

**Investigation under Section 41  
of the Airports Act 1986  
of a complaint made by bmi  
against  
Heathrow Airport Limited**

**A Consultation**

**July 2011**

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## SUMMARY

- 1 bmi has complained to the CAA that Heathrow Airport Limited (HAL) has unreasonably discriminated by: equalising domestic and EU passenger charges, basing landing charges solely on noise values, and not phasing in changes to its structure of charges over time. HAL contended that its passenger charges were cost-related, its landing charges were based on the same criteria for all its airlines and incentivised the best use of its scarce runway capacity, and it would not have been possible to phase in the changes as they affected airlines in different ways.
2. Following its preliminary investigation, the CAA considers that HAL's justifications need to be transparently and objectively substantiated. The CAA is now formally investigating HAL's structure of charges, and invites representations to be sent no later than 6 September.

## 1 INTRODUCTION

- 1.1 bmi made a complaint to the CAA on 28 January 2011 against HAL. bmi expressed concern that in deciding on its structure of airport charges from 1 April 2011, HAL had breached the provisions of Section 41 (S41) of the Airports Act 1986 (the Act) in the following respects:
  - a. HAL unreasonably discriminated against bmi and passengers on domestic routes by equalising domestic and EU passenger charges;
  - b. HAL unreasonably discriminated against short-haul carriers (including bmi) by basing landing charges solely on noise values; and
  - c. HAL unfairly discriminated against bmi by implementing the charging regime from 1 April 2011 instead of phasing it in gradually.
- 1.2 This document starts the CAA's formal investigation following its preliminary assessment of representations made by bmi, HAL and certain third parties. Non-confidential copies of these representations have been placed on the CAA's website.<sup>1</sup> The CAA sets out its initial views following its preliminary assessment on the key issues in section 3 and invites comments on these from any interested party.

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<sup>1</sup> Available at [www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=12293](http://www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=12293)

For the interests of the parties and market certainty, the CAA is keen to resolve this matter as soon as possible. Its current intention is to conclude its investigation by end October 2011. To help it do this it requires any representations to be sent by no later than **Tuesday 6 September 2011** preferably by e-mail to [airportsregulation@caa.co.uk](mailto:airportsregulation@caa.co.uk)<sup>2</sup>.

- 1.3 If you would like to discuss any aspect of this investigation please contact Rod Gander on 0207 453 6225 or [rod.gander@caa.co.uk](mailto:rod.gander@caa.co.uk).

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<sup>2</sup> Or alternatively representations can be sent by post to: Susie Talbot, Regulatory Policy Group, CAA House, 45-59 Kingsway, London, WC2B 6TE.

## 2 BACKGROUND

### *HAL's changes to its structure of charges*

2.1 Heathrow Airport is designated by the Secretary of State under section 40(10) of the Act for price control. In March 2008, the CAA set a price control that limits the maximum per passenger revenue that HAL can receive from airport charges at the airport for each of the five years from 1 April 2008 to 31 March 2013<sup>3</sup>.

2.2 The current price control does not prescribe the structure of airport charges at Heathrow and the airport can therefore structure its charges within the constraint of the overall price cap. In its decision of March 2008 that set the current price controls the CAA said that the structure of charges was first and foremost the responsibility of each airport operator following consultation with its airline users. The CAA did not therefore propose to involve itself in the determination of the structure of airport charges although it would consider under its S41 powers, and in line with its guidelines on the operation of these powers, any case brought by an airline which alleged undue discrimination which might have been effected through changes in the structure of charges.<sup>4</sup> HAL's airport charges consist of the following separate charges on airlines: landing charge, air navigation services (ANS) charge, per passenger charge and parking charge. bmi's complaint relates to the landing and per passenger charges.

2.3 HAL held a number of informal meetings with the airline community between January and June 2010 to discuss possible changes to its structure of charges. On 2 August 2010, HAL issued a consultation document<sup>5</sup> proposing changes in the structure of charges. HAL said the proposals were designed to:

- support Heathrow's hub status by introducing a discount for transfer passengers;

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<sup>3</sup> In April 2011, the CAA extended the price control for an additional year so it now expires on 31 March 2014.

<sup>4</sup> Economic Regulation of Heathrow and Gatwick Airports 2008-2013 – CAA decision (March 2008) paragraphs 3.28 and 3.29. Available at [http://www.caa.co.uk/docs/5/ergdocs/heathrowgatwickdecision\\_mar08.pdf](http://www.caa.co.uk/docs/5/ergdocs/heathrowgatwickdecision_mar08.pdf)

<sup>5</sup> Available at [http://www.heathrowairport.com/assets/Internet/Heathrow/Heathrow%20downloads/Static%20files/Consultation\\_Document.pdf](http://www.heathrowairport.com/assets/Internet/Heathrow/Heathrow%20downloads/Static%20files/Consultation_Document.pdf)

- encourage efficient use of scarce resources by increasing the minimum departure charge and charging for transit passengers;
- simplify the charging structure, for example in parking charges;
- promote environmentally responsible behaviour by encouraging airlines to use aircraft with lower noise and air quality impacts; and
- safeguard legal and regulatory compliance.

2.4 On 29 October 2010, HAL issued its decision document<sup>6</sup> revising its structure of landing and per passenger charges from 1 April 2011. HAL had proposed amending the structure of its aircraft parking and ANS charges as well, but did not amend them in its final decision. Instead, HAL decided to consult further with airlines on these charges. On 18 March 2011, HAL published a consultation document<sup>7</sup> proposing changes in the structure of aircraft parking charges.

2.5 On 12 November 2010, HAL issued a consultation document<sup>8</sup> proposing its airport charges for 2011/12. The proposed charges reflected HAL's revised structure of charges and increases allowed under the price cap set out in the CAA's March 2008 decision. On 7 January 2011, HAL announced its decision on charges for 2011/12.<sup>9</sup> The revised charges came into force on 1 April 2011.

2.6 A summary of HAL's previous structure of passenger and landing charges, the structure of charges proposed in HAL's consultation and the revised structure is shown in Table 1.

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<sup>6</sup> Available at  
[http://www.heathrowairport.com/assets/Internet/Heathrow/Heathrow%20downloads/Static%20files/airport\\_charges\\_final\\_decision\\_291010.pdf](http://www.heathrowairport.com/assets/Internet/Heathrow/Heathrow%20downloads/Static%20files/airport_charges_final_decision_291010.pdf)

<sup>7</sup> Available at  
[http://www.heathrowairport.com/assets/Internet/Heathrow/Heathrow%20downloads/Static%20files/AircraftParkingChargesConsultationPaper\\_LHR.pdf](http://www.heathrowairport.com/assets/Internet/Heathrow/Heathrow%20downloads/Static%20files/AircraftParkingChargesConsultationPaper_LHR.pdf)

<sup>8</sup> Available at [www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=12293](http://www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=12293)

<sup>9</sup> Available at [www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=12293](http://www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=12293)

**Table 1: Summary of the changes in HAL's structure of passenger and landing charges**

	<b>Previous structure (pre April 2011)</b>	<b>Proposed structure (HAL's August 2010 Consultation)</b>	<b>Current structure (from 1 April 2011)</b>
<b>Passenger charge by destination</b>	Domestic  Republic of Ireland  International	European (i.e. combined domestic and rest of EU)  Other	European (i.e. combined domestic and rest of EU)  Other
<b>Transfer passenger charge</b>	Not differentiated from origin and destination charge	25% transfer passenger discount	25% transfer passenger discount
<b>Transit passenger charge</b>	No charge	Charged as per transfer passengers	Charged as per transfer passengers
<b>Basis of landing charge</b>	Movement	Movement (no change)	Movement (no change)
<b>Noise charge(1)</b>	Undifferentiated chapter 4	Differentiated Chapter 4	Differentiated Chapter 4
<b>Emissions charge(2)</b>	Per kg of NOx	Per kg of NOx (no change)	Per kg of NOx (no change)

Notes: (1) The noise charge is based on ICAO and ACI noise categories for aircraft. Chapter 4 is the quietest category. From 1 April 2011, HAL divided Chapter 4 into three sub-categories.

(2) The emissions charge is based on emissions of Oxides of Nitrogen from the engine type of the aircraft.

2.7 HAL's passenger and landing charges for 2010/11 and 2011/12 are shown in Table 2

**Table 2: HAL's passenger and landing charges 2010/11 and 2011/12**

	2010/11 charges (£)	2011/12 charges (£)
<b>Landing charges</b>		
Chapter 2	£2,328.00	£4,912.05
Chapter 3 high	£1,164.00	£4,912.05
Chapter 3 base	£776.00	£1,637.35
Chapter 3 minus	£698.40	n/a
Chapter 4 or equivalent	£659.60	n/a
Chapter 4 high	n/a	£982.41
Chapter 4 base	n/a	£818.68
Chapter 4 minus	n/a	£491.21
Emissions charge (per kg of NOx)	£2.73	£6.09
<b>Departing passenger charges</b>		
Domestic	£13.43	n/a
Republic of Ireland	£17.38	n/a
Europe	n/a	£21.80
International	£22.97	n/a
Rest of World	n/a	£30.63
Europe – transfer	n/a	£16.35
Rest of World – transfer	n/a	£22.97

**Section 41 of the Airports Act 1986 and the CAA's policy and process**

- 2.8 Under S41 the CAA may, if it thinks fit, impose a condition on an airport operator where it appears that it is carrying out a course of conduct specified in section 41(3). One of the courses of conduct is:
- the adoption by the airport operator, in relation to any relevant activities carried on by him at the airport, of any trade practice, or any pricing policy, which unreasonably discriminates against any class of users of the airport or any particular user or which unfairly exploits his bargaining position relative to users of the airport generally.
- 2.9 Relevant activities are defined in section 36(1) of the Act as the provision at the airport of any services or facilities for the purposes of:
- (a) the landing, parking or taking off of aircraft;
  - (b) the servicing of aircraft (including the supply of fuel); or
  - (c) the handling of passengers or their baggage or of cargo at all stages while on airport premises (including the transfer of passengers, their baggage or cargo to and from aircraft).
- 2.10 bmi mentioned in its complaint section 41(3)(b) of the Act which is concerned with the granting of rights by virtue of which relevant activities may be carried on at the airport. However, as the complaint is concerned with charges levied by HAL on airlines and no rights have been granted in this respect, the CAA is not investigating HAL's conduct with respect to this part of S41.
- 2.11 Under Regulation 11(1) of the Civil Aviation Authority (Economic Regulation of Airports) Regulations 1986 (the Regulations), if it appears to the CAA that an airport operator *may* be pursuing one of the courses of conduct specified in section 41(3) of the Act, it *shall* investigate the matter (italics added). In assessing the merits of the complaint, the CAA must take into account its statutory duties under section 39 of the Act. These are:
- to further the reasonable interests of users of airports within the United Kingdom;
  - to promote the efficient, economic and profitable operation of such airports;

- to encourage investment in new facilities at airports in time to satisfy anticipated demands by the users of such airports; and
- to impose the minimum restrictions that are consistent with the performance by the CAA of its functions.

2.12 In December 2006, the CAA published its policy and processes for handling S41 cases<sup>10</sup>. It said it would handle cases consistent with its statutory powers and duties in the Act and, would expect to adopt an approach that is consistent with the application of competition law, except where the circumstances of a particular case suggest it should follow a different approach.

2.13 The CAA set out a three-stage process for handling complaints:

- Stage one: an initial consideration of a complaint – to determine whether it fell within the scope of S41, was not trivial, frivolous or vexatious, and whether there was a more effective alternative way to address the complainant's concerns;
- Stage two: preliminary investigation by the CAA – to determine whether the available evidence raised any concerns that the airport might be carrying out a course of conduct specified in S41(3); and
- Stage three: a formal investigation, in which the CAA would invite representations from interested parties into the matter.

2.14. This document opens the CAA's stage 3 formal investigation.

2.15 At stage 2 the CAA invited comments from HAL on bmi's complaint. In addition, the CAA was aware that other airlines had concerns over HAL's revised structure of charges, and it had also received correspondence from regional interests expressing their concerns. The CAA therefore decided to request comments from Heathrow airlines (via the AOC and ACC<sup>11</sup>) and the regional interests concerned. The CAA received comments from: Heathrow AOC, ACC Heathrow, Virgin, Aer Lingus, the Northern Ireland Department for Regional Development, and the Scottish Minister for

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<sup>10</sup> The CAA's use of section 41 of the Airports Act 1986 – the CAA's policy and processes (December 2006), available at <http://www.caa.co.uk/docs/5/ergdocs/section41policy.pdf>

<sup>11</sup> The Airline Operators' Committee and Airline Consultative Committee are airline representative bodies at Heathrow.

Transport and Infrastructure. The CAA also received correspondence from the Consumer Council for Northern Ireland and Newcastle Airport.

- 2.16 Should the CAA conclude at the end of its formal investigation that it appears that HAL has undertaken a course of conduct described in S41 it can, if it thinks fit, impose conditions on HAL to remedy or prevent what it considers to be the adverse effects of that conduct. Under S41(6) the CAA would have to notify HAL of any conditions it proposed to impose and if, within one month, HAL objected the CAA could not proceed with the implementation of its proposed conditions but could instead make a reference to the Competition Commission under S43(3).
- 2.17 The CAA's policy sets out that we shall inform stakeholders of the timetable for completing our stage three investigation. Our current intention is to try and conclude this investigation by the end of October 2011. This is subject to change. The precise timetable will depend on a number of factors, including whether the parties request an oral hearing before a CAA panel.

### 3 THE CAA'S INITIAL VIEWS

3.1 The CAA considers that it should broadly adopt the approach used in European and domestic competition cases in its investigation. Accordingly, the CAA considers that the principal points it would expect to be relevant in this case are:

- Is Heathrow in a position of significant market power?
- Is there an objective justification for the pricing structure that HAL has adopted and the timetable for its introduction?
- Does HAL's revised pricing structure cause harm or have the potential to cause harm to passengers and/or the competitive process?

3.2 The CAA's initial views on these issues are set out below. As part of its stage two assessment, the CAA prioritised its consideration by seeking views from the parties of objective justification in particular.

#### ***Is Heathrow in a position of significant market power?***

3.3 The CAA has undertaken its stage one and stage two assessment on the presumption that Heathrow has market power in the absence of any compelling contrary evidence. Although the CAA is currently gathering evidence for its latest competition assessments at the designated airports, due to report in December 2011, it does not consider it is proportionate to delay consideration of this complaint until this time when:

- (a) Heathrow remains a designated airport; and
- (b) a significant body of relevant evidence on this issue was discussed and evaluated in the course of the recent Competition Commission market inquiry into BAA. Amongst other things, this inquiry concluded that Heathrow's position as the only significant hub airport in the UK was a feature that restricted competition.

3.4 The CAA's initial view is that it should continue to assume that Heathrow has market power for the purposes of this investigation unless compelling evidence is submitted to the contrary by interested parties.

***Is there an objective justification for the pricing structure that HAL has adopted and the timetable for its introduction?***

- 3.5 Unfair discrimination can be thought of as applying dissimilar terms for equivalent transactions or similar terms for dissimilar transactions without an objective justification. The weight of evidence received to date seems to the CAA to bear principally on whether HAL has an objective justification for its conduct. Given HAL has advanced a cost relatedness objective justification the CAA is keen for HAL to further substantiate this and do so in a transparent manner.
- 3.6 The CAA also has an interest in HAL's justification for its transfer passenger discount given concerns raised by Aer Lingus and Virgin.
- 3.7 It is important to recognise that charges need not match costs exactly. The CAA accepts that there is not one 'right' way to allocate sunk and common costs and there are a number of legitimate approaches HAL could adopt. It has a margin of discretion about how it recovers the sunk and common costs associated with providing airport infrastructure.<sup>12</sup> Furthermore each different route, or aircraft type, could impose different costs on the airports, and a charging structure that attempted to reflect these cost differences exactly would be extremely complex. The CAA considers that there can be merit in adopting a simpler charging structure. With this in mind, should HAL's claimed cost justification be substantiated by this investigation, the CAA's initial view is that the equalisation of charges would not in itself be in contravention of S41. It is also important to note that it may be necessary to consider relevant non-cost related objective justifications that can be legitimate and demonstrable such as encouraging efficient use of a scarce asset or improving the passenger experience. In such circumstances, the CAA would expect the airport to ensure its reasoning can be transparently and objectively justified rather than simply asserted.

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<sup>12</sup> See the CAA's recent decision in relation to the Ryanair v Gatwick Airport Limited Appeal under the 1997 Ground Handling Regulations for a discussion on the principles that support objective justification in relation to pricing conduct. Available at <http://www.caa.co.uk/docs/5/GH111GALRyanair.pdf>.

*Passenger charges – views of parties*

- 3.8 bmi said that the equalisation of domestic and other EU passenger charges had led to a 50% increase in the charge in respect of passengers on domestic routes. It thought that any such increase in the charge should be objectionable *per se*, but in any event if that increase was cost-related there should be clear evidence to demonstrate that.
- 3.9 bmi thought that HAL had failed to provide the required cost evidence and that its cost modelling was founded on wrong assumptions. HAL had failed to take account of the lower cost of domestic operations and had incorrectly assumed similar usage of landside facilities and baggage systems by domestic and international passengers, ignoring the reduced dwell time of domestic passengers at the airport.
- 3.10 bmi said that HAL had failed to take into account the impact of the changes in domestic passenger prices on bmi, which was unique in its reliance on the domestic market, with 53% of all its Heathrow passengers travelling on domestic routes. HAL had argued that the newly introduced transfer passenger discount would offset the increase in domestic charges, but bmi said this ignored the characteristics of its passengers. Only 30% of bmi's domestic passengers were transfer passengers, compared to 60% of Heathrow's traffic on all domestic routes.
- 3.11 Aer Lingus thought that HAL had also discriminated against passengers on routes to the Republic of Ireland (ROI). HAL's cost analysis had been flawed as it had not identified categories of cost where the handling of different passenger types was materially different, such as immigration and passport control. Aer Lingus would not benefit from the transfer passenger discount as it carried below average numbers of transfer passengers, and the discount had resulted in higher costs to non-transfer passengers. HAL had failed to provide evidence showing how the transfer discount would increase passenger numbers.
- 3.12 Virgin thought that HAL's decision to differentiate passenger charges was flawed as all Heathrow's facilities are common use. The introduction of a transfer passenger discount was based on an incomplete analytical model and created harmful competitive effects against non-hub carriers.
- 3.13 HAL said it consulted with airlines about changes to its pricing structure, and that the revised structure took into account responses to its consultation and was aligned with

the airport's objectives. HAL mentioned that the task of structuring airport charges was complex and difficult given the need to balance the varied and conflicting interests of many airport users

- 3.14 HAL said it had reviewed the cost of providing airport facilities to domestic and EU passengers and found no material difference between them. Passengers departing to domestic and EU destinations used equivalent facilities at the airport and there was no objective justification for charging them different prices<sup>13</sup>.
- 3.15 HAL said it had taken account of the impact its charges would have on airport users, but HAL could not modify its charges to take account of the characteristics of individual airlines, as all airlines operating at Heathrow were unique, and it would not be possible to have different charges for different airlines. HAL had reviewed the impact of the restructure would have on airlines and that had shown that bmi was not more acutely affected by the new charging structure relative to other airlines.

*Passenger charges – CAA's initial view*

- 3.16 CAA notes HAL's argument that its conduct is objectively justified on the grounds of cost relatedness. Cost-relatedness would be an example of an objective justification that could support HAL's conduct if it could be substantiated. HAL has modelled the costs of handling different categories of passengers: domestic and ROI, EU, and the rest of the world. Overall this analysis shows that the cost of handling a domestic or ROI passenger is about 88% of the cost of handling a European passenger.
- 3.17 The CAA is not in a position to confirm this assessment without undertaking a formal investigation and undertaking due diligence on the HAL model to test various assumptions. Following concerns raised by bmi and others, the CAA is keen to understand:
- a. why HAL only looked at asset costs and not at other, potentially significant, factors such as operational costs and commercial revenues?
  - b. why HAL chose to base its analysis on theoretical new build terminals for either domestic/ROI only, EU only, or non-EU passengers only?

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<sup>13</sup> A note by HAL on its cost model for determining the passenger charge differential by destination is on the CAA website at: [www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=12293](http://www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=12293).

- c. how HAL's costs relate to its cost drivers, such as passenger dwell times and passenger characteristics?
- d. what is included in "other passenger assets" and why HAL chose to spread these costs equally between all except transfer passengers?

*Landing charges – views of parties*

3.18 bmi said that by continuing to use a basis for calculating landing charges that was not based on aircraft weight, HAL had ignored the higher infrastructure costs generated by larger aircraft, such as:

- larger aircraft exert more pressure on the runways;
- larger aircraft require larger and wider runways; and
- the greater wake vortex created by larger aircraft requires greater separation between aircraft thus reducing the number of movements that can be accommodated on a runway.

3.19 bmi said that most airports, even those that suffer from congestion, use weight as the differentiator in their charges. The financial impact of HAL's approach on bmi and other short-haul carriers is that they contribute an unreasonable proportion of the costs associated with landing charges, and as a result unreasonably subsidise other aircraft types.

3.20 Aer Lingus agreed with bmi's arguments. It was unaware of any of Heathrow's peer airports that used a similar pricing methodology. Aer Lingus recognised that ICAO policies indicate that allowance might be made in certain circumstances for movement based charges, or a combination of a fixed charge and a weight based element, such as at congested airports and at peak periods. However, it submitted that HAL should have regard to the overall effect of changes in charges on individual airlines.

3.21 HAL said that its landing charges were based solely on environmental factors, aircraft noise and NOx emissions. The charges were objectively justified as the level of charge varies according to the environmental effect produced by each aircraft landing at the airport. Landing charges could not be discriminatory as they applied equally to all aircraft using the airport. HAL considered that this aspect of the complaint did not

concern discrimination but instead was an objection to the noise element of the charging structure, and was therefore outside the scope of S41.

- 3.22 In its consultation with airlines, HAL highlighted the importance of encouraging airlines to use runway slots efficiently so they made the most effective use of scarce capacity.

*Landing charges – CAA's initial view*

- 3.23 HAL has not argued that its landing charges are justified by cost-relatedness, but that it set these charges to incentivise more efficient use of its runways and to incentivise quieter and cleaner flights. The CAA recognises that Heathrow's runways are very highly utilised and that the demand for aircraft slots exceeds supply. The CAA considers that incentivising a more efficient use of its runways could be an objective and justifiable reason for a charging structure that tends to discriminate between different classes of users. Such an approach would be in line with the CAA's statutory duties, in particular its duty to promote the efficient, economic and profitable operation of airports. The CAA is therefore seeking to substantiate whether HAL's chosen charging structure does, in fact, fulfil this objective.
- 3.24 The CAA supports HAL's objective to promote environmentally responsible behaviour and does not consider that setting charges to incentivise the use of quieter and cleaner aircraft is inappropriate. Indeed, the Civil Aviation Act 2006 makes it clear that an aerodrome authority may charge aircraft operators for use of the aerodrome by reference to the emissions from an aircraft as well as the noise produced. The Government's intention was to enable aerodrome operators to set their charges to reflect the impact of aircraft on local air quality in the vicinity of an airport.
- 3.25 The CAA does not consider that HAL is necessarily obliged to adopt the most commonly used charging system worldwide.

*Implementation of charges – views of parties*

- 3.26 bmi said that the time allowed for implementation of the charges was unreasonably discriminatory to bmi, as it denied the airline the proper opportunity to undertake the necessary restructuring in the available time. bmi said it would suffer a significant financial detriment as a result. In particular, it would need to re-structure its route network and fundamentally change its fleet profile.

- 3.27 bmi said that HAL had ignored the ICAO principle of gradualism in all the important areas of its price re-structuring. Other airports had revised proposed fundamental changes to their charging structure or agreed to introduce changes over a period of time. bmi had the opportunity to comment on HAL's original pricing proposals, but these were significantly amended in HAL's decision and bmi had no opportunity to comment on the final structure<sup>14</sup>.
- 3.28 bmi mentioned, in particular, that the immediate introduction of new Chapter 4 noise categories would not have the desired effect of incentivising quieter aircraft. It was not immediately clear to bmi into which Chapter 4 category its aircraft would fit. It suggested that phasing in the new categories, with the phasing known from the outset, would allow airlines to re-consider the composition of their fleets in response to the charges.
- 3.29 Aer Lingus agreed with bmi's arguments on gradualism.
- 3.30 HAL disagreed with bmi, saying that all airlines using Heathrow were subject to the same implementation schedule. It would not have been possible to have different implementation dates for different airlines, as they affected airlines in different ways. The lack of gradualism, therefore, could not be discriminatory, and was outside the scope of S41.

*Implementation of charges – CAA's initial view*

- 3.31 Gradualism is an ICAO principle, but it is not mandatory, and has not been notified to the CAA as an international obligation to which it must have regard. Furthermore the ICAO guidelines themselves recognise that there may be circumstances where a departure from the principle may be necessary. The CAA would not therefore consider a lack of gradualism to be objectionable *per se*. The CAA notes that bmi would not have enough time to adjust its fleet in response to HAL's changes to its structure of charges, but considering the time taken to adjust aircraft fleets (bmi mentioned that it takes a minimum of two years for the delivery of new aircraft) the CAA does not consider that changes to pricing structures must be phased to fit in

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<sup>14</sup> HAL withdrew both its parking and navigation charge proposals after closing the August 2010 consultation. Had HAL not withdrawn significant elements of its initial proposals, the increased charges for bmi would have been offset to some extent by decreases in other charges.

with this timetable. For the CAA to insist on such timing of implementation would be unnecessarily prescriptive.

- 3.32 The European Airport Charges Directive (Directive 2009/12/EC) requires airports to consult on new charges at least four months before they come in force, and normally publish revised charges at least two months before they come into force. HAL met these deadlines.
- 3.33 The CAA is not persuaded that bmi, nor any other respondent, has made the case so far that the speed of the implementation of the revised charges has been unreasonably discriminatory. It does not intend, therefore, to consider this aspect of bmi's complaint further unless a respondent can present further evidence that the lack of gradualism has been unreasonably discriminatory.
- 3.34 Consistent with the findings of its recent Ground Handling Appeal (Ryanair v Gatwick Airport)<sup>15</sup> the CAA does not consider that a large price increase in and of itself is discriminatory if it is based on a cost related justification and therefore entails revising a pricing structure that is itself unreasonably discriminatory or has become so over time.

***Does HAL's revised pricing structure cause harm or have the potential to cause harm to passengers and/or the competitive process?***

- 3.35 The revised structure of HAL's charges is revenue neutral within the price control and thus the amount charged to airlines in total has not changed. At one level it could therefore be argued that the overall effect on passengers might not be significant. Nevertheless, if HAL did not have an objective justification for its conduct it could be argued that such pricing behaviour for an airport with market power would lead to distortions to the competitive process in terms of the prices airlines could then charge passengers.
- 3.36 This could impact different users, or classes of users, in different ways with increases in fares for some or reduction in route choice. Some parties who contacted the CAA

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<sup>15</sup> Appeal to the Civil Aviation Authority under Regulation 20 of the Airports (Groundhandling) The Regulations 1997 made by Ryanair Limited against Gatwick Airport Limited and BAA Airports Limited: The CAA's Decision (May 2011). Available at <http://www.caa.co.uk/docs/5/GH1111GALRyanair.pdf>

following bmi's submission to the CAA of its complaint drew attention to adverse effects on passengers on domestic and Irish services.

- 3.37 Against this background, the CAA notes that in 2005 and 2007 it published reports into UK Regional Air Services<sup>16</sup>. These reports recognised that access to Heathrow was an important issue for regional economic development, and in particular for passengers wishing to connect to other services. There had been some reductions in services between UK regional airports and Heathrow over the decade preceding the report, but services to other London airports more than offset the loss of Heathrow services, and links to other European hubs provided an alternative means of making connections. Overall the CAA found there had had been improvements in the connectivity of UK regions, delivering benefits to passengers and, potentially wider economic benefits to UK regions through the aviation industry responding to incentives created through liberalisation. The reports recognised that there could be alternative policy interventions open to the government, for example by public funding via Regional Development Funds, or through Public Service Obligations<sup>17</sup>.
- 3.38 The CAA's initial view is that harm can be presumed should HAL be considered to have market power and have no objective justification for its pricing conduct that has a significant impact on a class or classes of user. However, the CAA ought not to use S41 to pursue wider policy goals of regional connectivity given that the CAA has to apply S41 against its statutory duties in the Airports Act alone. The regulatory regime of Part IV of the Act is not designed for wider purposes that could risk importing distortions and where such wider purposes are more properly addressed by alternative mechanisms open to the government.

### **Views invited**

- 3.39 This document sets out the matters that the CAA will be investigating and its initial views based on its preliminary assessment. Before reaching a decision on its formal

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<sup>16</sup> CAP 754 UK Regional Air Services – a study by the UK Civil Aviation Authority (2005), available on the CAA website at: <http://www.caa.co.uk/docs/33/CAP754.PDF>.

CAP 775 Air Services at UK Regional Airports – An update on Developments (2007), available on the CAA website at <http://www.caa.co.uk/docs/33/CAP775.pdf>.

<sup>17</sup> Under European law Public Service Obligations would be permitted where there is no access from a region to a city, e.g. London. However, it is less certain whether they could be used to protect a route to Heathrow if there are routes to other London airports.

investigation the CAA would welcome representations from the main parties and any other interested parties on its initial views set out in this section.

3.40 In particular, the CAA welcome views on:

- the basis of HAL's objective justification for its passenger charges (including its transfer passenger discount); and
- whether HAL's landing charges fulfill its objective to incentivise more efficient use of its runways and cleaner and quieter flights.

3.41 The CAA would also be open to:

- views relating to CAA's presumption that HAL has significant market power;
- compelling evidence that the speed of the implementation of the revised charges has been unreasonably discriminatory; and
- views on any other matters parties consider to be relevant.

3.42 To enable a timely resolution of this complaint, the CAA seeks views by no later than **Tuesday 6 September 2011**.