

ANNEX E

THE CAA'S APPROACH TO THE AIRPORT MARKET – 2007 TO 2013

THE CAA'S APPROACH TO AIRPORT CAPACITY IN LONDON	
CC BAA MARKET INVESTIGATION - CAA'S INITIAL SUBMISSIONS TO CC ON BAA MARKET INVESTIGATION (MAY 2007)¹	
20	<p>... A well-functioning market that involves significant investment in sunk infrastructure will tend to exhibit periods where capacity is relatively unconstrained – with access (slot) prices and airport returns that are relatively low – followed by periods where capacity is more constrained – with access (slot) prices and airport returns that are relatively high.</p> <p>...</p>
26	<p>... whilst the operation of the planning regime is likely to impact on the nature of competition, its operation does not, in principle, prevent airports from competing.</p> <p>...</p>
3.26	<p><i>[32 – error in paragraph numbering]</i> As in many other markets, as infrastructure becomes more intensively used, and capacity constraints become binding, the value of access rights (in this case slots) tends to rise. This can put upward pressure on airfares and increase the cost of entry in the relevant airline markets. However, this may not be sufficient to conclude that slot constraints prevent, restrict or distort competition. A well-functioning market that involves significant investment in sunk infrastructure will tend to exhibit periods where capacity is relatively unconstrained – with access (slot) prices and airport returns that are relatively low – followed by periods where capacity is more constrained – with access (slot) prices and airport returns that are relatively high.</p> <p>...</p>
3.54	<p>Capital-intensive businesses can, and do, compete, even where local and/or national planning policy significantly affects the range of potential investments. For example, investment in electricity generation, gas storage and ports are all taken on commercial grounds by competing undertakings...</p>
CC BAA MARKET INVESTIGATION - SUMMARY OF HEARING WITH CC, 28 JUNE 2007²	
5.	<p>... As for capacity constraints, capacity was not just a function of the airport infrastructure but was also affected by the airlines' assets—larger planes could increase capacity by attracting more passengers to the airport. That said, short term capacity constraints could affect competition: airports with spare capacity were likely to compete more vigorously than a comparable airport operating within a capacity-constrained market...</p>
THE CAA'S ADVICE TO THE SECRETARY OF STATE ON DE-DESIGNATION OF MANCHESTER AND STANSTED AIRPORTS FOR PRICE CONTROL REGULATION (JUNE 2007)³	
8.116	<p>The CAA has also highlighted that there are a number of plans for capacity expansion in the relevant market, including at Stansted Airport, and that the incentives faced by competing airport operators to expand would be increased should Stansted fail to invest in a timely manner. While it is not possible to quantify the likelihood of any one of these investment plans coming to fruition, the likelihood is that in a tightening market for capacity there will be an investment response from airports. On balance, therefore, the CAA considers that the most likely outcome is that Stansted Airport will not acquire a position of substantial market power for the foreseeable future.</p>

¹ http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2007/airports/pdf/third_party_submission_caa.pdf

² http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2007/airports/pdf/hearing_summary_caa_3.pdf

³ http://www.caa.co.uk/docs/5/ergdocs/de-designation_advice.pdf

...	
8.122	The CAA has set out above that the level of capacity and, in particular, the balance between supply and demand in the relevant market, is an important determinant of the incentives faced by the airport operator and, therefore, the degree of market power it enjoys.
8.123	The CAA has also highlighted that a tightening of the supply-demand balance and rising price levels is not necessarily a sign that a market is not functioning in a competitive manner. Indeed, rising prices would provide a signal and incentive to competing airports to expand.
8.124	Against this background, the CAA has set out its views in respect of the impact of capacity availability on its assessment of Criterion 1. However, should the barriers to investment in airport capacity rise then this would increase the likelihood that Stansted meets Criterion 1. The corollary of this is that a reduction in the barriers to airport investment – through, for example, the anticipated creation of an Independent Planning Commission – would reduce the likelihood that Stansted meets Criterion 1.
...	
8.134	The CAA has considered the arguments made by respondents that the tightening of the supply-demand balance would over time increase the degree of market power held by Stansted Airport. It agrees with respondents that the absence of additional investment in capacity in the relevant market would tend to increase the degree of market power held by the airport. However, in assessing the impact of the balance between the demand for and supply of available airport capacity and inter-airport competition, it is important to recognise that a tightening of the supply-demand balance in a competitive market can be expected to put upward pressure on prices and would do so in an airport market, as in others. Such a response may provide a signal of the need for investment in additional capacity and is not necessarily a sign that the market suffers from some form of dysfunction.
CC BAA MARKET INVESTIGATION - CAA'S RESPONSE TO EMERGING THINKING (MAY 2008)⁴	
7.	The CAA does not view the existence of capacity constraints as a feature that necessarily has adverse effects on competition, as many well-functioning markets, including those in capital intensive industries, at times operate with relative scarcity of capacity. It is important, therefore, to distinguish between 'natural' and 'artificial' capacity constraints. Part 4 of the CAA's response expands on this. Part 4 is not replicated here.
THE CC'S QUINQUENNIAL REVIEW OF STANSTED – THE CAA'S RESPONSE TO THE ISSUES STATEMENT (JUNE 2008)⁵	
A.4	... the CAA considers that in well-functioning airport markets the changing balance between demand and available capacity will tend to result in the competitive price path varying above and below the average competitive price level ⁵ . This pattern of expected pricing does not depend upon the airport acquiring, or enjoying, market power, as it simply reflects the changing (competitive) market-clearing price level.
CC BAA MARKET INVESTIGATION - SUMMARY OF HEARING WITH CC, 8 JULY 2008⁶	
7.	Asked how far it was possible to distinguish between natural and artificial capacity constraints, the CAA said that the airports market was characterized by very capital intensive businesses—particularly capital intensive because of the effect of the commercial revenues offsetting the operating costs, which meant that the net revenue stream corresponded almost one for one with capital items. It was therefore necessary to look at these businesses over a long period of time to get a sense of what was going on in the markets in which they operated. Over that relatively long period of time it might be expected that the competitive price would rise and fall around an average level, there would be periods of abundant capacity and periods of scarce capacity, and the price would have an inverse relationship with available capacity. In that context, capacity becoming scarce did not mean that competition stopped or could not

⁴ http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2007/airports/pdf/responses_et_cca.pdf

⁵ http://www.caa.co.uk/docs/5/ergdocs/ccissues_response.pdf

⁶ http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2007/airports/pdf/hearing_summary_cca_5.pdf

exist between different airports. Rather, growing scarcity meant that no airport thought the time had yet come to justify the next investment, other things being equal; it was no surprise that capacity could become scarce and stay scarce for a while until demand had built up to the point at which the next investment to serve the next wave of demand was justifiable. There was no good reason for investment without sufficient demand to support it. So the CAA's view was that if a market was at a point at which capacity had filled up but was still not at the point at which it was economic to invest in the next tranche of capacity, that might very well be as a result of a natural capacity constraint.

CC BAA MARKET INVESTIGATION - CAA'S RESPONSE TO PROVISIONAL FINDINGS REPORT AND NOTICE OF POSSIBLE REMEDIES (SEPTEMBER 2008)⁷

3.13 The CAA would encourage the CC to ensure that it distinguishes clearly between the existence of competitive constraints and the existence (or not) of spare capacity. The former is relevant to the question as to the form and intensity of economic regulation that should apply. The latter is not directly relevant. This is discussed further in Chapter 4 of this submission.

...

5.5 In the CAA's view, the CC has significantly understated the scope for competition in the short term for two reasons. First, the CC appears to have accepted too readily BAA's argument that capacity constraints substantially reduce the potential for competition. As noted in the previous chapter, the CC has not demonstrated that capacity has been artificially constrained (with the potential for harmful effects on consumers) rather than resulting from natural constraints. Moreover, there is no a priori reason to believe that runway capacity would be artificially constrained post-divestment, assuming appropriate remedies to any adverse effects arising from planning, Government policy and current economic regulation.

...

5.12 In summary, there is the potential for competition between airports to take place in many different ways in advance of investment in new runway capacity. Moreover, it should be recognised that any natural capacity constraints could be expected to stimulate – rather than inhibit – the competitive process. Economic regulation can adapt (even in the short term) to enable competition between airport on price, service quality and investment. For these reasons, the CAA considers that the CC has significantly understated the scope for competition between airports in the short term.

THE CAA'S GUIDANCE ON THE ASSESSMENT OF AIRPORT MARKET POWER (APRIL 2011)⁸

5.7 Scarce capacity can be a normal feature of a market and may not necessarily lead to market power and monopoly pricing. However, the underlying causes of scarce capacity might constitute significant barriers to entry and expansion.

5.8 In the airports market, scarce capacity is likely to manifest itself in the form of limited runway slots and/or terminal capacity. Although barriers to entry and expansion are one way in which scarcity can be created, scarcity could also be a normal and/or transitory feature of a generally competitive market. In the context of a competition assessment, it is important to distinguish carefully between different causes of scarcity.

5.9 Where capacity constraints are caused by barriers to entry and/or expansion, they are likely to affect the strength of competitive constraints faced by an airport, and may give rise to market power held by incumbent airports, particularly where the barriers are non-transitory in nature. However, even where such barriers result in capacity constraints, there may still be considerable rivalry between incumbent airports and sufficient choice for users. Barriers to entry might also affect different airports to different degrees, causing scarcity at one airport relative to its competitors, which might affect the balance of market power held by the different competing airports.

5.10 Non-transitory capacity constraints may also take the form of artificial scarcity, where it results from firms deliberately restricting capacity expansion in order to put upward pressure on the price level, and raise prices above the competitive level. Such airports behaviour would be considered an abuse of market

⁷ http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2007/airports/pdf/response_pf_caa.pdf
⁸ <http://www.caa.co.uk/docs/5/Final%20Competition%20Assessment%20Guidelines%20-%20FINAL.pdf>

	<p>power and is prohibited by the Treaty for the Functioning of the European Union (TFEU) and the UK Competition Act 1998.</p>
5.11	<p>In considering the existence and consequences of non-transitory scarcity, the CAA would consider evidence including, but not limited to, some or all of the following factors:</p> <ul style="list-style-type: none">• the extent of the capacity scarcity;• the duration of the capacity scarcity;• evidence and effects of relative capacity scarcity;• evidence of previous under-investment;• evidence of commercially viable projects not being pursued;• the potential for countervailing effects from airlines increasing aircraft capacity; and• the impact of Government policy.
5.12	<p>In general terms, the underlying causes of capacity constraints in the airports market could potentially have different consequences for different airports. An assessment of market power would therefore need to take account of the particularities of the effects of scarcity on a case-by-case basis.</p>
THE CAA'S INITIAL VIEWS ON STANSTED MARKET POWER (2012)⁹	
41.	<p>Capacity constraints at early morning times appear to be a feature at Luton, Gatwick and a number of other European airports. This lack of early morning capacity might reduce the ability of airlines to relocate operations from Stansted, although Gatwick – which is relatively full by European standards – has been able to accommodate a number of new airline services, including a number of services switching from Stansted.</p> <p>...</p>
3.229	<p>It is clear that there is significant capacity off-peak at Stansted, albeit that this might reduce over time, as demand grows. However, at peak times, there is very little spare capacity. The period over which these capacity constraint holds is currently somewhat limited, relating to 2 or 3 hours, but as demand grows these constraints would be likely to spread to other hours.</p>
3.230	<p>Capacity constraints at early morning times appear to be a feature at Luton, Gatwick and a number of other European airports. This lack of early morning capacity might reduce the ability of airlines to relocate operations from Stansted, although Gatwick – which is relatively full by European standards – has been able to accommodate a number of new airline services, including a number of services switching from Stansted.</p>
THE CAA'S CONSULTATION DOCUMENT (JANUARY 2013)	
11.	<p>Looking to the future, LCCs with based aircraft at Stansted (especially Ryanair, less so easyJet) appear constrained in their ability to switch significantly more based aircraft. This is because serving London has major strategic importance to their business models, and capacity constraints at other London airports mean they do not have the option to switch away from Stansted and still serve London. This is likely to become an increasing factor as demand recovers in line with economic growth and capacity constraints in the London region further tighten.</p> <p>...</p>
15.	<p>The most likely source of market power possessed by STAL is the inherent attractiveness of the London market and its strategic importance to airlines, combined with capacity constraints in the London system,</p>

⁹ <http://www.caa.co.uk/docs/5/StanstedMarketPowerAssessment.pdf>

which limit the number and size of available alternatives. Over 2014-2019 these capacity constraints are expected to tighten further and lead to a spill of traffic from other London airports to Stansted. This tightening can be expected to reduce STAL's incentive to price keenly to incentivise growth.

...

23. Regarding STAL in particular, our 'minded to' position in relation to test A tends to suggest that there may be a risk of STAL being in a position to engage in exploitative behaviour. Given the size of the operation at Stansted, the potential harm to the user from any such abuse could be significant. The CAA's responses to emerging problems might be slower if it had to prove established dominance and the remedies for such exploitation might also take time to formulate and implement, during which time damage to the structure of competition might continue. Further, the current moratorium on airport expansion within the South East means that scarcity will not in the short term lead to investment to produce extra capacity. As such, reliance only on the functioning of the market could see higher prices. Although these might not be enough to motivate individual passengers to change which airport they use, nevertheless collectively these will not necessarily be in the best interests of passengers and cargo owners, as they will not drive market entry or additional capacity expansion. Therefore, this approach may not be consistent with the CAA's duty under the CA Act to promote the interests of passengers and cargo owners.

...

- 2.8 In particular, since the publication of the Initial Views the CAA's thinking has evolved with respect to (amongst other issues):

...

The ability of airlines to switch from Stansted (see section 5). The ability of an airline to switch airports is important for a number of reasons, not least that it influences the reliance on market share analysis as part of a competition assessment. Without appropriate consideration of an airline's ability to switch (which includes consideration of airport capacity constraints and airline switching costs), the level of market power an airport operator may hold, when measured by market share analysis alone, may be under or over represented. However, the CAA also considers that there are many limitations associated with market share analysis which limits its usefulness as a 'stand alone' indicator of market power (this issue is discussed further below).

A detailed analysis of capacity constraints is carried out in paragraphs 5.76-5.89.

...

- 5.121 One way to understand the nature of barriers to entry and expansion is to consider the history of entry and expansion in the market. As outlined in the Initial Views document there is very limited evidence of significant entry or expansion in Stansted's market. However, there are two recent examples of expansion in the form of Southend and the recent announcement of Luton's intention to increase capacity.

...

- 5.135 By 2019, the forecasts show that Gatwick airport would be capacity constrained for most of the day, so aircraft from Stansted could only be switched to Luton. There is generally sufficient capacity to switch four to five departures from Stansted to Luton, although limited overnight aircraft parking stand capacity is likely to limit airlines' ability to do so as Stansted airlines typically require the ability to operate early morning departures in order to maximise aircraft utilisation. The analysis of arrival slot availability provides the same conclusions for these airports.

...

- 5.139 The CAA is minded to conclude that, in the next five years, the tightening of capacity constraints at Heathrow and Gatwick will result in an increase in the degree of market power at the London airports that have spare capacity. Given its overall size, range of facilities and level of spare capacity, we would

anticipate that STAL would be a beneficiary of these trends, which are subject to a recovering economy.

...

5.141 The Initial Views also considered that the tightening capacity constraints might lead to infrastructure development at other London and regional airports which could erode the market position of Stansted. While other London airports, such as Gatwick and Luton, have developed plans to expand capacity, these are unlikely either to constitute sufficiently large increases or be completed in sufficient time as to create significant additional constraints on Stansted. In addition, although Southend airport entered the market in 2012, and easyJet has relocated aircraft away from Stansted to the airport, the airport is limited in size and consequently in its ability to constrain Stansted.

...

5.184 While strategic constraints are likely to restrict based airline (and charter) substitution away to non-London airports, capacity constraints in addition appear to limit the scope for switching between London airports. To allow efficient utilisation of based aircraft, airlines with based aircraft require early morning departure slots, as this allows a sufficiently early departure to serve passenger demand and allow the aircraft to perform four to six daily rotations. As a result, for based airlines flying short-haul routes to consider switching to another London airport, it is particularly important that there is sufficient capacity at the alternative airports to meet both morning and evening peak requirements.⁴⁰⁵ In addition, due to the typical “back and forth” pattern of based aircraft, there also needs to be sufficient capacity available at the same airport outside of this period.

5.185 Although Stansted has a considerable degree of spare capacity during the early morning peak, which would give the operator the incentive to attract new traffic, this is not likely to be a relevant consideration for incumbent airlines’ ability to constrain the airport operator. However, the capacity constraints during the early morning peak at Luton and Gatwick airports suggests that there is limited scope for the relocation of aircraft to these airports. While Southend airport has significant spare capacity during the relevant times of day, its relatively short runway makes it technically impossible for Ryanair to relocate Stansted aircrafts to that airport.

...

6.8 In the case of London airports, there are additional reasons why market shares may not be a reliable measure of the level of market power of airports, including:

- Long term capacity constraints at Heathrow airport and to a lesser extent at Gatwick airport. As stated by the OFT in its guidance, where competitors are unable to increase output substantially because of capacity constraints, “the undertaking would be in a stronger position to increase prices above competitive levels than an otherwise identical undertaking with a similar market share operating in a market where its competitors were not close to full capacity”.

...

6.89 While the individual indicators of market power may each suggest slightly different outcomes, when considered as a whole, we consider that, on the balance of probability, they suggest the airport operator has market power. In addition, the indicators suggest that it is more likely than not that the airport operator will have relatively more market power going forward, not least due to improving economic conditions and tightening capacity across the London airports.

...

7.21 The most likely source of any substantial market power possessed by STAL would appear to stem from the inherent attractiveness of the London market and its strategic importance to airlines in general and

easyJet and Ryanair in particular, combined with capacity constraints in the London system, which reduce the number and size of available alternatives. This is especially the case for LCCs that are based at Stansted and require access to the morning peak to be able to fully utilise their aircraft throughout the day (e.g. Ryanair).

...

7.24 There are reasons, however, to believe that over 2014-2019 capacity constraints will tighten further to result in a 'spill' of traffic from other London airports to Stansted, which may further weaken competitive constraints on STAL.

...

8.61 In the CAA's considerations of Test B careful consideration of the capacity situation at the airport in question and the market in which the operator operates will need to be reviewed. Consideration will be needed of the likelihood of constraints coming into force over the medium term and the risks that this may result in incentives to abuse its position. The situation may be one where SMP may build up as a product of diminishing capacity in the market. Action under CA98, Article 102 can only be initiated once the legal test of dominance can be met and evidence of abuse of that dominance can be obtained. This may take time and the risk is that the competitive structure of the market will deteriorate further in the meantime to the detriment of users of air traffic services and competition in the market. Therefore, where an airport operator is operating in a capacity constrained market and this is likely continue, we should consider carefully whether regulatory safeguards can be put aside in favour of competition law controls.

APPROACH TO THE EUROPEAN-WIDE MARKET	
CC BAA MARKET INVESTIGATION - INITIAL SUBMISSIONS TO CC ON BAA MARKET INVESTIGATION (MAY 2007)¹⁰	
2.1	... discusses the importance of considering the full range of potential sources of airport competitive constraints. These can range from the potential for passengers and/or airlines to switch to alternative local airports to the potential for airlines to relocate their business (or their future growth plans) to airports within the European Aviation Area (or further afield). ...
2.22	Whilst the competition for airline business appears to be most intense between neighbouring airports, there also appears to be some competitive tension between airports across the European Single Market as they compete against each other to win business from airlines with capacity to place. ...
2.24	... Some airlines have many alternative uses for their assets: no-frills carriers have demonstrated an ability to compare route options across the single European market... ...
2.39	But the growth of direct services (both short- and long-haul) from UK regional airports, the evidence of increasing competition for domestic and short-haul traffic between airlines at Heathrow and at other airports serving Southern England, and the potential competition for interlining traffic from other European and more distant hubs suggest that it [Heathrow] is likely to face some competitive constraints.
CC BAA MARKET INVESTIGATION - SUMMARY OF HEARING WITH CC, 28 JUNE 2007¹¹	
5.	... An additional relevant factor was that the low-cost carriers were pan-European businesses, so if they could not make money at a particular UK airport serving a particular catchment area, they would not necessarily be locked into serving that catchment area from another local airport. Instead, they could decide to operate completely different services between other airports elsewhere in Europe.
THE CAA'S ADVICE TO THE SECRETARY OF STATE ON DE-DESIGNATION OF MANCHESTER AND STANSTED AIRPORTS FOR PRICE CONTROL REGULATION (JUNE 2007)¹²	
33	In addition, the emerging evidence suggests that airlines are able to modify their growth plans, and switch some of their existing aircraft, between airports over a very broad area, comparing the returns that can be earned operating to/from Stansted with those that can be earned by serving other airport pairs across the European Aviation Area. Stansted appears, therefore, to face significant competitive pressure from UK and other European airports outside its immediate geographic market. ...
2.41	...A number of considerations suggest that there might be relevant competitive constraints arising from a broader geographic area... ...
2.67	Airlines are informed purchasers of airport services and appear actively to compare alternative uses of their aircraft across a wide range of alternatives. As noted above, the creation of the European Aviation Area enabled the airlines from Member States to operate services between any Member State, and has encouraged a number of airlines to expand across Europe, evaluating the relative profitability of services

¹⁰ http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2007/airports/pdf/third_party_submission_caa.pdf
¹¹ http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2007/airports/pdf/hearing_summary_caa_3.pdf
¹² http://www.caa.co.uk/docs/5/ergdocs/de-designation_advice.pdf

across Europe. For example, Ryanair has 20 bases across Europe (six of which are in the UK), whilst easyJet has 17 (of which ten are in the UK).

...

8.106 ...there is emerging evidence that airlines are able to modify their growth plans, and switch some of their existing aircraft, between airports over a very broad area, comparing the returns that can be earned operating to/from Stansted with those that can be earned by serving other airport pairs across the European Aviation Area. Stansted appears, therefore, to face significant competitive pressure from UK and other European airports outside its immediate geographic market.

...

8.110 The CAA, therefore, concludes that the analysis of Stansted Airport should be undertaken against a background of a geographic market that includes London and the East Anglia regions but extends to include Birmingham and East Midlands. In addition, there appears to be a reasonable basis to conclude that airports within this market also face significant competitive pressure from outside of this geographic area.

...

8.131 In assessing current and likely future competitive constraints faced by market power at the airport, the CAA has first considered the relevant market(s) within which Stansted operates, concluding that the relevant geographic market is relatively broad and that the analysis of Stansted Airport should be undertaken against a background of a geographic market that includes London and the East Anglia regions, and extends to include Birmingham and East Midlands airports. In addition, it appears that the airport faces significant competitive pressure from UK and other European airports outside this area.

CC BAA MARKET INVESTIGATION - CAA SUBMISSION TO THE CC ON ECONOMIC REGULATION OF UK AIRPORTS (FEBRUARY 2008)¹³

1.4 ... the increasing importance of regional airports and the growth of competition between airports both domestically and internationally, partly in response to the changes in the airline market.

CAA'S COMMENTS ON THE CC'S COMPETITION WORKING PAPER (AUGUST 2008)¹⁴

1.4 The CAA also highlights a number of significant evidential shortcomings, in the CC's paper including that it:

...

- dismisses the role of pan-European competition, despite evidence being provided to the CC from airports and the CAA, and airlines' own public statements that they operate (and optimise their networks) across a European market;

...

4.10 Referring to the potential for other European airports to act as a competitive constraint on Stansted, the CC states that it is:

"... not convinced that this is currently a significant constraint on Stansted's prices. An increase in charges at Stansted does affect the relative profitability of routes, but it is difficult to see, if a particular route was profitable prior to the Stansted charge increase, why it was not already being served. Given relatively strong competition between low-cost carriers, we would expect to see entry occurring at unconstrained airports until rents are competed away. As no passengers would switch from the Stansted route to the European route, there would be no increase in demand on the European route following a price increase

¹³ http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2007/airports/pdf/third_party_submission_caa_2.pdf

¹⁴ <http://www.caa.co.uk/docs/5/ergdocs/cccompetitionpaper.pdf>

at Stansted. It is difficult to see then why airlines would switch to this route, unless they had previously been constrained in the number of planes they could deploy.”

4.11 The CC’s argument seems to ignore the link between Stansted charges, opportunity costs and the likelihood of expanding operations at other airports. An increase in Stansted charges would reduce airline yields on the affected services. As a result, the opportunity cost of the next best alternative use of the aircraft (be it in the UK or beyond) would fall, making previously unprofitable services profitable. It should also be noted that the act of shifting capacity in response to changing relative prices would affect supply in the market into which the capacity was added. This would have the effect of increasing demand.

4.12 This view is also simply not tenable given the observed operation of the European aviation market. This market operates with real constraints and actual imperfections. Airlines cannot increase the size of their fleets without facing additional costs – it does, after all, take a considerable time to build additional aircraft – and face limits on the speed with which their management teams can identify and exploit profitable opportunities.

4.13 Further, this view of the market does not compare well to the statements made by airlines to their investors of how they expand their businesses. . For example, Ryanair recently announced reductions in its use of Dublin, Glasgow, Rome, Warsaw, Leeds Bradford and Stansted. easyJet has announced reductions in its use of Stansted and Dortmund. Both of these airlines have also stated that they plan to continue to grow. The presumption here must be that there has effectively been switching of airline capacity away from a number of airports – including Stansted – and towards other airports.

4.14 Finally, the CC also states that:

“Analysing the strength of this potential constraint is difficult because airlines have not told us that they would switch in this way and we cannot look at passenger behaviour in this context.”

4.15 However, it is not clear whether this conclusion is arrived at because the airlines were not asked the appropriate question or gave an answer which, in the context of this inquiry, is in their commercial interests. Indeed, as written, the CC’s paper appears to place weight on the absence of a statement by airlines, rather than any positive statement that they do not operate in this way.

4.16 Either way, the conclusion is not tenable because it ignores a raft of evidence:

- evidence presented to the CC by the CAA in writing and at hearings, and in two reports on regional air services which reflected discussions with a wide range of airports and airlines;
- evidence from airports about the pan-European dimension of competition they face; public statements by airlines themselves including:
- easyJet’s 2008 interim results statement that: “Performance management of the network and improving the quality of the schedule continue to be the key drivers of easyJet’s success with new routes added including the southern European GB Airways destinations and domestic routes in France and Italy. In addition, easyJet has culled 11 underperforming routes.”;
- Slide 26 (and the supporting commentary) of easyJet’s Interim Results presentation highlights the pan-European nature of its network optimisation; and
- Ryanair’s Director of Scheduled Revenue, Sean Coyle recently stated that “Edinburgh Airport has competed successfully against airports across Europe for Ryanair’s 27th base.”

4.17 It is clear that the development of the low cost point to point model in the context of the Single European Aviation Area has generated competition between airports across Europe for both based aircraft and inward [journeys]. Understanding this as part of a set of cumulative competitive constraints on UK airports is important background to the Stansted inquiry but would also be expected to form part of a broader understanding of the market relevant to the BAA market inquiry. It is therefore surprising that this feature of the market is so readily dismissed on the basis of such limited – and partial – evidence.

4.18 Indeed, this form of competitive constraint is widely recognised, as illustrated by the following extract from a recent article in the Financial Times:

“While [Ryanair] is reducing its flying programme at some airports for part of the coming winter season to reduce lossmaking operations - chiefly at London Stansted and Dublin, its main European bases - it is increasing its overall capacity in the winter by 8-9 per cent following an expansion of 18-19 per cent during the current summer months.”

THE CAA'S INITIAL VIEWS ON STANSTED MARKET POWER (2012)¹⁵

16. ...the largest airlines at Stansted have a relatively large number of existing bases across Europe, and a large number of airports to which they already operate, which will tend to reduce the costs associated with moving capacity away from Stansted. However, the airlines at Stansted emphasise the importance of Stansted (and of serving London) to their businesses, and the impact that switching away from Stansted has on their yields. Airlines have also highlighted the lack of responsiveness to recent increases in the level of charges at the airport, which is discussed below.

17. ...Furthermore, it appears that the switching of marginal airline services is likely to take place over a broader area, such that the geographic market relating to the supply of services to airlines is likely to be European wide.

18. Stansted provides infrastructure and infrastructure services to cargo-only carriers for the air transportation of cargo. This includes the provision of runway and apron space, as well as providing access to cargo-handlers, access to warehousing facilities, and infrastructure to allow the efficient onward transfer of cargo. In general, we consider that the airport operates in a very broad market, and competes with a number of airports across the UK and Europe for much of this cargo traffic.

...

2.138 These airlines, and other no frills operators, also have a track record of moving services between different airports, cancelling under-performing routes and moving their growth across a number of different European markets. Given that they already have bases across Europe, it should be easier for them to switch aircraft between bases than it would be for a network carrier to relocate to a new base.

...

2.143 It appears that, given the business model of airlines at Stansted, and the likely magnitude of switching costs (which are discussed in more detail in chapter 3) that the airports in the Southeast of England are likely to be very close substitutes to Stansted (although Heathrow is likely to fall outside of this market, due to its particular operational characteristics). Furthermore, it appears that the switching of marginal services is likely to take place over a broader area. In particular, the number and distribution of existing bases of Stansted's two largest customers – and the large number of European airports to which they currently operate – means that the geographic market relating to the airlines at Stansted is likely to be European wide.

THE CAA'S CONSULTATION DOCUMENT (JANUARY 2013)

8. In February 2012, the CAA published its Initial Views on STAL's market power. That document discussed whether Stansted should be considered as part of a Europe-wide market. However, further information gathered since then has shown that the competitive constraints posed by airline switching (or threat of switching) to European airports from UK airports including Stansted appears to be relatively weak, and little evidence has come to light of actual switching of established airline capacity from London airports to European airports.

...

4.116 As set out above the evidence the CAA has seen to date indicates that both airlines and airport operators in the main consider a rather limited geography around the airport. The 60-90 minute catchment appears to be the key selling point for airports in their negotiations with airlines and airlines' strategy also seems to focus closely on this. That said, as we intimated in our Guidelines, it has been suggested that airports

¹⁵ <http://www.caa.co.uk/docs/5/StanstedMarketPowerAssessment.pdf>

operate in a European market.

...

- 4.123 The CAA considers that the theory of a pan-European airport market is not supported by the evidence it has seen in relation to Stansted. The CAA considers that within the Initial Views it understated the costs and strategic implications involved in the switching for LCCs. The CAA also considered that insufficient weight was given at the time to the impact on passengers. The CAA therefore considers that it would be inappropriate to widen the geographic scope of the market to a European level. The CC reached a similar conclusion with regards to airport markets as part of the BAA airports investigation (and subsequently in its report considering possible changes of circumstances). The CC view is summarised as:

"...if Ryanair has a customer who wants to fly from the UK to Spain, the customer will not think that an airport in Italy is a close and effective substitute for Stansted from which to fly. It seems to us that airlines care about access to particular locations precisely because the passengers who will choose to fly from a UK airport will not be the same as those who are based close to, for example, an Italian one."

- 4.124 Although the CAA does not consider that the market should be widened to include European airports it does recognise that the LCC business model, which dominates at Stansted does operate a pan-European network. The network yield optimisation of these carriers involves a degree of switching assets between differing markets across Europe. This ability to yield manage across a range of markets is likely to provide some degree of constraint on airport pricing. However, when moving capacity from Stansted to a European airport, more so than to a neighbouring UK airport, the airline will be giving up on its competitive position at Stansted and the customers it serves. The likely revenue loss to the airline of a sufficient pan-European switch of capacity from Stansted is likely to exceed the impact of a 5-10 per cent increase in airport charges. Section 5 further discusses the likely strength of the European dynamics constraint.

...

- 7.5 In its Initial Views document the CAA questioned whether Stansted should be considered as part of a European wide market. However, upon reflection and further discussions with stakeholders, the CAA now considers that the market should not be defined as European wide because the competitive constraints posed by airline switching (or threat of switching) to European airports from UK airports including Stansted appears to be relatively weak and the CAA has found little evidence of actual switching of established airline capacity from London airports to European airports. Where there has been such switching, the evidence suggests that it has not constrained STAL's behaviour.

APPROACH TO COMPETITION BETWEEN LONDON AIRPORTS	
CC BAA MARKET INVESTIGATION - INITIAL SUBMISSIONS TO CC ON BAA MARKET INVESTIGATION (MAY 2007)¹⁶	
7	UK airports do not appear to possess the cost characteristics associated with natural monopoly businesses and there is therefore, the potential for airports to compete." ...
15	...Indeed, the CAA's analysis, as part of its price control review, of the competitive constraints facing Stansted suggests that there is a case for considering the removal of price control regulation at that airport, even with BAA's current ownership structure. ...
24	...any analysis of the airport market should distinguish between those elements of the planning regime that impose necessary constraints on the market – constraints within which all airports compete – from these that might unnecessarily distort competition... ...
26	...whilst the operation of the planning regime is likely to impact on the nature of competition, its operation does not, in principle, prevent airports from competing. ...
30	The CAA has considered the degree to which the London airports interact and has concluded that there are material interactions between the larger London airports... ...
1.11	The OFT's market definition placed less weight on the impact of airports outside of the London area than the CAA, which proposed a market definition for Stansted Airport that included a number of smaller airports in the South East and also a number of airports located outside the South East planning district... In particular, Stansted Airport is more likely to face material competitive constraints from airports located to the north and northwest of London than, say, Gatwick, whilst airports to the southwest and west of London are less likely to be relevant to understanding the competitive constraints faced by Stansted Airport. ...
2.13	... The CAA has considered the degree to which airports interact as part of its supporting analysis for the current price review of designated airports and has concluded that there are material interactions between the larger London airports... ...
2.37	Examples of such short-term competition include: <ul style="list-style-type: none">• strong evidence of fares correlation between airlines located at Luton and Stansted;• strong route overlaps and competition for passengers within the London population centre by airlines at Luton-Stansted-Gatwick; and• competition in specific sectors between carriers based at Heathrow, and those at other London airports particularly for domestic and short-haul traffic (e.g. easyJet-BA)."
2.38	In addition, there are a number of instances of airlines switching routes, and/or their growth plans, between airports. For example, Ryanair relocated its main base from Luton to Stansted and has

¹⁶ http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2007/airports/pdf/third_party_submission_caa.pdf

	previously demonstrated an ability to switch routes between airports.
	...
3.14	... CAA data suggests that there are considerable overlaps between the catchment areas of these three airports, an observation that is consistent with the analysis presented by the OFT. (referring to Gatwick, Heathrow and Stansted)
3.15	It should also be noted that there is considerable evidence to suggest that BAA's London airports also interact with other London airports, namely Luton and London City, as well as a number of other airports located outside of the South East planning area...
CC BAA MARKET INVESTIGATION - SUMMARY OF HEARING WITH CC, 28 JUNE 2007¹⁷	
6.	... analysis carried out by the CAA might support the view that there was competitive interaction between the London airports; however, due to the quality of the available data, the statistical significance of some of the relevant coefficients was relatively low...
THE CAA'S ADVICE TO THE SECRETARY OF STATE ON DE-DESIGNATION OF MANCHESTER AND STANSTED AIRPORTS FOR PRICE CONTROL REGULATION (JUNE 2007)¹⁸	
32	... Analysis of the propensity of passengers to travel to reach Stansted Airport and the strength of the interactions between the airport, other London airports and regional airports suggests that the relevant geographic market is relatively broad and that the analysis of Stansted Airport should be undertaken against a background of a geographic market that includes London and the East Anglia regions, and extends to include Birmingham and East Midlands airports.
	...
48	... The CAA's analysis shows that Stansted faces significant competitive constraints from other airports which limit its market power now and, most likely, in the future...
	...
8.12	The CAA also considered whether the interactions between neighbouring airports might broaden the relevant market, due to competitive constraints arising from a "chain" of competing airports. The CAA concluded that the market was likely to be extended through the competitive interactions arising from airports located further afield.
	...
8.14	... survey evidence also suggested that Stansted passengers were reasonably sensitive to changes in the level of airfares and that a number would seek to use airports outside of the southeast planning region.
	...
8.16	Based on the evidence available, the CAA concluded that the relevant geographic market for analysing the competitive constraints faced by Stansted Airport was likely to be broader than the London area and likely to include the East Anglia planning region. In addition, the CAA concluded that there was strong evidence to include Birmingham and East Midlands airports and some grounds for including more distant airports on the basis that they provided an indirect constraint on the airport.
	...
8.60	However, set against these switching costs, it appears to the CAA that the cargo market is highly competitive, with multiple providers of capacity, utilising a number of different cargo hubs across Europe. Indeed, there are major flows of cargo that operate on a global basis. This suggests that Stansted is likely

¹⁷ http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2007/airports/pdf/hearing_summary_caa_3.pdf

¹⁸ http://www.caa.co.uk/docs/5/ergdocs/de-designation_advice.pdf

to compete with a number of cargo hubs in northern Europe, as part of these global flows of cargo between the major global regions. For example, Frankfurt, Amsterdam and Paris are the three largest cargo hubs in Europe, and all are likely to provide an alternative route for shipping cargo to the UK and for shipping cargo through Europe without going via the UK. Indeed, cargo volumes at Heathrow have recently fallen, at the same time as volumes have continued to rise at the other major European cargo hubs.

...

8.81 On balance, the CAA considers that whilst there may be significant barriers to switching some aircraft away from Stansted, particularly if this involves closing (rather than just scaling down) a base at the airport, there are reasonable grounds – not least due to recent behaviours and statements by airlines – to conclude that airlines based at Stansted are willing and able to move a significant number of their aircraft and/or their growth plans away from the airport.

...

8.93 The CAA has considered the arguments put by respondents and has presented analysis to assess them. Overall, the CAA does not consider that the balance of evidence suggests that the CAA should modify its view of the relevant geographic market. The evidence on the strength of overlaps between the London airports and regional airports suggests that these airports can provide a significant competitive constraint to Stansted. In addition, recent market evidence highlights that market factors can affect the growth in passengers at Stansted, although at this stage it is difficult to establish their relative impact.

...

10.37 As discussed in Chapter 8, Stansted Airport has significant direct competitive interactions with airports such as Luton, Birmingham and East Midlands airports, as well as a number of other airports through a 'chain of substitution'...

CC BAA MARKET INVESTIGATION - CAA SUBMISSION TO THE CC ON ECONOMIC REGULATION OF UK AIRPORTS (FEBRUARY 2008)¹⁹

17 ... Airports can, and do, compete for airlines' business. The UK airport market is not characterised by natural monopoly. Rather, the degree of competition varies between airports, meaning that they do not necessarily need to be regulated (unlike network utility businesses).

...

1.18 ... The CAA's analysis indicates that Stansted does not currently enjoy a sufficiently strong market position that would normally be associated with the need to apply standard price caps.

1.19 The conclusions drawn by the Government and the CAA from the available evidence differ. The Government considers that it is more likely than not that Stansted alone will acquire substantial market power in the future, whilst the CAA considers that the airport is not likely to do so. Moreover, the CAA's analysis also indicates that even if Stansted's market position were to strengthen then competition law would constrain the airport's conduct and mitigate the risk that airport users could be subject to market abuse.

...

3.53 ... in the case of Stansted Airport, the CAA identified sufficient competitive interactions, even with BAA's joint ownership of London airports, to lead it to recommend that the airport be de-designated.

¹⁹ http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2007/airports/pdf/third_party_submission_caa_2.pdf

THE CC'S QUINQUENNIAL REVIEW OF STANSTED – THE CAA'S RESPONSE TO THE ISSUES STATEMENT (JUNE 2008)²⁰

2.8 What appears clear is that Stansted Airport has not enjoyed a market position equivalent to that enjoyed by Heathrow or Gatwick airports. Stansted has heavily discounted its airport charges below the price cap and has not been able to recover its allowed (regulated) cost of capital for a prolonged period of time.

CC BAA MARKET INVESTIGATION - SUMMARY OF HEARING WITH CC, 8 JULY 2008²¹

1. The Civil Aviation Authority (CAA) agreed with the Competition Commission's (CC's) finding that there was direct competition between neighbouring airports and that this could act as a constraint. It was a factor that the CAA had considered in recommending the dedesignation of Manchester Airport, when it had looked at competition with Liverpool and Leeds Bradford airports but also, and in the context of analysing neighbouring UK airports, airports further afield because there was quite a strong argument that there was a chain of competing airports that extended the market beyond the immediate neighbours.

...

32. The CAA did not think that the possible benefits from comparative competition were very important for the airports that it was dealing with, which operated in different circumstances. A little comparative competition between Gatwick and Stansted might be possible but the CAA had tried to go beyond airports in the South-East when seeking comparative information on operating expenditure in the recent price control reviews. Similarly, the CAA would normally look for comparators elsewhere for service quality: other hub airports in Europe might be appropriate comparators for Heathrow because their product was similar, whereas Gatwick might be compared with Orly. There might not be a comparator quite in the same way for Stansted but it would be necessary to look broader than the different airports within the BAA south-east group.

CAA'S COMMENTS ON THE CC'S COMPETITION WORKING PAPER (AUGUST 2008)²²

1.3 More specifically, the CAA observes that the CC's approach is inappropriate for the analysis of airport competition as it:

...

- ignores or dismisses key sources of constraint on Stansted, including no mention of the potential for interactions with Heathrow and Gatwick nor of the important role that the price caps on these airports play in explaining the overall competitive dynamic;

...

- fails to assess the cumulative impact of all the competitive constraints, instead dismissing individual constraints unless they are individually capable of disciplining Stansted;

...

1.4 The CAA also highlights a number of significant evidential shortcomings, in the CC's paper including that it:

...

- dismisses the existence of competitive interactions between UK airports – including between Stansted and Luton and between Luton and regional airports – on the basis of a flawed argument of assumed 'back fill' and despite there being a significant body of evidence – notably from airport operators –

²⁰ http://www.caa.co.uk/docs/5/ergdocs/ccissues_response.pdf

²¹ http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2007/airports/pdf/hearing_summary_caa_5.pdf

²² <http://www.caa.co.uk/docs/5/ergdocs/cccompetitionpaper.pdf>

suggesting that this is relevant;

...

2.15 In short, the CC has failed to analyse one of the major sources of constraint on Stansted's conduct. Whilst, the price controlled airports of Heathrow and Gatwick cannot be viewed as operating 'as if' they were wholly independent competitors, it is equally inappropriate to ignore the potential for these airports to constrain Stansted, as the price caps on these airports affect the incentives faced by BAA at Stansted. The price caps on Heathrow and Gatwick prevent BAA from coordinating price rises across the airports and dull the incentive to do so, as gains experienced at Heathrow and Gatwick are 'clawed back' by the price control mechanisms at these airports. As a consequence, the price caps at Heathrow and Gatwick are a relevant source of 'competitive' constraint on Stansted.

...

2.21 ... evidence suggests that regional UK airports could collectively impose a discipline that is similar in magnitude to that of Luton.

...

2.36 The CC then identifies some limitations to this type of analysis before concluding that:

"For this reason, we do not agree with the CAA that there is a significant competitive constraint on Stansted from non-London airports."

2.37 However, the CAA did not suggest that the survey evidence was sufficient to conclude that there "is a significant competitive constraint from non-London airports". Rather, the CAA argued that this piece of evidence provided some supportive evidence that there was current and potential competition from regional airports.

2.38 However, the CC goes on to summarise this evidence by stating that it "...showed little, if any, evidence of a competitive constraint being imposed on Stansted from non-BAA airports outside London." It is difficult to understand how this evidence – albeit evidence that is not definitive or without some shortcomings – can reasonably be viewed as showing "little, if any" evidence of competitive constraints. The fact that around 40 per cent of passengers indicated some preference for a non-BAA airport outside London suggests that this summary is both unreasonable and untenable, not least given the growth in recent years of regional airports relative to those in London.

2.39 Indeed, this example provides a useful illustration of the overall construction of the CC's argument¹⁵: dismissing individual pieces of evidence in their entirety whenever they are not individually sufficient to indicate that Stansted faces competitive constraints. Such an approach inevitably leads to overly definitive conclusions on individual aspects of the analysis which, when all of these individual conclusions are assimilated, will tend to lead to into an overly definitive conclusion that is out of line with the overall balance of the evidence, whereas a balanced assessment of each individual aspect would lead to a more balanced and appropriate overall conclusion. The CAA also notes that the CC's current approach stands in stark contrast with the reality that market power is always a matter of degree rather than absolutes.

...

7.7 It is clearly important to understand the reasons for excluding regional (and other) airports from the CC's analysis in light of the fact that cumulatively these airports appear to offer a competitive constraint similar in magnitude to Luton, based on:

- the CC's catchment analysis (Table 2) which shows regional airports with a greater overlap than Luton (10 versus 9 per cent);
- the CAA's survey evidence (which indicates that 40 per cent of Stansted passenger have some preference for a non-London airport);
- • BAA's survey evidence which shows that 13 per cent of BAA's passengers expressed a second

choice of Luton whilst 12 per cent gave a regional airport.	
THE CAA'S INITIAL VIEWS ON STANSTED MARKET POWER (2012)²³	
10.	In order to establish a geographic market for the supply of services to passengers, we consider a range of evidence, including a number of different ways to define an airport catchment. This showed that there were significant overlaps between the catchment areas of Stansted and all of the major London airports, and that they all draw a significant proportion of their passengers from the Greater London area. These overlaps, when combined with the location of the airport and evidence on passenger responsiveness, supports the view that the relevant geographic market covers the South East of England, Greater London and includes a number of districts falling in the East Anglia planning region.
THE CAA'S SCARCE CAPACITY DECISION ON THE MOSCOW ROUTE (2012)²⁴	
91.	As noted in paragraphs 36 to 40, the CAA considers that the Commission's decision on market definition in the IAG-bmi merger case is not directly comparable to the current case. However, both Virgin and easyJet made reference to the Commission's assessment and so the CAA has given careful consideration to that decision.
92.	In that decision, the Commission discussed a working paper of the CAA analysing the catchment areas of Heathrow, Gatwick, Luton and Stansted. As noted by the Commission, that paper concluded that there was a considerable extent of catchment area overlap between Heathrow, Gatwick, Luton and Stansted, although the Commission was unable to conclude whether or not flights offered from these various airports are substitutable for passengers travelling on specific routes. In its decision, the Commission also considered the CAA's initial view on airport market power, which was published in January 2012 and which is subject to revision on the basis of comments received. This suggests that there is a degree of substitutability between Gatwick and Heathrow. The CAA notes that easyJet's argument that many passengers would be willing and able to travel through either Heathrow or Gatwick is consistent with these assessments.
93.	Having considered all the evidence presented by the parties, the Panel therefore confirms its view, as set out in the Panel Brief, that the relevant geographic definition of the market is London-Moscow.
THE CAA'S CONSULTATION DOCUMENT (JANUARY 2013)	
6.	<p>The CAA has adopted the standard approach of regulators engaged in assessing market power and has sought, as a starting point for its analysis, to define the relevant markets in which Stansted Airport Limited (STAL) operates. This provides the framework for analysing competitive constraints, whether they come from within or outside the market. The CAA is minded to take the view that STAL currently operates in two distinct markets, combining the product and geographic dimensions of market definition:</p> <p>Core aeronautical services for Low Cost Carriers (LCC) and charter airlines covering a geographic market that includes at least Stansted, Luton, Southend and possibly Gatwick. This market is referred to as the Stansted short-haul market.</p> <p>Core cargo aeronautical services⁸ provided to cargo-only airlines at Stansted. This market is referred to as the Stansted cargo market.</p> <p>...</p>
4.92	Although far from definitive this is supportive of the evidence that the CAA has received to date showing that for both of Stansted's largest airlines there is lower route overlap between Stansted and Luton than between Stansted and other possible competing airports, thus suggesting that from an airline perspective, Luton may be perceived as a closer substitute to Stansted than other London airports.

²³ <http://www.caa.co.uk/docs/5/StanstedMarketPowerAssessment.pdf>

²⁴ <http://www.caa.co.uk/docs/213/20121024MoscowFinal1.pdf>

...

4.158 For LCCs and charters the CAA has evaluated evidence that suggests both Luton and Southend are sufficiently substitutable with Stansted. Whereas the evidence on substitutability of Heathrow, London City, Birmingham, East Midlands and Manchester suggests that these airports are poor substitutes for Stansted. The reasons differ from airport to airport but include congestion, price, infrastructure and remoteness from the Stansted catchment.

...

7.26 The CAA acknowledges that the development of competition among London airports is still in its early stages with the relatively recent transfer of Stansted and Gatwick airports to their new owners. The legacy of joint ownership of these airports and Heathrow has had an influence on the extent of current rivalry among the main London airports in terms of how they are perceived by passengers, existing patterns of use and consequently the willingness of passenger and airlines to switch. It remains to be seen how the market will develop over future years and how it will fulfil the potential for competition that the Competition Commission saw when it recommended the sale of Stansted and Gatwick.

APPROACH TO THE POSSIBLE SEGMENTATION BETWEEN LOW-COST CARRIERS AND OTHER CARRIERS / PASSENGER AIRLINES AND CARGO AIRLINES

CC BAA MARKET INVESTIGATION - INITIAL SUBMISSIONS TO CC ON BAA MARKET INVESTIGATION (MAY 2007)²⁵

2.18 The airline market is dynamic and has seen significant evolution in terms of airline business models and route networks over the last decade, notably with the emergence of no-frills carriers. However, there has also been some significant blurring in the traditional distinctions between the new entrant "no-frills" and incumbent airlines and between scheduled point-to-point and charter operations. For example, BA has recently adopted a "no-frills" fares structure on its short-haul routes, whilst easyJet now offers a number of services (for example, fixed price flexible fares, optional business lounges, flexible departure times, priority boarding etc) including, on certain routes, high frequencies and departure schedules that are designed to appeal to business traffic more usually associated with full-service incumbents. A number of charter carriers have also adapted their business models and now sell tickets on a "seat only" basis. More recently, long-haul point-to-point dedicated business carriers have entered the market at Luton and Stansted serving a segment of passengers previously the domain of formal network businesses.

THE CAA'S GUIDANCE ON THE ASSESSMENT OF AIRPORT MARKET POWER (APRIL 2011)²⁶

3.40 Historically it has been common to distinguish between three main airline business models: "full service" or "legacy" carriers; "no frills" or "low cost" carriers, both of which offer scheduled services; and charter carriers, traditionally used by tour operators for package holidays. However, the boundaries between the various airline business models are becoming increasingly blurred, with "full service" carriers adopting pricing structures introduced by "low cost" carriers, and some "low cost" carriers offering additional "frills" such as loyalty programmes, assigned seats or fast track boarding. Charter carriers, on the other hand, also sell seat-only flights, whilst some no-frills carriers also sell accommodation through their websites. A further distinction exists between point-to-point services and network services, in that the latter involves airlines actively facilitating connections between two individual flights – whether wholly on their own services, or in conjunction with the services of other airlines – to provide for a large number of possible of origin/destination combinations, often with short haul flights "feeding" the airline's long haul flights.

THE CAA'S CONSULTATION DOCUMENT (JANUARY 2013)

FN42 Stansted was designed to serve a range of different airlines but most passengers that use this airport fly with low cost carriers (LCCs). While there is no exact definition of what a LCC is, the distinction between a LCC and a full service carrier is becoming harder to draw as airlines from each category have each adopted some of the practices of the other. For the purpose of this chapter we have deemed both easyJet and Ryanair to be LCCs. The LCC operating model is typically seen as having several elements, all of which help reduce operating costs: (1) flights are normally only available on a point-to-point basis; (2) a single class of service on board; (3) greater use of secondary airports; (4) ticket sales are carried out directly by the airline; (5) focus is on shorter routes; (6) a simplified fleet structure (often with only a single aircraft type); and (7) quick turnaround times.

...

4.35 By comparison to LCCs, long-haul carriers have significantly greater price and service differentiation in passengers with three distinct groupings; economy, business, and first class. In order to meet the needs of certain classes long-haul carriers may require access to additional airport facilities, such as lounges and priority security lanes for business and first class passengers. Some long-haul carriers also require an extensive short-haul network from which to feed their long haul services, to ensure sufficient load factors on these flights. The use of feeder traffic requires additional airport facility to transfer passengers between aircraft without the passengers leaving the airport, such as a transfer baggage system. Some airlines, such as BA or Lufthansa, provide the majority of their own network. Other airlines such as Virgin

²⁵ http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2007/airports/pdf/third_party_submission_caa.pdf
²⁶ <http://www.caa.co.uk/docs/5/Final%20Competition%20Assessment%20Guidelines%20-%20FINAL.pdf>

Atlantic Ltd. (Virgin) operate using code share agreements allowing passengers to transfer from other carriers such as Flybe. In contrast, the LCC business model does not allow for this to take place in an integrated manner.

...

4.44 At this stage, the CAA is minded to consider that it is appropriate to segregate the airport operation service market by service provided to short-haul LCC and charter operators against those provided to full service Long-Haul carriers and associated feeder traffic. This segregation is based on the demand characteristics of these broad airline groups as well as limited opportunities for supply-side substitution.

...

4.151 The CAA's analysis suggests that airports supply a broadly generic product. Where the CAA sees differentiation in the product market is in the facilities required to service particular segments; LCCs and charters, full service long-haul carriers and their associated feeder traffic, and cargo-only operators.

4.152 For LCCs and charters the CAA sees limited differentiation in their passenger base which results in the need for generic facilities. Additionally LCCs require the airport be to be able to provide tight turnaround times for their operations.

4.153 Full service long-haul carriers and their associated feeder traffic have a segmented passenger base requiring the provision of facilities for these passengers, i.e. first class and business lounges. There is also a requirement to allow for passengers to interline between the feeder flights and the long-haul flights to ensure efficient load factors.

...

4.155 The CAA is minded to consider that each of these would form distinct product markets.

...

5.155 First, Due to the nature of modelling, it is important to consider the limitations of each of these estimates. the NAPALM model used by the CAA (as well as by Frontier Economics) has a number of limitations, key among which are the following.

- The model treats passengers travelling in full service scheduled, charter and LCCs separately. As a result, given the very high proportion of low cost traffic at Stansted, the demand that is displaced from Stansted cannot go directly to Heathrow, as there are no low cost services there. It will have to go to low cost services at Luton and Gatwick. There is also an effect of increasing route specialisation over time whereby the airports in the model retain their existing routes. We believe that this artificial separation may weaken the extent of substitution reported by the model, depending on whether there are enough alternative services at Gatwick and Luton...