

**INVESTIGATION BY THE CIVIL AVIATION AUTHORITY ("CAA") UNDER SECTION 41 OF THE AIRPORTS ACT 1986 ("1986 ACT") OF THE STRUCTURE OF AIRPORT CHARGES LEVIED BY HEATHROW AIRPORT LIMITED ("HAL")**

**CAA CONSULTATION DOCUMENT DATED 29 OCTOBER 2013 (REF: CAP 1121)  
("CONSULTATION DOCUMENT")**

**1 Introduction**

**1.1 Background**

- 1.1.1 This is Aer Lingus' response to the CAA's Consultation Document.
- 1.1.2 According to the CAA, the Consultation Document seeks to solicit views on the issues raised by Aer Lingus in its application for a judicial review ("JR Application") of the CAA's 17 December 2012, now withdrawn ("the 17 December Decision").
- 1.1.3 The Consultation Document constitutes the CAA's third attempt to rectify its decision on a complaint by Aer Lingus<sup>1</sup> under section 41 of the 1986 Act in relation to the decision by Heathrow Airport Limited ("HAL") on 29 October 2010 (the "HAL Decision") to adopt a restructured passenger charge. Aer Lingus' complaint relates specifically to HAL's decision to revise the structure of its departing passenger charge ("DPC") from three categories (for "domestic", "ROI" and "international" passengers) into two categories (namely, "European" and "other" departing passengers).
- 1.1.4 The CAA first published a decision on Aer Lingus' complaint on 12 March 2012 (the "12 March Decision"), concluding that HAL's new charging structure did not amount to unreasonable discrimination contrary to section 41 of the 1986 Act. The CAA subsequently re-categorised this decision as provisional after Aer Lingus sent the CAA draft grounds for judicial review.
- 1.1.5 After further consultation with interested parties, the CAA published the 17 December Decision in which it found (contrary to the 12 March Decision) that HAL's passenger charges are indeed unreasonably discriminatory as they do not take account of the material difference in the costs of handling domestic/ROI as opposed to other European passengers, without any adequate justification. Remarkably, however, the CAA declined to impose a remedy in respect of that unreasonable discrimination on the basis that it had not found any sufficient adverse effects on airline competition and/or on passengers.
- 1.1.6 On 21 May 2013, and following the filing by Aer Lingus of the JR Application, the CAA withdrew the 17 December Decision, giving rise to this latest Consultation Document.
- 1.1.7 HAL's response to Aer Lingus' complaint throughout the CAA's investigation (as it had been during the initial consultation process) was that it had analysed the costs of providing airport facilities to domestic/ROI and other passengers using a model based on asset costs for theoretical terminals constructed for domestic/ROI, European and Other passengers and found that there was no material difference associated with domestic/ROI passengers. As a

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<sup>1</sup> The CAA opened the section 41 investigation following a complaint issued by bmi on 28 January 2011. By prior agreement with the CAA, Aer Lingus supported the bmi complaint rather than issuing one of its own. However, when bmi subsequently withdrew from actively participating in the CAA's process (shortly before the oral hearing on 27 January 2012), Aer Lingus took bmi's place as the section 41 complainant.

result, it concluded that there was no objective justification for charging different prices for domestic/ROI passengers.

- 1.1.8 As described by the CAA in the 17 December Decision, when HAL's cost modelling was eventually provided to the parties in the course of the CAA's investigation (despite repeated refusals by HAL to do so during its consultation), it became clear that HAL's cost analysis was fundamentally flawed as it contained a number of basic errors. Notably, HAL had based its modelling on an entirely wrong set of figures from its 2005 consultation analysis.<sup>2</sup> Using the correct set of figures showed that the cost of handling domestic/ROI passengers was in fact 16% lower than the cost of handling other EU passengers, rather than the 11% difference claimed by HAL.<sup>3</sup> Further, HAL had incorrectly allocated a figure of £1.04bn representing RAB indexation. Correcting that allocation increased the cost differential further, to 18% (see further below).<sup>4</sup>

## 1.2 The CAA's approach in the Consultation Document

- 1.2.1 In view of the above sequence of events, HAL's initial consultation and the CAA's subsequent investigation into this matter can only be described as shambolic, falling far short of the standard which airlines are entitled to expect on such an important matter. It is entirely unacceptable that the CAA's investigation has yet to be concluded, despite the fact that almost three years have passed since the initial section 41 complaint was filed. As a result, Aer Lingus has suffered significant financial harm from a charging structure which has been in effect at Heathrow Airport since April 2011 and which the CAA has recognised to be discriminatory.
- 1.2.2 In this context and despite irrefutable evidence of the serious financial harm caused to Aer Lingus by the new charging structure, it is astonishing that the CAA should persist in the view (as outlined in the Consultation Document) that no remedy is warranted under section 41.
- 1.2.3 As explained further below, the Consultation Document is flawed in many respects containing basic errors and presenting information in a misleading manner. This is inexcusable given the background to this investigation as outlined above and undermines the validity of this consultation process.
- 1.2.4 Further, in a transparent attempt to justify its continued failure to reach a final decision, the Consultation Document clearly goes beyond its stated brief (see paragraph 1.1.2 above) and attempts, without any justification, to open up issues which have not to date been considered by any of the parties to the section 41 investigation, let alone by the CAA in either of its (two) withdrawn decisions or the numerous consultation documents which preceded them.
- 1.2.5 Aer Lingus has significant concerns that the CAA is attempting now to introduce such issues *de novo* into its decision-making process. Such an approach is unacceptable. Those concerns are further magnified by the fact that the outcome of the CAA's section 41 investigation has consequences that go beyond the airport charging structure at Heathrow, given in particular the obvious "read through" to other UK airports that are also subject to the Airports Act regime.

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<sup>2</sup> Not simply "a" wrong figure as stated at §3.22 of the 17 December Decision.

<sup>3</sup> 17 December Decision, §3.22.

<sup>4</sup> *ibid*, §3.23.

### 1.3 Executive summary

- 1.3.1 Irrespective of the manifest procedural flaws and basic errors in the Consultation Document, Aer Lingus' overall submission is, as it has been throughout the section 41 investigation, that HAL's revised DPC charging structure for airport charges at Heathrow (applicable as from 1 April 2011) infringes section 41(3) of the 1986 Act.
- 1.3.2 From 1 April 2011 (when the new charging structure at Heathrow came into force) up to 21 November 2013, Aer Lingus has paid approximately £113 million in airport charges to HAL, of which approximately £63.8 million alone is accounted for by the DPC. On this basis alone, it can be argued that had HAL properly reflected the (18%) differential in its own cost allocation model (when correctly applied) between domestic/ROI and other European passengers, Aer Lingus would already have paid approximately £11.5 million less in airport charges than it has done since April 2011.<sup>5</sup>
- 1.3.3 By any measure, this overcharge figure is significant in magnitude. The payment of that overcharge has had a material adverse impact on Aer Lingus and should, on Aer Lingus' submissions as to the correct application of the section 41 test (on which see section 3 below), be sufficient to warrant the exercise of the CAA's discretion to impose remedial conditions on HAL.
- 1.3.4 With regards to the specific points raised by the CAA in the Consultation Document:
- It is entirely inappropriate now for CAA, more than three years on from HAL's original consultation process, for the CAA to question HAL's modelling as the basis for the calculations of the overcharge. Whilst it must of course subject that modelling to critical scrutiny, as Aer Lingus has done for the purposes of its (numerous) submissions to the CAA during the section 41 investigation, the CAA should limit its analysis to ensuring that HAL has correctly applied its cost model so as to reach the decision it did on the revised structure of charges from April 2011.
  - Whilst Aer Lingus accepts, as a point of principle, that airport charges cannot necessarily be entirely cost reflective, it is apparent that the failure of the revised structure of the DPC to reflect costs goes beyond any possible "margin of appreciation".
  - It is completely illogical, as the CAA attempts in the Consultation Document, to argue that any consideration of the adverse effects of HAL's charging structure should start from the outward bound of the materiality range within which HAL's differential (and non-cost based) pricing might have been permitted. Once pricing behaviour is discriminatory, it is the totality of such pricing against which any adverse effects must be considered.
  - Aer Lingus has given the CAA an exhaustive explanation as to how it carried out its overcharge calculations. Those calculations bear critical scrutiny and form the proper basis for any assessment of the adverse impacts of the revised charges. The CAA's attempt now to re-calculate the overcharge based on alternative assumptions and underlying methodology is self-serving and unfounded. So too are its selective

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<sup>5</sup> This amount is consistent with Aer Lingus' initial calculation of a cost impact of £4.1 million per annum as this number was based on the estimated cost impact in 2011 which increases in subsequent years due to the annual regulated increase by HAL of its airport charges.

references to Aer Lingus' overall financial performance and the importance of Heathrow to the group.

- The CAA has made a basic error in paragraph 2.22 of the Consultation Paper in its recalculation of the domestic/ROI and European charges. The CAA's approach to this recalculation is fundamentally flawed as it is based on the incorrect assumption that HAL's revenues from European passengers should remain constant. As outlined below, this would lead to an over-recovery by HAL by more than £37 million if the DPC applicable to international charges is also adjusted to reflect the 40% cost differential between European and international passengers. On the contrary, it is necessary to adjust each of the DPC charges taking account of HAL's projected passenger numbers in each category to ensure that the total projected revenues from the DPC remains constant. This manifest error by the CAA undermines the entire Consultation Paper as its assessment of the financial impact on Aer Lingus is based on this incorrect calculation.
- Section 41 of the 1986 Act requires the CAA to identify any adverse effects of HAL's pricing behaviour. There is no requirement that it must show a sufficient distortion of airline competition. Further and in any event, the CAA continues to rely on the wrong test to identify a distortion of competition given that it requires evidence of an actual deterioration in the competitive position of those affected by HAL's overcharge and gives no consideration to the relevant counterfactual situation. Consequently, the evidence relied on in the Consultation Document is fatally flawed and provides no sufficient basis on which to form any conclusions as to the exercise of its section 41 powers.

1.3.5 Each of these issues is considered in further detail below.

## **2 HAL's cost model**

- 2.1 One of the clearest examples of the CAA's self-serving attempt to re-cast entirely the basis on which to conduct its section 41 investigation is the reference to "limitations" in HAL's modelling and the assertion that the CAA cannot necessarily rely on that model for any calculation of the adverse financial impact of HAL's revised charging structure.<sup>6</sup> According to the CAA, Aer Lingus' financial impact analysis relies on the HAL model to a greater degree of granularity than the CAA's "broad" analysis of the model, and as a result, the CAA has to be cautious as to using the model as the basis for any conclusions as to whether or not a remedy is warranted.
- 2.2 It is entirely inappropriate and irrational for the CAA to question HAL's model in this way more than three years after HAL used it as the sole basis for its revised charging structure. As the CAA itself acknowledges, any cost-based model will necessarily rely on a number of assumptions. Nevertheless, all the parties to the CAA's section 41 investigation have proceeded on the basis that, whereas the HAL cost model is not a perfect one (nor is it ever likely to be so), the starting point for any assessment must be whether the changes to its charging structure can be justified by reference to that model given HAL's reliance from the outset on a cost-oriented justification for those changes and the fact that the CAA has never previously questioned it.

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<sup>6</sup> Consultation Document, §2.5-2.8.

2.3 Aer Lingus position is not, nor has it ever been, that the CAA should accept HAL's modelling without critical oversight. On the contrary, Aer Lingus vigorously contested the fact that, until it was forced to do so by the CAA's intervention, HAL did not provide a full copy of its cost modelling.<sup>7</sup> As referenced above, once it was able properly to analyse that cost modelling, Aer Lingus discovered that it was fundamentally flawed in two key respects:

- (a) HAL had based its modelling on the wrong set of figures from its earlier (2005) consultation analysis; and
- (b) HAL had incorrectly allocated a figure of £1.04 billion representing RAB indexation.

2.3.2 HAL has previously accepted the first error (which, on HAL's own model, brings the cost differential between handling domestic and ROI customers versus other EU passengers to 16%), but not the second (which increases the cost differential still further to 18%). The CAA has not explained anywhere in the Consultation Document why the 18% figure should not be the proper starting point for its analysis.<sup>8</sup> Rather it simply performs certain of its "revised" calculations on the basis of both a 16% and an 18% cost differential.

2.3.3 At this late stage of the process, the CAA clearly must limit its analysis to ensuring that HAL has correctly applied the cost model on which its charging structure was based. Once it has done so, however, it would be entirely inappropriate for it to draw any adverse conclusions from the limitations which are inherent in any cost-based model of the type constructed by HAL, or otherwise attach any lesser weight to the results of that model.

### **3 Misapplication of the section 41 test**

#### **3.1 The three stage-test to be applied by the CAA**

3.1.1 Aer Lingus' JR Application explained in some detail how the CAA had, in the 17 December Decision, failed to apply the correct test under section 41 of the 1986 Act. Remarkably, the Consultation Document singularly fails to engage with the analysis put forward by Aer Lingus. Rather, the CAA simply persists in applying the same, flawed, approach to the exercise of its powers under section 41 as it had in the 17 December Decision.

3.1.2 As Aer Lingus explained in the JR Application, sections 41(2) and 41(3) of the 1986 Act sets out a three stage process for the CAA to follow in investigating complaints such as the one being considered in this case:

- (a) First, the CAA is required to decide whether the airport operator is pursuing one of the objectionable courses of conduct in section 41(3). As set out above, the relevant course of conduct here is that set out in section 41(3)(a), namely the adoption [by HAL] of a pricing policy that "*unreasonably discriminates against any class of users of the airport or any particular user*".

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<sup>7</sup> The consultation document (dated 2 August 2010) in which HAL set out and consulted on its proposals for changes to the structure of charges at Heathrow contained only two high level tables which purported to set out the costs calculations on which it had calculated its revised charges. In subsequent correspondence with HAL, Aer Lingus attempted (without success) to obtain greater clarity as to the basis for those calculations. However, it was only during the course of the CAA's investigation that HAL eventually provided its cost modelling in full.

<sup>8</sup> The 17 December Decision acknowledged (at §3.64) that HAL had not advanced any sufficiently compelling evidence to refute Aer Lingus' submission that 18% was the correct starting point for the cost differential. Aer Lingus refers also on this point to the Expert Report of Dan Elliott of Frontier Economics which was appended to its original application for a judicial review following the 12 March Decision.

- (b) Second, the CAA is required to identify the “adverse effects” of that course of conduct, for the purposes of its remedies discretion. This is on its face a broad and general test. It is explicitly not limited to a test of (actual or potential) distortion of competition, or effects on passengers. It is simply a reference to “adverse effects” in general which the CAA must identify in order to decide the remedies that are appropriate.
- (c) Third and finally, the CAA has to consider whether it is appropriate to impose any conditions to remedy or prevent those adverse effects, if necessary by reference to its statutory duties under section 39(2) of the 1986 Act.

3.1.3 The fundamental error which the CAA made in the 17 December Decision and has failed to rectify in the Consultation Document is that it has improperly assessed the substantial adverse effects of the charging structure on Aer Lingus. For all the reasons it has previously stated and as summarised further below, the manifest and substantial adverse financial effects of the (effective) overcharge by millions of pounds per year on Aer Lingus clearly qualify as an adverse effect for the purposes of section 41. The CAA has never properly explained why it considers otherwise, nor can it do so on any rational basis.

### **3.2 The relevance to the CAA’s analysis of HAL’s “margin of appreciation”**

3.2.1 Aer Lingus accepts, as a point of principle, that the airport charges issued by HAL cannot always be fully cost-reflective. Nevertheless, it is self-apparent that, in this instance, the cost differential which HAL’s own model demonstrates between the processing of domestic/ROI versus other passengers goes beyond any reasonable bounds of materiality. Further, as the CAA recognises in the Consultation Document<sup>9</sup>, in the present case HAL’s failure to maintain a separate domestic/ROI DPC cannot be justified on the basis that HAL would effectively have to replicate the same approach to all destinations for which there are different cost profiles. This is particularly so where HAL has consistently defended the changes to the structure of the DPC on cost-based grounds.

3.2.2 In (another) entirely new approach, the CAA now suggests in the Consultation Document that, assuming that some percentage of differential between charges and costs would be acceptable to justify the removal of a separate domestic/ROI DPC, its consideration of “adverse effects” under section 41 should start from the point at which any cost differential not included in the DPC is not to be regarded as “material”. The Consultation Document suggests (without any further justification) either a 5 or 10% differential.<sup>10</sup>

3.2.3 If pricing behaviour is unreasonably discriminatory, it defies all reasonable logic to state that the impact of that behaviour should only be assessed above a certain (permitted) level of discrimination. To use a relevant analogy, under Article 101 of the EU Treaty, parties whose market shares are *de minimis* fall outside the prohibition on anti-competitive agreements (provided also their agreements do not contain “hardcore” restrictions). Where, however, their shares exceed those thresholds, no competition authority will ever exclude from their analysis of any breach of Article 101 the portion of the market which is below the *de minimis* level. This is tantamount to arguing, in the context of a vertical agreement, that a 40% market share is really only a 25% market share given the impact of the 15% *de minimis* threshold.

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<sup>9</sup> Consultation Document, §2.11.

<sup>10</sup> Consultation Document §2.29.

3.2.4 Once the CAA has found therefore that the cost differential demonstrated by HAL's own model was not immaterial, it clearly must look at the entirety of the overcharge on Aer Lingus.

## 4 Impact on Aer Lingus

### 4.1 Aer Lingus' cost calculations

4.1.1 Aer Lingus is extremely surprised and disappointed that the CAA has decided in the Consultation Document to call into question the methodology used by Aer Lingus for its overcharge calculations. This is particularly so since Aer Lingus explained at considerable length, both in correspondence prior to the oral hearing on 27 January 2012 and at the hearing itself<sup>11</sup>, how it had calculated the extent of the overcharge. More importantly still, on request from the CAA after the oral hearing, Aer Lingus provided a spreadsheet showing exactly how it arrived at the calculations quoted in the Consultation Document, on which the CAA provided no further comment (nor sought any further clarification) either before or in the 17 December Decision. It is therefore completely disingenuous for the CAA now to claim that it does not fully understand the basis for those calculations.

4.1.2 In any event, as had already been made clear to the CAA, Aer Lingus' calculations were undertaken "in the round", taking into account all aspects of the airport charges borne by Aer Lingus at Heathrow, irrespective of whether or not those elements were favourable or not to Aer Lingus. The Aer Lingus analysis therefore:

- (a) includes not only the DPC, but each of the different charges levied on airline users of Heathrow (ie including landing and parking charges);
- (b) accounts for the reduced DPC payable by Aer Lingus' transfer passengers;
- (c) took out of the calculation of the negative impact on Aer Lingus, the impact of HAL's permitted (14.1%) regulated increase from 2011 onwards.
- (d) ensured that the relativity between the EU and the international DPC charge reflected the cost differential identified by HAL (i.e. 40%) was maintained by increasing the international DPC proportionately; and
- (e) ensured that the total allowable revenue received by HAL from the DPC remained constant.

4.1.3 Aer Lingus' methodology clearly therefore forms a proper basis for any assessment of the impact of the revised structure of the DPC, and Aer Lingus disputes entirely the revised calculations put forward by the CAA in the Consultation Document as to the financial impact of the overcharge.<sup>12</sup>

4.1.4 In contrast to the compelling methodology applied by Aer Lingus, the CAA has made a basic error in paragraph 2.22 of the Consultation Paper in its recalculation of the domestic/ROI and European charges as it is based on the incorrect assumption that HAL's revenue from European passengers should remain constant at £218 million. As outlined in Appendix 1 to this response, this would lead to an over-recovery by HAL of more than £37 million if the DPC applicable to international charges is also increased to reflect the 40% cost differential

<sup>11</sup> See, for example, the transcript of the oral hearing at pages 108-111.

<sup>12</sup> Aer Lingus is also unable to comment further on the figures presented by the CAA in its Table 1 below §2.27 of the Consultation Document, not least since it is unclear what, if any, reliance CAA places on those figures.

between European and international passengers (i.e. the international DPC must be increased from £30.63 to £32.19 to reflect a 40% differential compared to the CAA's revised European DPC of £22.99).

- 4.1.5 Instead, it is necessary to adjust each of the DPC charges taking account of HAL's projected passenger numbers in each category to ensure that the total projected revenues from the DPC remains constant. (i.e. £885,770,957).<sup>13</sup> This correct alternative approach, which is set out in detail in Appendix 1, gives rise to a domestic/ROI charge of £18.10 when assuming an 18% cost differential (as opposed to the £18.85 calculated by the CAA), a European charge of £22.07 (as opposed to the £22.99 calculated by the CAA) and an international charge of £31.12 (which, for the reasons outlined above, the CAA wrongly assumes should remain unchanged at £30.63).
- 4.1.6 This manifest error by the CAA undermines the entire Consultation Paper as its assessment of the financial impact on Aer Lingus as set out in Tables B1, B2 and B3 is based on this incorrect calculation.
- 4.1.7 As shown below, using these corrected figures combined with the data used by the CAA in Table B2 of the Consultation Paper, the corrected financial impact on Aer Lingus of HAL's failure to reflect an 18% cost differential in the domestic/ROI charges is approximately £3.9 million. This figure bears much closer comparison with Aer Lingus' previous calculation of £4,112,854 (which was set out in the spread sheet provided to the CAA after the oral hearing):

	<b>At HAL charges</b>	<b>Aer Lingus methodology with 18% differential</b>	<b>CAA alternative approach with 18% differential</b>	<b>Corrected alternative approach</b>
Aer Lingus point-point passengers	889,380	889,380	889,380	889,380
Aer Lingus transfer passengers	208,620	208,620	208,620	208,620
Point to point charge	£21.80	£17.88	£18.85	£18.10
Transfer charge (75%)	£16.35	£13.41	£14.14	£13.57
Revenue from pt-pt charge	£19,388,484	£15,902,114	£16,764,813	£16,096,835
Revenue from transfer charge	£3,410,937	£2,797,594	£2,949,887	£2,831,851
Total Revenue	£22,799,421	£18,699,709	£19,714,700	£18,928,685
Difference		£4,099,712	£3,084,721	£3,870,736

<sup>13</sup> Revenue and passenger numbers are derived from the data contained in HAL's Consultation Document on Airport Charges for 2011/12 dated 12<sup>th</sup> November 2010

## 4.2 The adverse impact of the revised charges

- 4.2.1 As explained in section 3 above, section 41 of the 1986 Act requires the CAA to consider whether Aer Lingus has itself been adversely affected by the discriminatory aspects of the new charging structure. Aer Lingus (as the CAA correctly pointed out in the 17 December Decision) is the only airline that operates exclusively domestic and ROI flights at Heathrow. As such, all of its flights suffer from the impact of the discriminatory DPC. Therefore, even if the quantum of the overcharge is not by itself enough to qualify as an "adverse effect" (which Aer Lingus would strongly dispute in any event), the particular fact of Aer Lingus' flight profile from Heathrow means that it has clearly suffered such an effect.
- 4.2.2 The CAA's "answer" in the Consultation Document to this inescapable conclusion is to rely (at paragraphs 2.30-2.36) on selective data relating to Aer Lingus' overall financial performance and public statements as to the importance of Heathrow to its overall strategy. It is wholly irrational for the CAA, having concluded that Aer Lingus is subject to an unjustified overcharge of £3 - 4 million per annum, that no remedies are warranted under Section 41. Instead, the test applied by the CAA in paragraph 2.36 of the Consultation Document to justify the imposition of remedies is that the level of overcharge should be so great as to cause Aer Lingus "to reduce the quality and/or scale of its operations at the airport". The imposition of such a stringent test is an unreasonable exercise of the CAA's discretion under Section 41.
- 4.2.3 As the CAA itself acknowledges, it has not even attempted to look in more detail at the profitability of Aer Lingus' routes from Heathrow<sup>14</sup>. As such, it is simply not sufficient for it to suggest that HAL's pricing structure has not impacted on Aer Lingus' operations at Heathrow. Indeed, as set out in the table below, Aer Lingus' passengers numbers on its routes to/from Heathrow which had been increasing in the years prior to 2011, have been steadily falling since 2011.

<b>Aer Lingus Departing Passengers ex- Heathrow</b>					
	<b>Actual</b>				<b>Act/Fcst (10+2)</b>
<b>Route</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>A2013</b>
Dublin- Heathrow	584,546	571,270	614,601	591,814	557,760
Cork- Heathrow	243,058	195,737	196,881	190,838	194,784
Shannon- Heathrow	64,885	132,579	135,808	131,360	124,181
Belfast(BHD)- Heathrow	132,727	141,096	143,681	114,190	99,249
<b>TOTAL</b>	<b>1,025,216</b>	<b>1,040,681</b>	<b>1,090,970</b>	<b>1,028,202</b>	<b>975,974</b>

- 4.2.4 Nor can anything rest on Aer Lingus' submissions during the oral hearing that it had not always chosen to pass on the full extent of the cost increase to passengers without any further explanation as to how, if at all, this might be relevant to the adverse impact of the revised charges on Aer Lingus. To the extent that Aer Lingus has been able to pass on the cost increase to its passengers, the revised charging structure has had an adverse impact on

<sup>14</sup> See §2.32 of the Consultation Document.

passengers who have been required to pay higher fares than would otherwise have been the case.

#### 4.3 Conclusion

- 4.3.1 In sum, it is manifestly clear from the relevant cost analysis, properly undertaken, that the substantial adverse impacts of the revised charges on Aer Lingus are sufficient for the CAA to reach a finding that the new charges are unreasonably discriminatory and therefore contrary to section 41(3)(a) of the 1986 Act. Indeed this was the CAA's own finding in the 17 December Decision.

### 5 Impact on airline competition

#### 5.1 The test to be applied: tendency to distort competition

- 5.1.1 Though it fails completely to engage with Aer Lingus' arguments as to the proper application of the section 41 test, the CAA continues in the Consultation Document to maintain that the exercise of its discretion to impose conditions under section 41(2) of the 1986 Act requires it to identify adverse effects on competition or passengers. For the reasons already outlined, this approach is entirely at odds with the wording of the 1986 Act.
- 5.1.2 Moreover, even the CAA is entitled (quod non) to interpret "adverse effects" as requiring adverse effects on airline competition or passengers, the CAA has incorrectly applied the test for assessing the relevant impact on competition.
- 5.1.3 European case-law has made clear that, in deciding whether a dominant company has engaged in discriminatory conduct under Article 102(c) (the appropriate comparator in this case), the relevant test is one of tendency to distort competition. That test expressly does not, as the Consultation Document appears to suggest, require any proof of an actual quantifiable deterioration in the competitive position of those affected by the behaviour.<sup>15</sup> The CAA has singularly failed to explain in the Consultation Document why it should apply a test that is contrary to the settled EU precedent.
- 5.1.4 The Consultation Document also dismisses Aer Lingus' reliance, in determining the relevant parameters against which to apply the relevant test, on case law from the European courts referring to cases of discrimination against transport operators (notably the *Aéroport de Paris, Corsica Ferries* and *Portugese airports* cases<sup>16</sup>). Instead, the CAA apparently favours recent merger cases which have focussed on a "city pair" or "origin and destination" approach, ostensibly because they involved "similar routes" to those that are relevant in the present case.
- 5.1.5 In the cases cited by the CAA, the European Commission was being asked to consider the impact on competition of the proposed combination of two airline entities. Such an analysis is

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<sup>15</sup> See in particular Case T-31/04 *Clearstream v Commission* [2009] ECR II-3155, §192-194, referring back to the decision of the ECJ in the *British Airways* case. The same test was also endorsed more recently by the European Court of Justice in Case C-549/10P *Tomra Systems v Commission* [2012], where the ECJ held, at §68, that: "**for the purposes of proving an abuse of a dominant position within the meaning of Article 102 TFEU, it is sufficient to show that the abusive conduct of the undertaking in a dominant position tends to restrict competition or that the conduct is capable of having that effect**" (decision dated 19 April 2012).

<sup>16</sup> Case T-128/98 *Aéroports de Paris v Commission* [2000] ECR II-3929, upheld in Case C-82/01 P [2002] ECR I-9297, §116; Case C-18/93 *Corsica Ferries* [1994] ECR I-1783; and Case C-163/99 *Portugal v Commission* [2001] ECR I-2613.

entirely different from the one being conducted here, being whether the pricing below of a dominant operator (HAL) has the tendency to distort competition between those airlines that suffer the operator's discriminatory charges.

- 5.1.6 In determining whether that test is met it is entirely appropriate (as the courts have done in the cases relied on by Aer Lingus) to consider the specific profile of those affected by the discriminatory behaviour. As the Court of Justice (as then was) put it in the Portuguese airports case:

*"There is no disputing that a measure of this type also confers an advantage on carriers who operate more than others on domestic rather than international routes and so leads to dissimilar treatment being applied to equivalent transactions, thereby affecting free competition. In this case, the discrimination results from the application of a different tariff system for the same number of landings of aircraft of the same type."*<sup>17</sup>

- 5.1.7 Aer Lingus self-evidently falls into a category of carriers who are impacted more than others given in particular the (domestic/ROI only) profile of its routes.

## **5.2 The application of the competition test (if required) to this case**

- 5.2.1 The CAA's approach in the Consultation Document to the competition test (as it was in its 17 December Decision) is to consider passenger data across domestic/ROI routes. While the CAA carries out a simplistic analysis of passenger numbers since the new charging structure was implemented in April 2011 to justify its conclusion that there has not been any adverse effect on competition or on passengers, such analysis patently disregards other factors which impact on passenger numbers, particularly macroeconomic effects.

- 5.2.2 No detailed consideration is given by the CAA as to how competition / passenger numbers might have developed if the domestic/ROI charge had been retained. The necessity to properly consider this counterfactual in any proper competition analysis was recently confirmed by the UK Competition Commission in its report on the acquisition by Ryanair of a minority shareholding in Aer Lingus.

- 5.2.3 Specifically, the Competition Commission dismissed evidence of intense competition between the parties as evidence that the transaction had not had adverse effects on competition. Rather, the Competition Commission concluded that the competitive effects of the transaction might manifest themselves in the absence of certain actions that might otherwise have been taken and that it could not determine whether the transaction had reduced competition relative to the counterfactual solely from observing the competitive actions that Aer Lingus and Ryanair had taken since the acquisition.<sup>18</sup>

- 5.3 Indeed, there is very recent evidence available to the CAA that the removal of a relatively small charge can have a significant impact on airlines' strategic decisions as to the quality and/or scale of their operations at an airport. In October 2013, immediately after the Irish government confirmed that it would be scrapping its €3 per passenger travel tax on airlines, Ryanair announced that it would, as a direct consequence, seek to expand by over one million passengers per year the amount of its capacity from the affected airports.<sup>19</sup>

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<sup>17</sup> Case C-163/99 Portugal v Commission [2001] ECR I-2613, §66 confirming as correct, the Commission's earlier analysis on this same point.

<sup>18</sup> See Competition Commission Report dated 28<sup>th</sup> August 2013, particularly §7.8 – 7.10.

<sup>19</sup> <http://uk.reuters.com/article/2013/10/16/uk-ryanair-idUKBRE99FOKE20131016>.

- 5.4 Pointedly, certain of the limited evidence which the CAA presents in the Consultation Document indicates that the revised charging structure has had an adverse effect on passenger numbers at Heathrow compared to London Gatwick, the only other London airport which still currently has a separate domestic/ROI charge. Specifically, this data shows that passengers on domestic and ROI routes at Gatwick grew by 2.1% over the relevant period compared to a fall of 2% in passengers on domestic and ROI routes at Heathrow representing a gap of 4.1%. As noted above in paragraph 4.2.2, the available evidence points to the revised charging structure having an adverse impact on Aer Lingus' passenger numbers on its Heathrow routes.
- 5.5 Even allowing for this obvious inconsistency, the other evidence presented by the CAA to justify its failure to impose any remedies is plainly insufficient for several reasons, including that:
- (a) any analysis as to absolute passenger numbers on individual routes from Heathrow (whether for all airlines or for Aer Lingus in isolation) cannot account for those passengers who may have chosen those routes but for HAL's discriminatory charging structure, or indeed what factors are relevant overall to passenger choices;
  - (b) it is not relevant to compare the Heathrow figure with those for other London airports without accounting for relevant differences between those airports, for example as to their absolute passenger charges;
  - (c) the CAA's own figures contain several inconsistencies, drawing further doubt on their accuracy. For example, the figures in Table 6 show that passenger numbers at Heathrow using domestic and ROI routes decreased by 2% between 2010/11 and 2012/13 as compared with a 2% increase overall at other London airports in Table 7;
  - (d) the CAA has not considered the impact of higher charges on passengers on domestic/ROI routes who, to the extent that these charges have been passed on, have been required to pay higher fares than should have been the case;
  - (e) Aer Lingus has previously explained in some detail to the CAA why it is inappropriate to rely on the HAL "Top 40" analysis<sup>20</sup>, quite apart from the fact that the heavily redacted nature of the data provided makes it extremely difficult for Aer Lingus to assess the data or draw any meaningful conclusions from them. None of the points raised by Aer Lingus have been dealt with by the CAA in the Consultation Document. In particular, Aer Lingus notes that the analysis is wholly based on total airport charges. This means therefore that any of the increases borne by individual airlines could simply be a feature of operational factors that are wholly unrelated to the impact of changes made by HAL to the airport charging structure, a factor which the CAA has simply refused to address.

## 6 Conclusion

- 6.1 For all the reasons set out above, Aer Lingus considers that the CAA should reach a finding that:
- (a) HAL's revised charging structure at Heathrow, as applicable from 1 April 2011, is unreasonably discriminatory within the meaning of section 41(3)(a) of the 1986 Act in

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<sup>20</sup> In particular, see Aer Lingus' letter of 10 August 2012.

respect of the cost differential applied to domestic/ROI as opposed to other European and International departing passengers;

- (b) the revised charging structure has had a significant adverse impact on users of Heathrow, in particular Aer Lingus and its passengers; and
- (c) in the proper exercise of its discretion under section 41(2) of the 1986 Act it must impose conditions on HAL which are sufficient to eliminate the unreasonably discriminatory aspects of the revised charging structure.

**28 November 2013**

### Appendix 1

		HAL Actual			Charges with 18 % CAA Alternative Approach			Charge with 18 % CAA Corrected Alternative Approach		
		Number of Passengers	DPC	Revenue Generated	Number of Passengers	DPC	Revenue Generated	Number of Passengers	DPC	Revenue Generated
<b>O&amp;D Passenger</b>	Domestic / ROI	n/a	n/a	n/a	2,881,967	£18.85	£54,330,265	2,881,967	£18.10	£52,160,546
	Europe (Excluding domestic/ROI)	n/a	n/a	n/a	7,124,911	£22.99	£163,801,704	7,124,911	£22.07	£157,260,160
<b>Transfer Passengers</b>	Domestic / ROI	n/a	n/a	n/a	676,016	£14.14	£9,558,089	676,016	£13.57	£9,176,379
	Europe (Excluding domestic/ROI)	n/a	n/a	n/a	3,084,975	£17.24	£53,192,681	3,084,975	£16.55	£51,068,392
<b>O&amp;D Passenger</b>	EU	10,006,878	£21.80	£218,149,940	n/a	n/a	n/a	n/a	n/a	n/a
	Other	16,155,040	£30.63	£494,828,875	16,155,040	£32.42	£523,680,161	16,155,040	£31.12	£502,766,602
<b>Transfer Passengers</b>	EU	3,760,991	£16.35	£61,492,203	n/a	n/a	n/a	n/a	n/a	n/a
	Other	5,360,646	£22.97	£123,134,039	5,360,646	£24.31	£130,317,304	5,360,646	£23.34	£125,117,478
<b>Transit</b>	EU	0	£16.35	£0	n/a	n/a	n/a	n/a	n/a	n/a
	Other	150,000	£22.97	£3,445,500	150,000	£24.31	£3,646,500	150,000	£23.34	£3,501,000
<b>Remote Stand Rebate</b>				-£15,279,600			-£15,279,600			-£15,279,600
<b>Total Departing Passenger Charge Revenue</b>				<b>£885,770,957</b>			<b>£923,247,105</b>			<b>£885,770,957</b>
<b>HAL Overcharge</b>				<b>£0</b>			<b>£37,476,148</b>			<b>£0</b>