

STANSTED ACC

Representing Stansted Airport Users

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Mr Iain Osborne
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Civil Aviation Authority
CAA House, 45-59 Kingsway
London WC2B 6TE

8th November 2013

Dear Iain,

Re: Assessing the Market Power of Stansted Airport

Thank you for your letter of 17th October 2013, regarding additional consultation in light of relevant market developments.

This response represents the consensus view of airlines operating at Stansted, with the exception of easyJet, which has commented only to the extent that if the CAA finds that Stansted has SMP, then the airport should be regulated. What follows is consistent with that position, but to be clear, easyJet has neither specifically endorsed nor contradicted the positions set out in this letter, which will begin by describing the market context, before briefly commenting on the implications of the CAA's actions on MAG's customers and drawing apposite conclusions.

Airlines, including easyJet, may therefore wish to engage confidentially and bilaterally with the CAA, in order to provide evidence in regard to their positions.

Executive Summary

In January 2013 the CAA concluded that SMP existed (or would shortly exist) in both short-haul and cargo markets at Stansted. Consequently, in April 2013 it set out initial proposals for regulation. Stansted's SMP is undiluted by any subsequent deals.

The context within which MAG and airlines are reported to have reached deals is contingent on ongoing regulation (and separate ownership). It is astonishing that having seemingly reached a longstanding goal of creating a context within which deals between airports and airlines could be negotiated, the CAA cannot see the relevance of regulation in achieving this.

The CAA has confirmed that Stansted currently has market power in the cargo market. The benefits of regulation clearly outweigh the costs – and in this light, the CAA cannot reasonably abandon regulation, allowing cargo airlines to be exploited by MAG.

easyJet and Ryanair are reportedly currently protected by deals; however, regulation was required to achieve these deals and remains a requirement to ensure that normal commercial arrangements continue. Without regulation, deals cannot be re-negotiated or renewed.

Without ongoing regulation, the interests of non-easyJet/Ryanair passengers go unprotected. The Airport Charges Directive (ACR) provides nothing to prevent MAG increasing charges to this section of the passenger market, but it is possible that regulation will lead to deals.

Market Context

In its January 2013 ‘minded to’ market power assessment of Stansted, the CAA found that:

‘... the CAA is minded to conclude that, in relation to the Stansted short-haul market, MAG holds a degree of market power which may currently be substantial, and is likely to become substantial over the period 2014-2019.’¹

It also said:

‘[t]he CAA is therefore minded to conclude that MAG currently has substantial market power in the Stansted cargo market.’²

No structural aspect of the relevant market has changed, since the CAA came to these conclusions, which were subsequently reflected in its April 2013 initial proposals:

*‘...for the short-haul passenger market (low cost carrier (LCC) and charter) MAG may have SMP at present and that it is likely to have SMP in the future especially as capacity constraints in the London area tighten as demand picks up in line with the economy. Although some airlines can switch their business to alternative nearby airports, this is not the case for all airlines and particularly those that require a significant base at Stansted given their high asset utilisation and flight turns. **This means that competitive constraints are not sufficient to constrain MAG’s pricing behaviour.**’³ (Emphasis added.)*

It is true to say, therefore, that by April 2013 the CAA had considered market power at Stansted and had concluded that this existed (or would shortly exist) in both short-haul and cargo markets – and consequently that ongoing regulation was necessary.

Subsequent ‘*relevant market developments*’, that is, deals reached between MAG/easyJet and MAG/Ryanair, are the subject of the CAA’s current consultation; however, these are not structural changes to the market and therefore not relevant factors to a consideration of market power. Rather, they are outcomes of a set of circumstances, one of which is market power and Stansted’s SMP is undiluted by these deals

Airports (like most commercial organisations) seek to maximise profits for shareholders – and because they are relatively capital intensive (that is most costs are fixed), there is a particularly strong correlation between profits and revenues. Effectively therefore, airports seek to maximise revenues – and can do this in one of two ways (or combination thereof):

- by increasing unit revenue (airport charges/commercial revenue); and/or
- by increasing volume (passenger traffic/ATMs).

The costs of increasing unit revenue are always less than those of increasing volume, because (amongst other things) there is a marginal cost associated with the latter. Therefore, where airports are able to increase unit revenue, this is always the preferred option.

¹ Stansted Market Power Assessment: developing our ‘minded to position’, CAA, January 2013, paragraph 14.

² Ibid, paragraph 19.

³ Economic regulation at Stansted from April 2014: initial proposals, CAP1030, CAA, April 2013, paragraph 9.

Before December 2009, when all three airports were in common ownership, BAA was constrained in its ability to increase unit revenue, by economic regulation; albeit, it had been consistently successful in convincing the regulator to increase price caps at all three airports. At the same time, the three airports did not compete for volume growth, because to do so would have entailed offering discounts at some airports, with a potential to attract passengers from others: effectively discounting to cannibalise.⁴ No rational airport operator would do this.

Consequential to the divestment of Gatwick (December 2009) and Stansted (February 2013), this dynamic has changed. Growth at those airports with spare capacity (essentially Stansted) no longer entails cannibalisation, because although passengers may be attracted from either of the other two London airports, these are no longer in common ownership. That said; although growth is now an option, the preferred route to revenue maximisation remains increasing unit revenues.

As the CAA acknowledges in its April 2013 initial proposals, at that time no deal had been possible at Stansted. It is apparent that MAG had hoped that in January 2013 the CAA would have concluded that Stansted did not have SMP and that de-regulation would follow. Following the CAA's finding that Stansted did have SMP, between January and April 2013, MAG actively sought what would have been an ineffective form of regulation for Stansted. Only when the CAA's initial proposals indicated that Stansted would be effectively regulated, something MAG described as 'a *de-facto* price cap',⁵ was the context for deal-making complete. That is to say, in April 2013 it became clear that the only way for MAG to increase revenues was through growth deals.

So it is true to say that the context within which MAG and airlines have reportedly been able to reach deals is contingent on ongoing regulation and separate ownership. It is equally true that removing either one of these, would lead to a significant change to that context.

It is therefore astonishing that having seemingly reached a longstanding goal of creating a context within which deals between airports and airlines could be negotiated, the CAA cannot see the relevance of regulation in achieving this. Because the CAA recognised SMP at Stansted and signalled that it would regulate accordingly, the new owners were faced with a choice: stagnation/decline or negotiating for growth. Unsurprisingly, MAG chose the latter.

Cargo Airlines

As set out above, the CAA has concluded that Stansted currently has SMP in the cargo market. This position is confirmed in the current consultation, which states:

*'... the CAA is not aware of any significant analogous recent developments such as new bilateral agreements between MAG and the cargo users.'*⁶

Cargo airlines are dependent on hub-type operations and many have invested heavily in infrastructure at Stansted. The costs of relocating to another airport, even were this operationally/commercially feasible, are consequently prohibitive.

Cargo operations run to demanding schedules and are heavily reliant on surface connectivity. Surface access to airports other than Stansted is simply inadequate to maintain existing

⁴ The pre-April 2007 discounts at Stansted were offered by BAA in order to capture the generative growth delivered by LCCs, which it viewed might otherwise materialise outside the three London airports.

⁵ Public Version, 'Economic Regulation at Stansted from April 2014: Initial Proposals', M.A.G's response to the CAA's consultation, 25 June 2013, page 5.

⁶ Stansted Market Power Assessment: consultation on relevant market developments, CAP1104, CAA, October 2013, paragraph 5.

operations. Moreover, potential alternative hubs are in common ownership with Stansted⁷ - and while consolidators currently use 3rd party operations, to the extent that these are possible and/or viable, the usefulness of this is strictly limited.⁸

In short – and it remains the position of the CAA – cargo airlines have no viable alternative airports from which to operate and in consequence, are subject to the SMP of Stansted.

The question raised by the CAA can be boiled down to whether, despite an acknowledgement of SMP, it is worth regulating the cargo market – that is, do the benefits of regulation outweigh the costs, in a market representing 6% of Stansted revenues.⁹

The CAA is yet to present a breakdown of the costs of regulating Stansted – something that was requested at a CAA/SACC meeting of 10th October 2013. That said; it is apparent that the majority of the costs of regulating Stansted have already been incurred, as the CAA has already developed a regulatory structure, which (until this month) it intended to implement.¹⁰ This mechanism was designed to be relatively light-touch – and so it seems incongruous to suggest that this would somehow be too expensive. Significant marginal costs would only be incurred should, for example, the SCT be activated – in which case, the benefits of regulation would clearly be substantial.

For this reason, the marginal costs of regulating the cargo market at Stansted are insignificant, when compared with the benefits – and so, it should be subject to ongoing regulation.

easyJet & Ryanair

easyJet and Ryanair have reportedly reached growth deals with MAG. It is because these deals exist, that MAG cannot directly exert SMP over easyJet and Ryanair, by increasing unit prices - a situation that will continue only as long as these deals remain in place; however, an indirect consequence of removing regulation would be to remove any incentive on MAG to re-negotiate or renew such deals.

Neither can the CAA ignore the fact that in order to realise prices less than the current cap, which the CAA has recognised as being above the competitive level, easyJet and Ryanair have had to commit to very significant volume growth. In other words, MAG has leveraged its SMP not to increase prices, but (in the face of potential regulation) to increase volume.

Airports, including Stansted, have often argued that regulation is a barrier to normal commercial relationships; however, events of the past six months disprove this theory. Before April 2013, when MAG had hoped for de-regulation, no deals were done. It is telling therefore, that only when it became apparent that the CAA would regulate Stansted, was it possible for MAG (unable to increase unit revenue) to justify volume deals.

Under normal commercial arrangements, it is often the case that parties review and re-negotiate over the course of an agreement. This is normal commercial behaviour, which it is entirely possible that MAG, easyJet and Ryanair may wish to participate in at Stansted. This will only be possible if the conditions under which these deals were done remain in place – and so, regulation must continue.

⁷ MAG owns Manchester, East Midlands and Stansted airports.

⁸ For example, by placing cargo in the hold of long-haul passenger aircraft, operating at Heathrow.

⁹ In effect, is test C passed?

¹⁰ Price monitoring.

Other Passenger Airlines

In taking a position that 90% of the passenger market at Stansted is currently protected by deals, the CAA is tacitly admitting that the remaining 10% is not – and in the absence of regulation, will be subject to exploitation by MAG. It is hard to see how this could possibly support the CAA's primary duty to passengers' interests.

The CAA has sought to mitigate its position by suggesting that the ACR provides protection from discrimination; however, this clearly is not the case. All it says is:

*'Member states shall ensure that airport charges do not discriminate among airport users, in accordance with Community law. This does not prevent the modulation of airport charges for issues of public and general interest, including environmental issues. The criteria used for such a modulation shall be relevant, objective and transparent.'*¹¹

It is therefore quite open to MAG to offer volume deals in which other airlines at Stansted are unwilling or unable to participate. Either being the case, it is clear that these airlines will be subject to anti-competitive charges. Therefore, the only protection from exploitation available to these airlines is ongoing regulation – which, in the same way as for easyJet and Ryanair, could lead to deals between these airlines and MAG. Without a price cap, there is no incentive on MAG to engage in negotiations with other airlines.

Conclusions

The effects of separate ownership of the London airports, in combination with the apparent realisation of ongoing regulation at Stansted, have led to a situation wherein it has been possible to reach deals at Stansted. Such deals have been a longstanding objective of the CAA. It is hard to understand; therefore, why having reached this point, the CAA is considering abandoning regulation – one of the key contextual factors – just when a desirable outcome is being achieved.

If the CAA wishes to see such arrangements develop, as well as if it wants to provide immediate protection to the cargo market and those parts of the passenger market currently without deals, then it must implement price monitoring regulation, as it was minded to do in April 2013.

Yours sincerely,



Ian Clayton
Chair

¹¹ Directive 2009/12/EC of the European Parliament and of the Council of 11th March 2009 on Airport Charges, Article 3.