

## **Gatwick Airport's response to the CAA's Stansted market power assessment consultation on relevant market developments**

**11 November 2013**

**Reference: Q5-050-LGW66**

### **Introduction**

Gatwick welcomes the opportunity to comment on the CAA's evaluation of recent market developments relevant to its assessment of Stansted's market power. However, we are disappointed that the CAA has not taken the opportunity to revisit more comprehensively its market analysis at Stansted, Gatwick and Heathrow airports, in light of the substantive comments that the CAA has received in response to its 'minded to' consultations. The responses received by the CAA demonstrated a number of significant errors in the CAA's analysis which are required to be addressed.

We have a number of comments and observations on the CAA's most recent Stansted consultation, many of which have a read-across to the CAA's assessment of Gatwick's market power. We have limited our comments to the passenger market.

### **Inconsistencies in the CAA's analysis**

Gatwick considers that the CAA is taking an inconsistent approach to its analysis of market power at Stansted and its equivalent analysis at Gatwick. In particular, the CAA places substantial weight on the change in ownership at Stansted and the resulting changes in behaviours and the implication of these for its market power. In contrast, the CAA has been largely dismissive of the same factors at Gatwick, and it has not adequately factored in the greater competitive threat from Stansted that flows from the CAA's own analysis of the impact of changed ownership, and its associated constraints on Gatwick. We expand further on these points below.

### **Change of ownership**

We agree with the CAA that the change in ownership at Stansted has been accompanied by a more commercial approach and that this is relevant to the CAA's assessment of market power. However, the CAA has so far in its analysis of Gatwick simply noted that the change in ownership at Stansted could result in it posing a greater competitive threat to Gatwick. In contrast, the CAA, in its Stansted analysis is now (rightly) recognising that Stansted is operating as an effective competitor and is winning significant business. We consider that this change in the CAA's approach to its analysis of market power at Stansted in itself requires a wholesale revision to its analysis of Gatwick's market power, in particular the CAA's analysis of the competitive constraint posed by Stansted on Gatwick.

## CAA's interpretation of evidence on impact of change of ownership

The CAA, in the Stansted market power assessment consultation quotes MAG, in response to the CAA's 'minded to' market power assessment of Stansted as stating<sup>1</sup>:

*"As the new owner of Stansted, MAG believes that real competition between London's airports under separate ownership will emerge quickly and as part of a new approach, we would encourage the CAA to allow new management to compete freely for passengers and airlines. In the 12 weeks since MAG completed the acquisition of Stansted, excellent progress has been made in implementing a positive and dynamic new strategy to improve customer service and deliver value to airlines, including plans for a £40 million transformation of the terminal building to dramatically improve the passenger experience. These initiatives represent just the beginning of MAG's plans for Stansted. Building on Stansted's core strengths, significant opportunities exist to deliver growth and build connectivity, reduce operating costs and drive commercial revenues. MAG is confident that its new approach to operating and developing Stansted will succeed in a market where airports across the UK and Europe are competing to attract new business. This competition will protect and promote the interests of consumers, and bring significant additional benefits."*

The CAA also quotes MAG's Chief Executive as stating in May 2013<sup>2</sup>:

*"Under MAG's ownership, we are already competing hard for new passengers and airlines and Stansted provides the CAA with the perfect opportunity to adopt a forward looking approach and promote competition in the interests of passengers."*

The CAA attaches weight to these statements as evidence of a change in commercial approach.

As the CAA is aware, Gatwick has made similar statements about the increase in competition and changes in Gatwick's behaviours on many occasions over the last three years. It has made these, inter alia, in its various submissions to the CAA on market power. However, the CAA appears to interpret the evidence presented by Gatwick differently from how it has interpreted the evidence presented by Stansted. In the case of Gatwick, the CAA is doubtful as to whether these behaviours demonstrate that Gatwick is operating as an effective competitor. For instance, the CAA indicated that the observed changes in Gatwick's behaviour could be driven by new owners attempting to maximise their return on their investment, rather than indicating a step change in the level of competition.

These behavioural changes at Gatwick have also been noted by airlines. During the course of the Competition Commission's (CC) market investigation the CC noted<sup>3</sup>:

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<sup>1</sup> Paragraph 2.5

<sup>2</sup> Paragraph 2.6

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*“Ryanair said that Gatwick management had made the passenger experience at the airport more pleasant, and that it had noticed improvements in the security area, as well as increased productivity”.*<sup>4</sup>

Likewise, the CAA reported the airlines’ view, albeit in the context of their view that Gatwick has SMP, in evidence to the CAA Board in June 2013:

*“Airlines considered that, since the change of ownership, GAL has been a good operator and had made significant improvements to the airport in many areas.”*

It is not clear to us why the CAA is taking an inconsistent approach in its assessment of the evidence on (and impact of) changed behaviours under separate ownership at Stansted and at Gatwick. The only difference is the existence of bilateral agreements at Stansted. However, as we explain below, we do not consider this is, of itself, sufficient grounds for reaching such a strikingly different conclusion. First, this evidence of bilateral contracts needs to be assessed alongside other evidence on the overall market context, where previous CAA errors need to be corrected, and where (as identified below) the CAA’s approach in the Stansted consultation differs from its previous approach. Second, as we have noted elsewhere, Stansted has had an advantage over Gatwick in progressing long-term contracts due to the early signalling from the CAA that there would be no binding RAB-based regulation beyond the end of Q5 at Stansted. Significant progress is now being made on contracts at Gatwick following the clarity provided by the CAA’s Final Proposals. In any event, the CAA needs to take full account of Gatwick’s voluntary Commitments which it has confirmed will be honoured whether or not the CAA determines it meets the market power test.

### **Developments related to the passenger airlines**

Gatwick agrees that the introduction at Stansted of multi-year pricing agreements at a level below or consistent with the competitive price level is relevant to the CAA’s market power determination at Stansted. However, this development is only one of a range of factors that are relevant to the determination and should not be considered determinative in the way that the CAA’s consultation appears to do. Our Commitments, on terms which the CAA considers consistent with the achievement of its statutory duties, are also relevant to the CAA’s market power determination at Gatwick.

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<sup>3</sup> BAA airports market investigation, Consideration of possible material changes in circumstances final report, Competition Commission, July 2011, paragraphs 61 and 62

<sup>4</sup> We note that Ryanair went on to state that there was a lack of price competition and that Gatwick would only behave competitively if it came under competitive pressure from Stansted after it had been sold by BAA. While Ryanair provided no evidence to support this assertion the sale of Stansted has now occurred and, therefore, consistent with the views of the CC (and of Ryanair), further increased the competitive constraints on Gatwick.

### Potential implications for the passenger market

In paragraphs 3.18 and 3.19, the CAA states:

*“In terms of airline switching, separation of HAL and STAL does not add directly to the competitive constraint on STAL in the short-run. As regards the constraint from passenger switching, there is a catchment overlap between Stansted and Heathrow but the CAA considers that passengers are unlikely to be very sensitive to changes in airport charges because they form a small proportion of the total ticket price.”*

*“The CAA considers that the change in ownership, despite being structural in nature, is unlikely to have altered the short to medium term constraints on STAL on its own.”*

Gatwick does not agree with the CAA’s assessment of the competitive constraints on Stansted arising from the separate ownership of Stansted. The CAA’s current view is inconsistent with that of the CC in its possible material changes in circumstances decision in 2011 where the CC concluded that separation would lead to an increase in competitive constraints, even in the short-run<sup>5</sup>:

*“Even without new runways being built, there would now be a significantly greater level of competition for customers and airlines between Heathrow and Stansted if they were under separate ownership.”*

Further, we note that the approach the CAA takes in paragraph 3.18 is inconsistent with the market definitions in its ‘minded to’ consultation, where it concluded that Heathrow and Stansted were not competing in the same relevant markets, on the grounds that Stansted is active only in the LCC and charter passenger market, whereas Heathrow is active only in the FSC and associated feeder traffic passenger market.

We consider that the CAA’s apparent revised formulation, which recognises the constraints (potential or actual) between Stansted and Heathrow, is a more appropriate formulation. As we have previously submitted to the CAA, the definition of separate markets for i) LCC and charter and ii) FSC and associated feeder traffic is a false distinction and should be revisited, including in the context of the CAA’s analysis of Gatwick’s market power.

Moreover, the apparent revision to the CAA’s approach (which has so far not been explained) has implications for geographic market definition. It suggests that, as we have also previously submitted to the CAA, the narrow geographic markets which have been defined by the CAA cannot be substantiated and a broader geographic market should be defined, to include, at least, all of the London airports, and potentially extended to include airports in the EU. We also observe that, in paragraph 3.29 of the consultation, the CAA effectively accepts in recognising Ryanair’s and easyJet’s utilisation of capacity across their networks, that the market is effectively EU-wide. The CAA’s attempt to distinguish between new and existing capacity is not tenable, particularly when

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<sup>5</sup> BAA airports market investigation, Consideration of possible material changes in circumstances final report, Competition Commission, July 2011, paragraph 111.

assessed against the background of Ryanair having moved significant capacity from Stansted in the recent past.

### **The change of ownership at Stansted increases competitive constraints on Gatwick**

We agree with the CAA that that under new ownership Stansted has adopted a much more commercial approach than under the previous ownership. It is clear from the quotations presented by the CAA in paragraphs 3.20 and 3.21, amongst other evidence, that MAG is seeking to improve the passenger experience at Stansted, rather than operating (as was the case previously) so as to maximise BAA's returns from Heathrow.

We consider that the more commercial approach of Stansted poses an additional competitive constraint on Gatwick, even in the short term. Both Ryanair and easyJet could fulfil their obligations to Stansted at the expense of Gatwick in terms of current routes and passengers and securing for Stansted potential future routes and passengers in preference to Gatwick. We note in this context that a recent independent consultants' report, produced for the CAA by York Aviation/CTAIRA, highlighted the substantial catchment overlaps between Stansted and Gatwick.

We also agree with the CAA that the pricing behaviour and relationship with airlines at Stansted under MAG's ownership are different to when the airport was owned by BAA. This is similar to the experience at Gatwick, which was acknowledged by the CC in 2011<sup>6</sup>:

*"We [the CC] recognize that Gatwick has only been under new ownership for a year and a half, and we would not expect the full scope of competition between airports as a result of Gatwick being separately owned to develop fully in such a short time frame. For the reasons set out below, we find that there are some tangible signs already of non-price competition to attract airlines and their customers by Gatwick, and a scheme aimed, among other things, at encouraging airlines to switch long-haul flights to Gatwick using financial incentives (see paragraph 55).*

*There has been some switching of airlines from Stansted to Gatwick since the 2009 report (as well as one route switching from Heathrow to Gatwick). Gatwick said that the main attraction of Gatwick for switching airlines was a strong catchment area, but that the airlines would also have looked at the way service improvement was being driven through when deciding to switch to Gatwick. We note that the long-haul incentive scheme has not yet resulted in significant levels of switching to Gatwick from other airports, but this appears to us to be an example of Gatwick seeking to win airlines and their customers using price competition.*

*In our view, as noted in paragraphs 53, 54 and Appendix A, there are tangible signs already of non-price competition for airlines and their customers by Gatwick, for example in terms of improving the customer security experience, development of*

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<sup>6</sup> BAA airports market investigation, Consideration of possible material changes in circumstances final report, Competition Commission, July 2011, paragraphs 100 to 102.

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*baggage facilities and its capital expenditure process. This evidence is encouraging; although Gatwick has not been under separate ownership for very long, the evidence is in line with what we would expect to develop over time. We would expect benefits from service quality improvements to continue at Gatwick and to intensify with further competitive rivalry and also to arise at Stansted once it is independently owned. Gatwick's appointment of an agency to encourage airline users to think of Gatwick as their first choice airport in London (see paragraph 54) appears to us to be in line with our view that airports can and, when faced with competition from neighbouring airports, will compete for end-customers."*

The available evidence since the CC's report continues to support a conclusion that Gatwick is competing with other airports for airlines and passengers. The sale of Stansted to MAG further increases the competitive constraints faced by Gatwick.

### **Gatwick's Commitments compared to Stansted's bilateral agreements**

As the CAA is aware, Gatwick has proposed Commitments which deliver, amongst other things, a price path at a level below the regulatory price proposed by the CAA in its Final Proposals, covering 100 per cent of current and future airlines and passengers at Gatwick. The Commitments, and the CAA's endorsement of them in its Final Proposals, provide an environment which has stimulated increased airline engagement on bilateral agreements. We will of course update the CAA on any bilateral agreements which are signed before its regulatory review concludes.

In contrast to the situation that has prevailed at Stansted since July 2012, it is only since 4 October 2013 that the prospect of binding RAB-based price controls at Gatwick has largely been removed by the CAA and an approach that enables commercial agreements has emerged. Previously the expectation of on-going cost-based regulation formed a substantial barrier to any significant progress in reaching bilateral agreements with airlines. As the CAA is aware, it has been our long-held view that the CAA's approach, which continued to focus primarily on developing a binding RAB-based price control for Gatwick, would hamper our ability to reach commercial agreements with airlines. This is because it was entirely rational for airlines to first understand the CAA's proposals for future pricing at Gatwick before entering into their own negotiated agreements with Gatwick. The interest shown by a number of airlines since publication of the CAA's Final Proposals serves to confirm that the CAA's process was itself a barrier to discussions at Gatwick.

### **Test A for the passenger market**

Gatwick agrees that presence of bilateral agreements at Stansted indicate that airlines enjoy buyer power and such a finding would be consistent with the guidance referenced by the CAA on this issue. However, the absence of bilateral contracts to date at Gatwick does not demonstrate the lack of buyer power at Gatwick but, as stated above, reflects an entirely rational strategy for the airlines of awaiting the CAA's proposals for future pricing at Gatwick before entering into serious bilateral negotiations with Gatwick.

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The CAA in its assessment at Stansted notes that airlines have the ability to allocate new growth away from Stansted. As noted above, this also applies to reductions in existing capacity as demonstrated by Ryanair at Stansted under BAA when there were no bilateral agreements in place. Likewise, airlines have the ability to allocate new growth and existing traffic away from Gatwick, particularly to airports which have spare capacity, such as Stansted and Luton in the London area and many other airports in the EU. The degree of spare capacity at Stansted, upon which the CAA places some weight, may condition Stansted's behaviour in relation to its own airlines. It also reflects a significant competitive constraint on Gatwick.

Gatwick also agrees with the CAA that the presence of bilateral agreements with a subset of airlines, absent robust evidence to the contrary, would suggest that such bilateral agreements would be available to other airlines, if they wished to enter into such agreements. We also agree with the CAA that its statutory duty is to passengers and that passengers could switch to airlines covered by contracts and charged prices judged consistent with competitive levels.

### **Test B for the passenger market**

The CAA suggests that bilateral agreements between Stansted and a significant proportion of its airlines may be viewed as substantially reducing the risk of price-based abuse of dominance and that it may indicate that Stansted is willing to self-regulate. Gatwick agrees with this assessment. To the extent that the bilateral agreements also cover non-price factors such as service quality (both airline and passenger facing), consultation and dispute resolution, then this would further support a conclusion that any risk of abuse would be minimal at most. As such, Test B is not met at Stansted.

Moreover, the CAA's view that Stansted's bilateral agreements substantially reduce the risk of price-based abuse must, in our view, be equally applicable to Gatwick's Commitments, if not more so, as they apply to all current and future airlines operating at the airport and their passengers. In addition, the Commitments unequivocally cover quality of service, transparency and consultation, and dispute resolution, and as such, are likely to afford greater protection against any risk of abuse of dominance than do the bilateral agreements at Stansted. We also note that, unlike the bilateral agreements at Stansted, the terms of the Commitments are publically available.

This means that Test B is not met at Gatwick.

We also consider that that the CAA, in its Test B analysis, should take an approach consistent with government policy and the will of Parliament. It is clear from the passage through Parliament of the Civil Aviation Act 2012 and the Enterprise and Regulatory Reform Act 2013 that Parliament's clear preference is for sectoral regulators to prioritise the use of competition law to protect against the risk of abuse of dominance over the use of sector specific powers.

### **Test C for the passenger market**

The CAA considers that the existence of long-term bilateral agreements that cover over 90 per cent of existing passenger traffic and have prices that are within the range of what the CAA considers to be the competitive level, means that Test C is likely not to be met. Gatwick agrees with this conclusion. However, with the Commitments covering 100 per cent of the current and future traffic at Gatwick, having prices within the range of the CAA's "fair price", and including minimum commitments to quality of service, transparency and consultation, and dispute resolution, Test C must also not be met in relation to Gatwick.

### **Implications if the market power test is failed**

Gatwick agrees with the CAA that, if the market power test is not met at Stansted, the CAA could continue to monitor prices and performance and it may make a subsequent market power determination whenever it considers it appropriate to do so. We note this is not unique to Stansted, and the CAA can monitor prices and performance, and conduct a market power determination at any airport not issued with a licence, including Gatwick, if the CAA decides in January that the market power test is not met here.