.

25 See chapter 1 for a description of the MPT.

26 easyJet, easyJet's reply to the CAA's 'minded to' decision on STAL's market power, p. 1.

- The scope for meaningful airport competition in London is limited due to congestion.[27]
- The presumption that its presence at other London airports provides it with a degree of buyer power is incorrect and noted the CC's consideration that Southend was unlikely to provide a long-term risk to STAL.[28]

E29 With respect to competitive constraints from Southend, easyJet:

- Considered that Southend provided a complementary service to satisfy unmet demand; only one route has been moved from Stansted to Southend [✂] and that a more detailed analysis was required.
- Noted that operational restrictions at Southend limited the routes which could be switched and the number of aircraft that could be based there.

E30 However, since the release of the minded to Consultation, easyJet has agreed a long-term deal with STAL and has reversed its view on whether or not STAL has SMP. easyJet now considers that STAL does not have SMP. This was stated in an SACC letter dated 25 June 2013 to the CAA[29], which said that easyJet considered: '*that STAL does not have SMP over easyJet'* and '*in consequence, from easyJet's perspective, STAL does not require economic regulation.'*

E31 easyJet confirmed this view in a reply email to the CAA[30] where it noted that:

easyJet's view of Stansted's market power is that Stansted is not currently exerting market power over easyJet. Therefore we do not believe there is any need for it to be economically regulated.

E32 Ryanair welcomed the CAA's minded to Consultation and made a number of comments on the analysis that had been undertaken. In particular, Ryanair considered that STAL holds SMP rather than may currently hold SMP.[31]

E33 Ryanair also outlined that:

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27 easyJet, easyJet's reply to the CAA's 'minded to' decision on STAL's market power, p. 2.

28 easyJet, easyJet's reply to the CAA's 'minded to' decision on STAL's market power, p. 2.

29 SACC, letter to the CAA, available at: http://www.caa.co.uk/docs/78/SACCApr13.pdf.

30 Source: easyJet [✂].

31 Ryanair, Ryanair's reply to the CAA's 'minded to' decision on STAL's market power, section 1 paragraph 3.

- Capacity constraints mean that it is unable to switch from Stansted to Gatwick.[32]
- It disagreed that LCCs' ability to yield manage across a range of markets provides a degree of pricing constraint on STAL. Ryanair also noted that previous switching had been ineffective in securing lower airport charges at Stansted.[33]
- It questioned whether new owners at Stansted would result in increased competition with Heathrow.[34]

The additional Consultation

E34 The CAA received seven responses to the Market developments consultation, five of which were relevant to the STAL passenger airline market:

- MAG;
- Ryanair;
- SACC;
- GAL; and
- London First.

E35 The principal points made in the responses are summarised below.

Airport operators' views

E36 MAG agreed with the CAA's revised view that airlines' ability to negotiate prices that are lower than the current regulatory price cap, which the CAA regarded as being commensurate with the reasonable range of a competitive price for Stansted, provided evidence that airlines at Stansted have buyer power.[35]

E37 However, MAG also considered that the effect of the developments since January 2013 on Test A went much wider than the issue of CBP. MAG

[32] Ryanair, Ryanair's reply to the CAA's 'minded to' decision on STAL's market power, paragraph 5.

[33] Ryanair, Ryanair's reply to the CAA's 'minded to' decision on STAL's market power, section 2 paragraph 3.

[34] Ryanair, Ryanair's reply to the CAA's 'minded to' decision on STAL's market power, section 2 paragraph 6.

[35] MAG response to CAA Stansted Market Power Assessment consultation on relevant market developments, p. 8.

maintained that the new situation demonstrated the behaviour of a business operating in a competitive environment, and not one with SMP.[36]

E38 In addition, MAG drew the CAA's attention to its (approximate) £40 million investment in the terminal transformation project at Stansted and aspects of the deals it had concluded with airlines that it expected to increase significantly the level of retail income per passenger.[37]

E39 GAL considered that the CAA was being inconsistent in its treatment of a change of STAL's ownership and its treatment of the same issue with respect to GAL.[38]

Airline views

E40 Ryanair and the SACC (with the exception of easyJet) considered that the signing of the long-term deals did not provide any justification for the CAA to change its 'minded to' conclusion that Test A was passed. Both considered that market power is a function of the underlying conditions in the relevant market and the recent agreements had not altered the fundamental issues, which demonstrated that STAL has market power.[39]

E41 SACC noted that it was only in April 2013, with the release of the CAA consultation, Economic Regulation at Stansted from April 2014: Initial Proposals, CAP1030 (the Initial Proposals)[40], which indicated that STAL would, in effect, be regulated that the context for deal-making was complete. SACC's view was that, in April 2013, it became clear that the only way for MAG to increase revenues at STAL was through growth deals.[41]

E42 Ryanair and the SACC also considered that STAL had exercised its market power by getting easyJet and Ryanair to commit to very significant volume growth to achieve prices that are less than the current cap, which is above the competitive level.[42]

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36 MAG response to CAA Stansted Market Power Assessment consultation on relevant market developments, p. 8.

37 MAG response to, CAA Stansted Market Power Assessment consultation on relevant market developments, p. 9.

38 GAL response to, CAA Stansted Market Power Assessment consultation on relevant market developments, p. 1.

39 Ryanair, Response Letter to the CAA, Re: Stansted Market Power assessment: consultation on relevant market developments, 11 November 2013; and Stansted ACC, Response Letter to the CAA, Re: Assessing the Market Power of Stansted Airport, 8 November 2013, p. 2.

40 This document is available at: http://www.caa.co.uk/application.aspx?catid=33&pagetype=65&appid=11&mode=detail&id=5523.

41 Stansted ACC, Response Letter to the CAA, Re: Assessing the Market Power of Stansted Airport, 8 November 2013, p. 3.

42 Ryanair, Response Letter to the CAA, Re: Stansted Market Power assessment: consultation on

Section 4: CAA analysis

E43 In light of the representations from stakeholders as part of the minded to Consultation the CAA has re-evaluated its assessment of the evidence on the competitive constraints on STAL and has changed its position from outlined in that document. The CAA now considers that the evidence on competitive constraints suggests that STAL does not have SMP and that it is unlikely to acquire it over the Q6 period. This view is consistent with the provisional view outlined in the additional Consultation.

E44 For the purposes of this document, the CAA considers that there are sufficient constraints, particularly from the degree of buyer power held by STAL's two key airlines, easyJet and Ryanair, to offset STAL's market power.

E45 The evidence and reasons for this conclusion is set out in the section below on an issue by issue basis. In particular:

- Section 4.1 discusses the means by which a passenger airline might be able to discipline an airport operator.
- Section 4.2 discusses the likely scale of airline switching that would be necessary to discipline an airport operator and whether margin analysis is a useful means of estimating actual switching.
- Section 4.3 discusses switching costs and the ability of Stansted's passenger airlines to switch in general. It includes a discussion of the strategic importance of London to passenger airline switching.
- Section 4.4 discusses barriers to entry and potential competition, including:
  - The degree of the competitive constraints that may result from entry and/or expansion by other airports.
  - The implications of current capacity constraints.
  - The potential implications of future demand forecasts and future capacity constraints.
- Section 4.5 discusses countervailing airline buyer power.
- Section 4.6 discusses the effect of measures to increasing spending by passengers at Stansted.

relevant market developments, 11 November 2013. p. 2 and Stansted ACC, Response Letter to the CAA, Re: Assessing the Market Power of Stansted Airport, 8 November 2013, p. 4.

- Section 4.7 discusses the evidence on switching across London and Europe; and the scope and scale of actual switching following the 2007 removal of discounts from airport charges at Stansted.;
- Section 4.8 presents the conclusion and overall assessment of the competitive constraints on STAL.

E46 The CAA received a number of responses to the Stansted - Market Power Assessments, the CAA's Initial Views – February 2012 (the Initial Views), the minded to Consultation and the additional Consultation. It has carefully read and considered all the points made in each response. This document contains summaries of, and answers to, many of those points.

E47 Each section in this appendix presents the CAA's position as set out in the Consultations on an issue by issue basis, followed by stakeholders' views and then the CAA's analysis. Each section has a conclusion that presents the CAA's position on that topic. The final section presents the CAA's conclusion on whether the evidence on competitive constraints suggests whether or not STAL has SMP.

Section 4.1: Means of airline switching

The minded to Consultation

E48 In the minded to Consultation, the CAA identified several ways an airline could try to discipline an airport operator by switching. These mechanisms were described separately but the CAA's conclusion took account of their cumulative effect in reaching its overall conclusion.

E49 The CAA considered that:

- Allocating growth may not, by itself, lead to a reduction in the short term of an airline's existing services at an airport, which means that this strategy might not result in a significant constraint.
- The scope for an airline to discipline the airport operator by reducing the frequencies relied on the airline operating W patterns, which they rarely did.
- Switching marginal based aircraft away from Stansted was likely to be the most effective way to constrain the airport operator.
- Grounding based aircraft was unlikely to be a rational switching response especially during the summer traffic seasons due to the significant opportunity cost of doing so for airlines.

Stakeholders' view

E50 MAG submitted that *'if evidence of airline switching is taken as a whole, it is clear that the scope for switching is sufficient to constrain Stansted's pricing'.*[43]

E51 MAG also considered that grounding of aircraft could constitute a considerable form of switching as the grounding of aircraft significantly affected STAL's revenues and profitability as non aeronautical charges are payable, the parking fees associated with a grounded aircraft are minimal and STAL's commercial revenues are adversely affected by the reduction in passengers.[44]

CAA views and analysis on means of switching

E52 Consistent with the minded to Consultation, the CAA considers that allocating growth to other airports may not, by itself, lead to a reduction in the short term of an airline's existing services at an airport. Therefore, it might not result in a significant constraint if the airport considers it more profitable to achieve higher margin on existing traffic than lower prices on volume traffic after growth has been allowed for.

E53 However, when there is significant spare capacity at an airport, the allocation of growth directly affects the airport operator's future revenues and profit, which is not the case when an airport is at or approaching full capacity. The allocation of growth by easyJet and Ryanair (airlines with large shares of STAL's business) is considered in the discussion on CBP below.

E54 The CAA also considers that reducing the frequency of existing routes to and from an airport might constrain an airport operator if the reduction is of a sufficient scale. However, the evidence suggests that achieving this by flying W patterns is not attractive to airlines for operational reasons.

E55 Switching based aircraft and grounding is also another way that an airline could look to discipline an airport operator. As noted in the minded to Consultation, the majority of movements at Stansted are undertaken by aircraft based at the airport. However, a number of airlines fly to Stansted from other destinations (4 per cent of Stansted's passengers). For example, CAA analysis of registrations and flight pattern on 2 July 2012 indicated that around 20 per cent of Ryanair and 25 per cent of easyJet's Stansted services were inbound.

[43] MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to' document, p. 71.

[44] MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to' document, p. 78.

E56 Since the removal of discounts to airport charges in 2007 there has been some switching of based aircraft away from Stansted.

- Airlines that have switched to Gatwick are set out in appendix D.
- In April 2012, easyJet sponsored the entry of Southend by moving 3 based aircraft from Stansted to Southend.
- There appears to have been a small reduction of [✂] summer based aircraft, from [✂] in 2007 to [✂] in 2012, in Ryanair's fleet based at Stansted.[45]

E57 However, it is not clear how much of the observed switching was due to airport charges. The evidence on the switching to Gatwick appears to have been mainly market reasons that are not price-related. The CAA therefore considers that while moves for market reasons establish that switching is possible, they do not establish that switching would occur in response to an increase in airport charges and thereby exert an effective constraint on STAL.

E58 The CAA also considers that grounding based aircraft is a form of switching that should have a similar effect to re-basing aircraft. For example, Ryanair told the CAA that the number of its based aircraft at Stansted in the winter traffic seasons was reduced by over 30 per cent between 2006 and 2012 (through grounding or reducing their use). Ryanair also told the CAA that this grounding was in response to STAL's withdrawal of discounts to its main airlines, which resulted in a doubling of airport costs, a lack of agreement for off-peak growth support, as well as rising fuel costs. However, Ryanair has indicated that its withdrawal of aircraft had no disciplining effect on the airport under BAA's ownership, as STAL failed to deliver reductions in airport charges even in the winter months at that time.[46]

E59 While MAG maintains that the evidence of grounding by Ryanair and easyJet, shows that the grounding of aircraft by airlines is a form of switching that could make a 10 per cent price increase unprofitable,[47] it is not clear to the CAA how much of any increase in grounding can be attributed to an increase in airport charges as opposed to other factors such as reduced demand or higher fuel prices.

E60 The CAA also considers that the opportunity cost for airlines of grounding aircraft in the winter season is typically lower than in summer seasons

45 Source: Ryanair [✂].

46 Source: Ryanair [✂].

47 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', pp. 76 to 77.

mainly due to lower overall demand for air travel during winter months.[48] However, the relevant question that needs to be addressed is whether an increase in airport charges is likely to tip an aircraft from operating to being grounded and thereby impose a constraint on airport prices at the margin. This depends on the relative size of an increase in airport charges and operating margins.

E61 The CAA accepts that STAL's commercial revenues are adversely affected by the reduction in passengers that would result from increased groundings.[49] This link was taken into account in the critical loss analysis that the CAA outlined in appendix F and has been considered as part of the CAA's overall decision on whether STAL has SMP.

Conclusion on means of switching

E62 On the basis of the discussion above, the CAA considers that airlines at Stansted are capable of constraining STAL by four different means of switching. However, the effectiveness of these four different means of switching is different.

- Allocating new growth to other airports: as Ryanair and easyJet account for over 90 per cent of passengers at Stansted, the CAA considers that they have an ability to allocate growth to exercise buyer power. This is examined in section 4.5 on buyer power below.
- Reducing frequencies of existing based or inbound aircraft: the CAA considers that the evidence does not suggest that this appears to be an effective form of switching to the extent that it entails altering flying patterns.
- Switching marginal based aircraft or inbound aircraft: this is likely to have the most important incremental impact on the profitability of a price rise because of the number of frequencies removed. However it is dependent on the availability of capacity at the switched-to airport.
- Additional grounding of based aircraft appears to be a potential means of switching at the margin.

E63 The CAA accepts that it is the cumulative effects of all means of switching that it is relevant to assessing the degree of competitive constraint, to which STAL is subject.

[48] However, this is principally in reaction to a lower level of demand, and does not necessarily indicate a temporal market.

[49] MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', p. 77.

Section 4.2: The required scale of switching and estimates of the scale of switching

The minded to Consultation

E64 In the minded to Consultation, the CAA examined the number of passengers and aircraft that would need to be switched away to make a 10 per cent increase in airport charges unprofitable for STAL, taking account of its loss of aeronautical and non-aeronautical revenue from reduced passengers (the critical loss).

E65 Frontier Economics estimated on behalf of easyJet that, to make a 10 per cent price increase unprofitable, Stansted would have to lose between 1.1 million and 1.3 million passengers per year out of the 2011 total of 18 million. It estimated that this was equivalent to 29 daily Air Transport Movements (ATMs)[50], which means that to discipline the airport, easyJet would need to relocate 4 to 5 of its aircraft currently based at Stansted.[51]

E66 Drawing on Frontier Economics' analysis, the CAA estimated the number of passengers that Stansted would need to lose to make a price rise unprofitable. The CAA estimated that with a 10 per cent increase in aeronautical revenue per passenger, estimated that approximately 4 aircraft, representing between 1.2 million and 1.4 million passengers per year, would amount to a critical loss of movements for Stansted, making the price increase unprofitable.

Stakeholders' views

E67 MAG's view was that the CAA must undertake an analysis of route yields at Stansted to identify marginally profitable routes, as this would enable the CAA to identify which airlines would switch away from Stansted in response to a price increase.[52] MAG considered that this would be a means of estimating the actual amount of airline switching that would occur in response to an increase in airport charges.

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50 Having estimated the passenger numbers required to respond to a price increase Frontier Economics convert this into the number of planes required to switch away from an airport. To derive the number of planes required to switch, Frontier Economics assumed that there is a uniform percentage reduction in passengers across ATMs.

51 The analysis undertaken by Frontier Economics indicates that the price elasticity of demand for air travel required for passengers to switch so that there is no additional profit at Stansted airport is 6.7. (Source: Frontier Economics report, Table 2, p. 13.)

52 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to' document.

CAA views and analysis of marginal route profitability at Stansted

E68 The CAA has analysed route revenue and profitability data it received from Ryanair and easyJet to identify:

- The extent to which marginal routes at Stansted were at risk of being cut in response to a 5 to 10 per cent price increase in STAL's airport charges.
- How many passengers those routes carried as a proportion of the total.

E69 The CAA examined the bottom of the route profitability distribution for each carrier and considered how much a €1/£1 reduction in profit per passenger would affect that distribution.

E70 However, in doing so the CAA recognised that there are difficulties in determining exactly where the appropriate cut-off for a marginal route is, let alone if a cut off actually exists.

E71 To try and address this risk, the CAA took a range of cut-off points towards the bottom of the route profitability distribution and estimated the number of passengers in routes within €1/£1 of that range cut-off points on the assumption that these would be the numbers of passengers that would be lost if airport charges were to increase. The CAA then compared relative reduction in passenger numbers with the relative increase in terms of airport charge that a €1/£1 increase represents to compute implied airport charge elasticities. If these were below the critical elasticity then that would indicate that an increase in airport charges would be profitable for STAL.

E72 There are, however, several limitations in using this data to infer an airport charge elasticity of demand in this way:

- This analysis assumes that the airlines are not able to pass on any airport charge increase to passengers and instead airlines absorb all the airport charge increase.
- This analysis also assumes that, faced with a price increase, the only tool available for airlines to respond to the airport charge increase is to close routes. In practice, airlines also have the ability to reduce frequency and continue serving some of these marginal routes as well as to reduce frequency on non-marginal routes. Airlines can also try to increase the efficiency and adjust the offering of their services.

- Capacity and route selection decisions are much more complex than is assumed by this analysis. Considerations of route maturity, corporate strategy and product range, strategic competitive effects, economic expectations, the need to complete an efficient schedule and retaining strategic slots or volume deals will all play a part on the airline's decisions to drop or maintain a route.

E73 The combined effect of these limitations on the elasticity is uncertain. Nevertheless, the CAA presents the analysis of confidential data received from Ryanair and easyJet in turn below.

Ryanair

E74 Figure E.1 (below) shows the number of passengers and profit per passenger for the [✂] Ryanair routes at Stansted in 2012.[53]

E75 The smallest route considered had [✂] passengers and the largest had [✂]. Route average profit per passenger ranged between [✂] and a [✂].

Figure E.1: Routes' profit (€) and passengers on Ryanair's routes at Stansted

[✂]

Source: CAA analysis of Ryanair's data

E76 The CAA considers that routes with average profit per passenger between [✂] to be the most likely to be marginal with respect to airport charges. [✂]. The routes in this range represented [✂] per cent of Ryanair's passengers at Stansted.

[53] Profit being defined as earnings before interest tax debt and amortisation (EBITDA).

Figure E.2: Routes and passenger numbers in selected €1 profit intervals of Ryanair's routes at Stansted

€1 Profit interval (€)	Routes in interval	Passengers (000s) in interval	per cent of total Ryanair's passengers at Stansted
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]

Source: CAA analysis of Ryanair's data

E77 Based on the data presented in Figure E.2 above, the CAA estimates that the passenger loss accruing from marginal route loss, if Ryanair were to be faced with a €1 profit reduction per passenger, would be around [✂]. Since a €1 increase represents an increase of about 12 to 14 per cent increase on a £6 to £7 airport charge,[54] then that would imply an airport charge elasticity of about [✂]. This estimate is [✂] and it would therefore mean that marginal route switching would be unlikely to be able to constrain significantly STAL's pricing.

easyJet

E78 Figure E.3 (below) shows the number of passengers and "contribution" (a measure of route profitability in terms of contribution to overheads provided by easyJet) per passenger for the [✂] easyJet routes at Stansted, in 2011. If all costs were inputted to the routes, the contribution curve should shift downwards.

E79 The smallest route considered had [✂] passengers and the largest had [✂]. Route average contribution per passenger ranged between [✂] and [✂] per passenger.

54 Given an exchange rate of €1.15 to the pound.

Figure E.3: Route contribution (£) and passengers on easyJet's routes at Stansted

[✄]

Source: CAA analysis of easyJet's data

E80 Again, the CAA looked at the bottom of the route profitability distribution and considered how much a £1 variation in contribution per passenger would affect that distribution. The CAA considers that routes with average contribution per passenger between [✄] to be the most likely to be marginal with respect to airport charges. [✄]. The routes in this range represented [✄] per cent of easyJet's passengers at Stansted.

Figure E.4: Routes and passenger numbers in selected £1 pound contribution intervals of easyJet's routes at Stansted

£1 Contribution interval (£)	Routes in interval	Passengers (000s) in interval	per cent of total easyJet's passengers at Stansted
[✄]	[✄]	[✄]	[✄]
[✄]	[✄]	[✄]	[✄]
[✄]	[✄]	[✄]	[✄]
[✄]	[✄]	[✄]	[✄]
[✄]	[✄]	[✄]	[✄]
[✄]	[✄]	[✄]	[✄]
[✄]	[✄]	[✄]	[✄]
[✄]	[✄]	[✄]	[✄]
[✄]	[✄]	[✄]	[✄]
[✄]	[✄]	[✄]	[✄]
[✄]	[✄]	[✄]	[✄]

Source: CAA analysis of easyJet's data

E81 Based on the data presented in Figure E.4 above, the CAA estimates that the passenger loss accruing from marginal route loss, if easyJet were to be faced with a £1 profit reduction per passenger, would be around [✂] per cent. If £1 represents an increase of about 14 to 17 per cent increase on a £6 to £7 airport charge, then that would imply an airport charge elasticity of about [✂]. This estimate is [✂] and it would therefore mean that marginal route switching would be unlikely to be able to constrain significantly STAL's pricing.

Conclusion from the analysis

E82 In reaching its market power decision, the CAA has placed limited reliance on this analysis (particularly on any point estimates of price sensitivity) given the limitation of the analysis identified above.

E83 Overall, the CAA considers that the effect of a 5 to 10 per cent increase in airport charges on route profitability alone is unlikely to lead airlines to cut routes to such an extent that they would prevent STAL from profitably increasing its charges. That is mainly because a 5 to 10 per cent increase in airport charges represents a small amount compared with the airlines total profits per passenger and its variance across routes.

E84 The CAA could not see evidence that a 5 to 10 per cent increase in airport charges would be sufficient, on its own, to induce a large drop in passenger numbers because of airlines cutting routes of marginal profitability per passenger.

Conclusion on the estimated and required scale of switching

E85 The CAA maintains its minded to Consultation position on the magnitude of the critical loss required to make an increase in airport charges unprofitable and its assessment, based on estimates of passenger elasticity of demand, that actual losses of passengers would be insufficient to do so.

E86 The CAA also considers that the analysis of route profitability is not a reliable means of identifying marginal capacity at Stansted.

Section 4.3: Switching costs

Minded to Consultation

E87 The minded to Consultation examined the types of switching costs faced by Stansted's airlines and whether or not they would be likely to be incurred if airlines switched to another airport. The categories of switching costs potentially faced by an airline were described in detail in the CC's

2009 report, BAA Markets Investigation, which is summarised in Box 1 below.[55]

E88 The CAA found that the costs of physically switching aircraft and crew are typically low for both based and inbound LCCs and charter airlines. However, there were other costs that have to be considered, when switching away from an airport, including the potential cost of losing economies of scale and loss of service quality that might result from switching away a number of based aircraft. The costs of marketing new routes and loss of yield on new compared to mature routes were also considered to be important.

E89 The CAA also outlined that it had considered the traditional switching costs of the three general types of passenger airlines at Stansted i.e. based LCCs, inbound scheduled carriers and charters.

55 See appendix 3.1, BAA Airports Market Investigation, Competition Commission 2009, available at: BAA airports market investigation | Our work | Competition Commission (accessed 23 December 2013).

Box E1: Summary of the switching costs identified in the CC's 2009 BAA Report

Cost of physical relocation: these are one-off costs incurred when re-basing aircraft, which could include relocating flight crew if the airport to which the aircraft is rebased is a considerable distance from the current airport. There may also be ground staff redundancy or recruitment expenses. If an aircraft is being relocated to an airport where the airline has existing operations, these costs may well be smaller than if it were opening a new base, in which case some additional start-up expenses might be incurred.

Long-term commitments: an airline might have a multi-year contract with an airport where the charges it pays are linked to the volume of passengers it carries. An airline could also have long-term arrangements for maintenance facilities at the airport. Full or partial switching of aircraft or services could well break these agreements, and the benefits of these agreements would need to be considered against the offer at an airport to which the airline may switch.

Loss of economies of scale: switching away one or more aircraft from a base could result in the loss of economies of scale at that particular airport as the size of the airline's operations is reduced. However, this switching cost might be offset by the creation of economies of scale at the airport to which the aircraft is (are) being relocated, or may not be significant if the aircraft switching occurs between two or more sizeable bases.

Market effects: these include transitory costs of switching aircraft to substitute airports. Marketing costs can be incurred for new routes, and the lower yields in the first year(s) of a route's operation as the yields reach maturity. These costs could be offset to an extent by the airport to which the aircraft is (are) relocated offering discounts (or direct marketing support) to new airlines or for the operation of new routes. In addition, these costs may be smaller if the aircraft and routes are moved to airports that are proximate to the original airport, and whose catchment area(s) overlap with it. However, there may be longer-term market effects resulting in lower yields, even on mature routes, which could occur from operating routes from airports whose location is less attractive or where the airline faces more direct competition.

Network effects: network effects can occur at an airport where the number of airlines or routes offered increases the number of passengers choosing to fly from the airport, which in turn can make the airport more attractive to other airlines. Switching away from an airport, in particular to a smaller airport, might result in the airline losing the benefits of these network effects. However, the strength of these effects varies on a case-by-case basis.

Capacity constraints: capacity constraints at other airports that are seen as substitutable by an airport's incumbent airlines can reduce the threat and likelihood of airline switching as airlines might be less able to relocate aircraft in a profitable way and on a sufficient scale to constrain the airport. These capacity constraints can occur, for example, from a lack of suitable runway slots, aircraft parking stands capacity, and/or terminal capacity.

Sunk costs: these are irrecoverable costs resulting from an airline's investment in infrastructure and facilities at an airport, either through purchase or leasing. Where the assets are owned by the airline, the initial investment costs might be, to an extent, recoverable through the sale of the assets, thereby reducing the size of the sunk costs.

E90 The CAA also considered that strategic constraints could be an important factor in an airline's decision to switch away marginal aircraft from London. For example:

- Ryanair and easyJet, operating from London appeared to be central to their network strategy.
- Charters seemed to face fewer strategic constraints in switching away from Stansted due to their business model targeting an airport's local core catchment area.
- Inbound scheduled airlines appeared unlikely to face considerable strategic constraints in their decisions to switch away from Stansted.

Stakeholders' views

E91 MAG, in response to the minded to Consultation criticised the CAA for not estimating switching costs directly.[56] MAG also raised a number of other concerns with the CAA's approach:

- MAG argued that strategic switching costs are a novel and unevidenced concept, which ignored the key consideration of marginal customers.[57]
- MAG criticised the CAA for a lack of precision of what constituted a strategic switching cost. MAG found it difficult to reconcile the CAA's analysis of strategic switching costs with '*the large scale exit of capacity from Stansted over recent years*'.[58]
- MAG considered that the existence of strategic switching costs must imply that there is '*substantial value in servicing London routes even when they are not "ordinarily" or traditionally profitable*'.[59] MAG also disagreed that London offered unique attributes to airlines.
- MAG questioned whether backfill was likely at Stansted and considered that:
    - Backfill is unlikely to be a problem while Stansted operates at less than full capacity as an airline could always return once it had abandoned its slot.

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[56] MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to' document, p. 75.

[57] MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to' document, p. 11.

[58] MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to' document.

[59] MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to' document, Annex A, p. 20.

- An entrant taking up the vacated route would have to be more efficient than the airline vacating the route.

E92 Ryanair agreed that London is of strategic importance to airlines and that there are capacity constraints at other London airports. It also noted that based aircraft at London cannot be considered marginal given the importance of London.[60]

E93 easyJet also considered that the CAA was correct to recognise the potential for strategic and capacity constraints to limit airlines' ability to constrain STAL.[61]

CAA views, analysis and conclusion on switching costs

E94 It is useful to consider the switching costs of based and inbound LCCs and charter airlines separately as they are likely to be different.

Based LCCs

E95 As mentioned, Ryanair and easyJet carry approximately 90 per cent of Stansted’s airport traffic. Information on the switching costs of both of these is outlined below.

E96 Ryanair has indicated that the largest sunk switching cost it would face when switching away from Stansted is associated with the expenditure it has incurred through marketing and promotional fares offered on more than 100 routes at Stansted over the past two decades. Ryanair considers that these costs are substantial and that this prevents it from withdrawing a significant part of traffic on a year-round basis.[62]

E97 Other switching costs that Ryanair has indicated that it would incur included the loss of yield (relative to a mature route) from opening a new route[63], redundancy costs, the loss of efficiency of engineering facilities and economies of scale.[64]

E98 Frontier Economics carried out an analysis of switching costs for easyJet and this highlighted that:

60 Ryanair, Ryanair's reply to the CAA's 'minded to' decision on STAL's market power.
61 easyJet, easyJet's reply to the CAA's 'minded to' decision on STAL's market power, p. 3.
62 Source : Ryanair [✄].
63 Source: Ryanair [✄].
64 Source: Constructive Engagement transcript meeting notes, p.16.

crew relocation costs would be more significant if easyJet were to switch based aircraft between Stansted and Gatwick, these would be likely to be minimal if relocating between Stansted and Luton.[65]

E99 The Frontier Economics' report also estimated that easyJet faces [✄] per passenger in additional marketing costs in the first year of operating a new route[66]. It also indicated that the switching cost:

[✄][67] Similarly, additional evidence provided by easyJet shows that marketing costs for switching three aircraft from Stansted to Southend would be up to [✄].[68]

E100 Overall, the evidence suggests that the based scheduled airlines at Stansted would not face high physical switching costs if they were to switch away aircraft from the airport due to the lack of any significant infrastructure investment at Stansted. However, the CAA considers that marketing, promotional and route yield loss are significant switching costs for these airlines.

Inbound scheduled carriers

E101 In recent years, Stansted has lost a number of inbound airlines that have switched to Gatwick. Inbound airlines accounted for approximately 4 per cent of passengers at Stansted in 2011, having declined from approximately 6 per cent in 2007.

E102 The CAA asked three of these airlines, Air Asia X, Air Berlin and Wizz about the costs and practical aspects of switching away from Stansted.

E103 Air Asia X provided information on the level and type of costs that it incurred when switching airports. In particular, it noted that with respect to its move from Stansted to Gatwick that:

- It did not encounter any significant costs of switching from Stansted to Gatwick, largely because it did not have any based aircraft in the UK.
- Catering, groundhandling and hotel contracts were terminated, and notice served.

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65 Source: Frontier Economics - Market Power Assessment: Stansted and Gatwick Airport, http://www.caa.co.uk/docs/5/rpteasyJet%20Competition%20Assessment%20Final%20Report_Abridged.pdf (accessed January 2013), p. 27.

66 The CAA has checked the assumptions in the Frontier Economics estimates on the period required for a route to reach maturity with data on contribution per block hour over time and route-specific revenue projections, which appear to be reasonable.

67 Frontier Economics report.

68 Source: easyJet [✄].

- There were some costs of transferring passengers impacted by the move to Gatwick, e.g. because they were connecting to a Ryanair flight at Stansted or live around Stansted and that transportation (bus or taxis) was arranged to remedy this.[69]

E104 However, Air Asia X also noted that the situation outlined above would have been quite different if it had based aircraft at Stansted. In noted that in the event that it had based aircraft its move would have been far less simple and that the costs it would have incurred '*would have included moving staff, crew, parts, equipment, etc*.'[70]

E105 Similarly, Air Berlin told the CAA that:[71]

... apart from slots, it would probably need to undertake some new investment at a new airport and that there would be costs associated with that and ticketing (plus other costs) and this would take both time and resources. However, it noted that as it uses a handling agent and a ticketing agent these costs are relatively small.[72]

E106 Wizz Air also made a similar representation to the CAA:

As Wizz Air is an inbound carrier into LTN, it said it would not face many switching costs. Though it would face some operational costs, its crew and aircraft are based in Central and Eastern Europe. In order to rebuild part of its passenger base after a move to another airport such as STN, one-off marketing costs support would be needed but this would not be likely to be major.[73]

E107 The evidence from inbound operators suggests that they are likely to face similar types of costs to based operators. However the magnitude of these costs appears to be lower than they are for based operators as they have fewer airport-specific investments.

Charters

E108 Thomas Cook and Thomson Airways are charters, with one[74] and two[75] aircraft based at Stansted respectively, that operate throughout the year.

69 Source: Air Asia X [✂]

70 Source: Air Asia X[✂].

71 The CAA understands Air Berlin has now withdrawn from Gatwick, see: http://www.businesstraveller.com/news/air-berlin-to-drop-gatwick-nuremberg-route (accessed April 2013).

72 Source: Air Berlin. [✂].

73 Source: Wizz Air [✂].

74 Source: Thomas Cook [✂].

75 Source: Thomson Airways [✂] [✂].

In addition, Monarch operates charter flights during the winter traffic seasons on a smaller scale than Thomas Cook and Thomson Airways.

E109 Thomas Cook said that, other than the cost associated with operating new slots, there would be staff redundancy and recruitment costs involved in moving airports. As a result, some financial and reputational costs would be incurred.[76] Thomson Airways said that typical switching costs would include crew relocation, labour/union issues, and selling and buying office space.[77]

E110 The CAA considers that charters with one or two based aircraft are unlikely to face considerable traditional switching costs due to the small size of their operations at Stansted and consequent lack of significant infrastructure investment at the airport, though these costs would be lower for inbound charter airlines.

Strategic switching costs

E111 The CAA's analysis suggests that strategic considerations are a relatively important factor in an airline's decision to switch away from London. The CAA considers that an airline's business model and aspects of the London airport it uses e.g. whether it has spare capacity, will affect the scope for any potential movement away from the airport and it is therefore necessary to be cautious about making across the board assumptions that switching is possible. The CAA considered evidence on airlines' strategic reasons for serving London and Stansted.

E112 In a report commissioned by Ryanair[78], RBB set out reasons why a strong presence in London is important:

- A strong presence in London affects the brand value of an airline.
- The thickness of demand in London allows a large number of routes to be operated from the same base, which results in efficient aircraft utilisation.
- New routes can be launched with lower risk, in regard to profitability, from London airports rather than from non-London airports.

76 Source: Thomas Cook [✂].

77 Source: Thomson [✂].

78 RBB Economics, Ryanair: Assessment of Airline Bargaining Power at Stansted Airport, a report commissioned by Ryanair, November 2012, available at: http://www.caa.co.uk/docs/5/rbb%20stansted%20final%20non-confidential%20version%2029%20Nov%2011.pdf, p. 16.

- Significant sunk costs in marketing its London bases. There is a significant option value to a London presence associated with the ability to operate from London in the future.

E113 Charters indicated that their business model is focused on serving the local core catchment of each airport from which they offer flights.

E114 The CAA considers that for those airlines that serve London, there are likely to be costs of switching to serve a different market that are not captured by the traditional switching costs. In addition, the CAA considers that the concept of a strategic switching cost is consistent with the CC's view of switching costs in differentiated markets:

Conventional discussion of switching costs assumes that switching is between suppliers that are substitutes for one another (i.e. within the same market). Much of the evidence and debate regarding airlines switching between airports concerns switching between airports that are not necessarily good substitutes for one another. This evidence may, nevertheless, be relevant to our discussion of switching costs because airports are not perfect substitutes for each other and therefore costs arising from switching to airports with different characteristics may be relevant. [79]

E115 As an example of how airlines take longer term strategic issues into account, easyJet explained a comment on an internal presentation on Luton's capacity:[80]

[✂]:

- [✂].
- [✂].
- [✂].

E116 The CAA does not accept that the existence of strategic switching costs is limited to routes being run when they are unprofitable. [✂]. The CAA's view is that a strategic switching cost only implies a longer term profitability loss from switching, compared to continuing to serve London.

E117 In particular, Ryanair summarised the barrier that it faces in switching away from London as follows:

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79 CC, BAA Airports Investigation, Appendix 3.1, paragraph 26, available at: http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2009/fulltext/545_3_1.pdf.

80 Source: easyJet [✂].

Further cutting its presence at London was not a viable option. If more London aircraft were allocated to other bases the network would be less attractive and that would damage profitability. Some London sectors and routes were retained even though they were unprofitable.[81]

The importance of London: York Aviation and CTAIRA report

E118 To better understand the merits of airlines claims on the strategic importance of London, the CAA commissioned York Aviation and CTAIRA, independent aviation consultants, to undertake a study on the strategic importance of London to airlines.[82]

E119 This report found that:

- On a range of economic and related measures that London represents the strongest origin and destination market in Europe.
- London is a fundamentally attractive with the potential to deliver high levels of profitability to airlines.

E120 York Aviation and CTAIRA also considered that airlines are likely to face reduced long-term profitability if they are forced to switch marginal capacity (either routes, frequencies or aircraft), away from London.

E121 In coming to this view, York Aviation and CTAIRA noted that:

- While no single feature marks London out as unique, it offers a combination of features that would be difficult to replicate elsewhere.
- London is fundamentally attractive for airlines to serve, with its potential to deliver high levels of aggregate profitability.
- It is unlikely that the combination of volume and value that defines the London market can be replicated elsewhere and hence there is the potential for London to be strategically important to airlines
- In terms of European cities, it had not found any real comparators to London, with the closest comparators being Paris and to some extent Milan.

E122 However, connected to the last point above, York Aviation and CTAIRA identified second tier comparators, including Brussels, Frankfurt, Madrid and Munich. The business environment statistics for these cities,

81 Ryanair at CAA Board Stansted stakeholder engagement day, available at: http://www.caa.co.uk/docs/78/CAA%20Board%20%26%20Stansted%20Meeting03072013.pdf.

82 York Aviation & CTAIRA, The strategic importance of London to airlines, September 2013. This document is available at: http://www.caa.co.uk/docs/78/rpt%20strategic%20importance%20of%20London%20final.pdf.

summarised in Figure E.5 (below), show that there is a range of factors that contribute to attractiveness. Fundamentally:

- London is bigger in population and economic terms than other European cities.
- London is served by a wide variety of airline business models.
- London has more balanced in terms of inbound and outbound flows providing a more stable passenger demand for air services.
- London has stronger drivers in terms of value through the size of the business and premium travel demand.
- London is the number one tourist destination in Europe by far.
- London has strong point to point demand (52 per cent higher than Paris).

E123 While these factors contribute to the attractiveness of serving London, York Aviation and CTAIRA also considered that the importance of London to any particular airline depends on a range of factors. The strategic importance of London is therefore considered to be airline specific and dependent, not just in terms of airline type but also the domicile of the airline.

Figure E.5: Macro environment indicators

	London	Paris	Milan	Frankfurt	Munich	Madrid	Brussels	Amsterdam
1 - GDP ($ bn)	731.2	66.2	28.3	2269	2103	26.0	24.3	32.3
2 - GDP per capita ($ 000s)	52.0	53.9	37.9	51.6	54.5	40.0	45.6	46.0
3 - Employment (m)	7.9	6.1	3.6	2.5	2.3	3.0	2.4	3.9
4 - Population (m)	14.1	12.4	7.6	4.4	3.9	6.6	5.4	7.0
5 - Fortune Global 500 HQs	17	19	2	4	4	5	3	5
6 - Tourism Arrivals (000s)	15,106	8,404	2,075	1,596	2,135	3,431	2,285	4,202
7 - European Cities Monitor Score	0.84	0.55	0.12	0.32	0.19	0.25	0.25	0.26
8 - Size of Air Transport Market	131.4	88.8	36.7	60.3	38.4	45.2	19.0	51.0
9 - Business Passengers (m)	31.5	n/a	n/a	n/a	17.3	n/a	6.1	16.3
10 - Connecting Passengers (m)	28.8	21.3	1.1	31.5	15.0	14.9	3.0	20.9
11 - Point to Point Passengers (m)	102.5	67.5	35.6	28.9	23.4	30.3	16.0	30.1
12 - One Way Premium Class Seats (m)	9.4	6.5	1.9	3.0	1.1	1.9	1.2	3.2
13 - One Way Long Haul Seats	27.0	16.5	1.9	13.2	3.6	5.6	2.1	8.7

Source: York Aviation & CTAIRA, 'The strategic importance of London to airlines', October 2013
Note: 1 to 4 – Brookings Institute Metro Monitor 2012, 5 – Fortune Global 500, 6 – Euromonitor Top City Destinations and City of Frankfurt, 7 – Cushman & Wakefield European Cities Monitor 2011, 8 to 11 Civil Aviation Authorities and Airport Websites, 12 to 13 – OAG.

E124 In relation to LCCs, York Aviation and CTAIRA considered a different potential strategic response to a price increase than moving aircraft to any one alternative city. Rather than seek to replicate conditions in London in another European city, LCCs might simply disperse their available capacity across their European bases.

E125 The York Aviation and CTAIRA report also indicated that it is fundamentally attractive for airlines to serve London with its potential to deliver high levels of aggregate profitability. It is unlikely that the combination of volume and value that defines London can be replicated elsewhere and hence there is the potential for London to be strategically important to airlines.

E126 In addition, the York Aviation and CTAIRA report considered that although there are signs that LCCs are seeking to expand in other European cities in the same way, the fundamental strengths of London means that the city is embedded as an origin or destination within their networks to such an extent that disentangling and moving a substantial amount of capacity away from London would be very difficult:

- London acts as an anchor to the network, offering a 'safe' demand pool with strong two way flows of inbound and outbound traffic for establishing new bases and new destinations.
- The size of demand in London has enabled the airlines to develop major bases that enable optimal aircraft utilisation, mixing and matching routes and timings to reach a profitable solution.
- It has and potentially will enable these airlines to deal with the ongoing issue of market maturity, enabling them to 'churn' routes and adjust frequency and capacity on routes through different parts of the life cycle.

E127 The strategic importance of London does not imply a fixed level of capacity has to be allocated to serving London but that there are attractions to serving London that would be difficult to replicate and would be likely to make airlines reluctant to switch away. This is particularly so because any decision to leave London may be irreversible as capacity tightens in the future.

E128 Specifically, in relation to Ryanair's reaction to increased airport charges at Stansted in 2007, the report notes:

This (redeployment of aircraft) will also be influenced by wider considerations around the advantages of operating large aircraft bases, such as the ability to optimise aircraft utilisation at larger bases serving larger demand bases. Overcoming these conditions away from London is difficult. This helps to explain why Stansted has remained so important to Ryanair. It has been able to profitably redeploy some capacity but, *ultimately, the attractiveness of London is too great to realise more dramatic changes.*[83]

Backfill

E129 The Consultation considered a further strategic consideration in vacating a slot i.e. the possibility that it would be filled by a competitor airline (backfill).

E130 The CAA accepts that backfill is unlikely to be an issue at Stansted at present because of the significant amount of spare capacity at the airport, currently at 39 per cent.

Conclusion: switching costs

E131 The CAA considers that it would not have been practicable for it to make quantified estimates of switching costs as MAG suggested. Such an exercise would have required a number of assumptions about the volume and type of switching and, where aircraft were to be relocated, the destination.

E132 The CAA's view is that there is a range of switching costs applicable to airlines that seek to move from Stansted, including:

- Exit costs, including those associated with terminating staff contracts and third party handlers.
- Set up costs of opening routes at an alternative airport, including marketing, promotional fares and costs associated with new handler contacts.
- Opportunity costs associated with the switch as routes take time for yields to mature.

E133 Estimates of the costs associated with switching provided by the airlines range from three to ten times the cost of a 10 per cent price rise imposed by an airport operator.[84] However, a number of inbound airlines have suggested that the costs faced in switching may be lower than this because they have fewer physical ties to the airport than based airlines.

E134 The CAA considers that there is a continuum of switching costs faced by airlines at Stansted, with the highest costs faced by those airlines with large based operations and the lowest faced by those airlines with small inbound operations.

83 York Aviation & CTAIRA, The strategic importance of London to airlines, September 2013.

84 Frontier Economics report, Table 5.

E135 The CAA maintains its position that there are strategic reasons why airlines would be reluctant to leave London. It does not consider that the strategic importance of London rests in a single characteristic of the demand and supply conditions present in London. Rather, the CAA considers that the strategic value that airlines attribute to London arises from a combination of factors that are important to long term profitability. These factors include London's locational value, scarce capacity and, more fundamentally, the volume and value of demand presented by routes serving London and how that contributes to airlines' business models.

E136 The airlines' evidence to the CAA was that serving London is central to their business model. Overall, the CAA accepts that this is a strategic constraint against switching to non-London or European airports, whilst acknowledging that it may be possible to make marginal reductions to an airlines presence over the Q6 period in light of rising prices, or reductions in service quality or investment. Particularly if an increase in airport charges can eventually be passed onto users, the CAA considers that switching away from London is likely to lead to a reduced profitability arising from lost revenue or increased costs at the level of the airline business.

E137 The York Aviation findings are similar in many respects to those the RBB report commissioned by Ryanair consider above. In light of the these reports and other evidence, including that from airlines, the CAA considers that the strategic importance of operating to and from London is an important issue when evaluating airlines' ability and willingness to switch away from London.

Section 4.4: Capacity issues: Barriers to entry and expansion (potential competition) and capacity availability for switching

E138 This section considers airport capacity issues, including whether:

- Entry or expansion of competing airports would constrain STAL.
- There is sufficient current capacity to allow airlines to substitute competing airports for Stansted.
- Switching away from Stansted is likely to be easier over the Q6 period as a result of expansion of competing airports. This depends on the balance of future capacity and demand.

The minded to Consultation

Entry and expansion

E139 The minded to Consultation discussed whether the expansion and/or entry by existing aerodromes, and/or the threat thereof, may represent a source of competitive constraint on an airport operator. The CAA considered that the cost and timescales involved in expanding to accommodate sufficient switching were too high to constrain STAL's prices over the Q6 period.

E142 The minded to Consultation also concluded that, although relatively small scale expansion of capacity was possible, material expansion could only be achieved in the medium term.

Current and future capacity

E143 The minded to Consultation outlined that the availability of capacity to which airlines could move from Stansted, including an analysis of capacity at competing airports. This was presented in Annex 4 to the minded to Consultation.

E144 The CAA concluded that available capacity to move based aircraft away from Stansted was limited due to the stand capacity limits at Luton and the availability of peak time runway capacity at Gatwick. Substitution to Southend was also not considered possible for Ryanair, Stansted's largest airline, due to the runway being too short for its current aircraft fleet.

E145 On the availability of capacity over the Q6 period, the CAA considered that any constraint from other London airports would weaken as demand recovers in line with economic growth and capacity constraints in the London region further tighten.

Stakeholders' views

E146 In response to the minded to Consultation, MAG considered:

- There is spare capacity at other London airports (especially at London City) and that GAL and HAL could reallocate capacity and make more effective use of their slots.[85]

[85] MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', pp. 44 to 51.

- Available capacity in London has increased. It noted, for example, that in 2012 ATMs at Gatwick, Stansted, Luton, Southend and London City totalled 515,000, 16 per cent below the 2007 level.[86]
- The CAA's assessment of the availability of future capacity is unduly negative and fails to take account of infrastructure developments at Luton and Gatwick.[87]
- GAL's new charging structure incentivises the use of large aircraft and by making operational improvements GAL could increase movements to 55 per hour.[88]

E147 Following the CAA Board’s Stansted stakeholder day, MAG made a further submission to the CAA on its assessment of where airlines switching away from Stansted might be able to switch away to in London.[89] For example, MAG noted:

- The ability of airlines to grow organically at Gatwick by building slot holdings, citing easyJet's growth at the airport and Norwegian Air, which had switched there from Stansted.
- The availability of capacity at Southend and off-peak capacity at Gatwick.
- The planned growth at Luton and London City.

CAA views, analysis and conclusion

E148 This section presents the CAA's analysis and final view of capacity issues. This section is structured as follows:

- Current available capacity and capacity development, including consideration of currently available capacity and capacity development at particular airports.
- The availability of future capacity for airlines wishing to switch as a balance of capacity development and future demand:
- Consideration of airlines’ ability to switch to switch to an airport where capacity is constrained i.e. there are no available slots.

86 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', pp. 42 to 43.

87 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', p. 12

88 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', pp. 46 to 47.

89 MAG, MAG’s Further submission on airport capacity, August 2013.

Currently available capacity and capacity development

E149 The CAA accepts that there is currently more unused capacity and forecast future spare capacity in the London area than there was in 2007.[90] However, looking at the overall capacity level can be misleading as it is important to consider the distribution of available capacity against the needs of different types of carrier, for example based and inbound airlines and charters.

- Capacity during the early morning departure peak is particularly important to based LCCs in order for them to fit in the requisite number of daily rotations.
- Similarly, the number of aircraft parking stands is important to LCCs as they determine the maximum number of aircraft that can be based (i.e. parked overnight) at the airport.

E150 Therefore, the availability of peak time departure slots and stand/parking capacity at competitor airports, both of which are necessary for the operation of the LCC business model, is therefore more relevant to their ability to switch than total available capacity.

E151 Current capacity and developments that would be likely to affect future capacity at each of the London airports are reviewed below. These do not include the development of new runways at London's main airports as the UK Government Coalition Agreement states:

- *We will cancel the third runway at Heathrow.*
- *We will refuse permission for additional runways at Gatwick and Stansted*.[91]

E152 However, the availability of future capacity will also depend on how demand is forecast to increase. This is examined in the demand forecast section, which looks at how capacity availability in the main London airports is expected to develop over the Q6 period.

London City

E153 The CAA considers that, although London City has significant amounts of spare capacity, it is not suitable for most of the aircraft that currently use Stansted principally because its runway length is too short for almost all

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90 This is primarily as a result of the economic downturn and available capacity can be expected to tighten as the economy recovers.

91 HM Government: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/78977/coalition_programme_for_government.pdf.

the aircraft that operate out of Stansted. It is therefore not currently a viable substitute or expected to be so over the Q6 period (see appendix D. In addition, London City does not provide an effective constraint on STAL because of the difference in the business models of airlines operating at the two airports. For example, Figure F.6 shows London City has the highest percentage of UK and foreign business passengers of all the London airports while Stansted has the lowest.

Luton

E154 The type of airline business operated at Luton is similar to Stansted, with LCCs constituting most of Luton's airline business.[92]

E155 Limited aircraft parking stand capacity at Luton means that few additional aircraft can be based at the airport, as well as potentially leading to taxiway congestion if inbound early morning arrivals were to arrive off-schedule.[93, 94] In internal minutes of a meeting with [✂], STAL noted the lack of overnight aircraft parking capacity at Luton.[95]

E156 Luton's Masterplan sets out a plan to increase capacity at the airport from 10.3 million passengers per annum (mppa) in 2013 to 18 mppa by 2030, including a forecast increase in traffic up to 12.1 mppa by 2019, mostly through traffic spreading throughout the day.[96] However, the aircraft stand capacity constraints currently preventing airlines from basing additional aircraft at the airport to operate early morning peak departures. The first two additional aircraft stands included in the Masterplan are scheduled to be completed and operational by 2019.[97]

E157 From the above the CAA concludes that there appears to be capacity available for inbound frequencies at Stansted to be switched to Luton.

Gatwick

E158 Gatwick airport has a comparatively more varied airline customer base than Stansted and Luton, with long-haul services as well as charter and LCC airlines. Slot utilisation is high throughout the day in the summer

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92 See the minded to Consultation, Annex 4 for more details.

93 Leigh Fisher report for London Luton Airport Operations Limited, May 2012, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/2707/dft-2012-22-capacity-analysis.pdf (accessed January 2013).

94 Although Luton has a comparatively shorter runway (2160m) than Stansted (3048m), this is unlikely to affect switching by Stansted's low cost carriers operating short-haul services with narrow-bodied aircraft.

95 Source: STAL [✂].

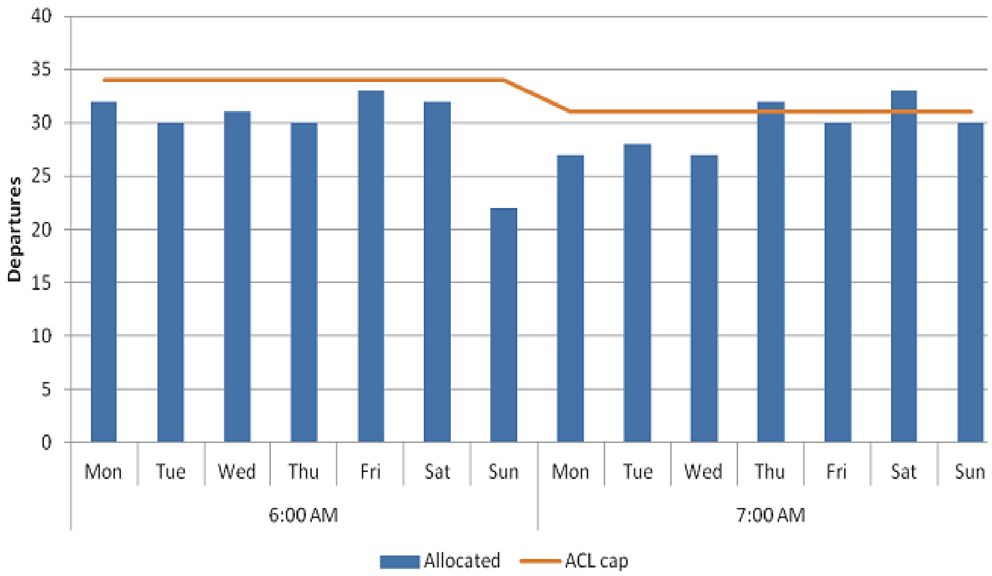
96 For more information see: http://www.london-luton.co.uk/en/content/8/1171/Masterplan.html.

97 See: http://www.eplan.luton.gov.uk/plannet/search.asp?authentication=LBC191006-Wg&ID=12/01400/FUL&StartingRecord=91.

traffic season, and, even after the recently announced increase in capacity[98], there appears to be limited available departure slot capacity during the early morning period to accommodate additional based aircraft for either scheduled or charter services from LCCs.

E159 As the CAA noted in Annex 4 of the minded to Consultation, on the basis of available early morning departure slot capacity, there would not appear to be capacity available for a substantial switch to Gatwick by an airline (for example by a based LCC or charter) that requires slots during the early morning peak at Gatwick. Figure E.6 sets out Gatwick's declared capacity and utilisation for departures in the peak week of summer 2012 between 6am and 8am. It can be seen that the amount of spare departure capacity is limited between those hours. The CAA accepts that, up to a limit, airports can increase the number of available slots through operational improvements and that GAL has increased its slot availability in this way. This is considered below.

Figure E.6: Gatwick capacity utilisation morning peak departures, summer 2012



E160 Ryanair told the CAA that neither Gatwick nor Luton have sufficient early morning capacity to allow for an efficient use of Ryanair's based aircraft.[99] Ryanair's statement was confirmed by ACL reports and by GAL itself. According to ACL start of season reports, there is considerable excess demand for these slots. Indeed, GAL told the CAA that it is aware of active consideration by airlines not currently at Gatwick to base aircraft at the airport. According to GAL, a number of currently based and inbound

98 Gatwick Airport Scheduling Declaration for Summer 2014', 3 October 2013.

99 Source: Ryanair [✂].

airlines (including, [✂]) sought to expand operations during the early morning departure peak in 2012, but were not able to do so due to the unavailability of appropriate slots.[100]

E161 Further evidence that may reflect the scarcity some peak slots is the transaction in July 2013 when easyJet purchased Flybe's slots for approximately £20 million.

E162 There is more capacity available during the mid-morning and mid-afternoon periods at Gatwick, which could give scope for switching to airlines operating based or inbound services at Stansted during the off-peak period. In addition, there appears to be currently sufficient aircraft parking stand capacity to accommodate additional based aircraft, as well as sufficient terminal capacity.

E163 In relation to MAG's view that GAL's charging structure incentivises the use of larger aircraft, which it maintains will increase future capacity. Since the Consultation, Gatwick has proposed a further amendment to its structure of runway charges from 1 April 2014.[101] The main change it is now proposing is to abolish weight-based charges. This will lead to a further increase in charges for those using smaller aircraft. Increases in aircraft size are incorporated to some extent in the Department for Transport's (DfT) forecasts of future capacity but recent changes in airport charges may not take account of this change.[102] The CAA considers that the effect of charging regimes that incentivise larger aircraft is uncertain, for example:

- LCCs prefer to operate uniform fleets and so may not be responsive to such an incentive.
- Decisions by FSC airlines to increase aircraft sizes will be affected by their network considerations and passenger demand for their services. An increase in aircraft size that reduced load factors would be unlikely to be attractive.

E164 Some changes in aircraft size may have little effect on slot availability. For example the CAA considers that easyJet's acquisition 25 of Flybe slots at Gatwick in July 2012 is unlikely to ease slot availability. While easyJet's larger aircraft may allow some Flybe routes to be served with fewer flights, thereby freeing up some slots, easyJet will use the slots for other

100 Source: GAL [✂].

101 GAL, Consultation on structure of charges, 16 August.

102 DfT, Aviation Forecasts, January 2013, p. 8 – available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/70259/aviation-forecasts.pdf.

routes. Therefore easyJet's purchase of Flybe slots is not expected to be a material influence on slot availability in the future as:

- Flybe was unusual in operating smaller aircraft from Gatwick; and
- Even if airlines move to larger aircraft, they are more likely to do so in order to accommodate additional demand rather than to rationalise their services and free up slots.

E165 The CAA recognises that GAL can achieve some increases in capacity through operational improvements. For example, on 3 October 2013, GAL announced a significant increase to its scheduled capacity limits for Summer 2014.[103] This announcement of the 21 new daily slots included 8 morning peak departing slots, constituting around 2.4 per cent of the total runway movements allocated on a peak summer week during Summer 2014.[104] The declaration of additional capacity noted that this is to be able to *meet the increased market demand through operational improvements*.

E166 Gatwick, being the busiest single runway airport in the world, has already been under runway capacity constraint especially during the peak periods. It is therefore CAA's view that availability of the new peak slots will help alleviate some of the excess demand and lead to increased overall traffic. After underlying demand growth has been accommodated, there may not be a significant increase in spare capacity. According to the ACC, easyJet, Thomson and Monarch have each acquired one of the eight peak slots while Norwegian Air and British Airways acquired the remaining two and three slots respectively from the International Air Transport Association (IATA) initial coordination conference in November 2013. As all the peak slots have already been allocated to existing airlines, there seems little room for additional growth.

E167 Airline and statistical evidence suggests that difficulty in obtaining early morning peak time departure capacity is likely to be a barrier to switching based aircraft from Stansted to Gatwick. Inbound services are likely to find capacity at Gatwick more easily as they can make use of off-peak availability.

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103 'Gatwick Airport Scheduling Declaration for Summer 2014', 3 October 2013.

104 Total runway movements allocated in a peak week during summer 2014 is 6021 movements according to the ACL London Gatwick Summer 2014 initial Coordination Report.

Southend

E168 Following the start of easyJet operations at the airport in April 2012, easyJet passengers have constituted 90 per cent of Southend's traffic, followed by approximately 9 per cent of passengers being transported by Aer Arann.[105] Southend expected traffic to reach between 600,000 and 700,000 passengers in 2012 and 2 million passengers by 2020. While the airport could technically handle more passengers, there is currently a movement cap in place which restricts the total number of flights.

E169 In April 2012, easyJet relocated three aircraft previously based at Stansted to the airport and began operations there.[106] easyJet operates its A319s at Southend but not its A320s. In addition, in its response to the minded to Consultation, easyJet noted that Southend was unsuitable for the longer sectors that it flies from Stansted and indicated that Southend does not have the capacity to substantially expand the number of based aircraft there.

E170 Due to the length of the runway at Southend (1739 metre take off runway available (TORA)), Ryanair is unable to operate from Southend.[107] This means that Southend is not a viable substitute for Stansted's largest airline in terms of both movements and passengers.

Future demand

E171 Future available capacity is the difference between future capacity and future demand. The primary drivers of future demand are the declining real cost of airfares and the growth of incomes.

E172 In the minded to Consultation, the CAA used a number of sources to forecast demand at Stansted and other London airports that might exert a competitive constraint on it.

E173 Since the publication of the minded to Consultation, DfT has published its new long term forecasts for the UK for the period to 2050.[108] Although forecast UK passenger demand is lower than in the August 2011 forecasts, the picture is the same for the London airports.

E174 In the central forecast for runway capacity, the five largest South East airports are forecast to be full by 2030. Of the airports that could attract additional ATMs from Stansted, Gatwick is forecast to be full by 2020,

105 These shares are constructed using passenger data at the airport between April and September 2012.

106 Source: CAA airport statistics.

107 Source: http://www.caa.co.uk/docs/5/MOLearytoIO25112011.pdf (paragraph 5) [✄]. Source: Southend Airport [✄].

108 DfT, Aviation Forecasts January 2013, p. 8.

while Luton and Southend would still have significant spare capacity available at that time.

E175 DfT's constrained forecasts make a number of assumptions[109], including:

- No new runways are built in the UK. The CAA considers this to be a reasonable assumption for forecasts, at least up to 2025, as the Airports Commission is scheduled to report in 2015 and there would a lag in capacity becoming available following this decision.
- Schemes that are already in the planning system and airport Masterplans are implemented by 2020.
- Incremental growth to full potential long-term capacity by 2030 taking into account the airports' own longer term plans, physical site constraints and up to 13 per cent capacity gain (where possible) through operational and technological improvements.
- Terminal capacity increased incrementally to service additional runway capacity.
- No changes after 2030.

E176 The CAA recognises MAG's concern that forecasts are subject to a degree of uncertainty but considers that it is reasonable to use the central forecasts rather than the high or low scenarios. The central forecasts show that capacity utilisation will reach 100 per cent for Heathrow and Gatwick by 2020, and London airports overall will have 86 per cent utilisation.[110] This is illustrated in Figure E.7 below.

[109] DfT, UK Aviation Forecasts, January 2013, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/223839/aviation-forecasts.pdf, paragraph 3.51.

[110] DfT's January 2013 demand forecasts are lower that the forecasts that it produced in 2011. However, the evidence clearly suggests that capacity constraints will tighten in the short to medium term up to at least 2025, as no new runway capacity is currently expected before that date.

Figure E.7: DfT's runaway capacity forecasts: UK airports runway capacity used, 2010-2050, 'max use' capacity scenario (central forecast)

Airport	2010	2020	2030	2040	2050
Heathrow	99%	100%	100%	100%	100%
Gatwick	90%	100%	100%	100%	100%
Stansted	58%	69%	100%	100%	100%
Luton	59%	60%	100%	100%	100%
London City	56%	87%	100%	100%	100%
Southend		42%	100%	100%	100%
London	81%	86%	100%	100%	100%

100 per cent = runway or terminal capacity exceeded, other per cent refer to runway usage.

Mainland UK airports only.

Source: DfT Aviation Forecasts January 2013.

E177 To some extent the model takes account of the relationship between aircraft size[111] and capacity by modelling airlines increasing aircraft size as reaction to a runway capacity constraint (thereby reducing landing charges per passenger).

Switching to a capacity-constrained airport by acquiring slots

E178 The CAA recognises that competition among airports can take place even when capacity is scarce. Switching to an airport where capacity is scarce will depend on how easy it is to obtain slots. Possible means of slot acquisition at capacity constrained airports include:

- Merger, for example IAG was able to acquire additional slots at Heathrow through its merger with bmi. easyJet expanded at Gatwick in the past through its 2008 merger with GB Airways, which allowed easyJet to take over 28 routes from GB Airways at Gatwick.[112]

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111 See: Box 2.5: Relationship between capacity, demand and aircraft size "UK Aviation Forecasts" DfT January 2013, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/223839/aviation-forecasts.pdf.

112 easyJet, 'easyJet plc agrees to acquire GB Airways Limited', available at: http://corporate.easyjet.com/media/latest-news/news-year-2007/25-10-07-en.aspx.

- Slot trading, for example, easyJet's acquisition of 25 Flybe slots at Gatwick for £20 million in July 2013.
- Through the slot pool. ACL told the CAA:

  At Gatwick, BA has approximately 100 fewer slots than 5 years ago in the morning peak, while easyJet has increased its slot holdings by approximately 100. However, these slots were not traded between these two airlines. Instead, easyJet acquired slots through mergers (for example GB Airways in 2008) and from the slot pool.[113]

E179 Airline mergers and acquisitions are costly and infrequent and are generally concluded as a means of furthering an airline's business plans. Merger or acquisition of another airline to acquire slots at an alternative airport does not appear to be a rational response to an increase in airport charges by STAL.

E180 The evidence of easyJet's purchase of Flybe's slots in July 2013 suggests that suitable slots were not available from the ACL slot pool at Gatwick.

E181 The CAA considers that, where there is a shortage of available capacity, finding an airline willing to sell slots is likely to act as a barrier to an airline switching. The CAA recognises that some switching is possible by acquiring slots at capacity-constrained airports but considers that this barrier is likely to increase as capacity across the London airports tightens.

E182 The CAA also considers that whether an airline can find slots to grow organically at an airport is a different issue to whether it can switch from one airport to another. A wider range of slots, including non peak time slots, is likely to be suitable to expand an airline's services than would be suitable as a substitute to which it could switch exiting services.

Conclusion on capacity issues

Entry and expansion

E183 Entry and expansion by other airports would not be an effective response in constraining any SMP that STAL might have. Airport entry and expansion require planning consent and in the south east of England are subject to Government policy on runway expansion. Given the time taken to obtain planning permission, entry and expansion would not be effective achieving an expansion of supply that would constrain an increase in STAL's airport charges over the medium term. This view is consistent with the CAA's view outlined in the minded to Consultation.

113 Source: UK ACL [✄].

Current capacity

E184 With respect to the availability of current capacity, to which airlines could switch, London City is not useable by the great majority of aircraft that currently use Stansted and serves a different type of airline business model.

E185 The CAA maintains its minded to Consultation position that capacity constraints during the early morning peak at Luton and Gatwick suggest that there is limited scope for the relocation of based aircraft to these airports. Non-peak capacity is available at both these airports and would allow Stansted inbound traffic to switch to them.

E186 Southend has significant spare capacity, including at peak periods. easyJet switched 3 based aircraft from Stansted to Southend in 2012. easyJet maintains that Southend is unsuitable for the longer sectors that it flies from Stansted.[114] Despite this limitation, an internal STAL note of a meeting with easyJet to discuss a growth deal noted:

Their plans for Southend SEN are [✂] *based aircraft by 2014.*[115]

E187 The CAA considers that this evidence suggests that easyJet could switch additional aircraft to Southend to discipline an increase in airport charges by STAL.

E188 The CAA also recognises that there is sufficient non-peak capacity at Luton and Gatwick that would allow inbound services or charters to switch. Although Gatwick is outside the relevant market, there is currently spare off-peak capacity at Gatwick, suggesting that Gatwick could provide some level of constraint against an increase in STAL's airport charges.

Future capacity

E189 The CAA maintains its view, as set out in the minded to Consultation, that capacity is likely to tighten across the London airports over the Q6 period.

E190 The CAA's view in the minded to Consultation was that there were limited infrastructural investments planned at competing airports that would significantly improve the prospects for switching based aircraft away from Stansted. This is consistent with the CAA's assessment of traffic forecasts for GAL as outlined in the Final Views for Gatwick[116], which shows an increase in Gatwick passengers from 35.4 million in 2013/14 to 39.9 million in 2018/19 (the final year of Q6). This increase includes

114 easyJet, Response to the minded to Consultation.

115 Source: STAL [✂].

116 This document is available on the CAA's website.

600,000 additional passengers from easyJet's July 2013 acquisition of the Flybe slots and an uplift in demand from economic improvement.

E191 DfT's aviation forecasts take account of major infrastructure developments that are expected to happen during the Q6 period that would have the effect of increasing capacity. Major infrastructural developments have a substantial lead time, for example, they require planning approval before they can be started. Therefore, the CAA considers that it has taken account of information on planned infrastructure developments that would be expected to increase capacity over the duration of Q6.

E192 In response to MAG's criticism that forecasts are subject to uncertainty and the CAA has taken an unduly negative view, the CAA acknowledges that there is uncertainty in any forecasts, which might imply higher or lower demand for airport capacity in London. The CAA considers that it is reasonable to rely on the DfT central forecasts rather than a 'high' or 'low' scenario in making its assessment of the tightening of capacity across London airports. These show that Gatwick is full by 2020 and that Luton is full by 2030.[117]

E193 The CAA considers that the competitive constraint that Gatwick and Luton will exercise on STAL is likely to weaken as increasing demand at these airports means that they approach full capacity. Based carriers demand peak slots, which are likely to be full well before the rest of the airport as a whole. The competitive constraint would then mainly come from inbound carriers and charters. This is considered along with other constraints that are expected over the Q6 period in the final section of this appendix.

E194 Having considered future expansion plans of the London airports and other potential substitutes and forecasts of future demand for airport capacity, the CAA finds it unlikely that the scope for switching marginal units will increase up to at least 2019.

E195 The CAA recognises that competition can take place between airports even when there are capacity constraints by airlines acquiring slots through purchase, or merger. In the last 5 years, slots at Gatwick have become available through a number of means. However, purchasing slots requires finding a willing seller and both slot purchase and merger appear more likely to be driven by an airline's business plans than a representing a rational response to an increase in airport charges.

117 Airports Commission, Discussion paper No. 1: Aviation demand forecasting, Figure 3.5, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/73143/aviation-demand-forecasting.pdf.

E196 Current and future capacity availability is considered in the assessment of the cumulative constraint on STAL in the section 4.8 of this appendix.

Section 4.5: Countervailing buyer power

The minded to Consultation

E197 The minded to Consultation considered whether airlines at Stansted would be able to constrain any SMP that STAL might have by leveraging the importance of their operations to the airport during negotiations.

E196 In the minded to Consultation the CAA considered that easyJet had a degree of buyer power. Its share of STAL's passengers, at 22 per cent, was sufficiently high, while its ability to sponsor the entry of Southend was an example of buyer power and its alternative north London base at Luton gave it additional options for switching sufficient business away from Stansted that it might be able to use in negotiations.

E197 Ryanair was considered to have less buyer power than its 72 percent share of STAL's passengers might suggest. It appeared to the CAA to lack options for switching to alternative London airports. The CAA considered that Ryanair lacked immediate alternative airports around London that would allow it to exercise buyer power in the short term by switching away from Stansted.

Stakeholders' views

E198 In response to the minded to Consultation, although it agreed with the CAA’s analysis of easyJet's CBP, MAG considered that Ryanair had buyer power. MAG identify two key principles in determining buyer power:[118]

- Buyer power is higher where the buyer has more outside options, that is, the buyer is able to switch supplier.
- Buyer power is higher if the seller has few outside options, that is, there are fewer alternative buyers.

[118] MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', pp. 67 to 70.

E199 MAG maintained that:[119]

- Ryanair has outside options whereas STAL would find it difficult to replace lost Ryanair business with other airlines as Ryanair's significant presence can deter other airlines from flying from Stansted, even when deep discounts are offered.
- Ryanair has switched existing services away from Stansted to other UK and continental European airports, and it has allocated growth in its overall fleet size to airports other than Stansted.
- Ryanair can and does switch, and can make credible threats to switch, away from Stansted.
- Ryanair has buyer power because a small number of aircraft withdrawals by Ryanair would be catastrophic for it, particularly as Stansted has spare capacity.

E200 Ryanair noted that '*as stated by Ryanair in its previous submissions, its decisions to cut capacity at STN and operate routes in other markets has had no effect on STAL's pricing*'. [120]

E201 easyJet disagreed with the presumption that its presence at other London airports provides it with a degree of buyer power and noted the CC's view that Southend is unlikely to provide a long-term risk to STAL.[121]

Stakeholders' views: the additional Consultation

E202 In response to the additional Consultation:

- MAG agreed with the CAA's revised view that the ability of airlines (large and small) to negotiate prices that are significantly lower than the current regulatory price cap, provides compelling evidence that airlines at Stansted have buyer power.[122]

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119 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', pp. 67 to 70.

120 Ryanair, Ryanair's reply to the CAA's 'minded to' Consultation on STAL's market power, section 1 paragraph 3 section 2.

121 easyJet, easyJet's reply to the CAA's 'minded to' Consultation on STAL's market power, p. 3.

122 MAG response to CAA Stansted Market Power Assessment consultation on relevant market developments.

- MAG considered that the impact of the developments since January 2013 on Test A goes much wider than the issue of countervailing buyer power. It maintained that the new situation brought about by the change in ownership demonstrates firmly the behaviour of a business operating in a competitive environment, and not one with SMP.[123]

- Ryanair considered that market power is a function of the underlying conditions in the relevant market and the recent agreements have not altered the fundamental issues, which demonstrate that MAG has SMP.[124]

- Ryanair considered that MAG's agreement to [✂] threats from Ryanair to cut traffic does not demonstrate that Ryanair enjoys buyer power. Rather, Ryanair submitted that this was a strategic move by MAG in the early days of its ownership of STAL to avoid regulation. It notes that MAG's agreement occurred at a crucial point of the CAA's evaluation of STAL's SMP where MAG was anxious to demonstrate (artificially) that a threat from an airline was sufficient to force it to reverse its exploitative behaviour.[125]

- Ryanair and the SACC considered that the change of ownership and long term deals were not structural changes to the market and therefore not relevant factors to a consideration of market power.[126]

- The SACC maintained that it was only when the CAA's initial proposals, in April 2013, indicated that Stansted would be effectively regulated, it became clear that the only way for MAG to increase revenues was through growth deals.[127]

- Ryanair and the SACC considered that easyJet and Ryanair have had to commit to very significant volume growth in order to achieve prices that are less than the current cap, which is above the competitive level.[128]

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123 MAG response to CAA Stansted Market Power Assessment consultation on relevant market developments.

124 Ryanair, Response Letter to the CAA, Re: Stansted Market Power assessment: consultation on relevant market developments, 11 November 2013.

125 Ryanair, Response Letter to the CAA, Re: Stansted Market Power assessment: consultation on relevant market developments, 11 November 2013; and Stansted ACC, Response Letter to the CAA, Re: Assessing the Market Power of Stansted Airport, 8 November 2013.

126 Ryanair, Response Letter to the CAA, Re: Stansted Market Power assessment: consultation on relevant market developments, 11 November 2013; and Stansted ACC, Response Letter to the CAA, Re: Assessing the Market Power of Stansted Airport, 8 November 2013.

127 Stansted ACC, Response Letter to the CAA, Re: Assessing the Market Power of Stansted Airport, 8 November 2013.

128 Ryanair, Response Letter to the CAA, Re: Stansted Market Power assessment: consultation on relevant market developments, 11 November 2013; and Stansted ACC, Response Letter to the

- The SACC's view was that normal commercial behaviour includes reviewing/re-negotiating terms over the course of an agreement and that this would only be possible if STAL continued to be regulated.[129]

CAA views, analysis and conclusion

Importance of spare capacity to airline buyer power

E203 The CAA considers that the current spare capacity at Stansted, which is currently at approximately 39 per cent, is a relevant feature which must be taken into account in assessing the existence and extent of buyer power. The CAA's study of capacity across the London airports[130] noted that there remains departure capacity available during the early morning peak at Stansted, and considerable departure capacity throughout the rest of day on each day of the week during the Summer 2012 traffic season. A similar pattern of utilisation was observed for the Winter 2011/12 traffic season, although at lower overall slot utilisation levels.

E204 As MAG noted in their response to the minded to Consultation:

Stansted is currently operating at around 61 per cent of its capacity. The 17.4 million passengers served by Stansted in 2012 is around 6.3 million passengers fewer than were served in 2007. In other words, Stansted requires growth of 36 per cent merely to return to its 2007 peak.

E205 Given the amount of spare capacity at Stansted , the CAA considers that airlines accounting for a substantial share of STAL's passengers will be aware that, they have a strong negotiating position in that their allocation of existing and future traffic will have a material impact on STAL's profitability.

E206 The threat of competitive backfill is low at Stansted. Therefore unlike at Gatwick or Heathrow, airlines are likely to be more willing to switch away or ground aircraft as the capacity will not be taken up by their competitors. This means that they can make credible threats to switch and will not lose competitive advantage by abandoning/under-utilising slots if they need to.

E207 In Hutchinson 3G v Ofcom [2005] CAT 39 the CAT explained that the degree of buyer power was important and whether it operated to a sufficient extent so as to mean that there is no SMP. It emphasised that CBP embodies a possible range of strengths, which will depend on the particular buyer and the particular seller and their respective bargaining

CAA, Re: Assessing the Market Power of Stansted Airport, 8 November 2013.

129 Stansted ACC, Response Letter to the CAA, Re: Assessing the Market Power of Stansted Airport, 8 November 2013.

130 See: Stansted Market Power Assessment January 2013 | Consultations and Responses | About the CAA Annex 4.

power. It also depends on the particular market in question and entails an assessment of how he market actually operates (or is likely to operate) in actual fact.

E208 That means that the assessment of CBP will be different now that a different operator, MAG, has taken over Stansted. To assess whether the degree of CBP is sufficiently strong to constrain STAL, it is useful to look at examples where the airlines have sought to negotiate with STAL and threatened to switch or reduce frequencies in response to an increase in charges.

Examples of exercise of CBP

Ryanair

The February 2013 price increase

E209 The CAA does not agree with MAG's assessment of Ryanair's options for switching existing aircraft based at Stansted to other London airports. The CAA considers that Ryanair has a much stronger presence at Stansted than at other London airports so that switching would lead to some loss of economies of scale. Furthermore, there are few options for basing additional aircraft at Luton or Gatwick due to capacity constraints and Southend is unsuitable for Ryanair's fleet. Ryanair might be able to switch some inbound services to other London airports but appear not to have done so since the 2007 withdrawal of discount by STAL.

E210 However, the CAA's view is that Ryanair has threatened to remove growth from Stansted as a response to STAL's increased airport charges since 2008 and that this threat has been successful on at least one occasion. In February 2013 STAL (still under BAA's ownership) announced an increase in airport charges of 6 per cent effective from April 2013. In response, on 28 February 2013[131], the same date as MAG acquired STAL, Ryanair announced that:

> *Ryanair, Europe's only ultra-low cost carrier (ULCC), today (28 Feb) announced that it will cut its London Stansted traffic by 9% over the coming year (from 12.5m to 11.4m) after the Ferrovial/BAA Stansted monopoly announced a further unjustified increase of Stansted's already high charges of 6% from April 2013.....*[132]

131 Ryanair:http://www.ryanair.com/en/news/ferrovial-baa-hikes-stansted-fees-by-6-percent-from-april-2013-in-a-parting-gift-to-manchester-airport-group-and-a-parting-slap-to-stansted-s-airlines-and-passengers.

132 See: Ferrovial/BAA Hikes Stansted Fees By 6%.

E211 In its press release, Ryanair was specific about how it would reduce its capacity at Stansted:

Ryanair, which had planned to grow its Stansted traffic by 5% from April 2013, will now cut frequencies on 43 of its routes and reduce its weekly operations by over 170 flights, with the loss of 1.1m passengers (-9%) and over 1,100 jobs at Stansted, in direct response to this unwarranted and unjustified 6% price hike.*[133]

E212 Ryanair has confirmed to the CAA that it uses its press statements as part of its negotiations with airports. When asked to reconcile press releases with actual switching activity, Ryanair stated that they *'do not provide 'reconciliations' to press releases which are forward looking statements and in some cases are part of a negotiating process with a particular airport.'*[134]

E213 MAG acquired Stansted on 28 February 2013. It attended a meeting with Ryanair in Dublin, the following week, on 7 March 2013. At that meeting, Ryanair raised the proposed price increase at Stansted and MAG [✂].[135]

E214 On 2 April 2013, Ryanair wrote to STAL (which was by then under MAG's ownership) as follows:

I refer to our meeting in Stansted last Friday.

I confirm Ryanair's acceptance of your offer [✂] *Ryanair will reinstate sufficient capacity with effect from early September to achieve total passenger traffic (arriving and departing) of 13.2m in the year ended 31st March 2014.*[136]

E215 On 14 April 2013, MAG wrote to Ryanair setting out the basis for its reinstatement of the core traffic, as follows:[137]

We will [✂] at 31 March 2014 the aviation charges incurred by Ryanair at STN in the period 1 April 2013 – 31 March 2014 [✂]. For clarity, the [✂] will be the departing passenger charge, landing charge, landing ATC charge and aircraft parking charge…

[✂], Ryanair will reinstate sufficient capacity with effect from early September to achieve total passenger traffic (arriving and departing) of 13.2 m passengers in the year ended 31 March 2014…

133 See: Ferrovial/BAA Hikes Stansted Fees By 6%.
134 Source: Ryanair [✂].
135 Source: MAG [✂].
136 Source: MAG [✂].
137 Source: MAG [✂].

E216 A further letter from Ryanair on 19 April 2013 confirmed this position:

As agreed at our meeting of 7th March, [✂]*. As I confirmed in my letter of 12th April, Ryanair has now added additional capacity in order to deliver this 13.2m commitment.*[138]

E217 Ryanair’s threat to reduce passenger numbers at Stansted included 9% of core traffic that was already committed for 2013/14 rather than growth plans. The amount of traffic that Ryanair threatened to remove, 1.1 million passengers, is approximately equal to the critical loss that the CAA calculated for a 10 per cent increase in airport charges, presented in section 4.2 above. This level of passenger loss would therefore have been more than sufficient to make a 6 percent increase in airport charges unprofitable.

E218 The threat was clearly considered to be credible by STAL because it responded promptly (in little over a week) [✂]. Ryanair threatened to remove committed capacity from Stansted and [✂] traffic to its original level and increase it to 13.2 million passengers a year. The CAA considers that this indicates that Ryanair effectively used its ability to switch existing capacity and allocate growth as a bargaining chip in its negotiations with STAL to achieve better terms from STAL. The CAA considers that STAL believed these threats to be credible. The [✂] negotiations were indicative of Ryanair having a sufficient degree of countervailing buyer power to constrain an attempt by STAL to increase airport charges.

E219 The original increase in airport charges was imposed under [✂]. However, it remains that the new owner could have [✂] chose to respond swiftly to Ryanair’s threat, suggesting that Ryanair exercised buyer power.

Allocating growth

E220 Taking into consideration Ryanair's and easyJet's shares of STAL's passengers, at 72 and 19 per cent respectively, the CAA considers that their growth plans are likely to be important to STAL’s financial future and that they would be able to use their growth plans in negotiations with STAL to achieve better terms.

E221 The CAA considers that Ryanair has tried to use its ability to allocate aircraft to alternative airports rather than at Stansted to achieve lower airport charges there. This view is supported by Ryanair statements, for example:

138 Source: MAG [✂].

Perhaps you could ....respond with an alternative low cost proposal that would incentivise Ryanair to switch our rapid traffic growth from your competitor airports to London Stansted.[139]

And:

Sadly, your previous offer remains totally uncompetitive when compared to far lower cost growth discounts available to Ryanair at many other UK and European airports [140]

Competitive discounts *– confining your proposed discounts to ....renders it uncompetitive in the current marketplace when many other airports in the UK and Europe are offering* [✂] *discounts on* [✂] *for terms between* [✂] *years.*[141]

And:

Due to the high prices at Stansted, Ryanair had allocated more of its new aircraft elsewhere, which harmed consumers.[142]

And:

...Ryanair has grown in other countries while removing capacity from STAL was a consequence of the doubling of charges at STAL in 2007.[143]

E222 In Ryanair's May 2013 Investor Call[144], Ryanair stated:

So we continue to be very opportunistic. We go wherever the airports give us the best package of efficient facilities and low costs". If all of those airports were to agree to the terms of our proposal today, we would not be able to handle that growth for about three or four years, so whoever kind of steps up first will likely win and get the immediate traffic growth and the others would simply have to wait in line.[145]

E223 The CAA considers that the statements presented in paragraphs E221 and E222 suggest that Ryanair has used its ability to allocate growth as a bargaining counter in negotiation with STAL in order to get reduced airport charges.

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139 Source: MAG [✂].

140 Source: MAG [✂].

141 Source: MAG. [✂].

142 Source: Ryanair Source: Ryanair: CAA Board Stansted Stakeholder Event..

143 Source:Ryanair reply to the CAA's 'minded to' decision on STAL's market power.

144 Ryanair, investor conference call, January 2012; http://www.media-server.com/m/p/h7g37293.

145 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to' document p. 34, citing a Ryanair, investor conference call, 20 May 2013. http://www.caa.co.uk/docs/1350/MAG%20response%20to%20STN%20MPA%20June%202013.pdf.

E224 The comparison of weekly departures from Stansted and other airports in Ryanair’s network presented by MAG (see section 4.7 below)[146] provides some support for the view that more growth may have been allocated to other airports in Ryanair's networks rather than Stansted.

E225 In addition, the CAA considers that the 2013 bilateral long term growth deal that Ryanair concluded with STAL (considered below) is evidence that Ryanair was able to use its ability to allocate growth across its network to achieve better terms from STAL because STAL offered long term reductions in airport charges in return for growth.

E226 In the minded to Consultation, the CAA observed that STAL had been pricing at or close to the regulated cap for over 5 years[147] and had not offered any discounts to existing airlines since 2008.[148] According to a independent benchmarking study by Leigh Fisher, STAL had been pricing approximately £1 above the average level of comparator airports and approximately £1.50 above comparators subject to lighter regulation.[149] The CAA concluded that STAL’s pricing was above the competitive level although it could not specify exactly how much[150].

E227 In contrast, Ryanair’s prices under the negotiated long term deal are significantly lower than the 2013/14 price cap and within the range of what the CAA considers to be the competitive level for Stansted. This suggests that Ryanair has been able to effectively exercise its bargaining position to constrain STAL’s pricing to a level that suggests that STAL does not hold SMP.

easyJet

E228 The CAA considers that easyJet has exercised buyer power in its sponsorship of Southend's expansion in April 2012 in response to increased airport charges imposed by STAL since 2008 under BAA’s ownership. When asked whether it was using Southend as a threat to switch traffic from Stansted to discipline STAL’s behaviour, easyJet noted:[151]

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146 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', p. 30.

147 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', paragraph 6.67.

148 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', paragraphs 6.79 and 7.15.

149 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', paragraph 6.59.

150 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', paragraph 6.62.

151 Source: easyJet [✂].

- [✄].
- [✄].

E229 Other easyJet statements support the CAA's view that easyJet's sponsorship of Southend's entry was an attempt to discipline STAL. For example:

[✄][152]

E230 easyJet provided further detail to the CAA on its move to Southend at a meeting held prior to MAG's acquisition of STAL:[153]

- [✄]
- [✄]
- [✄]
- [✄]
- [✄]
- [✄]
- [✄]
- [✄]

E231 An internal STAL note of a meeting with easyJet to discuss a growth deal also noted:

Their plans for Southend SEN are [✄] *based acft by 2014*

Cath (Cath Lyn, easyJet Customer and Revenue Director) explained that their move to SEN was a response to prices and network benefit for them.[154]

E232 Although easyJet's switching to Southend did not have any immediate impact on STAL's pricing polices under BAA's ownership, the reductions in frequencies and traffic did have an impact on MAG's commercial behaviour soon after it acquired Stansted in February 2013. That may be as a result not only of there being a new airport operator but also as a result of the increased spare capacity at Stansted over time.

152 Source: easyJet [✄].
153 Source: easyJet [✄].
154 Source: STAL [✄].

E233 The CAA's view is that sponsoring Southend's entry by moving 3 aircraft there from Stansted afforded easyJet a degree of buyer power that it continues to hold in that it could threaten to allocate additional aircraft to Southend or other airports in return for better terms from STAL. The CAA notes the CC's view cited by easyJet that Southend is unlikely to provide a long-term risk to STAL but considers that this is not necessary for easyJet to be able to threaten to move sufficient aircraft to get better terms from STAL in negotiations. The Southend move is likely to have signalled to STAL easyJet's willingness to move away from STAL.

E234 The CAA also considers that easyJet used its ability to allocate volume growth in negotiations with STAL. An internal STAL note of a meeting with easyJet to discuss a growth deal noted:

[✄]. [155]

E235 It appears that representatives from MAG and easyJet attended a meeting in Luton on 4 March 2013 to discuss commercial proposals for Stansted. During that meeting, the parties referred to the fact that easyJet's traffic at Stansted had fallen by over 1 million passengers (from over 2.4 million passengers in 2007 to 1.39 million in 2013).[156] easyJet indicated that a reversal of that trend would require a [✄].

E236 When asked if it had any examples of tools or strategies (successful or *unsuccessful*) used to discipline airports, easyJet noted:[157]

- [✄]
- [✄]
- [✄].

E237 The above evidence suggests that:

- easyJet sponsored Southend's entry in an attempt to discipline STAL. Its move of 3 aircraft to Southend in April 2012 was close to the critical loss presented in section 4.2 above.
- Since 2007, easyJet has withdrawn more than 1 million passengers from Stansted – again this is close to the critical loss presented in section 4.2 above.

155 Source: STAL [✄].
156 Source: easyJet [✄].
157 Source: easyJet [✄].

- In December 2011 easyJet referred to the possibility that it could base [✂] aircraft at Southend in its negotiations with STAL to achieve lower airport charges.
- In 2012 easyJet used the threat of using Stansted as a [✂] base in negotiation with STAL on future airport charges.

E238 easyJet's prices under the negotiated long term deal are substantially lower than the previous prices imposed by STAL under BAA's ownership and are within the range of what the CAA considers to be the competitive level. This suggests that easyJet has been able to effectively exercise its bargaining position to constrain STAL's pricing to a level that suggests that STAL does not hold SMP.

Assessment

E239 Buyer power relates primarily (although not always) to the strength of a buyer in negotiations with sellers.[158] The evidence suggests that easyJet and Ryanair satisfy the main conditions for buyer power.

E240 Both airlines are well informed about alternative sources of supply and could switch, and have switched, a significant proportion of their traffic to alternative airports. As noted:

- easyJet was able to 'sponsor' new entry at Southend relatively quickly and without incurring substantial sunk costs. easyJet's switch of three aircraft to Southend is at the lower end of the critical loss.
- Ryanair appears more constrained in its ability to move aircraft currently based at Stansted to alternative London airports. While it is difficult to make a direct causal link between Ryanair's public statements about its allocation of growth and its actual decisions on where it allocates aircraft and the airport charges it pays to STAL, the CAA considers that Ryanair's statements support the CAA's view that it has used the allocation of growth in negotiations.
- Ryanair stated [✂]. The CAA considers that this displays a clear link between a threat to discipline STAL by removing capacity and that this was effective [✂]. This appears to be clear evidence that Ryanair was able to exert buyer power on STAL to achieve lower airport charges.

[158] See, for example, Hutchinson 3G v Ofcom [2005] CAT 39, paragraph 111 and the OECD competition committee roundtable on buyer power and the contributions by OECD members to that debate, summarised in OECD (1998). The OFT and the EC Commission refer to buyer power in a bargaining framework at OFT, Assessment of market power guideline (OFT 415), paragraph 6.2 and EC (2004a), paragraph 64.

- Both Ryanair and easyJet have threatened to reduce frequencies and/or have withdrawn traffic measuring in excess of 1million passengers which is at the lower end of the critical loss.

E241 Importantly, in view of the amount of spare capacity at Stansted, both airlines have opportunities for allocating future growth to alternative airports in their networks, without attracting switching costs.

E242 Both airlines are important outlets for STAL as the provider of airport operation services and other services. As set out in the minded to Consultation, Ryanair (68 per cent) and easyJet (22 per cent) account for around 90 per cent of Stansted's passengers. Those levels of business are commercially significant to STAL. These shares suggest that these airlines would have countervailing buyer power if they have the ability to switch away from the airport. Their ability to threat credibly to switch is reinforced by the fact that there is no competitive backfill so they are not deterred by the fact that they could lose a slot to a competing airline.

E243 The CAA considers that STAL's negotiating position, is substantially weakened by its spare capacity (approximately 40 per cent) and dependence on commercial revenues from passengers. Since the break-up of BAA, STAL can no longer leverage strength from its common ownership with Heathrow under BAA. Those considerations are likely to have incentivised STAL to cede better terms to them under the deals to retain their present business and secure future growth

E244 The CAA acknowledged in the minded to Consultation that Ryanair's presence at Stansted was a deterrent to other LCCs operating from it, thereby increasing STAL's reliance on Ryanair over that suggested by its share of STAL's business. The CAA considers that this is an additional factor that reinforces Ryanair's bargaining position, or weakens STAL's, in negotiations.

E245 The CAA considers that the existence of substantial spare capacity and lack of competitive backfill at Stansted is relevant to the assessment of buyer power. This is because:

- Low risk of backfill makes airlines more willing to switch and their threats to switch more credible.
- Threats or actual withdrawal of capacity (or promises of additional traffic) would not easily be replaced from another source and so would have a material impact on the airport's profitability. The CAA considers that this means that STAL is substantially dependent on these airlines' business for its viability.

E246 It is not necessary for the airports, to which growth is allocated, to be part of the relevant market. As the CC noted:

Where airlines can credibly threaten to move flights to other airports, this might also be a constraint even if those other airports are not viable substitutes for passengers.[159]

E247 In this case, Luton and Southend are other possible alternatives to Stansted although stand capacity limitation militates against moving based aircraft to Luton and Southend is not suitable for Ryanair's fleet. There are also limitations on moving based aircraft to Gatwick but in bound traffic that use only off peak capacity could be switched.

E248 The CAA considers that, in all the circumstances, both airlines have real and effective bargaining power and the ability to exercise some degree of CBP, stemming from their ability to allocate growth across their networks. Under BAA's ownership it appears that this ability had little effect in constraining STAL's airport charges. However, since the breakup of BAA's common ownership and the sale of STAL, MAG appears to have different commercial incentives to BAA.

E249 The long term growth deals agreed by STAL with easyJet and Ryanair represent a significant downward movement in airport charges, linked to the allocation of growth. The easyJet and Ryanair bilateral agreements include charges in their respective first years of operation that are below the current regulated charges for STAL and both agreements offer the potential for discounts if growth targets are met. Whereas previously STAL was pricing above the competitive level, these lower charges are within the range of what the CAA now considers to be a competitive level.[160]

[159] CC, BAA airports market investigation, paragraph 2.48c.
[160] The minded to Consultation, paragraphs 6.38 to 6.69.

E250 Although, the CAA accepts that STAL is likely to have had multiple reasons for concluding the deals rather than their being due to any single factor, the CAA considers that the structure of supply and demand at Stansted and the availability of alternative suppliers both within and outside the relevant market affords Ryanair and easyJet a substantial degree of buyer power through their ability to allocate growth to other airports and thereby threaten to harm STAL's business.

E251 Buyer power is more usually associated with a threat to remove existing volume rather than new growth. However, some of the additional growth required under the deals might be expected to happen in any case with an improvement in economic conditions over Q6. It is their ability (in Ryanair's case to [✄]) and in both cases to achieve lower prices across all of their traffic in negotiations by threatening to withdraw traffic or allocate growth elsewhere that is important for determining countervailing buyer power.

E252 Both growth deals have an initial 5-year term and can be extended. The CAA considers that the duration of the deals suggests that easyJet and Ryanair's buyer power will be instrumental in counteracting any SMP that STAL might have been likely to acquire over Q6 in terms of its ability to raise airport charges in future.

E253 easyJet's and Ryanair's buyer power is augmented by the loss of commercial revenues that would arise if passenger numbers at the airport were to be reduced. This effect is likely to be more important now that Ryanair has relaxed its one bag rule, [✄][161]

E254 The CAA expects that Ryanair's relaxation of the one-bag rule and easyJet's concession permitting airport purchases to be carried without charge on board in addition to cabin baggage will increase MAG's non-aeronautical income:

Similarly, easyJet's deal includes a [✄]*. As the Consultation Document notes, this is designed to increase commercial revenues at Stansted.*[162]

E255 Regarding Ryanair's view that MAG's agreement [✄] threats from Ryanair was a regulation strategic move by MAG, there is no evidence to support this assertion. In fact, the evidence suggests that MAG was not aware of the price increase imposed by BAA and was taken by surprise by Ryanair's announcement to cut its traffic.

E256 The [✄] Ryanair's traffic for 2013-2014 and did not extend to other airlines. If this was an attempt at regulatory gaming, one would have

161 MAG response to additional consultation, paragraph 34(b).

162 MAG response to additional consultation, paragraph 34(b).

expected STAL to remove the increase across the board for all of its traffic and for a longer part of the Q6 period.

E257 The move would have been poorly targeted on the CAA's minded to position that STAL 'may have SMP and is likely to acquire it' as it would only have responded to the current constraints on STAL rather than the future, which appeared to be the CAA's concern. Consequently, it does not appear to represent a credible gaming strategy.

E258 The CAA does not agree with the SACC's view that it was only when it became clear that STAL would, in effect, be regulated, that it became clear that the only way for MAG to increase revenues was through growth deals. The prices under the growth deals are significantly lower than the 2013/14 price cap of £7.68 per passenger. Had MAG thought it profitable it could have continued to price to this cap and accepted a higher margin over a lower volume of future traffic.

E259 Regarding the SACC's view, it would only be possible to renegotiate terms if STAL continued to be regulated, the CAA's view is that the terms of the agreements represent a starting point that can be renegotiated in the absence of regulation if there is a mutual benefit to the parties.

Conclusion on buyer power

E260 CBP is the ability of airlines to use their bargaining power effectively to offset the powers of the airport operator, whose allegedly superior powers are under consideration. The important question is whether it operates, in the wider context of the market and together with the other constraints on STAL, to a sufficient extent so as to mean that there is no SMP.

E261 The CAA considers that easyJet has CBP, which is evidenced by its sponsorship of Southend's entry and that it used its ability to allocate additional aircraft in negotiations with STAL. This position is consistent with the CAA's view outlined in the minded to Consultation.

E262 With respect to Ryanair, the CAA has changed its position from that outlined in the minded to Consultation. The CAA now considers that Ryanair has CBP. [✂] and the subsequent conclusion of a long term deal at airport charges that are consistent with the CAA's view of a range for the competitive price for Stansted has caused the CAA to reconsider the evidence on Ryanair's buyer power.

E263 The CAA concludes that the evidence presented above, including the negotiation and outcome of long term deals suggest that both easyJet and Ryanair have a sufficient degree of buyer power to constrain STAL's attempt to increase airport charges and to negotiate charges that remain within the competitive range. Both airlines appear to have used their ability to allocate growth to obtain better terms from STAL. The latter's position was weakened by the existence of spare capacity and the need to attract additional passengers for their contribution to its non-aeronautical income.

E264 The easyJet and Ryanair bilateral agreements include charges in their respective first years of operation that are below the current regulated charges for STAL and both agreements offer the potential for discounts if growth targets are met. These lower charges are within the range of what the CAA considers to be a competitive level based on the analysis included in the minded to Consultation.[163] The CAA considers that easyJet's and Ryanair's ability to negotiate prices that are within the range of the competitive level suggests that they have been able to sufficient exercise buyer power to constrain STAL's pricing to a level that suggests that STAL does not hold SMP.

Section 4.6: The terminal transformation project

E265 The terminal transformation project was described in the additional Consultation and stakeholders' views on its implications for STAL's SMP were invited as part of the change in behaviour resulting from the change in ownership.

E266 In March 2013, STAL consulted on options for its terminal transformation project. STAL set out its strategy for the project as:

- *Improving the passenger experience*
- *Improving the efficiency of security processing in Central Search*
- *Improving Stansted's overall departure lounge and retail offer*
- *To deliver the transformation quickly and to avoid disruption to 'business as usual'.*[164]

E267 In a letter to the SACC, STAL noted that a key component of the commercial case for the project was to increase retail spend per passenger:

We have assumed that the redevelopment of the Departure Lounge will increase retail revenue by around [✂] *per cent per passenger per passenger or around* [✂] *per passenger, which also reflects a revenue*

163 The minded to Consultation, paragraphs 6.38 to 6.69.

164 MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', p. 66.

reduction from the loss of some food and beverage outlets and some landside retail units[165.]

E268 In its response to the minded to Consultation, MAG set out how it considered that the terminal transformation project would affect the level of its airport charges:

We intend to increase the airside retail area of Stansted from the current 5,980 square metres to 10,660 square metres by 2015. These changes will cost in the region of £40 million. Our consultation document states that one of the aims of the changes is to increase retail yield per passenger (see page 19 of Annex F.... It is clear that these changes (in addition to other changes proposed) will have a significant impact on our incentives to increase passenger numbers and therefore limit spare capacity, thus reducing our incentives to increase aeronautical charges.

*It is also notable, **in this context** (emphasis added), that the Consultation Document refers to Ryanair's 'one bag rule' as resulting in suppressed demand for non-aeronautical services at Stansted (paragraph 4.13 of the Consultation Document, third bullet). We are currently negotiating with Ryanair* [✂] *a long term deal currently being discussed with Ryanair.*

E269 The project was announced on 20 June 2013. In its response to the additional Consultation MAG again highlighted that the terminal transformation project will strengthen Stansted's incentives to increase passenger numbers and reduce its incentives to increase aeronautical charges:

Terminal Transformation Project: As the CAA is aware, Stansted is investing approximately £40 million (and retailers are committing a similar amount) to improve passenger service, reduce operating costs and increase the airside retail area of the terminal building. By improving the retail experience for passengers, we expect to increase significantly the level of retail income per passenger. In the MPA Response, M.A.G highlighted that this project will strengthen Stansted's incentives to increase passenger numbers and reduce its incentives to increase aeronautical charges.

CAA views, analysis and conclusion on the terminal transformation project

E270 The CAA considers that the existence of substantial spare capacity that is expected to persist over Q6 incentivises STAL to increase passenger numbers. The terminal transformation project, described above, appears to add to this incentive by increasing retail revenue per passenger. Much

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165 Source: STAL [✂].

of the increase in revenue will come from STAL's existing passengers but, at the margin, additional passengers will also have greater value than was previously the case. This leads to an incentive for STAL to increase passenger numbers, which it could do by reducing airport charges but the effect of this may not be large and, clearly, if an airport was at full capacity there would be no incentive at all.

E271 The effect of a £1 increase in retail spend was taken into account in the critical loss analysis in appendix F where it was shown to reduce the level of the critical elasticity. However, the additional of £1 retail spend did not lead to a material reduction in the critical elasticity.

E272 Other changes designed to increase the demand for STAL's non-aeronautical services are also likely to moderate airport charges although the process for generating additional retail spend is different.

E273 The relaxation of the one-bag rule by Ryanair and easyJet's [✂] stating that airport purchases will be permitted to be carried on board, should also lead to increased passenger spending at the airport. Therefore, the benefit of increasing passenger numbers to the airport operator is, all else equal, increased.

E274 However, unlike the terminal transformation project, measures to increase passenger spending were part of negotiations between STAL and easyJet and Ryanair. The CAA considers that easyJet and Ryanair are likely to have considered the costs (i.e. the potential loss of on-board retail and food and beverage spend) against the benefits of reduced airport charges on current and/or future traffic. Similarly STAL is likely to have weighed the retail revenues benefits it expects from passengers being allowed an addition 'airport' bag being allowed on aircraft against the costs in forgone aeronautical revenue.

E275 It appears to the CAA that STAL has to some extent reacted to the combined incentive placed on it by its spare capacity and potential gains in profitability through retail revenue generation, as evidenced by its bilateral agreements. Essentially, increased revenue potential for STAL's non-aeronautical services encourages STAL to supply aeronautical operation services at a lower price.[166] STAL's investment in the terminal transformation project is a sunk cost (once completed). Together with the other changes to incentivise demand for STAL's non-aeronautical services it signals STAL's commitment to a business model which, while there remains substantial spare capacity a the airport, can be expected to exercise some constraint on airport charges.

166 This represents a downward shift of the supply curve for aeronautical services and is a different effect to the pricing interdependencies discussed in appendix D.

Section 4.7: Statistical evidence on switching

The minded to Consultation

E276 The minded to Consultation considered the amount of switching away from Stansted in the context of the ‘Natural Experiment’, the removal of discounts from the main Stansted airlines in 2007, which resulted in substantial increases in airport charges to its main airlines. The CAA concluded that it was difficult to distinguish between the reaction to the price increase and the economic recession. Any action taken by the airlines was not effective in constraining STAL, which was at that time under BAA’s ownership, as it did not reverse all or part the 2007 increase.

Stakeholders’ views

E277 In response to the Consultation, MAG maintained that the removal of a discount is not the same as a price increase. MAG stated that the withdrawal of discounts was fully anticipated, due to the expiry of the applicable contracts, and therefore the responses by airlines cannot be considered to be comparable to those resulting from an unanticipated price increase.

E278 MAG criticised the CAA for ignoring constraints from other London, UK and continental European airports. MAG submitted evidence showing the fall in monthly departures in the summer season from Stansted year-on-year from 2006 to 2012 for both Ryanair and easyJet, and the rise in weekly departures at other UK airports and other continental European airports within their respective networks over the same period.[167] In aggregate, MAG estimated that its largest customers have reduced their use of Stansted by 323 weekly departures while increasing their use of other London airports by 659 weekly departures over this period. MAG maintains that view that this is evidence of competitive constraints from other London, UK and EU airports.[168]

Analysis and conclusion

The 2007 natural experiment

E279 As part of its analysis of switching in the minded to Consultation, the CAA examined the experience of Ryanair and easyJet in 2007, when a number of long-term contracts between Stansted and its various airlines expired,

[167] MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', p. 32.

[168] MAG, Civil Aviation Authority Stansted Market Power Assessment, Interim response of M.A.G to the CAA's 'minded to document', pp. 42, 43

resulting in the loss of various discounts and the majority of STAL's airlines facing significant price increases.

E280 The evidence on the airlines' response to this change can help illustrate what disciplinary action they can take in response to an increase in prices. However, as noted in the Consultation, the period when discounts were removed was around the time the financial crisis and economic recession started and consequently the airlines would have been facing both the price increase and a negative demand shock. Therefore, any reduction of services may be influenced by these events.

E281 Overall, passenger numbers at Stansted fell from approximately 24mppa in 2007 to approximately 18mppa in 2012, which also includes a number of airlines ceasing operations and the effects from the worsening macroeconomic conditions during that period.

E282 The CAA does not agree with MAG's view that withdrawal of a discount is different to a price increase although it acknowledges that the increase in airport charges in 2007 might have been anticipated by certain carriers, and so cannot be considered a natural experiment in the purest sense. However, the CAA considers that evidence of switching by airlines following a price increase, whether anticipated or not, can still indicate their ability to switch marginal units away from Stansted and whether this was sufficient to constrain STAL. The CAA considers that BAA's reaction to any loss of business in this period may not be representative of that of the new owner which, is not faced with the prospect of divestment and does not take account of the impact of its behaviour on profitability at Heathrow, may take a different strategic approach to Stansted and its profitability.

Differences in departure trends between Stansted and other airports

E283 The CAA has carried out its own examination of departure trends between 2007 and 2013 (see appendix D) and notes that:

- It is difficult to distinguish the effects of the recession and airlines' reaction to the 2007 increase in airport charges by STAL. Comparisons across other airports and LCCs networks may also not completely standardise for the recession and other effects.

- The market for low cost air travel is in different states of maturity at different airports. Stansted was already a mature market in 2007 and therefore some of the difference between it and other airports may be due to other low-cost air travel markets maturing. Airlines' development strategies for particular airports and capacity may also account for some of the difference in departure trends between Stansted and other London airports.
- On the basis of MAG's analysis, it is not possible to say whether aircraft have been switched away from Stansted. The CAA is aware of few examples of switching away from Stansted other than easyJet's relocated three aircraft from Stansted to London Southend in 2012 and the moves to Gatwick described in paragraph 255, appendix D.
- MAG's analysis is consistent with airlines allocating new capacity to alternative airports but does not establish that this was caused by a difference in airport charges.

E284 MAG maintains that departure reductions at Stansted and departure increases at continental European airports suggest that the latter exert a significant constraint on STAL's operations. It criticises the CAA for failing to take account of these constraints and the evidence of switching by Ryanair and easyJet to European airports. The constraint from European airports was not considered strong enough for them to be part of the relevant market considered in appendix D although they may still exercise a constraint from outside the relevant market. In addition, the strategic importance of London to airlines' networks considered above suggests that they would be reluctant to switch capacity away from London.

E285 While the LCC model affords airlines some facility to switch aircraft across bases, in response to increase airport charges, the CAA considers that the evidence does not suggest that this is how they respond in practice.

E286 However, Ryanair stated in its minded to Consultation response that it had *grown in other countries while removing capacity from STAL [and that this] was a consequence of the doubling of charges at STAL in 2007.*[169] easyJet also stated that '[✂] *capacity at STN due to the increase in charges*.'[170]

E287 The differential rates of growth between Stansted and the rest of Ryanair's network are consistent with these statements.

169 Ryanair, Ryanair's reply to the CAA's 'minded to' decision on STAL's market power, paragraph 8.
170 Source: easyJet [✂].

Conclusion on evidence of switching

E288 The CAA maintains the view that it outlined in the minded to Consultation that a number of factors could have contributed to the difference in the change in departures from Stansted compared to other airports from 2007. The CAA has been able to identify very few instances of switching existing aircraft or routes apart from those set out earlier in this appendix.

E289 The CAA has not been able to identify aircraft or routes that have been transferred from Stansted to Europe. Ryanair evidence suggests that Ryanair, and potentially other LCCs, consider European airports as alternatives to Stansted when allocating growth over the medium term.

E290 The statistical evidence is consistent with easyJet and Ryanair statements about allocating growth away from Stansted to other airports.

Section 4.8: Conclusion and overall assessment of cumulative constraints

E291 This section concludes on the cumulative effect of the constraints on STAL. The evidence considered in this appendix suggests that the competitive constraint from all sources is sufficient to counter any presumption of dominance that arises as a result of STAL's market share.[171] The evidence in its totality suggests that STAL does not have SMP and is not likely to acquire it over Q6. The CAA's overall assessment of SMP, presented in chapter 5, draws on the evidence in this and other appendices.

171 As explained above, market shares are not conclusive and are dependent on market definition. If Gatwick is included in the relevant market STAL's market share would be in the region of 30 per cent.