

# **CIVIL AVIATION AUTHORITY**

CAA House  
45-49 Kingsway  
London, WC2B 6TE

Investigation under Section 41 of the Airports Act 1986

of the structure of airport charges levied by

Gatwick Airport Limited

## **CAA PANEL HEARING**

on

Thursday 24 May 2012

## **BRIAULT REPORTING**

Elton House, Headley Road, Epsom, Surrey, KT18 6BL

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## **ATTENDEES**

On behalf of the Civil Aviation Authority:

Mr Iain Osborne - Chairman  
Mr Richard Moriarty - Panel Member  
Ms Rebecca Staheli - Panel Adviser  
Mr Rod Gander - Panel Member

On behalf of Flybe:

Mr Jim French - Chairman & CEO  
Mr Andrew Strong - Managing Director, Flybe UK  
Mr Charles Stafford - Procurement – Airport Relationships  
Mr Jeremy Robinson - Gates and Partners Solicitors

On behalf of Gatwick Airport Limited:

Nick Dunn - Finance Director  
Robert Herga - General Counsel  
Colin Garland - Senior Manager, Economic Regulation  
Mr Martin Chamberlain - Brick Court Chambers  
Mr Anthony Jones - Pupil to Mr Chamberlain

Observing the proceedings:

Mr Thomas Carr - CAA  
Ms Vanessa Jones - CAA  
Ms Tina Dunkin - CAA  
Ms Rebekah Isaacs - CAA  
Mr James Jamison - BAA

Stenographer: Ms Charlotte Briault

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1 (9.46 am)

2 MR OSBORNE: Good morning, everybody. Welcome to the Civil Aviation  
3 Authority and to this oral hearing on Flybe's complaint under section 41 of the  
4 Airports Act of the structure of airport charges at Gatwick Airport.

5 I am going to make a few introductory remarks, just briefly outline the  
6 process and ground rules for the hearing and then we will go straight into your  
7 opening statements.

8 Housekeeping first. We are not expecting a fire alarm test. So, if it goes  
9 off, take it seriously. The quickest way from here is back into the main lobby and  
10 out the front door; if that is not possible, then turn right out of the door and go  
11 straight to the end of the corridor where there is a fire exit. The assembly area is  
12 at the back between the big building and the round building just over the road  
13 from there.

14 The nearest toilets are in the main lobby.

15 We are going to have a coffee break mid-morning but you are all adults  
16 and you look after your own needs.

17 On that theme, do feel free to take jackets off, take off ties and roll up  
18 sleeves as necessary. I feel rather apologetic about keeping you all in a bank  
19 vault on this beautiful day, so you must make yourselves comfortable.

20 It says on my notes now "I would be grateful if you would make sure that  
21 your mobile phones are off" so it would be a good idea if I followed my own  
22 advice -- off or at least on silent.

23 As you both know, we have provided break-out rooms. If there is a need to  
24 pause our proceedings for break-out discussions, then do say so and we will do

1 that. It would be preferable if we keep that to the coffee and lunch breaks but  
2 that is an option that is available to you.

3 We will aim to stop at 1.00 pm and resume again after about an hour, a bit  
4 less than an hour. We have not provided lunch, I am afraid, but this is a very  
5 good place from which to get lunch, there are lots of options up and down  
6 Kingsway.

7 To introduce myself and the Panel, my name is Iain Osborne. I am the  
8 CAA's Group Director of Regulatory Policy.

9 On my left is Rebecca Staheli from our Legal Department.

10 On my right is Richard Moriarty who is our Director of Economic  
11 Regulation.

12 On my far right is Rod Gander who works with Richard.

13 The purpose of today's proceedings is to enable the CAA to take the best  
14 decision, nothing more or less than that. It is an opportunity for us to explore the  
15 arguments that have already been put to us. We are working on the basis that  
16 the material that is relevant will already have been put to us. There have been  
17 quite a lot of exchanges of written material. So, we are not really expecting you  
18 to put forward new material but rather to make sure that the submissions are fully  
19 explored, to make sure that we understand properly the arguments and to give us  
20 an opportunity to ask questions.

21 Given the limits to the time available, it is important that we focus on the  
22 key issues and do not get sidetracked. Certainly, in our questions, we, the Panel,  
23 will be focusing on the key issues which have been outlined in the Statement of  
24 Issues which we have circulated in advance.

1 I will be fairly rigorous in asking people to keep to time according to the  
2 timetable that we circulated earlier.

3 We, on our side, will aim to keep to time by issuing a statement within  
4 more or less six weeks from today, which could be a final decision. It could be  
5 that if there is anything else that we need to consult on again that we will do so.  
6 For example, if we find against the Airport then we might need to consult on a  
7 remedy.

8 This has been a fairly extended process so we are looking to close it down  
9 reasonably quickly. Your initial complaint was in March 2011: We have taken it  
10 through the three stages of section 41 and are now getting towards the end of the  
11 third.

12 The Panel has in front of us a set of documents which includes our  
13 Statement of Issues, the written representations from both Flybe and Gatwick,  
14 which I think in each case consist of initial responses to our consultation last  
15 autumn, a further exchange in February and then a further set of slides just  
16 recently.

17 With the exception of a couple of confidential bits, I think you have both  
18 seen each other's material.

19 The documents we have in front of us also include representations from  
20 third parties and a copy of our September 2011 consultation as well as a copy of  
21 the CAA's 1989 decision on a section 41 complaint.

22 If you refer to those materials as you go through, it would be helpful if you  
23 could let us know where we can look at them. If there is any other material that  
24 you expect to be referring to today, now would be a good time to say, so that we

1 can get it copied and make sure that we have copies available when we come to  
2 it.

3 MR STRONG: Just to clarify, you have a copy of the latest data from  
4 ourselves?

5 MR OSBORNE: Yes. We do, thank you.

6 We expect to base our decision on the evidence before us today but if in  
7 our deliberations we consider we should use any other material, which has not  
8 been circulated, we will ensure that both of you have sight of it and the chance to  
9 comment on it before we make our final decision.

10 Our preference is for today's process to be conducted as transparently as  
11 possible. Where there is commercially confidential information that may be  
12 material to the decision that we have to take, we are expecting that that evidence  
13 will be shared on both sides. But, where necessary, that may be done within a  
14 confidentiality ring which comprises us, obviously the party whose information it  
15 is and the legal representatives of the other side, so it is covered by legal  
16 privilege.

17 If we touch on such material today, and we need to, I may clear the room  
18 except for the parties within that confidentiality ring, which is always slightly  
19 uncomfortable so I apologise in advance for the inconvenience if we need to do  
20 that.

21 We are keeping a transcript of the session. Charlotte here is keeping a  
22 record. I would ask you all, please, to try and be clear so as to assist Charlotte.  
23 Obviously if confidential material does end up in the transcript it will be excised  
24 before the transcript is published.

1           Those are my opening remarks. Are there any issues that you want to  
2 clarify from what I have said?

3           MR ROBINSON: None from our side.

4           MR CHAMBERLAIN: Not from us.

5           MR OSBORNE: For the sake of the transcript, I am going to begin with the  
6 top table and then go round the whole room just so we can get a note of who is  
7 present. Then we will look to Flybe for your opening statement.

8           Rod, do you want to begin.

9           MR GANDER: I am Rod Gander, CAA.

10          MR MORIARTY: Richard Moriarty, CAA.

11          MR OSBORNE: Iain Osborne, CAA.

12          MS STAHELI: Rebecca Staheli, CAA.

13          MS JONES: Vanessa Jones, CAA, observing.

14          MR CARR: Thomas Carr, CAA, observing.

15          MR JONES: Anthony Jones, I am a pupil of the legal representative of  
16 Gatwick.

17          MR DUNN: Nick Dunn, Gatwick.

18          MR HERGA: Robert Herga, Gatwick.

19          MR CHAMBERLAIN: Martin Chamberlain, counsel for Gatwick.

20          MR GARLAND: Colin Garland, Gatwick.

21          MR JAMISON: James Jamison, BAA.

22          MR STRONG: Andrew Strong, Flybe.

23          MR ROBINSON: Jeremy Robinson, Gates and Partners, on behalf of  
24 Flybe.

25          MR FRENCH: Jim French, Flybe.

1 MR STAFFORD: Charles Stafford. Flybe.

2 MR OSBORNE: Thank you.

3 Flybe, the floor is yours, to begin your opening statement through to about  
4 10.30 am.

5 OPENING SUBMISSION ON BEHALF OF FLYBE

6 MR ROBINSON: Thank you, Mr Chairman. We are going to structure our  
7 opening statement in three parts. In a second I am going to hand over to Jim  
8 French who is going to explain why Flybe has brought this case and why it is so  
9 important for Flybe and for the industry; then I will discuss some of the legal  
10 considerations that bear on your decision; and then I am going to hand over  
11 principally to Andrew, on my right, to elaborate the slides that you have seen and  
12 the key points of Flybe's evidence.

13 So, Jim?

14 MR FRENCH: Thank you, Mr Chairman. First of all, can I just say how  
15 grateful we are to the Authority for investing in this matter and for providing us  
16 with an opportunity to present our case at this hearing.

17 Flybe has brought this case because of unfair treatment causing great  
18 harm to Flybe and to others but without any sign of any benefit.

19 I say "unfair" because there has been a dramatic increase in costs to Flybe  
20 which bear no relation to any increased costs incurred by Gatwick Airport  
21 Limited.

22 These have been applied at a time when the UK domestic air travel market  
23 has fallen by 20 per cent in the last four years -- an unprecedented decline; at a  
24 time when consumer disposable income has fallen at the highest rate in recent  
25 history.

1 As a consequence, Flybe has little ability to recover such cost increases  
2 through pricing, which in turn has resulted in substantial negative impact on all of  
3 the Gatwick route economics.

4 I say "unfair" because, in a highly competitive market, where there is head-  
5 to-head competition on routes against a competitor which operates larger  
6 equipment, for an airport to introduce a significant distortion in the costing model,  
7 and one which gives a significant cost advantage to a competitor, that competitor  
8 can use that gifted cost advantage to reduce its price in the market.

9 I say "gifted" because it is a cost advantage that has appeared literally  
10 overnight, through no actions they have taken.

11 In terms of quantum, if you look at the cost per passenger on an A319 at  
12 Gatwick, compared to the cost per passenger on a Q400, one of our airplanes,  
13 there is an immediate cost advantage of £7.40 per passenger. Andrew, in his  
14 presentation on these slides, can take you through that calculation.

15 To understand the quantum of that £7.40 when you are operating airlines  
16 at very low margins -- and when I say a "gift" I wonder if I may just ask you to  
17 imagine -- that, for Andrew, as the Managing Director of the UK business, is  
18 rather like receiving a phone call from George Osborne, the Chancellor of the  
19 Exchequer, who recently opened our training academy and had a shot in the  
20 simulator. It is rather like George Osborne ringing Andrew and saying "Andrew,  
21 thank you so much for giving us a shot in the simulator and opening your training  
22 academy. I am so pleased that I have a gift especially for you. I am going to  
23 reduce your APD from £13 back to £5.50". Not for Willie, not for Michael, not for  
24 Carolyn. "For you, Flybe, I am going to give you that gift".

1           It is rather like a sheikh ringing up Andrew and saying, "Andrew, just for  
2 you, I am going to reduce your cost in fuel for every passenger by 50 per cent".  
3 That is the quantum.

4           I think sometimes one forgets the quantum and the impact. What might be  
5 a relatively very small proportion of the revenue for an airport authority has a  
6 massive impact on the economics of an airline, particularly a regional airline. In a  
7 competitive environment, it gives our competitor a substantial advantage. We  
8 believe that that process actually really interrupts the normal competitive process  
9 between two carriers.

10          Flybe has been at Gatwick since 1991. Gatwick is of significant strategic  
11 importance to us because of what I describe as its halo effect in the regions. For  
12 a regional airline with a range of services operating to and from a regional airport  
13 to have a product offering in their portfolio to one of London's premier airports is  
14 to add significant market presence and credibility in the regional market.

15          To lose that service has a damaging impact on their overall market  
16 performance beyond merely the single route into Gatwick from that region.  
17 Gatwick is also important to Flybe and preferred to any other of London's  
18 airports, assuming exclusion from Heathrow, since Gatwick offers a range of  
19 long-haul leisure destinations which are simply not available from the regions or  
20 from the other London airports. This opportunity would therefore be denied to  
21 customers were those services to be withdrawn.

22          MR ROBINSON: I am now going to turn to the legal issues. The question  
23 in this case is whether the pricing policy adopted by Gatwick Airport Limited,  
24 which I will refer to as "GAL" throughout, unreasonably discriminates against  
25 Flybe and against the operators of smaller aircraft more generally. If the CAA

1 finds in favour of GAL on this point, that obviously disposes of this matter. If the  
2 CAA finds in favour of Flybe, then it is for yourselves to consider whether and, if  
3 so, in what way, to intervene to remedy or prevent the adverse effects that we  
4 say result from that discrimination.

5 We note that you will aim to avoid arbitrary or distortionary regulatory  
6 interventions. So, we say that the relevant test for the CAA is as follows: The  
7 CAA will be able to find that GAL is engaging in unreasonable discrimination  
8 where any or a combination of three factors is present.

9 The first factor is that the justification for the discriminatory pricing is in  
10 reality a theoretical justification confined to a general statement of principle rather  
11 than adequately based on evidence that is specific and relevant to this case.

12 Secondly, even if that justification is in theory capable of being valid, it  
13 does not take enough account of the need to preserve a level playing field  
14 between airlines and to maintain in fact a strictly neutral position as regards  
15 competing airline business models.

16 Thirdly, the outcome of the pricing policy, regardless of how it is justified,  
17 gives rise to increased prices for a carrier that bears no relation at all to the costs  
18 imposed by its operations on the airport. We say that, if the CAA is with us in  
19 finding that the pricing policy is, on its face, discriminatory, it is then for GAL to  
20 provide compelling and specific evidence that its policy is objectively justified.  
21 We also say that such a justification cannot succeed if GAL is allowed by its  
22 policy to determine the winners and losers as between competing airline  
23 business models and to impose charges that are out of all proportion to costs.

24 We agree with the CAA that the test is not whether GAL has adopted the  
25 best structure of charges. We accept there may be many possible reasonable

1 ways of structuring charges. What we are saying is there can be no justification  
2 for a policy that fails properly to balance the desire to increase air passenger  
3 movements for each air traffic movement and the need for cost orientation in  
4 price setting and neutrality between business models. If the CAA is with us on  
5 this point, then we accept that the CAA has discretion on whether to intervene  
6 and impose a condition, mindful of the need that any intervention should make  
7 things better not worse.

8 Flybe did not bring this case just to win a mere point of principle. Flybe  
9 brought this case to seek a precise, limited and proportionate remedy to the harm  
10 that is caused by what we say is unreasonable discrimination by GAL.

11 What we are asking for is a condition similar to that which the CAA  
12 imposed in 1989 on Heathrow Airport Limited (HAL) in the British Midland, et  
13 cetera, case, a restriction on increases in charges on any one airline that is  
14 limited to twice the maximum percentage increase in yield per passenger  
15 permitted under the charges condition in this case in force for Gatwick Airport.  
16 Plainly the CAA has the power to do this under section 41 and has used this  
17 power in the past.

18 We believe that, if the CAA were minded to impose such a remedy, then it  
19 would be able to resolve the matter between the parties here fairly, without  
20 imposing undue cost burdens on GAL and maintaining their overall discretion to  
21 set the structure of their charges to achieve various objectives, including  
22 encouraging the better use of scarce runway resources. Although we say it  
23 would not be very costly to GAL, in our estimation, it would make all the  
24 difference to the ability of airlines to choose and operate a business model that

1 meets different consumers demands and promotes efficiency in the operation of  
2 airline services not only in the UK but also en route to European regions.

3 We do not believe that the result of such a finding would be that the CAA  
4 would be burdened with like cases. The facts of Flybe's dispute with GAL and  
5 the legal questions to be determined are quite different, for example, from those  
6 which you recently had cause to consider in the BMI and Aer Lingus case in  
7 relation to HAL. We do not believe that it would set a general precedent that  
8 complaints by airlines against an airport's structure of charges must automatically  
9 be met by the same remedy or any remedy at all. It would merely dispose of the  
10 present case between the parties in a fair way.

11 We also say that the CAA can reach this conclusion through the strict  
12 construction of section 41 of the Airports Act read in conjunction with the CAA  
13 statutory duties and section 39, paragraph 2.

14 I will go through these very quickly, in particular, the first objective of  
15 furthering the reasonable interests of users of airports within the United Kingdom.  
16 We say that it is in the interest of the present passenger users of airports, as well  
17 as future users, to be able to connect to UK and European regions, to be able to  
18 connect via a London hub airport and to have, as far as possible, a choice of  
19 airlines and airline business models.

20 To permit the airport to have a decisive role in determining which airline  
21 business models are appropriate we say would be a significant interference in the  
22 airline markets and the choice of the consumer. We say that the task for the  
23 CAA is to determine the proper balance between the interests of the airlines, in  
24 responding to their consumers demand, and the interests of airports in making a  
25 good return on their assets.

1           We say that a ruling that re-establishes the balance between airline and  
2 airport interests is consistent with the statement you have made earlier this week  
3 in relation to focusing on delivering better passenger outcomes in terms of a  
4 regime that is flexible enough to respond to consumer demand.

5           In terms of the second objective, to promote the efficient, economic and  
6 profitable operation of such airports, what we say is that our proposed remedy  
7 would be able to uphold GAL's wide discretion to set prices and establish  
8 incentives for its consumers but what it does do is establish certain clear limits to  
9 ensure that the use of that discretion does not impinge on the effectiveness of  
10 your other section 39 objectives.

11           In relation to the third duty, to encourage investment in new facilities,  
12 likewise, as we say, GAL will retain its discretion to set prices within the overall  
13 cap within limits that will not affect their ability to invest in infrastructure.

14           Finally, as we have said, we do not believe that any remedy, such as that  
15 which we are proposing, would go any further than is strictly necessary to  
16 dispose of this dispute in a fair way.

17           Flybe accepts that the CAA will be reluctant to intervene unless it is  
18 convinced of the need and the merits for doing so. One of the points for  
19 determination is whether there can be a reasonable expectation that GAL's  
20 pricing policy will have the effect that is claimed. We note in the correspondence  
21 that a question arose about whether GAL must prove actual positive effects of  
22 this policy or whether a reasonable expectation of those effects will suffice. We  
23 understand that the CAA's position is that a reasonable expectation will suffice if  
24 adequate evidence of actual effects is not yet available.

1           We have two points to make in this regard. The first is that there are actual  
2 effects, as indicated by Jim French and which Andrew will discuss in more detail  
3 very shortly.

4           Secondly, when considering the CAA's reasonable expectation of the  
5 outcome, we must ask what is the precise outcome that GAL is seeking and  
6 when such outcome might realistically be expected to be achieved. In this  
7 regard, we see, amongst other things, a high pressure on Flybe's operations out  
8 of Gatwick but, overall, no shift at Gatwick from peak to off-peak. We see an  
9 arbitrary line drawn by Gatwick between, effectively, the airline winners and the  
10 airline losers.

11           We note GAL has admitted that the currently illiquid market in slots can  
12 militate against airlines moving from peak to off-peak. We also note the  
13 dependence of certain carriers, particularly charter operators, on the summer  
14 peak months of July and August for their business.

15           So, the question is whether there is enough evidence that the claimed  
16 benefits will actually materialise to outweigh the likely damage, the actual  
17 damage to some airlines' operations and to the unlevelling of the playing field  
18 between those competing operations.

19           Given the seriousness of that question, we say that the CAA must apply a  
20 very high standard of proof to GAL's claim justification.

21           I have mentioned the need for the airport to be as neutral as possible  
22 between different business models. A charging policy that is neutral between  
23 those models allows the consumer, the market, to choose the services that suit  
24 its needs, whether it be the flexibility afforded by high-frequency daily services on  
25 smaller planes or lower frequency on larger aircrafts. It is for the market to

1 choose the best airline business model for its needs not for the airport, through  
2 its charging policy, unilaterally to determine which business models will be viable.  
3 While we accept it may be legitimate to take account of the scarcity of the  
4 infrastructure in setting pricing, this must be balanced with the need both for  
5 neutrality between business models and cost orientation. We say that the policy  
6 has moved further and further away from cost orientation so that Flybe is facing  
7 charges out of proportion with costs.

8 Before handing over to Andrew, I want to deal with a couple of matters that  
9 have arisen through the correspondence.

10 The CAA has been very clear that it does not see section 41 as an  
11 instrument to promote wider goals of regional connectivity, which are the proper  
12 domain of Government. We accept that section 41 is not about promoting  
13 regional connectivity but we do not see why section 41 cannot be used to prevent  
14 regional connectivity from being eroded from its current level, as that is  
15 consistent with your section 39 paragraph (2)(a) objective of promoting the  
16 interests of users of airports in the UK not just in London.

17 We see the CAA's duty as maintaining a neutral stance towards regional  
18 connectivity -- not promoting it but not taking a decision the consequence of  
19 which will harm it. The outcome of this case should be a minimal change to the  
20 degree of regional connectivity compared to the situation before Gatwick  
21 adjusted its pricing policy.

22 A further point arises in relation to the recent BMI/Aer Lingus case. In our  
23 view -- and I can go into this in more detail -- we do not consider that that  
24 provides a relevant or helpful precedent to your determination of this case. That  
25 case, as you know, concerned the equalisation of passenger charges between

1 domestic Republic of Ireland and other European passengers and transferred  
2 passenger discount. There were issues of transparency, accuracy of data and  
3 such like. In this case it is for the CAA to consider the question of when and how  
4 far peak pricing or a variant on peak pricing for scarce runway capacity can be an  
5 objective justification for price discrimination and whether the evidence shows  
6 that the expected outcomes outweigh the harm. So, we say, instead, the only  
7 relevant precedent is the 1989 British Midland case.

8 We are asking the CAA to consider what will deliver the better passenger  
9 outcome -- on the one hand an airport operating a level playing field between  
10 airline business models with cost-orientated pricing, different categories of  
11 demand catered for, including a range of long, medium and short-haul  
12 destinations, according to what the market requires, or an airport that has given  
13 the right to abandon cost orientation as a driver for charges and to manipulate  
14 the airline market at the airport in favour of certain types of operations at the  
15 expense of others. We want the CAA to impose a limited condition on GAL to  
16 strike a balance between efficiency and operating the airport and efficiency in the  
17 provision of airline services to customers and that, we say, will bring the better  
18 passenger outcome.

19 MR STRONG: Thank you, Chairman. Could I draw your attention to the  
20 slides that we submitted this week. I will just take you through the core points  
21 from this presentation.

22 Slide 2 represents the pie charts. The message here is that Gatwick  
23 Airport represents a significantly more expensive airport cost than our average  
24 Flybe airport. You can see there that on all routes, excluding Gatwick, our airport  
25 charges represent 14 per cent of our total cost. At Gatwick they are 21 per cent.

1 The core issue is not of it being an expensive airport but, as is very clearly  
2 demonstrated in slide 3 -- which is where we are looking at comparable capacity  
3 with our competitor in that market -- that the costs are discriminatory.

4 I believe that the costs here are closely aligned with those that GAL have  
5 submitted in their presentation. So, I do not believe that this is a question of  
6 data; I think it is one of questioning the impact of that data.

7 What you can very clearly see here in the bottom table is that, where we  
8 are delivering the same capacity as two 319s with 156 seats, with our four-a-day  
9 78 seats, the cost of us delivering that at Gatwick is 60 per cent more than our  
10 competitor.

11 As you can see in this table, at all the other major airports in the UK those  
12 costs are broadly neutral. So, the pricing policy in Gatwick prejudices the  
13 operation of a smaller aircraft frequency model.

14 To put that into context, that 60 per cent represents the £7.40 per  
15 passenger cost advantage to easyJet using a 70 per cent load factor for both  
16 operations.

17 Interestingly, when you look at Heathrow, the other slot-constrained airport  
18 within the UK, their costs are 7 per cent higher, which represents £2.40. So,  
19 Heathrow is more effective for us to operate into with a Q400 operation than  
20 Gatwick, something that Flybe strongly disagrees with.

21 We can compete in a market where we have neutrality in terms of capacity  
22 and cost. We cannot compete successfully where that market is distorted.

23 Taking you to slide 4, this distortion has occurred from 2010. You can see  
24 that, in 2008, on the same four-a-day programme with a Q400 versus two a day  
25 on a 319, the same capacity -- we have taken the passenger element out

1 because we have a comparable load factor -- the landing element was broadly  
2 the same in 2008 and 2009. So, we were actually operating in a competitive  
3 environment.

4 In this graph you can see the distortion that has occurred on the Flybe  
5 operation, which means that we are at a disadvantaged position in operating in  
6 and out of Gatwick Airport.

7 This is demonstrated in the three tables that follow where you can see that  
8 from 2008 Flybe's costs have increased by 83 per cent. Again, we have used the  
9 same typical Q400 operation on a four-a-day programme into London Gatwick.  
10 Our costs over that Q5 period have increased by 83 per cent.

11 A 319 operator delivering the same capacity to the market has seen a 50  
12 per cent increase in its landing fees using one peak and one off-peak scenario,  
13 the standard programme that we compete with in the market place. Just as an  
14 example, a wide-bodied aircraft with a notional 312 seats, which sits mid-way in  
15 that weight of aircraft in terms of capacity, and is the equivalent of four Q400s,  
16 has seen its costs increase by 5 per cent over the same period.

17 Slide 8: From that, I would conclude that, where there is an allowable yield  
18 at Gatwick Airport of RPI plus 2 per cent, which compounded over the period  
19 would see a 23 per cent cost increase, Flybe has actually suffered 83 per cent  
20 compared with our Airbus competitor at 50 per cent, and a notional 312 seats  
21 wide-bodied aircraft at 5 per cent. I will put to you that surely a cap should be  
22 applied in this sort of instance.

23 Just to conclude this data, finally we look at cause and effect. Flybe has  
24 been, as I would put it, discriminated against in terms of our charges. Has it

1 achieved the objective that was being sought? That, we understand, is to move  
2 traffic from the peak period to the off-peak period.

3 From the data here, which is the CAA data of London Gatwick Airport  
4 movements, you can clearly see that off-peak movements have declined and, in  
5 the peak period, from 2010, when the airport ownership changed, have actually  
6 increased. It has had the opposite effect to the one that was planned, with a  
7 decrease in off-peak flying.

8 Just to conclude, the Gatwick data as it has been presented gives a list of  
9 airlines and the spread of charges for 2009/10. The reason Flybe is representing  
10 here today is the fact that we are one of the few non state-owned airlines that are  
11 actually still trading, for those that have seen a cost increase over and above the  
12 average yield of 7.6 per cent.

13 MR ROBINSON: Before we hand over to you, just to clarify, the effect of  
14 what has been going on here is to have actually reduced off-peak flying  
15 compared to the peak of 2010 to 2011, which is the opposite of what was  
16 planned.

17 What we have shown by these slides is that there is substantial  
18 discrimination against smaller operators at Gatwick, and Flybe in particular. It is  
19 not merely inconsistency between GAL and other airports; it is in a completely  
20 different league altogether. We say that that is unreasonable.

21 As I have said, the question is whether that is redeemed by objective  
22 justification. Are there reasons not connected with GAL's own interests or its  
23 shareholders' interests that actually justify its policy? We say that it must be  
24 strong, compelling evidence of an objective justification, not just a theoretical  
25 argument about whether incentive-based pricing can in principle amount to an

1 objective justification. We say that GAL has not met this standard. On the  
2 contrary, we say there can be no reasonable expectation that its policy will  
3 operate as it would like and that that has been shown by the data. Even if the  
4 evidence did support some form of objective justification, at least to a degree, it is  
5 for the CAA to determine whether that is enough to overcome the distortions  
6 introduced into the market and whether it is really for GAL to determine what type  
7 of business model may thrive at the airport and whether it can impose price  
8 increases so vastly out of proportion with costs.

9 MR FRENCH: To conclude our submissions, we would like to leave the  
10 Authority with three points: First, we have shown that GAL's pricing is out of step  
11 with other UK airports, including Heathrow, imposing very large percentage  
12 increases in price to Flybe. This is both a direct and an indirect effect -- direct,  
13 because increases in costs undermine route profitability as they cannot be  
14 passed on in full or at all to consumers without damaging demand; indirect,  
15 because it distorts the playing field between Flybe and its competitors on key  
16 routes, allowing competitors an unfair advantage that will allow them artificially to  
17 keep prices lower than Flybe. This damages Flybe's business.

18 Secondly, whilst we accept that airlines may sometimes face rising airport  
19 costs, we do not accept that cost increases can be levied on this scale for some  
20 operators and not others simply based on the type of aircraft they operate and  
21 without any reference to the costs imposed on the airport infrastructure. This is  
22 neither fair nor is it reasonable.

23 Finally, we have shown that there can be no reasonable expectation that  
24 GAL will achieve the optimal use of its runway through the policy it has adopted.  
25 It will cause damage without doing any good.

1 For these reasons, we ask the Authority to intervene and to impose a  
2 limited remedy along the lines of that which we have suggested. Thank you.

3 MR OSBORNE: Thank you very much. Thank you for your clarity and for  
4 your brevity.

5 QUESTIONS BY THE PANEL

6 I am going to lead off the questions and then I will turn to others of the  
7 Panel.

8 Can I start with the analytical basis on which we should take the decision.

9 The guidance we published in 2006 underlined that we would look to use  
10 the conceptual framework of competition law to secure consistent and  
11 proportionate interventions.

12 Jeremy, the basis on which you argued this was very much from a direct  
13 construction of section 41 and section 39. Do you consider it is legitimate for the  
14 CAA to use the context of competition law in assessing this complaint?

15 MR ROBINSON: I do believe it is legitimate to use the concept of  
16 competition law but obviously that does not entirely dispose of the matter  
17 because what you have in section 41 is a test of unreasonable discrimination that  
18 was formulated by Parliament without reference to what later came into force.

19 We say that it is absolutely right to interpret that legislation using the  
20 helpful concepts developed by competition law but there are important  
21 differences, for example. We say it is not essential for you to find that Gatwick is  
22 a dominant operator or an operator with substantial market power. We believe  
23 that it is but it is not a legal requirement that you do so.

24 In respect of unreasonable discrimination, I think that there is a lot that we  
25 can use from competition law -- the concept of treating like situations in like

1 manner and unlike situations in unlike manner. But we cannot follow that  
2 slavishly. A number of airport dominance cases have been considered in  
3 Europe. They provide some assistance on that question. The question for you is  
4 whether or not the factual matrix of those cases is sufficiently similar to the  
5 present case actually to be useful to you. In the Portuguese airports' case -- I  
6 think paragraph 56, but I can check -- the Court very helpfully pointed out that  
7 objective justifications cannot just be general assertions; they have to be specific  
8 and relevant.

9 I would agree that there is scope for using the concepts of competition law  
10 here but you cannot follow it slavishly or exclusively.

11 MR OSBORNE: Thank you.

12 Richard, shall I turn to you to cover objective justification.

13 MR MORIARTY: I am keen to explore objective justification and the  
14 distinction between theory, principle, practice and reasonable expectation.

15 On principle, do you accept that, where there is a capacity-constrained  
16 scarce-runway asset, it is reasonable for the airport to adopt a differential pricing  
17 structure for airlines based on value, based on how much business the airlines  
18 bring to that airport?

19 MR ROBINSON: We accept and we have said in our submissions that in  
20 principle that is reasonable. The question is the degree to which you permit that.  
21 We are not saying that GAL has or should have no discretion to introduce  
22 variations in the structure of its charges, in particular, to take account of the  
23 scarce capacity of the runway resource. What we are saying is that that  
24 discretion must not be abused and it must be used within bounds. So what we  
25 are saying is you need to establish what those bounds are.

1 MR MORIARTY: Can I ask for clarity on two concepts. You mentioned  
2 competitive neutrality and I can see how a peak-pricing model would lead to  
3 implied per-passenger charges that are different for smaller aircraft and larger  
4 aircraft.

5 Taken to extremis, if you only have one passenger on the aircraft, is your  
6 view of neutrality that you ought to be paying the same per-passenger landing  
7 charge as an aircraft that has 200 passengers on it?

8 MR FRENCH: There is a fundamental issue here. One is an airport's right  
9 to charge peak pricing, which we absolutely understand -- peak and off-peak  
10 pricing, we understand that. If a flight is coming in in the morning, the first flight  
11 of the day, it would predominantly be business travellers and therefore you can  
12 charge a premium.

13 The fundamental principle we have objection to is that not only do you  
14 have peak and off-peak pricing but you then have a mechanism to distinguish  
15 and to penalise the size and shape of the airplane. Therefore, there is a double  
16 effect here. We understand peak and off-peak pricing but the unfairness comes  
17 in by having a different pricing for each aircraft type. That is not peak pricing;  
18 that is size-of-aircraft pricing.

19 MR MORIARTY: As I understand it, the way that this hits your business --  
20 though, please clarify -- is because of your business model of high frequency the  
21 loading on to the landing charge has that effect that you have described  
22 compared to your competitors.

23 MR FRENCH: Indeed.

24 MR ROBINSON: That's right.

25 MR FRENCH: It has a bigger impact. Yes.

1 MR MORIARTY: Do you accept that Gatwick is a capacity-constrained  
2 airport? Do you accept the fundamental premise that it is a scarce-runway  
3 asset?

4 MR FRENCH: As we do at Heathrow, exactly. But, as Andrew pointed out  
5 very eloquently, there is a mechanism at Heathrow that is substantially distorted  
6 at Gatwick compared to Heathrow, which is one of the world's most slot-  
7 constrained airfields.

8 MR MORIARTY: If Gatwick has -- and I appreciate it is not its direct choice  
9 -- two different aircraft that can use the same slot at the same time of the day,  
10 one carrying a few passengers and one carrying a lot of passengers, do you  
11 accept that it can differentiate its charges based on the differential value that  
12 those two aircraft can bring into the airport?

13 MR STRONG: I would say that you cannot do that on a specific slot basis.  
14 I would say that you have to look at it in the overall daily operation of that airport.  
15 You need to look at the total capacity that you are offering to that market and it  
16 needs to be done on a comparable basis, which, if you take a unique slot  
17 position, ideally Gatwick would have all A380s flying in there, which we know is  
18 unrealistic.

19 MR MORIARTY: But where there is evidence that it is capacity  
20 constrained, so there are competing demands for the period of the day or the  
21 period of the year, do you accept that it can differentiate its charges based on,  
22 say, size of aircraft or number of passengers?

23 MR STRONG: I would prefer to see a differentiation in the same way that  
24 all the other UK airports do, in the balance of landing fee and PLS. That is  
25 achieved both at non-constrained and constrained airfields. We can demonstrate

1 that, at a constrained airfield, such as Heathrow, there is a pricing policy in place  
2 that must deal with peak and off-peak pricing but that is not discriminatory to  
3 small aircraft on a frequency basis.

4 MR FRENCH: It is also the degree of the difference that we are objecting  
5 to here. We understand the principle exactly, we understand where you are  
6 coming from, but there is a degree of difference.

7 MR MORIARTY: The principle is accepted. This is about the scale and  
8 the impact.

9 MR STRONG: Yes.

10 MR FRENCH: Yes.

11 MR MORIARTY: As I said, you operate all year round, as I understand.  
12 So, the big issue here is less about the peak and more about the loading on to  
13 the landing charge. Is that correct?

14 MR STRONG: Yes. Unlike some other airlines, we have a fairly equal  
15 year-round operation. Therefore, the summer:winter issue is a problem for some  
16 airlines; it is less of a problem for Flybe.

17 MR MORIARTY: As to this distinction between point of principle being  
18 accepted and the scale effect, how should we, as the Authority, take into account  
19 this scale effect? How much is "unreasonable"?

20 MR STRONG: In my view, there is an allowable yield at the airport, which  
21 is RPI plus 2 per cent. We would have no problem with a matrix against that  
22 allowable yield but there is no mechanism for that at the moment; that is the part  
23 that is distorted.

24 MR FRENCH: As I understand it, it is the Authority's responsibility to look  
25 at the overall customer offering, the customers using that airport, and to make

1 sure that no individual segments or sectors are significantly disadvantaged. It is  
2 down to you to define reasonableness, with great respect, because at the end of  
3 the day, if it is unreasonable and customers are turned away, that is the point at  
4 which it becomes unreasonable.

5 MR MORIARTY: In terms of your contention as to the distinction between  
6 theory and practice, that it has not been evidenced that the objectives that  
7 Gatwick have in mind can actually be brought out in practice -- and you showed  
8 us some slides that suggest that that has not been the case -- these things often  
9 take time, they do not show up straight away. What is your view on whether,  
10 over the medium to longer term, we will indeed start to see the sort of outcomes  
11 that Gatwick has in mind?

12 MR STRONG. [REDACTED AS AGAINST THIRD PARTIES]

13 MR OSBORNE: If it is a point on which we have to take a view, that is an  
14 answer that does not give us anything to work with.

15 MR FRENCH: I understand what you say about how long does it take.  
16 Again, it is part of your responsibility, I would suggest, to consider what is the  
17 impact and the damage caused in the interim until that is proven.

18 MR MORIARTY: The impediments to Gatwick realising its objectives of a  
19 more efficient use of the runway -- you have mentioned slots -- could you just talk  
20 us through those impediments and why you feel that, despite Gatwick having  
21 their objectives, that will not be realised in practice?

22 MR ROBINSON: Perhaps if I start and then hand over.

23 The principle we are getting at here is that, under the current slot  
24 regulation -- and, actually, it is even likely under the current proposed new slot  
25 regulation -- there is an informal market in slot trading. In reality, it works by way

1 of exchanging a valuable peak-time slot for a less valuable non peak-time slot  
2 and there may or may not be an exchange of value between the parties as a  
3 result.

4 What happens to that non peak-time:off-peak time slot? Well, the airline  
5 that is shifting from peak to off-peak has a choice; they can find a route on which  
6 to deploy that slot. Equally, they can return that slot to the pool. Given how  
7 valuable these slots are, it is of more interest, I would suggest, for an airline to  
8 hold on to those slots in some way and if they cannot fly the slots themselves and  
9 thus maintain sufficient frequency of flights to obtain the grandfather rights for the  
10 next equivalent season, then effectively to lease them to another airline for that  
11 period.

12 It is not in the interest of an airline that has valuable slots at a slot-  
13 constrained airfield simply to give them up and to give them up necessarily in  
14 favour of carriers operating wide-bodied jets.

15 We are talking about a mismatch of incentives between what the airport  
16 might like to see happen, which is a gradual shift from peak-time slots being held  
17 by small aircraft to those of larger aircraft, and the incentive on the airline to  
18 follow that pattern.

19 Do you want to add anything to that?

20 MR STRONG: I think you have covered most of that.

21 MR OSBORNE: I would like to ask you to enlarge on that, though,  
22 because that does not match how I understand the secondary market for slots.  
23 We do see a fair amount of trade in slots. It appears that the prospective buyer  
24 takes a view on the present value or future use of that slot, which includes an  
25 auction value, and that is how they set the price, and the airline that holds the slot

1 equally assesses the auction value and present value of how they see use of the  
2 slot. We do see trading. I have not understood why you see there is grit in that  
3 wheel.

4 MR ROBINSON: The grit in the wheel is not in the exchange between  
5 peak and off-peak. There is grit in that because, at the end of day, if you have a  
6 peak time slot and you give it up and you take the value out of that slot, obviously  
7 you would have to put that value back in to get that peak-time slot back.

8 What we are saying is two things. One, you will retain your off-peak slot  
9 and may consider acquiring a peak-time slot in exchange at some later date.  
10 Also, instead of relinquishing your peak-time slot, you might lease it to somebody  
11 else.

12 MR OSBORNE: Yes. It is the same with an airplane: If you have a plane  
13 you do not need, you can lease it, you can park it in the desert, you can sell it. I  
14 do not see why this is different.

15 MR ROBINSON: Absolutely. But there is no guarantee. For example,  
16 Flybe could leave a peak-time slot, realise full value for it and give it to a wide-  
17 bodied jet operator or we could decide that we want to stay in this market  
18 potentially and not hand it over to an operator of larger aircraft.

19 MR OSBORNE: It has an option value, which you would expect to be paid  
20 for in the price. So, --

21 MR ROBINSON: What we are saying is that it does not necessarily follow  
22 from the system itself that the result that GAL may be hoping for will result --  
23 because, yes, even though there is trading, it is not a fully liquid market.

24 MR FRENCH: It is also quite a different market from Heathrow. Gatwick  
25 has a substantial seasonality of demand. There is quite a different value

1 attached to slots. It varies in value historically at Gatwick. Gatwick pricing on  
2 slots moves very substantially with demand, whereas Heathrow, because there is  
3 a constant demand, is a much more consistent value.

4 MR OSBORNE: The seasonality reduces it to a series of sub-markets.

5 MR FRENCH: Absolutely, yes.

6 MR OSBORNE: Which might be even less than the equivalent. I  
7 understand that.

8 MR MORIARTY: Can I draw upon that and caution in case you do not  
9 want to take this question in open session. How will the effect of these charges  
10 affect your route development over the next three years?

11 MR FRENCH: Andrew is the Managing Director; he will give you the  
12 specifics. I would say, in sincerity, that we have no debates currently at the  
13 board level regarding development. All our debates are about [REDACTED AS  
14 AGAINST THIRD PARTIES] cost burden because of something totally outside of  
15 our control has actually reduced much of our operation. [REDACTED AS  
16 AGAINST THIRD PARTIES]

17 MR MORIARTY: Are you able to say which particular routes or particular  
18 areas of the business?

19 MR FRENCH: It is probably better to do that in private, I would suggest, if I  
20 may. I think it would be wrong to do it publically.

21 MR MORIARTY: Yes. Point taken.

22 MR STRONG: All I would add to that is the fact that we would identify the  
23 markets where we have an equal competitive basis. At the moment, we feel, on  
24 some of these markets, we have a competitive disadvantage through this pricing  
25 structure.

1 MR OSBORNE: I was going to suggest that perhaps we take note of that  
2 question about route development and any other issues to just before the coffee  
3 break to avoid people shuffling in and out.

4 MR FRENCH: Yes.

5 MR GANDER: Obviously your airport charges at Gatwick are high  
6 compared to other airports that you operate in. How about the total costs of  
7 operation at Gatwick? Is it a high-cost airport or are there various areas where  
8 there are advantages for operating there?

9 MR STRONG: The only other area that you would look at really that is  
10 unique to an airport would be the ground handling.

11 Charles, the ground-handling contract that we have there now in  
12 comparison with other airports?

13 MR STAFFORD: It is very reasonable indeed. Very competitive. In fact,  
14 we went out to tender last year and the rates came down.

15 MR FRENCH: There is no substantial difference between Birmingham or  
16 Manchester? That is the question.

17 MR STAFFORD: No. If anything, it is cheaper in Gatwick -- in fact, it is  
18 cheaper in Gatwick than it is in Birmingham.

19 MR GANDER: You talked a bit about cost orientation. Some of your  
20 figures comparing your operations against an airline that is using a A319, you are  
21 talking about four flights of your aircraft versus two of a larger aircraft. Does that  
22 suggest that maybe you are imposing greater costs on the airport because you  
23 operate more flights?

24 MR STRONG: You can look at it on that cost perspective. You could also  
25 say that our aircraft need a far shorter runway length than a larger aircraft,

1 therefore, you need less tarmac. There is less investment to operate smaller  
2 aircraft. It does absorb more time -- there are four times the landings of a 747 --  
3 but the impact of four Q400 landings versus a 747, not being the expert, I would  
4 question whether it has four times the impact.

5 MR FRENCH: Secondly, if I may just add on to that, it depends to some  
6 extent what the nature of that airport is. If the airport is developing a hub  
7 concept, for example, and I understand the long-term strategy of Gatwick is to do  
8 that, then it may not be a big airplane but it may be that every single one of those  
9 passengers is using that airport to connect with other services and, therefore, the  
10 revenue generated is actually of much more value to the airport than merely the  
11 revenue generated on the single sector.

12 MR MORIARTY: Can I pursue that because there are other benefits of  
13 passengers coming through, whether they be commercial revenues or hub  
14 benefits. Do you have any evidence to suggest that, despite for the same  
15 number of planes flying in less passengers, actually your passengers make a  
16 more valuable contribution to the airport because they spend more on  
17 commercial revenues or they provide vital hub benefits for other flights?

18 MR FRENCH: We would have to give you separately the interline  
19 connectivity. It is the only measure we can give you. We have no idea what  
20 other passengers carry on other airlines, so we would have to just demonstrate  
21 the interline connectivity through airports, of course.

22 If there are no services from a region to an intercontinental hub, obviously  
23 the potential of interline coming into, say, Gatwick, is much higher, of a greater  
24 proportion, and therefore more important to that community. I know that is not a  
25 consideration for today's hearing. I understand that.

1 MR OSBORNE: To assess the total number of passengers who are using  
2 Flybe and then connecting at Gatwick, we would need to figure out self-  
3 connectors as well as interliners.

4 MR FRENCH: Indeed, yes.

5 MR OSBORNE: We can probably do that best with the CAA's own survey  
6 data. We will think about how we can best address that. We might not need to  
7 trouble you.

8 MR FRENCH: Any assistance we can provide, we will do, but I agree your  
9 stats are better than ours.

10 MR GANDER: This is possibly more of a legal question: Section 41 talks  
11 about unreasonable discrimination against any particular user, against any class  
12 of users of the airport. If you were to define a class of user, if you think a class of  
13 user is being discriminated against, how would you do that?

14 MR ROBINSON: In our submissions we have used the phrase "operators  
15 of smaller aircraft" which raises the follow-up question what is the cut off between  
16 a smaller aircraft and a larger aircraft?

17 Correct me if I am wrong here. Flybe's aircraft: The Q400 is a 78-seater  
18 and the E195 is 118-seater. The line which GAL has drawn between the winners  
19 and losers is round about 156 seats. There are a number of airlines which fly  
20 into and out of Gatwick, not just UK airlines but also European regional airlines  
21 that connect to a London hub that also operate smaller aircraft such as 737s. So,  
22 I think there is a definable community of airlines who operate smaller aircraft for  
23 the purpose of their own connectivity to London and we could argue about  
24 exactly where you draw that line. For Flybe's purposes, it is 120 seats or below  
25 but, equally, you could draw that line at 156-seaters and the like.

1 Do you want to add anything to that, Andrew?

2 MR STRONG: The only comment is that we have looked, and it is  
3 coincidental, the numbers do exactly tie up: Four frequencies on a 78-seater are  
4 identical to two frequencies on a 156-seater. I think that is the best analogy I can  
5 give of a small versus a medium-sized aircraft.

6 MR GANDER: Would you define a class of users in terms of passengers  
7 as well? Do you say a certain class of passengers is being unreasonably  
8 discriminated against?

9 MR ROBINSON: The basis of what we are saying is that there is an  
10 unlevelling of the playing field between business models -- which Andrew has  
11 talked about in detail -- between the 319 and the Q400. Andrew will jump in to  
12 add to this if need be. There are passengers who prefer the high-frequency  
13 model with smaller aircraft, which is Flybe's target market, and there are those  
14 who are less fussed about the frequency and are quite happy to fly on one or two  
15 a day on a larger aircraft. The way Flybe will define its users: They are those  
16 who prefer the flexibility of a high-frequency model.

17 You might ask that question of other airlines who also operate smaller  
18 aircraft but, from the Flybe perspective, there are clearly benefits and there is  
19 clearly consumer demand for the type of service, the type of business model that  
20 Flybe operates into Gatwick.

21 MR OSBORNE: Can I pause on this because I think this is really a very  
22 important point. If we ruled against you and the negative effects you are  
23 describing played and you exited, is there a continuous spectrum between high-  
24 frequency small planes and low-frequency large planes, and you are just a point

1 on it, if you exited other people could move along that spectrum to fill the space,  
2 or is it actually a discontinuity, that you cannot evolve from one to the other?

3 MR FRENCH: The key point to remember is that if we could fill a 180-  
4 seater in those regional markets, we would fly a 180-seater, because obviously  
5 the economics are much better. The fact is, a lot of these regional markets  
6 cannot sustain that size of aeroplane on a reasonable frequency to provide the  
7 service to the local community needs.

8 There is an irony to this whole thing because, as the Managing Director,  
9 Andrew is facing a substantial cost challenge this year at Gatwick of some scale.  
10 Andrew has the figures.

11 It is quite interesting. Andrew's first move was to protect the service to the  
12 communities but reduce the costs. How did he do that? He reduced the size of  
13 the airplane from 118 seats to 88 seats. So, the first effect of this pricing was to  
14 take 30 seats out because it cost us the same but the actual total cost of the  
15 airplane operation was substantially reduced. Therefore, some consumers in the  
16 morning are not getting a service because they cannot access it. There is a  
17 cause and effect here. The first impact on Andrew has been to reduce his cost  
18 because he has to and that has been to reduce the size of airplanes and actually  
19 compound the problem, almost.

20 MR GANDER: You mentioned the 1989 case. Obviously it is a long time  
21 ago now. It also predates our guidance on section 41 and the Competition Act.  
22 Seeing how maybe law on these matters has moved on, does it really have any  
23 relevance, do you think, today?

1 MR ROBINSON: I would want to see how you believe that the law has  
2 moved on in a way that is actually relevant to the determination of that case  
3 before I could comment fully on that.

4 What I would say about that case and your guidance is that the case  
5 provides very clear evidence of an approach and a thought process which did not  
6 dispute the principle that Heathrow Airport Limited could adjust its prices to take  
7 account of optimising or incentivising the optimal use of scarce runway capacity.  
8 It says plainly that that is fine. What it did not believe was reasonable was for  
9 that discretion to be unfettered, for it to be a total discretion. I do not think that  
10 there is anything in your guidance or in the competition law case law that has  
11 happened since that says that an airport with significant market power can  
12 effectively have unfettered free rein in the setting of its prices unless it can prove  
13 that the positive effects of that will outweigh the negative. But I would be  
14 interested in the particular cases where that point arises and then I could  
15 comment on that more specifically.

16 MR OSBORNE: Can I pick up and move on to the question of harm. One  
17 of the key implications of us looking to competition law principles is that we would  
18 not intervene unless we actually saw harm to competition or to passengers,  
19 which I think conceptually is a bit different from the basis on which you were  
20 inviting us to intervene which is the extent of damage to you as a particular  
21 airline; you just think it is an unreasonable impact on you as an airline.

22 Could I start by asking a general question: to what extent would you see it  
23 as legitimate for us to use the concept of harm and to take that into account when  
24 considering unreasonable discrimination?

1 MR ROBINSON: I think you can take it into account. The question is what  
2 is the test for the relevant level of harm. There is, as you know, a debate in  
3 competition law circles between formalistic application of competition law, article  
4 102 of the treaty on functioning of the European Union, chapter 2 of the  
5 Competition Act, and the effect-based formulation.

6 The current state of the law from cases such as BA states that you do not  
7 actually have to find actual effects. Obviously if you do find actual effects that is  
8 helpful and we have demonstrated some actual effects in respect of ourselves.  
9 Maybe other airlines would be able to demonstrate actual effects in respect of  
10 themselves. But the actual test that the courts still seem minded to follow is  
11 whether the actions complained of are capable of having the effect complained of  
12 -- whether they are likely to, whether they would tend to lead to the harm. In our  
13 view, the threshold for intervention on that basis is lower than the proof of actual  
14 effects but what we are saying is that we can show you the actual effects on us.

15 MR OSBORNE: And implicitly that we should place a higher value on  
16 something which is actual rather than something which is surmised.

17 MR ROBINSON: Indeed.

18 MR OSBORNE: I understand.

19 I will just return to this question of if your business model disappeared  
20 whether the market might evolve reasonably quickly to serve the same  
21 passengers more or less equally well. Jim, you said you cannot fill a big plane.  
22 Is that that there just are not the numbers of people who want to make that  
23 journey or is it also related to frequency? If you went less frequently, could you  
24 fill a bigger plane and how important is the frequency?

1 MR FRENCH: Clearly, the frequency and capacity relationship is critical to  
2 the economics of our business model but it is also critical to regional communities  
3 because, particularly if an airport is looking to become a hub, the frequency  
4 generates more inter-connectivity, inter-connectivity gives flexibility and flexibility  
5 is obviously a key driver, long term, into those economies. So, there is a balance  
6 between capacity and frequency.

7 If we were, as a business, to, as you say, run a 180-seater on a route such  
8 as Newquay to Gatwick, it would probably be one a day.

9 MR OSBORNE: Yes.

10 Is it the case that frequency creates inter-connectivity because is it not the  
11 case that many of the services that people connect on to are flying in waves --  
12 so, all you need to do is hit the wave, if you have two or three flights --

13 MR STRONG: That is great going out but what about coming back, as an  
14 example? You can hit the wave on the outbound but you need to have another  
15 aircraft coming back in that is going to hit the wave on the return. That gives you  
16 the spread over the day. There will be one wave in the morning and there will be  
17 a further wave in a hub airport. So, you need to have that frequency that is going  
18 to deliver the passengers to the start of that wave and then collect them off that  
19 wave as well.

20 MR FRENCH: As you well know, all of the principal hubs have  
21 five/six/seven waves a day and, because of the block second-sector times of  
22 some of the long-haul flights, which tend to come in from different parts of the  
23 globe at certain times of the day, therefore, to give you maximum connectivity,  
24 you need the maximum ability to hit as many waves as possible. That is why  
25 Amsterdam was considered London's third airport. The frequency through the

1 regions into Amsterdam enabled them to build the capacity to generate and it  
2 was self-fulfilling. If you have one a day, you only hit one wave and you may  
3 miss the Asia, you may hit the US, et cetera. That is why you need frequency.

4 MR OSBORNE: I understand.

5 Would it be possible for you to mitigate the harm to your business by  
6 evolving towards the direction of fewer connections and bigger planes?

7 MR FRENCH: Again, I do not want to get into the argument of regional  
8 communities, but I cannot exactly ignore it. If you are saying to people in a  
9 regional community "We will give you a flight once a day and that is all you are  
10 going to get", that may not meet your business needs to go into the south east or  
11 wherever it might be on a day-return basis, it may not achieve your needs to  
12 connect with flights and you may therefore have to travel overnight, et cetera. If  
13 you take that view, then, yes, we could operate a very low frequency on a very  
14 big airplane, but that is not actually what the market wants or needs. Therefore,  
15 we would be denying that opportunity to the market.

16 MR OSBORNE: What about the impact on competition? Do you think that  
17 the change in charging structure is having an impact not just on you but on the  
18 structure of competition?

19 MR FRENCH: If I were sitting in Andrew's shoes and I had a methodology  
20 of reducing my cost of £7.40 overnight in a highly price-competitive market, which  
21 is more than ten per cent of the yield achieved, I think that would have to have an  
22 impact on competition.

23 MR ROBINSON: The way we have structured our submissions today is in  
24 part on the unlevelling of the playing field, and that is what we are complaining  
25 on.

1 MR FRENCH: That is exactly right.

2 MR STRONG: Over the last three years.

3 MR FRENCH: That is exactly the point.

4 MR ROBINSON: So, the slides that Andrew has talked you through relate  
5 to a specific example in relation to Flybe, which is the comparison between  
6 putting the same amount of capacity in the market at a given load factor between  
7 two different aircraft types to demonstrate how that playing field has become  
8 unlevel.

9 MR OSBORNE: Do you have a view why the structure at Gatwick is so  
10 distinctly different from both Heathrow and a range of competitive airports that  
11 you have given us evidence on?

12 MR FRENCH: My view is that -- and I mean this with great respect to the  
13 airport and I understand that they have not set out to attack Flybe in any way,  
14 shape or form -- I suspect they did not fully appreciate the impact on our  
15 economics and the impact on our market. A £7.40 differential per passenger is  
16 vast, it is substantial; it is three times higher than that at Heathrow, the world's  
17 most constrained airport. That is my view.

18 I honestly do not think Gatwick Airport Limited had any objective to remove  
19 Flybe from its airport. I do not think that for one second. I just suspect they did  
20 not fully appreciate the impact on the economics and the potential, therefore, to  
21 lose a lot of feed traffic into that airport in the long term. That is my view.

22 MR STRONG: Exactly.

23 MR OSBORNE: Have any other airports consulted with you, to your  
24 knowledge, about moving towards stronger peak signals?

1 MR STAFFORD: Not really. There is only Heathrow. I am just trying to  
2 think.

3 MR FRENCH: Manchester?

4 MR STAFFORD: It is the ones that move towards movement related  
5 rather than weight. I am just trying to think.

6 MR STRONG: In our recent discussions with other airports we have seen  
7 it going the other way where they are actively trying to encourage that frequency.

8 MR OSBORNE: Why do you think they are doing that?

9 MR STRONG: I think they can see the benefits of it, which would be the  
10 increased traffic from the regions.

11 MR FRENCH: The benefit is that it generates more traffic. The totality of  
12 the value of the traffic is the key thing here. If it is a point-to-point airport, it is  
13 quite a different argument from an airport that is looking to generate interline and  
14 to generate hub traffic.

15 That is exactly why -- I am sorry to go back to this but it is my experience --  
16 Amsterdam was so successful 35 years ago because they welcomed high  
17 frequencies of small airplanes to generate the interline connectivity. That is the  
18 how Amsterdam was developed.

19 MR MORIARTY: Can I ask a follow-up to this because much of this  
20 conversation has been about two different business models within a market of  
21 passengers within the UK. To what extent do you think that, if Flybe is not using  
22 those times of day, there may be other business models who are flying  
23 passengers into other destinations in Europe, for instance, or elsewhere in the  
24 world?

1 MR FRENCH: Again, if you look at most of the primary airports, there is  
2 good connectivity to Amsterdam, primarily; Charles de Gaulle to a lesser extent;  
3 Dubai very large nowadays, of course.

4 But, again, the more that is developed and excluded from the south east,  
5 actually, the point-to-point market is underserved more and more into the south  
6 east. There is a market for the south east, of course there is, London being the  
7 capital of the country. There is a need for people to move into and out of the  
8 south east.

9 I am getting into the regional argument, which I have been trying to avoid,  
10 because you directed it to me, but it is very difficult. Through my chairmanship of  
11 the CBI in the south west of England, et cetera, there is ample evidence of the  
12 importance of these services to regional economics. There is no doubt about it.  
13 We have seen Plymouth closing and the impact that had on Plymouth, et cetera.  
14 There is ample evidence of that.

15 MR STRONG: As a second point -- and I am unaware but I would be  
16 prepared to be educated on it -- people have been unable to obtain the slots that  
17 they wanted into Gatwick. So, if you were using the example that we are using a  
18 slot that someone else would utilise, I am unaware of anybody long haul, even at  
19 a slot-constrained airport, that would currently want those to use.

20 MR FRENCH: Andrew, that is a very fair comment. If I may say, over the  
21 years I have seen genuine cases of no access at Heathrow. I have seen that.  
22 Over the years, and in the days of the CAA hearings here, everyone used the  
23 excuse "I can't get access" but if you gave them the route they got access, they  
24 did come, whereas at Heathrow there was a most definite restraint of access.  
25 That is a very good point from Andrew.

1 MR ROBINSON: Just to reiterate a point I made earlier about the regional  
2 argument, as Jim has repeated, we are not asking you to promote regional  
3 connectivity; what we are asking you to do is not take a decision, the effect of  
4 which will further damage that connectivity.

5 MR OSBORNE: To be clear, the interests of users who are located in the  
6 regions and those in the south east, we do not place any less weight on them.  
7 The point about regional connectivity is that we cannot give value to it over and  
8 above our statutory duties.

9 MR FRENCH: I absolutely understand that there is no direction from the  
10 Secretary of State to do that.

11 MR OSBORNE: Can I go back to the passenger flow. Do you think there  
12 are any reasons, from the point of view of the airport, why some passengers are  
13 more valuable than others or the ability of some airlines to deliver a flow of  
14 passengers into the airport is of more value from some airlines than from others?

15 MR STRONG: Dwell time at the airport can be a factor and I could see the  
16 benefit to Gatwick of having long-haul passengers in there with the dwell time at  
17 the airport. That is an advantage to them.

18 But I would come back to the point that I am unaware of long-haul carriers  
19 that are biting our arm off to get access to our slots. Therefore, our passengers  
20 are more valuable than no passengers. That is the base of it.

21 I can understand that there is a benefit for long-haul travel of dwell time at  
22 the airport. What we are trying to achieve -- and I do not know whether Gatwick  
23 see it as successful -- is to offer them the extended catchment area not just of  
24 London but of Aberdeen, of Inverness, of Belfast, of Jersey, of Guernsey, with  
25 the dwell time waiting for their long-haul flight at that airport. I would think that we

1 can offer that and it is not just a south-east passenger that has to be considered  
2 because we are actually extending the catchment area of Gatwick.

3 MR OSBORNE: This is another area where theoretically you can see that  
4 there might be a value in an approach. You just do not think it will happen in  
5 practice.

6 MR STRONG: There is the potential there. I would expect, with the  
7 feedback from our customers, there is a large element that talk about connectivity  
8 and wanting to have that dwell time.

9 MR MORIARTY: Is the implication of that that Gatwick's pricing structure  
10 is not to encourage other traffic to replace you but effectively for you to soak up  
11 this notional opportunity cost that they perceive is lost to them of these other  
12 planes, planes that you are saying are not actually there in practice?

13 MR STRONG: Can you just repeat the middle part? Sorry.

14 MR MORIARTY: If we go back to objective justification, I premised that by  
15 saying that Gatwick effectively can price its service for two different types of  
16 plane: Large planes and small planes. You accepted in principle that was  
17 reasonable. What you seem to be saying is, actually, there is no other offer,  
18 there is no other plane that could take that slot. So, actually, this is not about  
19 true opportunity cost pricing from Gatwick. It is basically just expecting you to  
20 pay a higher price.

21 MR FRENCH: You asked the question about demand for long-haul slots at  
22 that airport. Flybe currently leases a slot at Gatwick from two  
23 international/intercontinental carriers because they have no use for them, which I  
24 think therefore answers your point: It is a revenue source.

1 MR GANDER: You spoke about the £7.40 hit you took in one go and there  
2 was nothing you could do about that. If that was phased in over a number of  
3 years would you be able to respond to it in some way?

4 MR STRONG: It is not a £7.40 hit. It is a £7.40 difference between us and  
5 our competitor. We are happy to take a hit that is comparable in terms of  
6 capacity to our competitor. We are taking a disproportionate hit which is the  
7 £7.40 difference. It has come in over a period of three years and it has built up.  
8 If you look at the graph that is on slide 4, that £7.40 has been established over  
9 that three-year time frame. It is the difference that you are putting with a  
10 competitor. If that pricing policy continues, that £7.40, I would expect to see the  
11 lines diverge, in which case that sort of gap cannot be sustained.

12 MR OSBORNE: Thank you very much.

13 That leaves the point about route development which, for reasons we  
14 entirely understand, you were not comfortable to tackle in open session. So, I  
15 am going to offer everybody, except the confidentiality circle, an extended coffee  
16 break. Will Gatwick's legal representative then wish to stay with us? We will look  
17 to resume at 11.35. We will take five or ten minutes on this point and then have  
18 a coffee break. If I can invite the rest of you to leave us.

19 MR ROBINSON: Chairman, could we have a minute just to discuss  
20 amongst ourselves?

21 MR FRENCH: Is it possible that we retire for two minutes just to have a  
22 very brief discussion?

23 MR OSBORNE: You do not need to leave the room. We will go out.

24 MR FRENCH: That is very kind of you. Thank you.

25 (Short Break)

1 CONFIDENTIAL DISCUSSION

2 MR MORIARTY [REDACTED AS AGAINST GAL]✕

3 MR OSBORNE: Do you think there is any market at all, a secondary  
4 market for slots, or is it that your slots are completely unsalable or that you just  
5 have to discount?

6 MR FRENCH: As I said earlier, there are times when Gatwick slots have a  
7 value of £1.5/2 million, something like that. Hence we have a balance sheet  
8 liability. But Gatwick is very prone to seasonality and it is very prone to demand  
9 changes. Whereas Heathrow is not, Heathrow is constant, as you know,  
10 absolutely constant.

11 When the world recovers and the 20 per cent of passengers recover in the  
12 domestic market and the demand is high, then the value will come back. If you  
13 can tell me when that is, then I will be very encouraged. Thank you.

14 MR OSBORNE: I think we would be doing a different job!

15 MR FRENCH: It is a dilemma and we are sorry to pose it but we welcome  
16 the opportunity to have this in-private session to explain the situation.

17 MR OSBORNE: Can I just ask you about one thing that we have heard  
18 from Gatwick in their written submissions, which is that you have given up a  
19 couple of routes and those slots have gone back into the pool and that is the  
20 proof that there is a recycling mechanism that works.

21 MR FRENCH: The Leeds slots?

22 MR STAFFORD: We re-used some of those slots. We put it in the last  
23 submission.

1 MR STRONG: We did. Can we just make sure. Last time we made sure  
2 it was one hundred per cent accurate. We will just do the same now to clarify.  
3 There was a split of how those slots were reallocated. We used some.

4 MR FRENCH: In Andrew's last slide it shows that peak-slot usage has  
5 gone down. If we came off Leeds, which I suspect was 520 pairs on that route  
6 alone, you can see quite clearly they had not been utilised at the peak time. The  
7 evidence is there.

8 MR STRONG: The actual allocation is on page 8.

9 MR ROBINSON: Of the 8 February submission.

10 MR FRENCH: While you were looking through, I just made the point to the  
11 Panel that the evidence is actually on Andrew's slide, where it shows that off-  
12 peak has been consistent but peak has gone down. So, one has to assume that  
13 that was part of the upwards of 500 of those and they had not been utilised. The  
14 evidence is there.

15 MR OSBORNE: Thank you. That is very clear.

16 MR CHAMBERLAIN: I have a question of clarification because obviously  
17 some of what has been said in this session is properly regarded as confidential  
18 but some of it, it strikes me, probably is not. In particular, the last question that  
19 you just asked about the allocation of slots, is that a matter which Flybe  
20 considers to be confidential or not?

21 MR STRONG: No. That is absolutely fine.

22 MR OSBORNE: You are quite right. We drifted a bit.

23 MR CHAMBERLAIN: Yes. Similarly the discussion that we have had  
24 about the extent to which there is a market for slots, that is something that was  
25 mentioned before we went into the confidential session and it was said that Flybe

1 leases slots from two intercontinental carriers. Presumably that also is not  
2 confidential?

3 MR STRONG: That was mentioned before in the opening session.

4 MR OSBORNE: Prima facie, the way that an airline sources slots is not  
5 part of a public market. So, I think you are right to ask about it, because it is an  
6 area of caution. But that particular point appears to be.

7 MR FRENCH: The relevance I wanted to raise was the [REDACTED AS  
8 AGAINST GAL] and that was the part I wanted to explain.

9 MR CHAMBERLAIN: That I absolutely understand is confidential but I  
10 wanted to make sure that there was no lack of clarity as to where the line can  
11 properly be drawn.

12 MR OSBORNE: That is very helpful.

13 Let's wrap that up and take a five minute break.

14 (Short Break)

15 OPENING SUBMISSION ON BEHALF OF GAL

16 MR OSBORNE: Thank you for the material you have given us so far.  
17 There is opportunity now for your opening statement and then we will ask you  
18 questions. It is 11.45 now. If you could aim to have wrapped up by 12.20, we  
19 will take questions through to lunch. We will probably continue on after lunch but  
20 we will see how we go.

21 MR CHAMBERLAIN: I have prepared a short written version of my  
22 opening statement which I hope will assist people, simply so that they do not  
23 have to take a longhand note of everything I say.

24 What I intend to do, if I may, is to talk to you, rather than read out the note,  
25 go through the points which are made there and then to respond briefly to the

1 points made by Flybe in relation to their slides. There may be questions which  
2 will arise out of that which are better dealt with by Mr Dunn than by me but I will  
3 certainly give you the headline points.

4 There are three issues in this case which have been identified in the  
5 Statement of Issues. The first is whether Gatwick Airport Limited is in a position  
6 of significant market power. The second, whether there is an objective  
7 justification for the pricing policy and the timetable for its introduction. The third is  
8 whether Gatwick Airport's revised pricing policy causes harm or has the potential  
9 to cause harm to passengers and/or the competitive process.

10 The first of those has, we would say, appropriately been parked, if I can put  
11 it like that, by the CAA in the Statement of Issues. We say it was appropriate to  
12 park the issue but we put down a marker that if, contrary to our submissions, the  
13 CAA should find that the policy is not objectively justified, then it is an issue on  
14 which we would wish to make further submissions; indeed, it is an issue which  
15 would require a full investigation. That obviously would be a preliminary step  
16 prior to the consideration of any remedy.

17 The second issue is the main one which is whether there is an objective  
18 justification for the pricing policy. The submissions on this point are split into two  
19 parts. The first relates to the method, the focus of the investigation. The second  
20 relates to the evidence which we say the CAA should take into account in  
21 determining whether there is or is not an objective justification for the pricing  
22 structure or policy that has been adopted.

23 As to focus, our point is essentially a simple one, that any assessment of  
24 the question whether there is an objective justification ought properly to focus on

1 the justification which existed at the time that GAL decided to adopt the pricing  
2 policy.

3 The CAA ought not now, we say, to attempt a retrospective assessment of  
4 whether the aim in adopting that pricing policy has been fully achieved. The  
5 question really is whether, when that policy was adopted, it was objectively  
6 justified.

7 Why do we say that? I have set out in paragraph 7 the legal reasons that  
8 we have for adopting that approach. The first reason is to look at the wording of  
9 section 41(2) of the Act, "The power to impose conditions arises only where it  
10 appears to the CAA that the operator is pursuing one of the courses of conduct it  
11 set out in section 41(3) and these include the adoption by the airport operator in  
12 relation to any relevant activities carried on by him at the airport of any trade  
13 practice or any pricing policy which unreasonably discriminates" et cetera.

14 We would say it is plain from the statute that the focus of the analysis has  
15 to be on the adoption of the policy. That does not mean, we would say, that the  
16 effectiveness of landing charges can never be reviewed once the policy has been  
17 adopted. The reason for that is that, under the Airport Charges Regulations,  
18 Gatwick and other operators are under an obligation annually to provide details of  
19 future charges and to justify either a continuation of the status quo or a change in  
20 its charging system by reference inter alia to its forecasts for charges and for  
21 traffic growth and the details of actual use in the previous year. What that means  
22 is that a decision in the light of an annual review to maintain a particular charging  
23 policy triggers a further power of review under section 41. We would say that an  
24 interpretation of section 41, however, permits the CAA retrospectively to impugn  
25 bona fide, objectively justified decisions that were reasonable when made, would

1 create significant uncertainty for operators and, indeed, for those taking business  
2 decisions on the basis of the policy.

3 Finally, we say that the CAA has previously held, in its investigation into  
4 the charging structure at Heathrow, that an operator's reasonable expectation  
5 that the charges would achieve a more efficient use of the runway can be taken  
6 as evidence supporting an objective justification. We say that that phrase  
7 "reasonable expectation" is important. It indicates that one looks forward from  
8 the point at which the policy is adopted, taking into account what an operator  
9 would reasonably expect to happen, rather than backward, taking into account  
10 what, a year after the pricing policy has been adopted, has in fact happened.

11 As to the matters before Gatwick when the decision in this case was taken,  
12 we say that Gatwick's expectation was that pricing incentives will achieve a more  
13 efficient use of the single runway at Gatwick. The expectation related to Gatwick.  
14 Comparisons with other airports are not, we would say, relevant. An increase in  
15 the price payable on landing at Gatwick during peak periods was likely to  
16 discourage use of Gatwick during those periods by inefficient services and  
17 instead incentivise more efficient operators or more efficient services with a  
18 greater capacity to pay the charges was, we would say, entirely reasonable, not  
19 to say obvious.

20 The timetable for the introduction of the policy seeks to balance the desired  
21 efficiency gains with the need to avoid excessive disruption to airlines and  
22 preserve incentives for airlines to avoid landing. The choice as to how to conduct  
23 this balance was, we would say, one for Gatwick Airport Limited falling within its  
24 margin of discretion. On that point we are pleased to hear the acceptance this

1 morning by Flybe that the principle of pricing to achieve that objective is one  
2 which they accept or their only cavil is with the extent of the increase in charges.

3 We make the point that the pricing structure adopted here constitutes one  
4 step in an overall policy aimed at gradual introduction of stronger incentives for  
5 the efficient use of the runway.

6 There has been reliance on the Heathrow decision from 1989 and you  
7 have made a number of points in questions to Flybe which we would respectfully  
8 adopt as to why that decision should not be regarded as relevant in today's  
9 scenario.

10 The points that you made related to the way in which competition law has  
11 moved on. We have had the Competition Act. The development of competition  
12 law since 1989 has been very considerable and we would respectfully adopt that  
13 as a distinguishing feature, which means that the 1989 decision is no longer  
14 relevant. Another distinguishing feature, of course, is that the decision was made  
15 in the context of common ownership and that aspect of the competitive  
16 environment no longer holds good.

17 Then we come to look at the individual factors which you have identified in  
18 your Statement of Issues as ones on which you wish us to address you. What I  
19 have tried to do in paragraph 11 is to address each of these factors, in some  
20 cases by reference to the evidence we presented earlier this week.

21 Taking them in turn, the first concerned comparisons with charges at other  
22 airports. At this stage, can I just ask you to look at what I have called here  
23 appendix 1, but it should be the first of the documents that were submitted earlier  
24 this week. I should say there is a slight mistake in 11.1 where we say that the

1 comparison is between Gatwick and other UK airports. In fact, it is other airports  
2 because we included non-UK airports here as well.

3 What these data show is that, whilst we maintain our preliminary  
4 observation that comparisons with other airports are not strictly relevant, because  
5 the constraints on the runway of other airports may not be similar to the  
6 constraints operating at Gatwick, we do say that, if you look at annualised landing  
7 charges -- and, of course, annualised means taking both the summer period and  
8 the rest of the year -- they are at near or below the average for other comparable  
9 airports for most aircraft. Of course, what you see here is that a different picture  
10 emerges depending on which aircraft you take. But, for most aircraft, the  
11 charges here on an annualised basis are at or near or, indeed, below the  
12 average.

13 As to the reasonableness of -- and this is the way the CAA put it --  
14 extracting an opportunity cost for sub-optimal runway usage from those airlines  
15 that cannot respond to the pricing incentives, we would put the point slightly  
16 differently. We would say that we are not extracting an opportunity cost. We are  
17 exposing airlines to the opportunity cost of landing charges.

18 There is a range of mechanisms by which airlines can respond to this  
19 pricing incentive. Changing their own retail prices is one mechanism; moving to  
20 larger aircraft is another mechanism; discontinuing inefficient services is another;  
21 and, finally, trading slots to move services to non-peak times is a fourth. We say  
22 that, looking at the matter from Gatwick Airport's perspective, ie looking forward  
23 and considering what could be expected to flow from this pricing policy, Gatwick  
24 could not be expected to know in advance or predict which of these mechanisms  
25 would be used. It is sufficient that Gatwick considered that, through the use of

1 one or more of these mechanisms, it would be possible for airlines to respond to  
2 the pricing incentive which the policy constitutes.

3 Next, the impact of the charges on Flybe. It is said, against us, as we  
4 understand it, that the impact of the charges on Flybe is greater than the impact  
5 on other airlines. As to that, we suggest that, if one looks at the table, it is  
6 certainly true that Flybe is at the top end of the table in terms of the increase in  
7 impact, although not right at the top, but we say that, insofar as Flybe is more  
8 significantly affected, that is a result, in terms of opportunity cost, of the relative  
9 inefficiency of the services it operates.

10 Next, as to why Gatwick has chosen to use a wider-peak period than July  
11 and August, that is really explained in the next slide. We say that, whilst the peak  
12 in passenger numbers is one that one sees particularly concentrated in July and  
13 August, the peak for air transport movements lasts from April to September.  
14 Landing charges, of course, attach to air transport movement. So, it would not  
15 be rational for Gatwick to have used a peak period which captures something  
16 other than that which the landing charges relate to.

17 Fifthly, as to whether we are relying on traffic moving out of peak periods to  
18 off-peak periods to meet the efficiency objective, we reiterate that movements of  
19 that type are part of the mix of mechanisms by which airlines can respond to the  
20 efficiency incentives created by the landing charges along with measures to  
21 discontinue inefficient services, encouraging greater passenger numbers on  
22 existing services, transferring to larger aircraft and so forth.

23 In addition, we say it is important to emphasise that the movement of traffic  
24 from the summer peak to the winter season is not the only type of peak to off-  
25 peak movement one might expect to see. Also, movement of services from daily-

1 peak hours to off-peak hours is another mechanism available to operators  
2 through slot exchange or obtaining slots from the pool.

3 As to the evidence of efficient runway usage, we say -- we deal with this  
4 below and I will come to it in a moment -- that the evidence, such as it is, is  
5 consistent with the policy working, if I can put it like that.

6 What about the post-decision evidence. The first point to make about the  
7 post-decision evidence is that, as we have said before, we think it is not relevant  
8 for the CAA to take it into account. But, if it is, if we are wrong about that, we say  
9 that there are a number of caveats that you should have in mind when looking at  
10 that evidence. The first is that the practical circumstances of aircraft operators  
11 mean that their capacity to respond to price incentives differs one from another.  
12 The second is that the structure of the charges, in particular the extent of the  
13 summer peak period and the degree to which airlines can move services, might  
14 mean that the incentives established in the pricing structure are subject to limits  
15 in this year.

16 What I mean by that is that this pricing policy was introduced on 1 April  
17 2011. We are looking at one year's results. Because we are concentrating on  
18 the summer period, we are looking at the months immediately following the  
19 introduction of this policy. So, we are actually looking at less than a year's  
20 results. We are looking at results which come immediately following the  
21 introduction of the policy. If it were thought -- and we would suggest it should be  
22 -- that a policy of this kind might take some time to show results, it would be  
23 naive to expect the policy to be achieved in terms of actual results in the few  
24 months after its introduction. We would say that there are two separate types of  
25 evidence which are consistent at least with the conclusion. We do not go further

1 than that. We do not say that they demonstrate that we have achieved our  
2 objective but we say they are consistent with the conclusion that we drew at the  
3 time the policy was introduced -- that use of the runway during peak periods  
4 would be more efficient and profitable as a result of the introduction of the policy.

5 The first type of evidence is evidence of airlines reducing less efficient  
6 services from Gatwick and the second is evidence that, on average, the  
7 efficiency of air transport movements through Gatwick is, if anything, following an  
8 upward trend.

9 As to the first, we note that Flybe itself has discontinued its two least  
10 efficient: That is the Leeds service and the Dusseldorf service, which had load  
11 factors of 38 per cent and 44 per cent respectively. One has to bear in mind,  
12 when considering the submissions that Flybe has made, that those were services  
13 which were using aircraft considerably less than half full. That indicates, if  
14 anything, that the pricing policy which renders it less viable for airlines to land  
15 services with low patronage is encouraging airlines to avoid inefficient use of  
16 Gatwick.

17 At this stage, can I address one point which has been made by Flybe  
18 during the course of its submissions, that it does not really help anyone for these  
19 types of services to be discounted because there is no one else there to pick up  
20 the slot. We say that, if one looks at the evidence -- which, in fact, is contained in  
21 Gatwick's 13 July submission, pages 7 and 8 -- you have there a chart showing  
22 the demand for slots against the allocation of slots and then a red line showing  
23 capacity. What has been presented here is first the position for arrivals in the  
24 summer of 2010; second, the position for departures; and, third, the total position  
25 for 2010.

1           If one just concentrates for the moment on the peak period, looking at the  
2 morning, the peak period is 0600 to 1100. If we just concentrate on the bar  
3 charts for that period, 0600 to 1100, one can see there -- although it is true to say  
4 that there are a very few days of the week where the capacity line is above the  
5 demand -- in general there is considerable excess demand over capacity. That is  
6 the position that was presented right at the start in July 2011 by Gatwick in  
7 relation to demand for slots.

8           The position factually is we simply do not accept Flybe's assertion -- and it  
9 is an assertion and nothing more -- that slots which are given up by inefficient  
10 airlines will not be snapped up, if one can use that term, by other operators.

11          What about the evidence of an increase in efficiency. We would say that  
12 annexed to our letter of 8 February is evidence, statistics, which show that the  
13 average number of passengers per aircraft, the average load factor and the  
14 average aircraft size for the calendar year to 2011, are consistent with an upward  
15 trend in efficiency. It is a small upward trend in efficiency, we accept, and we put  
16 this evidence no higher than consistent with. We do not say it proves anything.  
17 Indeed, we say we do not have to show that it proves anything because this is  
18 retrospective evidence but, insofar as it shows anything at all, it shows an upward  
19 trend.

20          The next question, and I suppose it is the same question, is there evidence  
21 that the Gatwick runway was used more efficiently in 2011 to 2012? The answer  
22 is that the evidence, such as it is, is consistent with that conclusion.

23          As to the query whether there is similar evidence in relation to airline plans  
24 in 2012 to 2013, as far as we are aware, all aircraft operators other than Flybe  
25 have made plans consistent with more efficient usage of the single runway -- by,

1 for example, scheduling more flights in the summer peak on larger aircraft. We  
2 do not know what the reasons are, save insofar as they have been explained  
3 today, as to why Flybe has adopted a different course.

4 As to the final query, which is in relation to the "stickiness" of the slot  
5 allocation system, we say that, for three reasons, that does not have the practical  
6 effect of detracting from the evidence that we have shown of a marginal increase  
7 in efficiency. First, we say that the operation of the system does not restrict the  
8 capacity for airlines to trade or rent slots following allocation on a secondary  
9 market.

10 Second, we say that the alleged stickiness of the system will be reduced  
11 by the policy that landing charges will be used to promote efficiency. So, if there  
12 is a problem of inadequate competition in the slot-allocation system, this is a  
13 policy which will address rather than exacerbate that problem.

14 The third point we make is that, in any event, as we have said before,  
15 transfer of slots is only one of a range of mechanisms by which aircraft operators  
16 may respond to the efficiency incentives created by landing charges. Other  
17 mechanisms are not affected by the system.

18 Next is harm. Does the revised pricing structure cause harm or have the  
19 potential to cause harm? What is said against us is that the policy may lead  
20 Flybe, and perhaps other airlines like it, to withdraw certain services from  
21 Gatwick and thereby reduce the competition offered on those routes. They say  
22 that the routes that they offer are not likely to be taken up by other airlines  
23 because they too would be exposed to the same pricing structure. Therefore,  
24 they say that what is likely to result is the gradual extinction of short-haul flying at  
25 Gatwick. We address that in two ways. First, we do not accept that the

1 necessary effect of the pricing policy is that the operators of small aircraft, such  
2 as Flybe, will discontinue services from Gatwick. The pricing structure provides  
3 an appropriate incentive for airline operators to make the financial decision to  
4 move to a lower-frequency, higher-volume model or to an off-peak flight  
5 approach. So, there are a number of ways in which an operator like Flybe could  
6 change its business model so as to respond to this pricing policy.

7 We say that Flybe continued in the summer of 2011 to operate ten of the  
8 twelve routes operated in winter 2011. The ones which it discontinued were its  
9 worst-performing services in terms of efficiency. We say that it increased its  
10 services to Newquay, taking up services discontinued by another airline, and that  
11 that is indicative of the manner in which airlines are likely to make reasonable  
12 commercial decisions to adapt to the new pricing structure.

13 We do not accept that there will be an impact on the level of competition.  
14 The second point we make is that we do not accept that an effect on the routes  
15 provided by an airline such as Flybe will necessarily have an impact on  
16 passengers seeking to fly to regional destinations from London. We make the  
17 point that, with the exception of the Newquay route, every other route provided by  
18 Flybe is served by at least one airline operating from a London airport other than  
19 Gatwick.

20 Those are the reasons we put forward why we say the pricing structure is  
21 objectively justified. Can I respond now briefly to the points that were made by  
22 Flybe by reference to the evidence contained in its slides that were sent through  
23 earlier this week.

24 If one starts by looking at the first slide, how Gatwick's landing charges  
25 compare to charges at other airports, the first point to make of course is that

1 these are percentages and not the raw figures. Insofar as they tell one anything,  
2 they tell one simply that the percentage of total cost made up by net airport  
3 charges is higher at Gatwick than the average of the airports to which Flybe flies.  
4 That on its own may be true but uninteresting in the sense that one would have to  
5 then understand whether the runways of these other airports were capacity-  
6 constrained in the way that Gatwick is. If they are not, then you are not  
7 comparing like with like.

8 The rest of the analysis flows really from the raw figures which one sees  
9 presented on pages 5 and 6 of Flybe's slides. There are five points to make  
10 about these figures. Just before I make my five points, can I just explain what  
11 conclusions I understand Flybe to claim to derive from these figures.

12 If we look at page 5, the headline figure here in terms of percentage  
13 increase is 83 per cent and that is the figure that has been used by Flybe  
14 throughout. They say that the charges involve an 83 per cent increase for them,  
15 as opposed to one of their competitors, operating a different aircraft, the A319,  
16 whose charges have increased by 50 per cent. So, one has an 83 per cent  
17 increase for Flybe against a 50 per cent increase for the competitor, and that is  
18 said to be significant.

19 How are those figures derived? The figures are derived, I am afraid to say,  
20 by comparing apples and pears. If one looks at page 5, the Flybe figure is  
21 derived by using data based on three peak movements out of four. So, 75 per  
22 cent of the Flybe data is peak movements.

23 If one looks at page 6, there are two movements only. One of them is in  
24 the peak and one of them is not. What that means is that the comparator data is  
25 derived using figures based on 50 per cent peak usage. The first difficulty is that

1 you are comparing a mostly peak service with a 50 per cent peak and 50 per cent  
2 non-peak service. If you change the figures so that Flybe is flying 50 per cent  
3 peak, just as its comparator is, the figures change slightly, they change to 67 per  
4 cent for Flybe as opposed to 50 per cent for its comparator, and we can supply  
5 the analysis which leads to that figure if required.

6 Third, that all looks at a period of five years. If you are looking just at this  
7 year, which is, after all, what the complaint is about, then the figures are in fact  
8 clear from pages 5 and 6 themselves. If one looks at the figure for the 2011  
9 charge for Flybe, it is 29 per cent as against 19 per cent. If one then does the  
10 same analysis to even out the fact that they have chosen a 75 per cent peak  
11 service against a 50 per cent peak service, the figure you get is in fact not 29 to  
12 19 but 22 to 19.

13 The correct comparison comparing apples with apples rather than apples  
14 with pears, we would say, is 22 in Flybe's case, 19 in the competitor's case,  
15 looking at the position for 2011.

16 The final point is that these figures look at landing charges alone; they do  
17 not look at the per-passenger charge, which has remained steady throughout the  
18 relevant period. If you factor in the per-passenger charge as well, then we say  
19 the figure is 11 per cent for Flybe to 7 per cent for others.

20 That is our response, effectively, to Flybe's data.

21 Finally, let's look at the chart on page 9 which asked the question is the  
22 runway utilisation now more efficient? Again, the data give the answer that Flybe  
23 wants but the data are forecast data and not actual data. If one uses the actual  
24 data, our calculation in terms of percentage of flights using the peak period, as

1 opposed to the non-peak period, is that they have remained broadly steady in  
2 percentage terms at around 27.2 per cent.

3 Those are our points and those are our responses to Flybe's points. I  
4 hope, if there are detailed questions on the data, for my sake, Mr Dunn will be  
5 able to answer them.

#### 6 QUESTIONS BY THE PANEL

7 MR OSBORNE: Thank you very much. Thank you for coming in on time.

8 We may well ask questions about the data but also, to the extent that there  
9 is the scope for a difference about what is factually true, particularly, for example,  
10 actuals about peak, it will be important that Flybe have a chance to respond to  
11 that. If it is possible to compare notes over lunchtime so that we can cover that in  
12 closing statements, that would be very valuable, otherwise we will do it  
13 subsequently.

14 MR MORIARTY: Can I ask for clarification on this. I do not think we have  
15 yet had access to the calculations that you mentioned comparing the apples and  
16 apples and apples and pears.

17 MR DUNN: I have them here.

18 MR MORIARTY: If we could have access to those and if they that can be  
19 shared also with Flybe, that would be appreciated.

20 MR DUNN: Yes.

21 MR CHAMBERLAIN: Absolutely.

22 MR MORIARTY: Thank you.

23 MR OSBORNE: Moving into questions, I will begin with the same question  
24 that I put to Flybe, which is whether you are happy to accept our use of  
25 competition law concepts as the basis for us considering this complaint?

1 MR HERGA: Yes, absolutely. We think, for the reasons that have been  
2 discussed earlier, that the Airports Act, which section 41 derives from, was, in  
3 1986, well before its UK competition law anyway was developed, therefore it  
4 makes absolute sense, because it involves exactly the same concepts, that you  
5 should adopt competition law principles.

6 MR OSBORNE: To pursue that a little bit more, you have talked a great  
7 deal about efficient use of the runway. I am going to ask a question in two parts.  
8 First, what do you mean by efficient; then I am going to ask you how that relates  
9 back to the concepts, to our statutory duties under section 39.

10 Let's begin with the first of those, what do you mean by efficient in this  
11 context?

12 MR DUNN: In terms of having one runway, not only fixed capacity on that  
13 runway, because you are clearly aware of the work we are doing to look at how  
14 we can improve hourly movements on the runway on average, but within those  
15 constraints we only have a limited amount of access to that particular capacity,  
16 we want to encourage the best use of that capacity, whether it is in terms of  
17 passenger numbers, probably, ultimately, the ultimate test of the use of that  
18 runway, our policy is aimed at doing that.

19 MR OSBORNE: So, it is passenger numbers?

20 MR DUNN: Ultimately, the generation of value at the airport is going to be  
21 through how many passengers pass through the airport in its broadest sense.  
22 So, it is passenger numbers. Clearly, they only move on the runway in set  
23 quanta. The focus of our policy is to say, when you use that more precious  
24 capacity, which is the runway movement, our preference is that you use it with  
25 more passengers. We think it is passengers but if there are segments of the

1 market that are willing to pay for access to the runway and they value that access  
2 more greatly than another set of passengers, then clearly that would prevail  
3 ultimately.

4 MR OSBORNE: So, that is a different concept. That is not passenger  
5 numbers. That is the value that can be extracted from people to use the runway.  
6 It is a bit unclear to me.

7 There is another layer: Flybe has suggested that some passengers, who  
8 are using the airport to transit onto long haul and therefore supporting long-haul  
9 routes, are more valuable again. So, if you can expand on this.

10 MR DUNN: If I start with the main construct, we would see long-term value  
11 being predominantly generated by the number of passengers that come through  
12 the airport. That is the starting point of the construct. But, similarly, in terms of  
13 the access that we are giving and the constraint that we have around the runway,  
14 we are looking to price that in a particular way.

15 Ultimately, if one group of passengers or one airline prize that access  
16 greater than others, then they may part with a similar value or more than a larger  
17 number of passengers. We are not dictating what it should be. We have an ad  
18 hoc preference for 100 passengers versus 50, but ultimately it is the value they  
19 can generate through the airport as a whole.

20 MR OSBORNE: The generation of value would encompass connectivity,  
21 retail revenues? How do you assess the value?

22 MR DUNN: I suppose there are several levels. If you look at our  
23 revenues, those are about commercial revenues. Those are about access to the  
24 airport, so aeronautical charge and use of the facilities.

1           Clearly, as the market develops, we will look at passenger groups and  
2 understand what is it, the value that they bring. The point made by Flybe is that  
3 at some airports, such as Heathrow, they would value some short-haul services  
4 to feed some of those long-haul services. Where somewhere like Heathrow is  
5 operating as a hub, we understand that and that would probably pass through the  
6 minds of Heathrow when it is thinking about how it structures its charges.

7           For Gatwick, we are on an earlier stage of development, let's say. We are  
8 predominantly an origination/designation airport. Connectivity is a factor but  
9 predominantly we are origination/destination and it is about generating capacity  
10 and passengers from the local market.

11           MR OSBORNE: Thank you. I am sorry to press you on the point but I  
12 think these concepts are relevant to my follow-up question which is where I really  
13 wanted to get to. Ultimately, we have to decide this complaint on the basis of our  
14 statutory duties, as per section 39. How would you see the concepts of efficiency  
15 as we have just unpacked here, relating to our section 39 duties?

16           MR CHAMBERLAIN: You are right to pull us up on what do you mean by  
17 efficiency. The answer is that, when we use that phrase in our statistical  
18 materials, we are looking at passenger numbers. When we talk about, in our  
19 statistical materials, has there been any evidence of an increase in efficient use  
20 of the runway, we are, indeed, asking the question how many passengers per  
21 movement are coming in?

22           When one looks at it in economic terms, we would accept that efficiency  
23 has a broader meaning than that. In essence, our answer to the complaint is that  
24 this pricing structure leaves it to the market to decide how one responds to the  
25 pricing incentive. Put in very stark terms, if one has a set of consumers that

1 values the ability to have frequent flights, use small aircraft from particular  
2 destinations and is willing to pay the price which reflects that, then the pricing  
3 policy that we have adopted does not in any way prevent that from occurring. It  
4 allows an aircraft, an airline, to adopt a business model which seeks to attract  
5 that group of passengers.

6         You may say, what about people who cannot afford that increased price?  
7 For the people who cannot afford that increased price, the market analysis will  
8 tell you that somebody else who can afford it values the commodity more. In  
9 terms of your economic analysis of efficiency, we do not ask the question how is  
10 someone going to respond to this. We simply let the market decide how to  
11 respond to this. We let the market decide which of the different mechanisms it  
12 wishes to adopt to respond to the pricing incentive and we assume, along with  
13 standard competition law analysis, that whichever mechanism is adopted will be  
14 the optimal one in terms of value to the consumer.

15         MR OSBORNE: That very thoroughly addresses the first two of our duties,  
16 to users and to the airports. We also have duties to investment and to impose  
17 the minimum restrictions. Can you enlarge a bit more on how you see this  
18 relating to those duties?

19         MR CHAMBERLAIN: I am responding to the question with a question.  
20 Once one has adopted a pricing policy which is consistent with a classical  
21 competition law analysis, and which could reasonably be expected to produce an  
22 economically optimal result, I am not sure quite what room there is for the third  
23 limb of the CAA's test but, if you have in mind a particular difficulty that you think  
24 we should be addressing, perhaps you could --

1 MR HERGA: Probably you have answered that there is no inconsistency  
2 with your third duty. Indeed, if, as potentially will happen, you get a greater  
3 throughput of passengers as a result of the pricing policy, that will presumably  
4 lead to the airport being encouraged to invest in further facilities. So, it certainly  
5 is not consistent with your third duty.

6 MR OSBORNE: I did not have anything in particular in mind. That is a  
7 perfectly reasonable response.

8 MR CHAMBERLAIN: I am glad I have not missed anything.

9 MR OSBORNE: I wanted to be thorough and clear, really.

10 Richard, can I hand over to you to look at objective justification, please.

11 MR MORIARTY: I can see the points around objective justification. I  
12 welcome that there is at least a degree of common ground between the parties  
13 on the principle of peak pricing if not the scale and its application.

14 Can I ask Gatwick a point about proportionality because there is a large  
15 number of ways in which peak pricing can be done. One of the points Flybe have  
16 made is that, by loading the increase on to the landing charge, it disproportionately  
17 affects their business. Can you talk us through why in particular you chose the  
18 structure you did compared to the alternatives and why you believe it is a  
19 proportionate move given the context you have just outlined?

20 MR DUNN: Addressing the proportionate point first, as Martin outlined as  
21 he addressed the comments that have been made here, when you do bring  
22 things to be comparable in terms of the consumption of capacity at the airport --  
23 not delivery of passengers, but consumption also of capacity to handle capacities  
24 -- then you can see that the numbers we shared with you are very close together  
25 and are not materially different. But they are different and that does reflect the

1 different utilisation of the resource, even when you level the playing field, as it  
2 were, in terms of peak and off-peak utilisation. That is probably the main point to  
3 make.

4 In terms of options that we looked at, you have seen our consultation  
5 materials from the year. Ultimately, as we looked at the utilisation of the runway,  
6 we made a number of observations around its significant use by aircraft of lighter  
7 loading than the average. That included, say, a Flybe, or Aurigny relative to the  
8 average. We also observed that, relative to the average, somebody like British  
9 Airways would also utilise the runway in a less efficient manner than some of its  
10 competitors, such as easyJet, at the airport.

11 In terms of striving to expose carriers to the opportunity cost of using the  
12 runway to then allow us to process passengers through the airport, we felt that  
13 lifting landing charges was the best way to achieve that because it had a broad  
14 effect across all of our operators.

15 For example, clearly it incentivised Flybe, as a smaller operator, to think  
16 about how it used its capacity, particularly in the peak, where it is a  
17 disproportionate user. It incentivised airlines such as easyJet, who have a choice  
18 as to whether to bring an A319 or an A320 to the airport with no more movement  
19 and yet more passengers.

20 When you have a British Airways, who is considering what fleet it should  
21 bring to the airport -- should it continue to operate with a small-sized fleet or are  
22 the signals that we are giving about the utilisation of the airport going to  
23 encourage it, as it thinks about re-fleeting, to move to a higher level and therefore  
24 get more out of the runway and the capacity that we are able to build at the

1 airport -- that was the driving factor in looking at landing charges versus  
2 passenger charges being the most constrained asset.

3 At the same time, when looking to the winter, we see a lot of spare  
4 capacity. So, we felt, consistent with that, and consistent with a desire to  
5 encourage airlines at probably one of the more difficult times in the operating  
6 season, to reduce the fixed costs that they would face from operating at the  
7 airport, eliminating landing fees at Gatwick in the winter would help in that regard.  
8 That is reflected, therefore, in the numbers that you see before you in terms of  
9 the level of charges here.

10 MR MORIARTY: Can I pursue the point about pricing structure, a point  
11 made by Flybe, that obviously you have what might be described as a super  
12 peak around July/August. You can see it from the step up in your ATM  
13 movements on your slide.

14 Why did you chose to run the peak from April through to October and not  
15 to differentiate for what might be described as that super peak period?

16 MR DUNN: There are a couple of points to stress. The first one is if you  
17 actually look at passenger movements through the airports, if you start with  
18 passenger movements, not ATMs, you see a very significant peak in the  
19 summer. It almost doubles relative to the off-peak time. Most of that uplift in  
20 capacity is delivered by improved load factors, not through movements. Over the  
21 same time period -- and that would be this chart, if you added the two together --  
22 the movements are by about a quarter. Relative to the shoulder, it is 1.25:1,  
23 whereas in passenger numbers, in terms of processing, it is about 2:1.

24 Again, we are encouraging the right use of the runway. This is about  
25 focusing on landing charges.

1 In terms of the summer peak, first of all airlines are bidding to utilise the  
2 airport, effectively through the slot allocation process, during their normal April  
3 through to end of October. That is how the peak charge and the summer  
4 definition has been made. It is relative to that.

5 If you then start to look at the daily movements or the weekly average of  
6 those movements, you see something quite different. Within the days, relative to  
7 April and August, there is only a modest uptake in the volume of movements that  
8 we see in the peak hours, as we have defined them, but what you see is a very  
9 strong uptake in the number of movements in the off-peak hours of the day. That  
10 is the purpose of this chart.

11 [Indicating "Profile of Summer ATMs" slide] As you look across the  
12 summer, the blue line is drawing out. There is a little bit of modulation up in the  
13 middle of the summer, but most of the increase in movements is because people  
14 choose, then, in the peak months, to use the off-peak hours, which becomes  
15 important. This might be a charter operator deciding to run an eleven o'clock  
16 flight in the evening that in April it just simply would not do. That is why our  
17 charging structure focuses on particular points in the day, which are equally  
18 relevant from April through to October, and an off-peak that is incentivised and  
19 actually does get utilised. Does that help?

20 MR OSBORNE: I think I understood what Nick said but I did not think he  
21 answered the question. The chart appears to show quite a strong difference  
22 between July/August and April or September.

23 MR DUNN: In terms of the utilisation.

24 MR OSBORNE: In terms of ATMs, exactly.

1           So, why did you not design an incentive structure with focus dates on the  
2 super peak, as it were? I did not understand that.

3           MR DUNN: The point is that, if I looked at the hours of the day that we see  
4 as capacity-constrained or where we see, from the bidding process, more  
5 demand over supply, those are our peak hours of the day. So, this peak is peak  
6 hours of the day, and I am just showing you those throughout the summer. In  
7 terms of those times of the day that we nominate as peak, across the summer we  
8 see little modulation in the level of traffic.

9           MR MORIARTY: Is that because charter operators tend to use planes and  
10 slots outside the "daily" peak?

11          MR DUNN: Yes, in part. So, there is some change. There is some extent  
12 -- small -- to which some operators, while they have the right to use a slot  
13 through the whole summer, choose to use it just for six weeks. They are the  
14 ones that in the peak pop up here.

15          In the hours of the day that are off peak, where, even on a seasonal basis,  
16 we constantly do not see the demand there for the slots and therefore they are  
17 charged as an off peak, that is where the growth comes in the summer. Our  
18 charging structure is entirely consistent with that.

19          MR OSBORNE: It is not that I do not understand what you said. The  
20 question you just answered there is about what has motivated you in terms of the  
21 kind of incentives that might lead people to fly at 11.00 am rather than 8.00 am.

22          MR DUNN: Yes.

23          MR OSBORNE: If one drew a slightly different graph, where these two  
24 lines were added together so you had a single line looking at total ATMs, you  
25 would see that, in terms of total ATMs, there was a lot more demand in

1 July/August than in April or September. I have not yet heard or at least have not  
2 understood an answer to the question why did you not design a structure. If you  
3 are aiming for efficiency, why did you not incentivise those peak demands?

4 MR DUNN: Because of the demand that is emerging in terms of ATMs.  
5 This is important, the difference between passengers. Most of the efficiency  
6 comes through lift and load factor for delivering the large volumes of passengers.  
7 If you add them together, in terms of where there is an uptake in the level of total  
8 ATMs, it is delivered by people flying at hours that in any bidding process we do  
9 not see demand exceeding supply.

10 MR CHAMBERLAIN: To put it another way, it is the blue line that is  
11 relevant here, not the red line. If one looks at the blue line alone, one sees that  
12 there is not actually a massive peak in July and August. There is a gradual peak.  
13 It is important also to look at figures at the side. The blue figure for 1 April is just  
14 under 340; and right at the peak, close to 1 August, it is about 375. So, we really  
15 are not looking at an enormous spike in July and August.

16 MR MORIARTY: In ATMs.

17 MR DUNN: In peak ATMs.

18 MR CHAMBERLAIN: In peak ATMs.

19 Where there is an enormous spike is in off-peak ATMs, to which these  
20 charges are not relevant. So, when looking at this graph, it is the blue line and it  
21 is ATMs that we are looking at, not passenger numbers.

22 MR MORIARTY: I have no further questions on that chart.

23 In terms of Flybe's passengers/customers they put through the airport, do  
24 you have any evidence to suggest that they bring benefits in terms of commercial

1 revenues or connectivity benefits for flights elsewhere compared to other  
2 airlines?

3 MR DUNN: We are certainly aware, but not data rich in the area, that  
4 there is some connectivity that comes through. Where we do not have visibility is  
5 where we see connectivity from individuals who are self-connecting. Clearly,  
6 Flybe has interlining arrangements with one or two companies; therefore, there  
7 will be some connectivity.

8 Where we certainly see and do have visibility is the spending patterns of  
9 individual groups of passengers -- so, by airline, having a concept of who brings  
10 more to the commercial till than others. Flybe, because of the nature of the  
11 passengers that it is carrying, which tends to be business people looking to get  
12 through the airport and away quickly, tends to be at the lower end of commercial  
13 contribution.

14 MR MORIARTY: One of the issues I really want to get to grips with is  
15 around the opportunity-cost argument that has been mentioned. It strikes me  
16 that there is a sort of presumption around any opportunity cost analysis that there  
17 is a credible alternative. You have said there is, look at the charts. Flybe says  
18 there is not; we are leasing these slots from the intercontinental airlines.

19 Help us through this. What evidence exists that demonstrates that there is  
20 a credible alternative to the Flybe slots that would be used by an airline carrying  
21 more passengers?

22 MR DUNN: I think the best public data that is there is that that we have  
23 already referred to. We referred back to our July submission which lifts a piece  
24 of data from the ACL coordination process.

25 MR CHAMBERLAIN: Page 8 of the submission.

1 MR DUNN: It starts with arrivals, it has departures. Obviously, as a  
2 single-runway airport, it probably focuses on the aggregate overall. From that  
3 data, we know that demand for key slots exceeds the capacity that we have in  
4 those key times and that, ultimately, in running the allocation process, there are  
5 people who are left out of the allocation of slots by ACL because there is not  
6 enough.

7 MR MORIARTY: This is about the demand that people would like. What  
8 about the demand that people are willing to pay for? Do you have evidence of  
9 secondary trading uptake, in people trading out of slots, et cetera, as a result of  
10 your pricing policies?

11 MR DUNN: As a result of the pricing policies, if I wind back slightly,  
12 obviously slot trading is a grey market, it is not particularly overt. The volumes  
13 that you would see up at Heathrow are more public and known. It is less clear to  
14 us, it is less overt.

15 Obviously we have seen airlines choosing to pick up slots at Gatwick  
16 through the acquisition of companies operating with various significant slot rights  
17 at the airport. I think several years ago of easyJet's purchase. That is probably  
18 the data that we have.

19 We look at the ACL data. We also know, from our conversations with  
20 airlines, if they have gone through this process, their desire to operate at the  
21 airport or, for those who already operate at the airport, whether they can get  
22 additional slots. So, we know, I know, of airlines who have said, "If I could get  
23 another slot in the peak, I could run three rotations through the day and I would  
24 be operating certainly larger than a 150-seater aircraft".

1 MR MORIARTY: For that to support the opportunity-cost argument, which  
2 is half the premise of the pricing policy, would it not lead us to see more evidence  
3 of trading between parties on slots?

4 MR DUNN: One would imagine that over the course of time there would  
5 be more trading of slots.

6 MR MORIARTY: It has not been borne out yet?

7 MR DUNN: It is not an overt market. I think our pricing policy is about  
8 starting to expose the users of that asset, particularly around the peak, to the  
9 value of that peak. Ultimately, if they choose to stay or continue to utilise that  
10 themselves, it is because they see some value in it. If they choose to sell or  
11 hand back into the pool or stop operating a route, that is also their choice.

12 MR OSBORNE: You heard Flybe's evidence that the grey market comes  
13 and goes in terms of value of slots and liquidity. They suggested that at the  
14 moment it is pretty dead. Do you have reasons to disagree with that?

15 MR DUNN: I do not have evidence to disagree with an observation about  
16 a market that is not very overt. What I see is evidence, through the coordination  
17 process, of the demand for slots. I see, through our business development  
18 processes, the demand for slots but the inability to operate because they cannot  
19 get hold of those slots.

20 MR OSBORNE: Can I ask a factual question about the graphs on pages 7  
21 and 8. We have three bits of information given. Demand and capacity are the  
22 ones that you have been highlighting for us but then there is allocation which is  
23 frequently lower than both. Why would slots that were actually allocated be less  
24 than the airport was capable of delivering and less than demand?

1 MR DUNN: Because in many instances the request for a slot comes with a  
2 request for a series of slots throughout the whole day. An example might be a  
3 scheduled carrier who would, say, "If I could get a slot in this time, I could then  
4 run three rotations into the European market, and I will bid on that basis. You  
5 might say to me that I can have the off-peak but if I don't get the peak I will not  
6 operate at the airport". Therefore, what you see is that it falls away. Many of the  
7 bids that exceed, particularly in the quieter hours, then do not ultimately get  
8 allocated because the peak has not been allocated.

9 MR OSBORNE: The secondary market is not particularly transparent to us  
10 any more than it is to you. I would expect that, if there were a vigorous  
11 secondary market out there, that that inefficiency would be traded away. The fact  
12 that people would like a slot here but can't get one there, the secondary market  
13 would tend to eliminate that. I think it is the case that the graphs at Heathrow do  
14 not look like this; usually the grey bar is all the way up to capacity. I am testing  
15 this with you, really, Nick.

16 MR DUNN: The grey bar is almost always above capacity and the  
17 allocated bar shows a not dissimilar pattern.

18 MR OSBORNE: I have a black and white version. So, when I say grey, I  
19 am testing with you in relation to this gap is evidence that there is not such a  
20 strong secondary market at the moment.

21 MR DUNN: The key for us is those peak hours. If somebody cannot  
22 secure that peak hour, then they are not going to pick up anything during the  
23 balance of the day. As demand is already weaker at that time, I am not going to  
24 supply that. So, the key is the peak.

1 MR MORIARTY: If Flybe decided to move all their planes from the peak, is  
2 it your contention that they would be readily snapped up by wide-bodied, larger  
3 aircraft?

4 MR DUNN: No. I think it is somebody else's contention that it is wide-  
5 bodied, long-haul aircraft. If there were a lots of slots available, I would expect to  
6 see a very significant increase in short-haul volumes into mainland Europe. Long  
7 haul is part of our business but the majority is still short haul. Most of the  
8 discussions, certainly that I am aware of, about the desire to access those, would  
9 suggest that it is in short-haul operations, but of a wider body than those that are  
10 operated by Flybe.

11 You asked, in a sense, is there a vigorous market. Maybe the point is that  
12 currently we are looking to expose those who are using these peak resources to  
13 the cost of using those peak resources or the opportunity cost of them. Perhaps  
14 we have not exposed it yet and that is why you do not see a vigorous trading or a  
15 vigorous change, but we are seeing some change, obviously.

16 MR MORIARTY: You have been very clear that this is a step along the  
17 way, in terms of a pricing strategy, to expose people to the opportunity costs and  
18 right price signals. Just so we are clear, how does this fit into the longer term  
19 evolution, if you can say, of your structure of charges?

20 MR DUNN: In what way, sorry?

21 MR MORIARTY: If I have understood you correctly, and there have been  
22 a couple of references in your material, this is a step along the way of exposing  
23 airlines to the right price signals for particularly around peak. If this is not the end  
24 of the story, in terms of changes to your pricing structure, what comes next?  
25 What do you have in mind for the evolution for a pricing structure?

1 MR DUNN: As we have changed our pricing over the last couple of years,  
2 clearly what sort of effect that is having is going to be observed by us. If there is  
3 no effect, then we might draw the conclusion that it needs to move yet further. If  
4 we start to observe an effect, then perhaps we do not need to move it so much  
5 further. So, this will be an evolution.

6 In terms of other mechanisms that we have looked at, if you look at our  
7 consultation over the last couple of years, one of the concerns that we have aired  
8 with those operating at the airport is for those who choose to operate for very  
9 short seasons, even in the peak -- because there are, through historic slot rights,  
10 some who enjoy access to the peak and choose only to utilise that during the  
11 absolute summer peak -- we would encourage that group to move to longer  
12 series lengths.

13 We have consulted on that. Last year we chose not to implement  
14 something because we could see, coming down the track, the EU slot legislation  
15 which should move us from a minimum usage of six weeks to at least 15 weeks  
16 during the summer.

17 I can think of a charter operator such as Monarch who would be insulted to  
18 be called a charter operator now and who see themselves more as a scheduled  
19 operator. We have seen an evolution of their model where they are much greater  
20 users of the full summer season anyway. Ditto Thompson, who are a very active  
21 user of their slots.

22 Those are the sort of areas that we have been toying with on a ATM basis.

23 MR MORIARTY: So, if you do not see a switch from airlines using smaller  
24 planes with less people, one of your responses would be to increase the prices  
25 further to encourage that switch.

1 MR DUNN: You would need to look at the data at the time but one of the  
2 responses might be, has it moved, has it had the impact, has it had the effect that  
3 it was looking to have.

4 MR MORIARTY: This all presupposes that there is a credible alternative.  
5 Where my question is leading to is why does that not happen in any event? Why  
6 does not the credible alternative say to a Flybe or to someone operating in the  
7 peak, "Hey, what about your slot? Here is some money".

8 MR DUNN: I would expect that to change over time but each year that  
9 goes by, the opportunity of holding on to a slot that you are not making the most  
10 of, if your fixed cost of that is going up, should make you pause to think whether  
11 now is the time, on the part of the owner of that slot, to look themselves and,  
12 knowing this data, that there are people who will use it, go out and knock on  
13 people's doors and not sit and wait for somebody to knock on their door.

14 MR CHAMBERLAIN: To add to the methodology point that I made right at  
15 the start, we do say that you have to look at the reasonableness of our policy at  
16 the point when it is adopted. We can speculate about what responses Gatwick  
17 might make if the evidence turned out, for example, not to show much evidence  
18 of secondary slot transfers in the future. Our answer, in principle, would be that  
19 you would have to look at all the evidence at that time. If, looking at all the  
20 evidence at that time, the only reasonable conclusion was that this particular  
21 mechanism, which we are currently relying on, is a mechanism that simply does  
22 not work, is not available -- the slot allocation system is so sticky that it is not  
23 available to us at all -- that was the only reasonable conclusion we could reach,  
24 then we might have to rethink the policy. You might then say it may or may not

1 be reasonable at that stage to increase the incentives; it may be unreasonable to  
2 do so depending on what the evidence showed.

3 But what we are looking at at this stage, taking it step by step, is the  
4 evidence that is available to us now or, rather, the evidence that was available to  
5 us, we would say, at the time when the policy was adopted in March 2011. At  
6 that stage the evidence was that it was perfectly reasonable to expect that slot  
7 transfer would be one of the many mechanisms by which people might respond  
8 to this pricing incentive.

9 We would say, looking back at the position over the last year, one cannot  
10 say that that theory has been disproved, if I put it like that. One would not expect  
11 it to have been fully achieved or manifested over the course of one year.

12 In any event, looking forward to what we might do in the future is a very  
13 dangerous thing to do. What we do in the future is take a reasonable decision  
14 based on all the evidence then available to us.

15 MR MORIARTY: I can understand that future point. You are imputing a  
16 value, based on opportunity costs, which rests on a credible alternative to give  
17 you that value.

18 MR CHAMBERLAIN: Yes.

19 MR MORIARTY: What I am trying to get to the bottom of is a distinction  
20 between the parties on whether there is indeed a credible alternative on which  
21 that value can be imputed. There is at least one school of thought that says, if  
22 you do not see any credible alternative and you keep increasing the prices, is  
23 that not just about extracting more economic rent from your market position  
24 rather than an opportunity cost argument?

1 MR CHAMBERLAIN: To which I think the answer is, in principle, one can  
2 understand the sense of that argument but we have not reached the stage where  
3 one could say that, on the evidence available, you now reject the hypothesis that  
4 we worked on in March 2011 that that mechanism is in principle available.

5 If, after X number of years, one saw zero evidence of any effect, one might  
6 well have to go back to the drawing board and say our thinking back in 2010  
7 needs to be revised. Whether it needs to be revised in terms of increasing the  
8 incentives or revised in terms of these incentives are not working to achieve the  
9 objective that we are trying to achieve is another matter. At the moment, the  
10 position is that we do not have the evidence that would enable us to disprove the  
11 theory, based on standard economic principles, that this is what you would  
12 expect to happen.

13 We would say even now, looking back over the last year, one year of  
14 evidence -- or, as I have explained -- less than one year of evidence just is not  
15 enough to show that that mechanism, which one would expect to be present, is in  
16 fact not present.

17 MR OSBORNE: It seems to me the concept of opportunity cost is one that  
18 we, the CAA, have brought to this. I did not think I heard you, Nick, saying that  
19 you were trying to identify what is the opportunity cost and then expose the  
20 airlines to it so much as use this in a context where the secondary market is  
21 opaque and there are all sorts of actions available to airlines that you do not  
22 know about, you are trying to explore; you are trying to use this as a discovery  
23 process to see what the market is capable of doing. I can understand that.

24 What is not very obvious to me is why the steps that you have in fact  
25 taken? We heard earlier that it is by increasing load factors, that you get more.

1 That is the biggest way by which you get more passengers through the airport  
2 rather than increasing the numbers of ATMs. The straightforward response  
3 might be why did you not then abolish the passenger charge and load it all on to  
4 landing charges, for example? Why this particular approach?

5 MR DUNN: To take why not load the whole on to landing charges, that  
6 would be the extreme conclusion of continuing the gradual change that we are  
7 making or that we have made.

8 This is about starting to take a step towards saying there is a constraint,  
9 we can see it in our peak hours in terms of the bidding behaviour that we have,  
10 how can we incentivise the better use of that because we show people the  
11 opportunity cost, or start to show them the opportunity cost, that they can then  
12 start to make decisions about how they utilise that particular capacity.

13 I know you have focused a little bit on the trading of slots but we would go  
14 back and say there is a whole variety of ways in which we are expecting people  
15 to respond. I used examples such as British Airways. They are going through a  
16 fleet renewal. What are they going to do when they see the direction of travel,  
17 the way that Gatwick is looking to try and drive the right utilisation, the most  
18 efficient utilisation of its runway? If it has a choice over a smaller aircraft or  
19 something larger than a 156, then where is it going to pitch?

20 We know that EasyJet would like, say, additional slots at the airport. They  
21 are one of the parties you will see in this. One of the choices they can make is  
22 not increasing the number of movements but increasing the size of the aircraft  
23 that they put through or pricing differently to achieve higher load factors than they  
24 do.

1           There is a whole variety of ways in which we might see response to the  
2 pricing, the steps that we are starting to take.

3           MR OSBORNE: I am going to offer this question in the nature of a parting  
4 shot before lunch and then you can think about it over lunch.

5           The picture you are painting is one where you are exploring and you do not  
6 quite know what the effect is. One of the criteria that may well be relevant to the  
7 question of reasonableness is proportionality. How do you defend yourself, if you  
8 do not know what the effect is going to be, against the assertion that it is a shot in  
9 the dark and that it is disproportionate to what you might see? It seems difficult  
10 to have it both ways. Either you know what effects you are going to have, you  
11 know it is proportionate, or you do not know, in which case you are at some risk.

12           MR DUNN: My immediate response to that is, instead of saying we do not  
13 understand what might happen, what we know is that, by changing the pricing in  
14 the way that we do, how that will incentivise certain behaviours around particular  
15 airlines, some of the gift of that reaction is going to be to those individual airlines,  
16 but we know that the steps that we are taking will have those effects.

17           MR OSBORNE: All other things being equal. But you do not actually  
18 know what is going to happen.

19           MR CHAMBERLAIN: No. In a sense, that is built into the system. When  
20 you ask yourself the question is a pricing policy justified, you are never, at the  
21 stage when you adopt a pricing policy, going to be able to know what effect that  
22 policy is going to have because by its nature it is a future looking thing. So, the  
23 question you are asking yourself is, applying normal economic analysis and  
24 knowing what you know about the stickiness of the market and the other  
25 difficulties that there are, was it reasonable for the operator, at the time when the

1 decision was taken, to take the decision they took? We would say, yes, it was. It  
2 was reasonable to assume that the various mechanisms that we have described  
3 would, between them, result in an increased efficient use of the runway.

4 We would say, looking back from a year on, none of the evidence that we  
5 have from the past year dissuades us or disproves that those mechanisms are  
6 available. Of course, if in two or three years' time we have a different set of  
7 evidence, then obviously we may have to take a different decision -- and that  
8 may be to increase the incentives, it may be to remove them, it may be to say  
9 what we thought was reasonable at the time is not reasonable any more. What  
10 you cannot do is say, because you do not know what the result of your policy is  
11 going to be, therefore you cannot adopt it, because you are never going to know  
12 what the result is going to be; you are always going to have to work on the basis  
13 of what you would imagine, as a matter of principle, will happen given what you  
14 know.

15 MR OSBORNE: We probably could go on but I think we should break for  
16 lunch. Shall we resume at 2.00 pm.

17 (Luncheon Adjournment)

18 MR OSBORNE: Just before we resume questions to GAL, we have been  
19 talking over lunch about the case and I wanted to put you both on notice. There  
20 are a couple of issues we would be grateful if you would address during your  
21 closing remarks.

22 For GAL, the extent of enquiries during the consultation process about how  
23 the market might adapt, to what extent did you explore what is going on in the  
24 secondary market, what is the state of price sensitivity in different markets or  
25 different events, issues like that, how the consultation process worked.

1           Second, going back to slot scarcity, a factual point, are Flybe based at  
2 Gatwick? Looking at the graphs, it struck us that the scarcity at the peak times is  
3 quite asymmetrical. There are no departure slots early in the morning but there  
4 is lots of arrival capacity and vice versa. It is the question I would like Flybe to  
5 answer if we had not had the answer from you guys. Are Flybe based at Gatwick  
6 and leaving, which is very difficult to get a slot for, or are they based somewhere  
7 else and coming in, which is relatively easy to get a slot for. So, it is materially  
8 important.

9           For Flybe, the other question was about the legal basis of the dispute. I  
10 am not sure if the evidence that you have given us is about your unhappiness  
11 with a five-year pattern of change, whereas, actually, the dispute you have given  
12 us under section 41 is about a point event, the adoption in April 2011 of a  
13 charging scheme. I would like did you to address how those two relate to each  
14 other, please.

15           Wrapping up questions to Gatwick, I am going to move on to questions of  
16 harm. Under the intellectual framework we use, if there is no harm to competition  
17 or to passengers, we are much less inclined to engage.

18           Could I begin, please, with a question about, if we work on the basis that  
19 Gatwick has significant market power, which I know is a question that you have  
20 reserved to look at further, if necessary, but, if you do, do you accept that you  
21 have a special responsibility to avoid harm to the market?

22           MR MORIARTY: Do you want to come back to this in closing rather than  
23 answer now?

24           MR CHAMBERLAIN: Perhaps we will, yes.

1 MR OSBORNE: I should have said that I will give you both five or ten  
2 minutes between these questions and closing statements, given that I have  
3 asked you to address some things.

4 Practically, do you think that the way the structure of charges has evolved  
5 over the five years or in the last year has caused harm to airlines or to  
6 passengers?

7 MR CHAMBERLAIN: No.

8 MR DUNN: No.

9 MR OSBORNE: I did ask that double. There are some airlines who are  
10 quite significantly more substantially affected by the increase in charges than  
11 others.

12 Whether it is something that you have any reason to worry about is a  
13 different question but do you accept that there is harm to some airlines in the  
14 marketplace?

15 MR DUNN: As there is a wide range of airlines that operate with quite  
16 different business models, any change we make or choose not to make, even  
17 maintaining the status quo, has a differential impact on each one of those. I  
18 would not determine it as harm but there is clearly a differential impact on each of  
19 those.

20 MR HERGA: Probably the reason we had slight hesitation on the first  
21 question, if we are deemed to be in a dominant position, we do have certain  
22 responsibilities, but the way we fulfil those responsibilities may be potentially  
23 more "harmful" to one airline than it is to another airline.

24 MR OSBORNE: I am not trying to trick you.

25 MR HERGA: No.

1 MR OSBORNE: I am trying to tease out what you understand by that  
2 responsibility.

3 Perhaps I could ask the question in those terms: what would you regard as  
4 your responsibility, then?

5 MR HERGA: If we have substantial market power?

6 MR OSBORNE: Yes.

7 MR HERGA: I would just roll out competition law to you, which probably  
8 you do not need me to do.

9 MR CHAMBERLAIN: Certainly the responsibility would be mostly in terms  
10 of users rather than airlines. We do not have evidence to suggest that this will be  
11 the ultimate result but if a particular airline were forced to discontinue some of its  
12 services at Gatwick, and those were substituted by other services of another  
13 airline, that would not in itself be a factor that we would accept would constitute  
14 harm in the relevant sense. That would just be an absolutely expected and  
15 normal effect of a rational pricing policy.

16 MS STAHELI: That is on the assumption that one airline that serves one  
17 group of passengers would be replaced by another airline serving that same  
18 group of passengers.

19 MR CHAMBERLAIN: Or another.

20 MS STAHELI: Or might it be a different market segment altogether.

21 MR OSBORNE: Thank you. That is very cogent.

22 That is enough from me. Are there any further questions? [None  
23 indicated]

24 Can I give you five minutes to think about the follow-up points and then we  
25 will move into closing statements.

1 MR CHAMBERLAIN: Just to be clear, you would like us to address the  
2 follow-up points in the closing statements rather than separately?

3 MR OSBORNE: Yes. One way or the other, I do not mind.

4 (Short Break)

5 MR OSBORNE: Thank you, everybody, for coming back. I realise that, if  
6 only for the sake of the transcript, and just in case anybody wondered who you  
7 were, I should have asked those of you who joined us after lunch to introduce  
8 yourselves.

9 MS DUNKIN: Certainly. My name is Tina Dunkin and I work for the CAA  
10 in the passenger advice and complaints team.

11 MS ISAACS: I am Rebekah Isaacs and I work in the same capacity.

12 MR OSBORNE: Thank you.

13 Over to you for your closing statement.

14 CLOSING SUBMISSION ON BEHALF OF FLYBE

15 MR ROBINSON: Thank you, Mr Chairman. We have a number of points  
16 to make which both incorporate what we have heard this morning as well as the  
17 questions you have asked us directly.

18 First of all, I want to deal with a point raised by GAL in relation to the  
19 relevance of competition law to your discussions and, in particular, the relevance  
20 of the Dan-Air 1989 precedent.

21 We did cover that this morning. What I would like to reiterate is that  
22 competition law does not oust the interpretation of your duties under the Airports  
23 Act. It may inform how you deal with various questions on it but, as you know,  
24 the actual process for investigating an allegation of abuse of dominance and the  
25 consequences that flow from a finding of abuse of dominance are very different

1 from the situation you are dealing with now, which is the investigation about  
2 whether a pricing policy and the adoption of that policy was unreasonably  
3 discriminatory. Therefore, it is our view that, whilst informative, competition law,  
4 its evolution since 1998 and so forth, does not render the Dan-Air case any less  
5 relevant now than it was in 1989.

6 The second point we would like to make is in relation to a comment in the  
7 opening statement of GAL about the relevance of the recent BMI, Aer Lingus and  
8 HAL case. It was a relatively small point where they referred to a paragraph in  
9 the CAA's decision relating to whether it could be an objective justification to  
10 adopt a particular policy.

11 As we said this morning, that particular point was not determinative in  
12 relation to the decision in the Heathrow Airport case. We would say it was, in  
13 fact, strictly obiter and that that case turned on different issues and on different  
14 contentions to what you are dealing with in this case. We would submit that that  
15 case, and what you found in that case, does not help you determine the outcome  
16 of this case.

17 I now want to come on to the first of our big points, if you like. This is  
18 picked up in the question you asked us about the gap between the one-year  
19 framework under section 41 and the five-year pattern of change. Gatwick (GAL)  
20 have made quite a play over the technicality in section 41 about the relevant date  
21 being when the policy was adopted. We would note, however, that, when you  
22 adopt a policy, that policy does not speak just on the first day on which it takes  
23 effect, that policy speaks until that policy changes. Therefore, the question for  
24 the CAA to determine is what could reasonably be expected of that policy,  
25 moving forward, at the time they adopted it. So, it is not a one-day-only question.

1           When we see what GAL has said today and in its previous evidence during  
2 this case, about what its expectation of the effect was, it has really been a shot in  
3 the dark. It has been an experiment to see what has happened. They have  
4 accepted today that they would need to adjust that policy and keep it well under  
5 review and the best they could say is that nothing appears to be inconsistent so  
6 far with that policy from the outset.

7           Speaking on behalf of an airline, it is not terribly pleasant to be regarded as  
8 the subject of an experiment, particularly when that experiment involves, as we  
9 say, a significant intervention in the airline market. It is telling that in their  
10 evidence today GAL has not denied the central allegation that we set out in our  
11 third slide, namely, that the manipulation of the airline market would cause quite  
12 significantly damaging effects. So, we must ask ourselves, who is the real winner  
13 and who is the loser from all this? It appears to us that there is only one winner  
14 and that is GAL itself.

15           I would like to make one further point in relation to the one-off cut-off date,  
16 1 April 2011. If you look back through the data to 2010, it is clear that the gradual  
17 shift towards an increased emphasis on landing charges, as opposed to the  
18 balance between landings, parking and passengers, had already started.

19           We launched our complaint on the basis of the policy that was to be  
20 adopted for 2011/12 but there is already some movement that can be discerned  
21 before that. The CAA wanted some evidence of how this policy might be  
22 operating. It may be worth casting eyes backwards as well as forwards.

23           I now turn to the objective of GAL's policy. We have to ask ourselves  
24 whether it was seriously contemplated that the most likely outcome of the  
25 adoption of their policy was significantly improved utilisation of runway or

1 significantly improved revenue generation opportunities for the airport. The  
2 question for you in this case is how to balance the revenue generation  
3 opportunities and the possible improved efficiency in the use of the runway with  
4 meeting categories of consumer demand in the airline. I will come back to that  
5 point at the very end.

6 I now want to reiterate that what we are asking for here is not a complete  
7 overturning of GAL's policy. We are not asking the CAA to stop GAL having  
8 discretion in setting prices that move towards more incentive-based mechanisms.  
9 We are simply asking for a condition that would define clearly the limits of its  
10 discretion and we say that this is necessary to prevent particular harm.

11 Finally, I would like to turn to the last question you asked, just before we  
12 broke up a short while ago. The question was as to the nature, the practical  
13 effect of the special responsibility that would attach to GAL if it were accepted  
14 that GAL had a dominant position, a position of significant market power. GAL  
15 said that they felt that the duties that they owed were to the users and not to the  
16 airlines.

17 We have said that the manipulation in the airline market, the distortion that  
18 is created between, in the examples we have given, Flybe and its competitors,  
19 interferes with the market, with consumer demand. It is telling that GAL has said,  
20 in answer to your questions, that were certain categories of consumer demand  
21 not to be met any further, they were confident that there would be replacement  
22 capacity brought into the market but not necessarily on a like-for-like basis. If  
23 there are consumers who are no longer served in one area of the country, or one  
24 category of demand generally, there can be no expectation that those consumers

1 will still be served. If a special responsibility attaches in relation to the users, but  
2 not the airlines, we say that that is worrying.

3 Absolutely finally, in relation to your question on slot scarcity and where  
4 Flybe is actually based, Flybe operates presently nine aircraft; eight of those fly  
5 into Gatwick, only one of them flies from Gatwick. In terms of Flybe's relationship  
6 with certainly one of its competitors whose aircraft are based in London, when  
7 you consider that there is an asymmetry between the availability of landing slots  
8 at Gatwick and departure slots at Gatwick, there is a disjuncture between the  
9 hypothetical situation of Flybe ceasing to serve those markets in London from its  
10 regional bases and the ability of its competitor to reorganise, reposition its fleet to  
11 do likewise.

12 Just before the lunch break and during the evidence this morning the  
13 question arose about whether the data that we had presented to you this morning  
14 was accurate. The argument that we heard from GAL was that Flybe had used  
15 more peak time slots in relation to its aircraft on a 3:1 basis rather than on a  
16 50:50 basis for the comparator A319. This, it was alleged, meant that the gap in  
17 prices that we had set out was not as significant as we had originally said.

18 To explain exactly what is meant by those data, what we have tried to do is  
19 compare the amount of capacity that was put into the market using different  
20 aircrafts and assuming a 70 per cent load factor. We have also had to assume  
21 what happens in the real world at Gatwick. The allocation of timings for slots at  
22 Gatwick means that it is not possible to get two off-peak landings at Gatwick on a  
23 Q400. That is not the way the schedules work. The regional airports who are  
24 operating curfews would not make that possible in any case.

1           When GAL talks about comparing apples with apples, it is a very good  
2 technical and debating society point but it does not deal with the real world which  
3 is the actual availability and the actual balance between peak-time slots and off-  
4 peak slots.

5           MR STRONG: Very simply, there is a very small off-peak window, in the  
6 summer period. You cannot achieve a four-a-day schedule from a remote base  
7 into Gatwick, get back home again at the end of the day and achieve two off-  
8 peaks and two peak slots. It needs three peak and one off-peak.

9           MR OSBORNE: Understood.

10          MR ROBINSON: Mr Chairman, those conclude our comments.

11          MR OSBORNE: Thank you very much.

12 CLOSING SUBMISSION ON BEHALF OF GAL

13          MR CHAMBERLAIN: If we may, the way we would like to structure our  
14 reply is first of all for Mr Dunn to deal with your questions one and two, then I will  
15 deal with question three and also respond to other points that have been made  
16 during the course of the hearing.

17          MR DUNN: If I pick up the piece on runway movements to start with, you  
18 asked where Flybe was based but you also asked about the level of allocation of  
19 arrival slots versus capacity.

20          As a one-runway airport, we look more at the total movements that are on  
21 a runway. We have interchangeable slots, by and large, between arrivals and  
22 departures. So, the metric that we have to look at is the total movement.

23          What you will see is that, for example, in the most recent season, at seven  
24 o'clock, we declared around 30 slots available for arrivals and 30 available for

1 departures. Obviously, overall, we can only deliver 50. So, it is through that  
2 allocation process. It is key to look at the total.

3 The other point I would make is that in this year's consultation one of the  
4 pieces of structure that we consulted on and have changed is where previously  
5 charges were levied on landings. As seems to be very typical across most  
6 airports, we have moved it to be 50:50 on landings and departures because we  
7 felt that the structure now should more properly represent the demand that based  
8 aircraft had on the overall structure of the system, to level that particular issue.

9 You asked the extent to which during or prior to consultation we have  
10 visibility on the availability of slots. Clearly we had a lot of information on the  
11 availability of slots. As to trading through the shareholders and through the  
12 materials we prepared as part of due diligence, we are well aware of activity and  
13 historic change, to the extent that one could make an estimate of it, in terms of  
14 trading and activity. So, that fed into our considerations at the time.

15 MR CHAMBERLAIN: The third question you asked was whether we  
16 accept -- which we have not yet accepted -- that, if we have significant market  
17 power, that would entail that we had a special responsibility. The answer to that  
18 question is yes, it would. It would mean that we would have special  
19 responsibilities which somebody who did not have significant market power  
20 would not have. The responsibilities would be to competition in general and to  
21 consumers and not to individual airlines. So, if the result of a pricing policy were  
22 that a particular airline were driven to discontinue certain services or, indeed, to  
23 disappear from Gatwick all together, that would not, in itself, be a matter which  
24 would constitute harm for the purposes of the relevant test. Of course, it might  
25 do if it impacted adversely on competition, but we would say that in this case

1 there is no evidence and, indeed, nothing as a matter of principle to suggest that  
2 the pricing policy adopted would have that effect on competition.

3 Can I start by my response to the points that have been made against us  
4 by coming back to where Flybe started. They started by saying that the purpose  
5 of their complaint was to try to level the playing field. Different metaphors or  
6 phrases were used. We were accused of distorting the market. We were  
7 accused of manipulating the market.

8 What I would like to say just to start with is that these phrases are actually,  
9 though very resonant, incoherent when it comes to an analysis, because one has  
10 to ask the question against what benchmark is the market said to be distorted or  
11 manipulated? What is the level playing field which they say needs to be  
12 achieved?

13 I suppose one particular suggestion one could make is the playing field is a  
14 playing field which is cost neutral as between business models. That is one  
15 proposal that was put forward. What do they mean by that? The only way, if you  
16 think about it, that you could have a pricing structure that was cost neutral as  
17 between business models, would be to have one hundred per cent of the charge  
18 calculated on a per-passenger basis. So, you could say that every airline will pay  
19 the same to land at Gatwick per passenger. One could do that. But you have to  
20 ask yourself the question whether that would in fact be levelling the playing field.  
21 Of course it would not. If we had done that, no doubt we would be sitting here  
22 facing a complaint by somebody that operates a different business model. They  
23 would be saying, "We just want to level the playing field. Why can't you just do it  
24 on a per ATM basis? That would level the playing field".

1           So, it is quite clear that there is no level playing field that one can really,  
2           meaningfully discuss, except -- and this is really what they mean when they say  
3           "level the playing field" -- the status quo. That is really what they mean. They  
4           say that the benchmark against which they claim that we are distorting or  
5           manipulating the market, back to the level which they are asking you to restore, is  
6           the status quo.

7           Is it the CAA's function to measure pricing policies against the status quo?  
8           We say fundamentally not. Why do we say that We come back to something that  
9           was said by the Competition Commission when they recommended, in their 2009  
10          report, that the former monopoly or common ownership, in respect of the three  
11          London airports, should be broken up. What did they say? In paragraph 5.12  
12          they set out in the appendix their assessment of the potential for competition  
13          between BAA airports -- recalling at this stage that Gatwick was then a BAA  
14          airport -- within existing constraints. "In summary, even within these constraints,  
15          we consider that airports can rival each other in improving service quality and  
16          compete to retain valuable users, eg, airlines that bring a high number of  
17          passengers per ATM or passengers who contribute disproportionately to retail  
18          revenues". They go on to say, "There is also some scope for Gatwick and  
19          Stansted to compete for off-peak traffic by offering discounts on airport charges.  
20          They can also make better use of existing capacity through optimising tariff  
21          structures".

22          So, what the CC (Competition Commission) had in mind when it required  
23          BAA to relinquish control over Gatwick was the possibility for competition in  
24          relation to pricing policies. In other words, airports would compete, they would

1 adopt different business strategies. That was a benefit which was put forward by  
2 the CC to justify its proposals.

3 So, when one asks the question can one simply take the status quo and  
4 say is there a distortion from that, the answer is no, because the very reason why  
5 the CC was able to make the recommendations it did was because it foresaw  
6 benefits to consumers arising as a result of the different airports adopting  
7 different pricing structures.

8 What happened when Gatwick went into its current ownership is that  
9 indeed different business decisions were taken. We have been criticised on a  
10 number of occasions for doing things that are different from the way things have  
11 been done at Heathrow and at other airports. We are doing things that are  
12 different from the way that things have been done at Heathrow and that is  
13 precisely what the Competition Commission had in mind when it made its  
14 findings in 2009.

15 Allied to that, there is the point, we have been told repeatedly, that what  
16 has happened has caused damage to Flybe and possibly to other airlines in its  
17 position. Indeed, it was even said -- and I think I have written it down right -- that  
18 we had accepted -- not an acceptance I recall us making -- that our manipulation  
19 of the airline market would cause a significant damaging effect. We have not  
20 accepted that and we do not accept it.

21 Even if one for the moment makes an assumption that the pricing policy  
22 that has been adopted will have an adverse effect on Flybe, that is not the end of  
23 the story because one has to assume for the moment -- I will come on to the  
24 propriety of the assumption in a moment -- that if Flybe's 80 passengers are not  
25 able to come into Gatwick, then someone else's passengers -- maybe more,

1 maybe passengers who value the slot more -- will. What is damaging to Flybe  
2 may be, in the aggregate, beneficial to consumers, and that is precisely the  
3 object and purpose of the policy.

4 The policy does not prevent Flybe from using a slot if its passengers are  
5 prepared to pay a price which reflects the opportunity cost of that slot.

6 As to the suggestion that what we are doing is extracting an excessive rent  
7 -- and actually the point was put just a moment ago in these very resonant terms  
8 -- there would be only one winner out of the current policy and that was Gatwick  
9 itself. With respect, that is again a suggestion that is simply contradicted by  
10 Flybe's own case; because Flybe's case is that there is not anyone that is around  
11 to pick up the slots which are relinquished. If that is the case, Gatwick will not be  
12 a winner.

13 If it is true, as Flybe says, that when it relinquishes one of its slots there will  
14 be no one else to pick it up, that outcome is not in our interest and we would not  
15 have adopted this policy if we thought that that outcome would obtain.

16 The next question was the lack of evidence or alleged lack of evidence in  
17 relation to slot trading. I have already made the point that we would not have  
18 taken this decision if we thought that the outcome of it was going to be that slots  
19 were going to go unused. That would not achieve our commercial objectives at  
20 all.

21 The second point is that the decision was taken in March 2011 and it was  
22 taken on the basis, we considered, that there was excess demand for peak slots.  
23 We took that view on the basis of evidence which we have presented to you. We  
24 think that that evidence shows that there is excess demand for peak slots.

1           None of us knows what the future will hold. All we can do is take  
2 reasonable business decisions based on the evidence before us when we take  
3 them.

4           The third point is that the slot market is acknowledged to be non-  
5 transparent; so, there is a limited amount that one can draw from an alleged lack  
6 of evidence over the course of one year. In any event, one would not necessarily  
7 expect the incentives to have had the result of causing airlines to relinquish slots  
8 in as short a period as one year. It is a long-term policy. One would expect  
9 airlines to do all sorts of other things first before relinquishing slots, whether it is  
10 moving to a different size of aircraft or altering their own pricing structure to see  
11 whether passengers are prepared to pay the opportunity cost to which they are  
12 being exposed.

13           In conclusion, we say that the evidence does not suggest that Gatwick's  
14 reasoning was wrong. Finally, we say that if in due course there is a lack of  
15 evidence of actual slot transfers -- it depends, and it will depend on a full analysis  
16 of the evidence at the time -- that may show that the policy has been too  
17 cautious, not that it has been too stringent.

18           Finally, proportionality. I am glad to say there is a degree of consensus on  
19 this issue. There is consensus that an airport operator is entitled to adopt a  
20 pricing policy designed to promote efficient use of its runway and we were  
21 pleased that Flybe acknowledged that in its submission.

22           Second, there is apparently consensus, or at least I thought there was until  
23 the reply, that the policy was introduced in good faith for the purpose of achieving  
24 that objective -- in other words, that Flybe genuinely thought that its policy would  
25 promote the efficient use of its runway. If that is not accepted, then, we say there

1 is absolutely nothing to controvert our evidence that that was the basis on which  
2 the policy was adopted.

3 There is also an acceptance, as I understand it, that our pricing policy  
4 would be likely to deter the use of a runway by airlines which either run services  
5 with low load factors or run services with smaller planes. One can see that that is  
6 accepted because Flybe have been very candid about what they expect the  
7 effect to be on their own business and business model.

8 There is a question whether anything else will replace it. As I have said,  
9 we will replace slots which are relinquished. I have explained that, in our  
10 submission, there is certainly no evidence to suggest that relinquished slots will  
11 not be taken up by others.

12 The complaint at root is not about the principle; it is about the extent of the  
13 charge increases.

14 The Panel asked earlier in the hearing how it was that the CAA was to  
15 assess whether a price increase was excessive if introduced to further an  
16 objective which was admittedly valid. We say that there has been no satisfactory  
17 answer to that from Flybe. They said in their reply that they were not asking for  
18 the CAA to stop Gatwick from having discretion; they were simply asking for a  
19 condition setting the limits of the discretion. What form was such condition to  
20 take? That was a question which was never answered. We say, with respect,  
21 that the answer to it is that the CAA should be very wary indeed about setting a  
22 condition in a case where a policy has been adopted, admittedly in good faith, to  
23 pursue an objective, which is admittedly a rational one. It should be wary about  
24 doing that because of its own policy, as expressed in the Q5 report.

25 I will just read a passage from that report.

1 MR OSBORNE: I am going to need you to wrap up shortly.

2 MR CHAMBERLAIN: Yes. I will conclude very quickly.

3 Paragraph 3.28: "The CAA considers that each airport operator is best  
4 placed to consider how best to recover the cost of airport air traffic control costs,  
5 along with all other airport costs, through airport charges, taking into account the  
6 current charging arrangements, the potential to incentivise economic use of  
7 scarce airport capacity and users' general preference for changes in the structure  
8 of airport charges to be introduced gradually". That is what the CAA said in Q5  
9 and we would respectfully commend that approach.

10 We would say it makes it very difficult for the CAA, in a case when a policy  
11 is introduced in good faith and pursues an admittedly rational objective, for a  
12 condition to be imposed circumscribing the extent to which an airport operator  
13 can itself decide on the structure of its charges.

14 Unless there are any further points, those are our submissions.

15 MR OSBORNE: Thank you very much.

16 I do not have any questions. Do you have any clarification?

17 Rebecca was just highlighting that you did not say very much about the  
18 process of consultation. Then there is the question of what did you do, as much  
19 as you could, to ascertain what might be the market response to making those  
20 changes? You told us that you did make enquiries as to the extent of the trading  
21 and ACL data.

22 MR DUNN: The FPRCG is the subcommittee of the airport consultative  
23 group that looks at charges.

24 We ran a consultation process. We informally started probably the first  
25 papers about what we were looking to achieve in the year, particular structures

1 on how we might achieve that, I think in July 2010. Then, through the course of  
2 the summer, we put in some further proposals around September/October. Then  
3 there were the "these are our ideas" formal responses to those.

4 We ran an extensive consultation process in which a large number of  
5 airlines participated. You will have the minutes of those. You will know who  
6 participated with each of those airlines, either through that group or, in many  
7 instances, bilaterally. There are some aspects of it, given the broad church of  
8 airlines that operate at Gatwick, where there will be some very different views  
9 about whether the level playing field, the status quo, should remain or should be  
10 changed.

11 On this particular issue, around landing fees, we had dialogue with Flybe  
12 and we had dialogue with quite a number of airlines. People like the charter  
13 airlines obviously were unhappy about the fact that we were effectively  
14 incentivising year-round operations through cutting winter landing fees and  
15 putting them all on the summer when the charter operators are the only people  
16 who operate in volume at that time. Does that help?

17 MR OSBORNE: Yes.

18 MR DUNN: That is the primary mechanism for getting feedback from our  
19 users.

20 MR OSBORNE: We do have access to the records of those meetings.

21 Thank you to all of you for the time you spent in preparing for this session.  
22 I appreciate this is the tip of the iceberg, actually on the day.

23 The first thing that happens next is that, when we receive the transcript, we  
24 will give you an opportunity to check it. We will obviously excise confidential

1 material before we do that. Then it will be placed on the website. Then we will  
2 endeavour to produce our decision within six weeks.

3 Thank you very much, everybody.

4 (The hearing was adjourned at approximately 3.00 pm)