

# easyJet response to CAA consultation on Gatwick airport market power

## Introduction

easyJet welcomes the work that the CAA has put in to analysing Gatwick's market power. The CAA has made significant progress in setting out a framework for the analysis of airport competition, and we are broadly supportive of the CAA's current framework.

easyJet is Gatwick's largest airline, currently carrying 40% of its traffic. The CAA's assessment is of vital importance to both us, and our passengers.

This submission should be read alongside that of the Gatwick ACC. This paper focuses on the proposed product market definitions set out by the CAA.

## Summary

easyJet believes that Gatwick has significant market power. Further, we believe that without regulation Gatwick would use this market power to unreasonably increase prices. There would also be a significant risk of service quality failures.

In relation to the tests that are required of the CAA to determine whether it should economically regulate Gatwick we believe that Gatwick meets all those tests. Without economic regulation passengers will have to pay higher fares, so that airlines can pay the inevitable increase in airport charges, which will be taken as profits by Gatwick's shareholders.

## Test A

### Market definition

#### The product market

easyJet agrees that the product market is the provision of services to airports, however, we disagree with the CAA's view that there are two market segments: (1) low-cost carriers and charters and (2) full-service carriers and associated feeder traffic airlines.

We should first note that we do not think that these model definitions are helpful. The defining difference between airline models is in general whether they offer a point-to-point or network product. This would seem to be a more enduring definition rather than descriptors such as low-cost or full-service.

We do agree that different airline models have different requirements of airport infrastructure. For example point-to-point airlines do not need complicated baggage systems that can transfer bags across flights. So in theory such market segmentation may occur at an airport. However, this segmentation does not occur at Gatwick, where the airport infrastructure is only offered as a single bundle. For example there is no extra charge for the use of transfer security services, and nor is there a differentiated baggage system.

There clearly are airports where services are not provided for transfer passengers, and therefore these airports could not be used by network carriers as a connection point. But even this does not stop network carriers using these airports. For example Luton has a service by El AL.

The CAA has not identified any actual material difference in the services and related charges offered by Gatwick. We suggest that this is further evidence that there is no segmentation of the product market at Gatwick.

In addition, we note that in the Competition Commission's BAA airports market investigation report<sup>1</sup>, the CC considers that "...it is usual to define a single product market unless segmentation between groups of users is suggested by clear differences in realized average prices (that are not related to costs). We have not seen sufficient evidence of this at BAA's airports to justify segmenting the market between user groups. Accordingly, we see no reason to define separate markets for the aeronautical product according to user or type of use." (Paras 2.23 and 2.24.). The CAA has not provided any material evidence to change this conclusion.

### **The geographic market**

easyJet believes that the geographic market for an airport can only be defined in relation to airports themselves, matching the product market description. In other words where airports compete the geographic market would be described as the specific airports themselves. The geographic market can not be an airport's catchment area as: (1) this does not match the product market description and (2) there is no clear understanding of an airport's core catchment.

We recognise that the CAA has taken a different view, and the rest of this section is drafted in this context.

easyJet believes that Gatwick's geographic market only consists of Gatwick. There is no competitive constraint imposed on Gatwick by other airports. We therefore go further than the CAA, which says that 'it is unlikely' that the market includes Luton and/or Stansted (for LCCs and charter carriers). However, we support the analysis that underpins this work, in particular the understanding of the interaction between airline and passenger behaviour.

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<sup>1</sup> Competition Commission report dated 19 March 2009

We agree with the approach which the CAA has taken to identify the geographic market, in particular by focusing on the evidence of airline switching, route overlap and the analysis of passenger preferences and choices.

#### Airline route overlaps

We welcome the CAA's conclusion from its analysis of easyJet data that Gatwick is in a separate market to Luton and Stansted for airport services. We have seen no change since this data was provided to suggest any change from this conclusion.

#### Passenger analysis

We support the conclusions set out by the CAA in its analysis of passenger preferences and behaviour.

In particular we welcome the CAA's analysis of the relationship between airport charges and the airfares paid by passengers. We support the CAA's assessment that Gatwick's passenger base's price elasticity (to airport charges) is likely to be very low, due to the gearing effect between airport charges and airfares (as airport charges are only a proportion of the airfare).

While we are unable to carry out our own analysis of Gatwick's price elasticity, we suggest that the CAA may have been conservative in estimating this elasticity as we would expect the elasticity to be lower than that set out by the CAA. Given that airport charges are only a proportion of airfares, and that the DfT uses a low estimate of passenger airfare elasticity in its passenger forecasting, we would expect Gatwick's passenger base's price elasticity (to airport charges) to be below 0.25.

We particularly welcome the CAA's conclusion that a simple assessment of catchment overlaps may overestimate the competitive constraint from passenger switching as it only considers passengers' location and travel times and does not take account of passengers' price sensitivities.

There is clear evidence (which we provided in our response to the CAA's call for evidence on Gatwick) that passengers prefer to use their local airport and willing to pay for this benefit. This is the key driver of an airport's ability to capture rents where it has market power. We welcome the CAA's recognition that passengers value the location of the airport and route availability, and these factor highly in the reason for airport choice.

We should also note that we agree with the CAA's assessment that it is impossible to identify whether price differentials across airports are due to a different passenger mix or location premium or perceived quality.

### The Impact of airline competition

We agree with the CAA's view that *flights* at other London airports constrains fares offered at Gatwick and that there is airline competition for passenger demand at and across London airports.

### **Geographic market conclusion**

easyJet agrees with the CAA's conclusion that the geographic market consists of Gatwick and strongly believes, as the evidence indicates, that the market does not include Luton and Stansted. For FSCs, we could say that the evidence suggests that the market is Gatwick focused since capacity constraints prevent airlines from switching to Heathrow and that constraint is likely to remain throughout Q6.

### Competitive constraints

We support the CAA's analysis of competitive constraints on Gatwick and the ability of airline switching to constrain the airport. In particular we agree that:

- Allocating volume growth to other airports would have limited impact given the excess demand for early morning departure slots at Gatwick and capacity constraints elsewhere.
- The option to reduce frequency at Gatwick is also limited.
- The possibility of constraining GAL through grounding and switching aircraft is limited.

We also agree with the CAA's view the opportunity cost of switching is the main determinant of switching costs and that these need to be taken into account when considering switching costs. We also agree that strategic costs of switching are significant, particularly given Gatwick's capacity constraints and the importance of the London market.

We note that easyJet has limited, or indeed no, countervailing buyer power.

### **Conclusion on test A**

Agree that Test A is met, although not with the approach in defining two product markets.

The CAA reaches a firm conclusion on LCCs and charter market that GAL has SMP which is unlikely to be eroded. However its conclusion on the FSC and associated feeder market is weaker – something to discuss with the ACC?

### Conclusions on Test B

easyJet believes that where airports have market power, economic regulation is the only effective solution to protect passengers from higher prices and poor service. We therefore support the CAA's conclusion that competition law is unlikely to be sufficient and refer the CAA to the response submitted by the ACC.

### Conclusions on Test C

The ACC has provided a full response to the CAA's conclusions on Test C which easyJet fully supports.

easyJet

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