

APD 13

**Investigation under Section 41
of the Airports Act 1986
of the structure of airport charges levied by
Gatwick Airport Limited -**

CAA decision

17 JANUARY 2013

**DECISION OF AN INVESTIGATION UNDER REGULATION 11(1) OF THE CIVIL
AVIATION AUTHORITY (ECONOMIC REGULATION OF AIRPORTS)
REGULATIONS 1986**

Before: Mr I Osborne, Member of the Authority

SUMMARY

- S1 In April 2011, Gatwick Airport Limited (GAL) re-structured its airport charges, increasing its Summer landing charges by 62.5%, whilst reducing Winter landing charges to zero for most aircraft and leaving other airport charges unchanged. Flybe complained, under section 41 of the Airports Act 1986 that loading all of the increase in airport charges allowed under the CAA's price cap onto landing charges unreasonably discriminated against it and other operators of small aircraft at Gatwick.
- S2 The CAA investigated Flybe's complaint and in September 2012 published its provisional decision that although GAL's increased landing charges discriminated against users of small aircraft, the discrimination was not unreasonable as GAL's objective in re-structuring its charges of increasing the efficient use of its single runway justified its decision to make the changes challenged by Flybe.
- S3 The CAA has taken account of representations on its provisional decision, but has seen no evidence that has caused it to change its provisional finding.
- S4 The CAA's decision, therefore, is that GAL has not unreasonably discriminated against any particular user of the airport or class of users.
- S5 The CAA considers that some passengers may be harmed by GAL's changes to its charging structure. However, the CAA's conclusion is that the numbers involved are likely to be small and the adverse effects would be balanced by benefits to other passengers.

1. INTRODUCTION

1.1. This document sets out the CAA's decision following its investigation, under section 41 of the Airports Act 1986 (the Act), into whether GAL unreasonably discriminated against any particular user or class of user of the airport in its landing charges when re-structuring its airport charges from 1 April 2011.

Structure of document

1.2. The document is structured as follows:

- section 1 sets out the timeline of the complaint and the CAA's investigation, and the statutory and policy framework in the Act under which the CAA has powers to investigate GAL's conduct;
- section 2 sets out GAL's changes to its structure of charges. It includes summaries of Flybe's complaint, GAL's response to the allegations, and representations from other parties. It goes on to summarise the representations on the CAA's provisional decision of 14 September 2012;
- section 3 contains the CAA's approach to investigating an airport operator's conduct under section 41, a consideration of the appropriate users and classes of users for this investigation, whether GAL discriminates against any of these users or classes of users, and, if there was discrimination, whether the discrimination was unreasonable or GAL had an objective justification for its conduct;
- section 4 considers how GAL's charges have affected Flybe, competition between airports, competition between airlines, and regional services;
- section 5 states the CAA's conclusions having regard to its statutory duties under the Act; and
- section 6 sets out the CAA's decision.

Summary of the complaint against Gatwick Airport Limited (GAL)

1.3. Flybe complained to the CAA on 29 March 2011 that when GAL set its airport charges for 2011/12, the airport operator carried out a course of conduct specified in section 41 of the Act. In setting its airport charges GAL:

- put all of the maximum increase permitted by the CAA price control onto landing charges, leaving per passenger charges and aircraft parking charges unchanged;
- increased Summer landing charges by 62.5%; and
- reduced Winter charges for most aircraft types to zero.

1.4. Flybe alleged that:

- GAL's new charging structure represented an unreasonable discrimination against Flybe and/or against all operators of small aircraft at Gatwick and that GAL (as a dominant operator) was subject to a special responsibility not to act in a way that harms competition, without objective justification;
- GAL's charging structure would not achieve the airport operator's declared objective of seeking to increase the average number of passengers per aircraft movement; and
- GAL's charging structure might not be in the reasonable interests of the users of airports in the United Kingdom because it would limit the potential for point-to-point travel to/from London and the rest of the UK and the chance for the whole of the UK to connect to the world.

1.5. In September 2011, the CAA said that after a preliminary assessment of the case it was not minded to investigate the complaint further¹. The CAA's provisional view was that GAL had an objective justification for the charging structure it had adopted as it was designed to enhance the efficient use of Gatwick's scarce airport capacity – its single runway. Before confirming its view, however, the CAA invited representations from interested parties.

1.6. The CAA received responses to its consultation from GAL, Flybe, Aurigny, the States of Guernsey, BAA, Ryanair, Thomas Cook and two general aviation pilots². Flybe's response raised some issues that the CAA considered were worthy of further consideration. These included: the extent to which the effects of GAL's revised structure of charges could be observed at the time; whether the slot allocation system could frustrate GAL's aim of increasing the passenger use of its runway; and whether the revised charging structure affected competition between airlines.

1.7. On 10 May 2012, the CAA held an oral hearing at which Flybe and GAL set out their respective cases to the CAA and the CAA questioned both parties. To assist its deliberations, the CAA sent the parties a statement of core issues on which it would particularly value submissions at the hearing. The key issues, which the parties endeavoured to address at the hearing, were:

- Is GAL in a position of significant market power?
- Is there an objective justification for the pricing structure that GAL has adopted?
- Does GAL's revised pricing structure cause harm or have the potential to cause harm to passengers and/or the competitive process?

¹ 'Investigation under section 41 of the Airports Act 1986 of a complaint made by Flybe against Gatwick Airport Limited – a consultation' (September 2011), on the CAA website at <http://www.caa.co.uk/docs/5/GatwickFlybeConsult.pdf>.

² The responses are on the CAA website at <http://www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=12786>.

- 1.8. On 14 September 2012, the CAA published its provisional decision that GAL had not unreasonably discriminated against operators of small aircraft³. The CAA said it was making a provisional decision rather than a final decision at that stage, because it had examined its own statistical and survey data in considering the case, and had also used additional information on GAL's bilateral discussions with airlines provided by GAL at the CAA's request. The CAA wanted to give interested parties the opportunity to comment on its use of such data and the conclusions drawn from it. The CAA also wanted to give the parties the chance to comment on the CAA's reasoning in the case.
- 1.9. The CAA received representations on its provisional decision from GAL, Flybe and the Aberdeen and Grampian Chamber of Commerce.

Statutory and Policy Framework for the CAA's investigation

- 1.10. The economic regulation of airports in Great Britain is currently governed by the Act⁴. Under the Act, an airport operator with an annual turnover exceeding £1m must obtain a permission to levy airport charges. A permission to levy airport charges has been granted in respect of Gatwick Airport.
- 1.11. Under section 41 of the Act the CAA may, if it thinks fit and where there is a permission to levy airport charges in force, impose a condition on the airport operator where it appears that it is carrying out a course of conduct specified in section 41(3). One of the courses of conduct is:
- (a) the adoption by the airport operator, in relation to any relevant activities carried on by him at the airport, of any trade practice, or any pricing policy, which unreasonably discriminates against any class of users of the airport or any particular user or which unfairly exploits his bargaining position relative to users of the airport generally.
- 1.12. Users of the airport are defined in section 82 of the Act as:
- a person for whom any services or facilities falling within the definition of "relevant activities" are provided at the airport; or
 - a person using any of the air transport services operating from the airport.
- 1.13. This definition includes both airlines operating at the airport and passengers flying to or from the airport.

³ Investigation under section 41 of the Airports Act 1986 of the structure of airport charges levied by Gatwick Airport Limited – CAA provisional decision (14 September 2012), on the CAA website at <http://www.caa.co.uk/docs/2175/GALChargesProvDecision.pdf>.

⁴ The framework for the economic regulation of airports will undergo significant changes under the Civil Aviation Act 2012 that received Royal Assent on 19 December 2012. See paragraph 1.19.

- 1.14. Relevant activities are defined in section 36(1) of the Act as the provision at the airport of any services or facilities for the purposes of:
- the landing, parking or taking off of aircraft;
 - the servicing of aircraft (including the supply of fuel); or
 - the handling of passengers or their baggage or of cargo at all stages while on airport premises (including the transfer of passengers, their baggage or cargo to and from aircraft).
- 1.15. Flybe and the other airlines which were said to fall within the ambit of the alleged discrimination receive relevant activities from GAL at Gatwick and so are users of the airport.
- 1.16. Under Regulation 11(1) of the Civil Aviation Authority (Economic Regulation of Airports) Regulations 1986 (the Regulations), if it appears to the CAA that an airport operator *may* be pursuing one of the courses of conduct specified in section 41(3) of the Act, the CAA shall investigate the matter. The Regulations do not specify the form of the CAA's investigation. The CAA therefore has broad discretion in deciding how it should conduct an investigation. The CAA's process allows for both written and oral representations to be made to it.
- 1.17. In carrying out its regulatory functions under the Act, including assessing whether it appears that an airport operator has engaged in conduct described in section 41 of the Act, section 39 of the Act requires that the CAA does so in the manner it considers is best calculated:
- to further the reasonable interests of users of airports within the United Kingdom;
 - to promote the efficient, economic and profitable operation of such airports;
 - to encourage investment in new facilities at airports in time to satisfy anticipated demands by the users of such airports; and
 - to impose the minimum restrictions that are consistent with the performance by the CAA of its regulatory functions under the Act.
- 1.18. In December 2006, the CAA published its policy and processes for handling section 41 cases⁵. It said that it would handle cases in a way that was consistent with its statutory powers and duties in the Act and, to avoid the danger of arbitrary or distortionary regulatory interventions, would expect to adopt an approach that was consistent with the application of competition law, except where the circumstances of a particular case suggested it should follow a different approach. The rationale for this is that the exercise of the

⁵ The CAA's use of section 41 of the Airports Act 1986 – the CAA's policy and processes (December 2006), available at <http://www.caa.co.uk/docs/5/ergdocs/section41policy.pdf>.

CAA's functions under section 41 is sufficiently akin to the power of the Office of Fair Trading (OFT) when it applies competition law for the CAA to have regard to the analytical framework that would be adopted by the OFT when handling comparable cases under the Competition Act. The CAA observed that, in practice, this is likely to result in decisions which would be consistent under both section 41 and national and European competition law. The CAA made clear that it would, however, remain open to argument, in any particular case, that its powers and duties may lead it to a different conclusion than would result from applying the Competition Act.

- 1.19. In the present case, this means that the CAA will have regard to the approach taken to discriminatory conduct under competition law in considering whether it appears that GAL has pursued a course of conduct that amounts to unreasonable discrimination under section 41. The relationship between section 41 and competition considerations is expanded upon in paragraphs 3.2 to 3.10.

Statutory remedy

- 1.20. Should the CAA find at the end of this investigation that it appears that an airport operator has pursued a course of conduct described in section 41 it can, if it thinks fit, impose conditions on the airport operator to remedy or prevent what it considers to be the adverse effects of that conduct. Under section 41(6) the CAA would have to notify the airport operator of any conditions it proposed to impose and if, within one month, the airport operator objected to the proposal the CAA could not proceed with the implementation of its proposed conditions, but could instead make a reference to the Competition Commission under section 43(3) of the Act.

Airport regulation under the Civil Aviation Act 2012

- 1.21. The Civil Aviation Act 2012 received Royal Assent on 19 December 2012. The Act introduces a new regime of economic regulation of airports which will replace that of Part IV of the Airports Act 1986, including section 41. The Government is currently consulting on the transitional arrangements for bringing the new regime fully into effect by 1 April 2014. In the meantime, the CAA would retain its powers under section 41 with respect to designated airports (Heathrow, Gatwick and Stansted) until 31 March 2014. Consequently, the CAA would be able to investigate airport operator conduct under section 41 until that date and, where appropriate, apply conditions. However, any conditions imposed by the CAA under section 41 would lapse on 31 March 2014 although the CAA would have powers to enforce a condition on an airport operator where a breach occurred before 31 March 2014. The CAA, however, will, under the Civil Aviation Act 2012, have the powers to impose licence conditions on an airport operator that meets the market power test. The CAA will also, under the Civil Aviation Act 2012, obtain concurrent powers, with the OFT, that will enable it to investigate the

conduct of an airport operator under the Competition Act 1998⁶. Where the CAA is in the process of investigating a complaint brought under section 41 and there is not a reasonable prospect of the investigation (and any subsequent process) being completed by 31 March 2014 it could decide to use its competition powers instead in relation to the same complaint.

⁶ Agreements between undertakings, decisions by associations of undertakings or concerted practices which may affect trade within the UK, and have as their object or effect the prevention, restriction or distortion of competition within the UK; and abuses of a dominant position in a market that may affect trade within the UK are prohibited under the Competition Act.

2. BACKGROUND TO THE COMPLAINT

2.1. This section sets out GAL's changes to its structure of charges. It then includes summaries of Flybe's complaint, GAL's response to the allegations, and representations from other parties. Finally, it summarises the representations made in response to the CAA's provisional decision of 14 September 2012.

GAL's changes to its structure of charges

- 2.2. Gatwick Airport is designated by the Secretary of State under section 40(10) of the Act for price control. In March 2008, the CAA set a price control that limits the maximum average revenue per passenger that GAL can receive from airport charges at the airport for each of the five years from 1 April 2008 to 31 March 2013⁷.
- 2.3. The price control does not prescribe the structure of airport charges at Gatwick and GAL therefore has discretion to structure its charges within the constraint of the overall price cap. In its price control decision the CAA said that the structure of charges was first and foremost the responsibility of the airport operator following consultation with its airline users. The CAA did not propose to involve itself in the determination of the structure of airport charges although it would consider under its section 41 powers, and in line with its guidelines for the operation of these powers, any case brought by an airline which alleged undue discrimination which might have been effected through changes in the structure of charges⁸.
- 2.4. GAL's airport charges for 2011/12 consisted of charges on departing passengers, aircraft parking charges, an emissions charge (NOx charge), and aircraft landing charges.
- 2.5. In July 2010 GAL had commenced discussions with the airline community on changes to the structure of charges through the Finance Performance and Regulatory Charging Group (FPRCG). GAL said that one of the key principles that shaped its proposals was to encourage the efficient use of scarce resources. In particular, it wanted to encourage better utilisation of the airport facilities at peak hours and during the off-peak seasons (effectively the Summer off-peak (April-June and September-October) and the Winter season (November-March)). GAL regarded the public interest in the efficient use of existing airport infrastructure as aligned to the interests of the airport and airlines as increased traffic handled through the existing infrastructure would, other things being equal, reduce the unit operating and capital costs for the

⁷ In April 2011, the CAA extended the price control for an additional year so it expires on 31 March 2014.

airlines and enhance the competitive positioning of Gatwick. GAL also stated the following would be key elements of the structure of charges:

- balance between passenger and landing charges;
- peak/off peak and summer/winter differentials; and
- environmental signalling.

2.6. In January 2011, GAL announced its decision on its airport charges for 2011/12. Its decision was:

- to charge up to the maximum average price cap of £7.946 per passenger;
- to increase Summer landing charges by 62.5%;
- to reduce Winter landing charges for most aircraft to zero;
- to leave per passenger charges (domestic, Republic of Ireland and international charges) unchanged;
- to leave aircraft parking charges unchanged; and
- to leave emissions charges unchanged.

2.7. The whole of the permitted increase in charges was therefore loaded onto Summer landing charges.

Summary of Flybe's complaint

2.8. Flybe argued that the revised structure of charges, with all of the increase allowed under the CAA price cap loaded onto landing charges, unreasonably discriminated against it as well as other operators of smaller aircraft at Gatwick. Flybe also complained about peak pricing. However, in subsequent correspondence and at the hearing Flybe mentioned that its main concern was with the loading onto landing charges of all of the permitted increase allowed under the price control.

2.9. Flybe estimated that the total airport charges it paid at Gatwick would rise on average by 18% per departing passenger in 2011/12 compared to the previous year. On a route by route basis the increase ranged from 5% to 22% on domestic routes and between 35% and 68% on its international routes. Since it was the largest operator of domestic scheduled services at Gatwick, and the third largest overall in terms of aircraft movements, Flybe argued that an average increase of 18% would have a significant impact upon a large number of passengers through higher fares or the withdrawal of services on particular routes. Therefore, in the context of the CAA's duties under section 39 of the Act, Flybe contended that the CAA should consider the impact of the structure of GAL's charges on a wide market of passengers

⁸ Economic Regulation of Heathrow and Gatwick Airports 2008-2013 – CAA Decision (March 2008) paragraphs 3.28 and 3.29. Available at http://www.caa.co.uk/docs/5/ergdocs/heathrowgatwickdecision_march08.pdf.

including those travelling point to point between London and regional points and those wishing to connect to the world via Gatwick.

- 2.10. Flybe said that during the consultation on charges GAL had made it clear that its intention was to encourage the use by airlines of wide-body long haul aircraft at the expense of small aircraft. Flybe argued that Government policy with regard to runway capacity in the South East had placed a special responsibility on GAL not to abuse the special position it held as the proprietor of Gatwick's single runway. Furthermore, Flybe thought that GAL had a special responsibility under competition law not to abuse its dominant position.
- 2.11. Flybe stressed its position as a specialist in the provision of regional services and its contribution to a policy of developing regional air services in response to pressures on airport capacity in the South East. By undermining Flybe's services GAL's charges had a damaging effect on regional services and communities.
- 2.12. Flybe claimed it had invested significantly in establishing its Gatwick base and it had a legitimate expectation that it would be supported by GAL.
- 2.13. Flybe contended that the increase in landing charges had a particularly severe impact on its operations because there were fewer passengers across whom an operator of smaller aircraft could spread the charges. Furthermore, because it generally operated a four times a day service, more of its frequencies were caught by the higher peak charges than some of its competitors such as easyJet which operated fewer daily services.
- 2.14. Flybe thought it was not certain that GAL's revised airport charges would achieve its objective to increase the average number of passengers per air transport movement at Gatwick. Flybe played a significant role in both providing domestic and short haul European services into Gatwick and in feeding traffic into the networks of other short haul and long haul operators at the airport. If Flybe, and other short haul airlines, were squeezed out of Gatwick, long haul airlines would be more likely to choose to operate at other airports. This would not meet the CAA's statutory objective of promoting the efficient, economic and profitable operation of Gatwick.
- 2.15. Flybe also thought that the rigidities in the system of slot allocation meant that GAL's pricing policy would not have the intended effects, as there was no mechanism by which it could ensure that users of small aircraft would give up slots, nor that users of larger aircraft would obtain the slots necessary for them to operate new services at Gatwick.
- 2.16. If the CAA found that GAL had been unreasonably discriminating, Flybe suggested that the remedy should be a restriction on increases in charges on any one airline that is limited to twice the maximum percentage permitted increase in yield per passenger under the price control. This remedy would

be similar to that in a 1989 section 41 case about Heathrow's charges for domestic services⁹.

Summary of GAL's Response

- 2.17. GAL contended that its new charging structure was objectively justified by the reasons for its introduction as set out in paragraph 2.5 above - the need to make efficient use of a scarce resource - being the single runway at Gatwick. GAL said that there was excess demand for arrival and departure slots throughout most of the day, in most days of the week during the Summer months. This prevented passengers and airlines that would like to access the constrained facilities at Gatwick from doing so even if they attached greater value to the use of the slot than the incumbent passengers and airlines.
- 2.18. GAL referred to a European Commission report on sub-optimal slot use at congested airports¹⁰, which concluded that the system of slot co-ordination should be designed to ensure that limited capacity is used as effectively as possible. This report referred to the fact that the high proportion of small aircraft at some airports had limited the number of passengers using the airports and had prevented efficient slot use. GAL was seeking to encourage the effective utilisation of peak slots by attaching a premium to those slots, and encouraging slot use across the Summer period, whilst incentivising slot use outside peak periods.
- 2.19. GAL was seeking to encourage the use of peak slots by aircraft carrying more passengers, by both higher load factors and, potentially, larger aircraft. Those using smaller aircraft should recognise the opportunity cost associated with their use of those slots.
- 2.20. GAL said that the CAA's Q5 decision set an overall price cap which offered price protection to airlines and passengers as a whole¹¹. It was left to its own discretion to set the structure of charges within the confines of the revenue yield per passenger price cap. It had chosen to do so in a way which addressed, at least in part, the inherent inefficiency of the slot allocation mechanism.
- 2.21. GAL said that the services which Flybe had ceased operating since the introduction of the new charging structure were the worst performing with load factors significantly below Flybe's average at Gatwick. This was evidence of

⁹ APD3 – Decision on investigation under Regulation 11(1) of the Civil Aviation Authority (Economic Regulation of Airports) Regulations 1986 at <http://www.caa.co.uk/docs/5/ergdocs/APD3HeathrowDomestic.pdf>.

¹⁰ European Commission: Impact assessment of revisions to Regulation 95/93 – Final report (March 2011).

¹¹ In its response to the CAA's provisional decision Flybe said this was factually incorrect as the price control did not offer Flybe any price protection. This is an incomplete picture. The price control limits the amount that GAL can receive from airport charges per passenger in total (or 'as a whole'). However, the price control does not limit the amount that GAL can receive from individual airlines or passengers, nor the total revenue that the airport operator can receive from airport charges as it can receive more if it attracts more passengers. Section 41 offers protection for individual airlines and passengers, as the CAA has powers to remedy charges levied on an individual airline (or class of airlines) that are unreasonably discriminatory.

the new charges starting to deliver the more efficient use of scarce assets to the benefit of passengers.

- 2.22. GAL denied that it intended to unreasonably discriminate against operators of smaller aircraft, but was recognising the economic cost of airlines using slots at peak periods.
- 2.23. GAL agreed with the CAA's position in its September 2011 consultation that it should not use section 41 to pursue wider policy goals of regional connectivity, and should rather apply its section 39 duties alone.

Summary of other submissions

- 2.24. Aurigny Air Services (which operates services between Gatwick and Guernsey) said that GAL had acknowledged that it would be the most proportionally affected operator as a result of the re-structuring of charges. Aurigny said that the logical conclusion of GAL's pricing strategy would be that operators of relatively small aircraft would only operate at Gatwick in the Winter. Aurigny considered that the CAA had a duty to protect airport users who are providing vital regional routes on a year round basis.
- 2.25. The States of Guernsey regarded GAL's charges as discriminatory against operators of small aircraft, operators of year-round scheduled services and the passengers of those airlines, as they did not recognise the disproportionate impact they have on regional airlines operating smaller aircraft which operate lifeline services on a year round basis. It also thought the policy impacted disproportionately and unreasonably on operators of year-round scheduled services. The States of Guernsey said that the CAA had no statutory power to balance the interests of hypothetical future users of the airport against the interests of current users.
- 2.26. The States of Guernsey regarded Jersey and Guernsey as very dependent on their connections to the UK mainland and specifically into Gatwick which provided essential links to London and onward connections around the world. The States of Guernsey thought that any future continuation of GAL's strategy would undermine the viability of Guernsey's link to London and South East England.
- 2.27. 2.26 BAA supported the CAA's preliminary view in September 2011 that incentivising the effective use of assets could be an objective justification for a pricing policy. It also supported the CAA's view that an airport operator using its discretion to encourage more profitable traffic can be an efficient means of using capacity constrained facilities. BAA thought that an airport operator should be able to apply a pragmatic judgement so long as it had a reasonable basis on which to do so.
- 2.28. Ryanair supported competitive airport pricing structures which promoted growth and incentivised the efficient use of airport facilities. It considered

that, taken in isolation, GAL's revised landing charges appeared to serve this purpose and that the CAA could not uphold Flybe's complaint on the grounds submitted. However, Ryanair urged the CAA to highlight GAL's failure to apply growth and efficiency principles or competitive market prices to its overall pricing and policies.

- 2.29. Thomas Cook thought that higher landing charges in the Summer would simply act as windfall income for GAL at the expense of airlines, tour operators and passengers. It did not regard this as being in the reasonable interests of users. The higher charges would not cause airlines to move to off-peak times as their passengers were constrained by the dates of school holidays as to when they could travel. Thomas Cook, therefore, did not believe that GAL's charges would promote the efficient and economic operation of Gatwick.
- 2.30. Two general aviation pilots said that GAL unreasonably discriminated against users of light or small aircraft. One of the pilots thought that Gatwick had the capacity to accept more general aviation traffic than at present.

Summaries of responses to the CAA's provisional decision

- 2.31. GAL agreed with the CAA's provisional decision that it had not unreasonably discriminated against a class of users of the airport or any particular user. It thought that the provisional decision was supported by the evidence. GAL did not consider that the class of user used by the CAA was necessarily the correct definition. However, it agreed that an alternative definition would not make a material difference to the outcome of the case. GAL thought that the CAA should have taken account of opportunity costs in its consideration of direct discrimination. The CAA, therefore, should have been more equivocal in its conclusion that the common landing charge in the peak directly discriminated against operators of small aircraft.
- 2.32. Flybe did not agree with the CAA's provisional decision. It thought that GAL's charging policy was unreasonably discriminatory in principle and harmful to airline competition in practice. It made three main points:
- that GAL's charges discriminated between business models by charging Flybe which uses 78 seater aircraft 60% more than a competitor using 156 seater aircraft for the same capacity in terms of aircraft seats;
 - GAL had levied unfair and discriminatory increases in costs. Flybe's landing charges had increased by 83% since 2008, whilst a competitor using 156 seater aircraft had faced landing charge increases of 50% over the same period; and
 - there was little evidence that GAL's charging policy would achieve the desired effect, therefore, GAL's arguments were only a theoretical justification not supported by adequate reasoning.

- 2.33. Flybe said it was not seeking the maintenance of the status quo, rather the CAA should define ex ante the broad limits of GAL's discretion.
- 2.34. Flybe said that the CAA had committed a breach of natural justice by accepting in evidence, without testing, information provided by one party and not shared with the other. In particular it mentioned the evidence provided by GAL on its confidential business development discussions and the evidence of Airport Coordination Limited (ACL)¹² Flybe alleged that the CAA had taken the evidence at face value without testing its quality and robustness. Flybe thought that both GAL and Flybe would have no specific knowledge or experience of an airline's negotiating stance or strategic purpose. Flybe said that the CAA should disregard the evidence entirely.
- 2.35. Flybe thought that the CAA had failed to address the relevant precedent of the CAA's 1989 decision on a complaint by domestic airlines against Heathrow Airport's charges.
- 2.36. Flybe also thought that the CAA's failure to assess GAL's market power meant that it could not, on its own reasoning, properly assess the degree of harm or the degree to which the claimed objective justification is proportionate to it.
- 2.37. Flybe mentioned that the CAA had failed to address in its provisional decision:
- the States of Guernsey's argument that the CAA would be acting *ultra vires* if it took into account the views of hypothetical users of the airport. Flybe thought the CAA should explain why hypothetical users of, for example, an airport in China should take precedence over actual users in the UK; and
 - Thomas Cook's argument that the re-structuring of charges would not achieve the desired effect because the greater part of Thomas Cook's business is in the Summer peak months where the demand would not shift to the off-peak in response to peak pricing.
- 2.38. Flybe considered that to support GAL's objective the CAA would need to conclude that GAL could contemplate with reasonable certainty when slots will have transferred from use by smaller to larger aircraft. Without being clear about how far the slot allocation system impedes or slows down the effect of peak pricing, Flybe thought that the CAA could not conclude that the slot allocation system would merely delay, and not undermine, the achievement of GAL's objectives. Flybe also thought that the CAA had not asked itself whether the other mechanisms (apart from transferring slots) by

¹² ACL is an independent, not for profit company with a governance structure made up of eight UK airlines. ACL is responsible for slot allocation and schedule facilitation for a number of airports in the UK (including Gatwick) and worldwide.

which airlines could respond to the efficiency incentives created by GAL's airport charges could be expected to work in the way that GAL suggests.

- 2.39. Flybe thought that the CAA had not properly addressed its arguments that GAL's pricing policy would affect competition between different airline business models.
- 2.40. The Aberdeen and Grampian Chamber of Commerce was concerned that North East Scotland would be disadvantaged by GAL's charging structure. It said that Aberdeen Airport had a limited catchment area and a restricted market which resulted in airlines using smaller aircraft to service the market appropriately. Flybe had already announced that it would be withdrawing its Aberdeen to Gatwick service. The Chamber of Commerce thought that the CAA had deemed that passengers that cannot fly were non-passengers. It further thought that analysis of the influence of the changes to GAL's charging structure would demonstrate whether the benefits that GAL predicts are theoretical or actual.

3. CAA ANALYSIS

3.1. This section contains the CAA's approach to investigating an airport operator's conduct under section 41, a consideration of the appropriate users and classes of users for this investigation, whether GAL discriminates against any of these users or classes of users, and, if there was discrimination, whether the discrimination was unreasonable or GAL had an objective justification for its conduct.

Approach

3.2. As mentioned in paragraph 1.16, the CAA must treat section 41 cases in a manner consistent with its duties under section 39 of the Act and would expect, but is not compelled, to use an approach consistent with the application of competition law.

3.3. Flybe's complaint is that GAL has pursued one of the courses of conduct specified in section 41 of the Act, specifically because its new charging structure represents unreasonable discrimination against Flybe and/or all operators of small aircraft at Gatwick. In this regard, the CAA notes that:

- discrimination, being the course of conduct of which Flybe complains, is also one of the forms of conduct which may constitute an abuse of a dominant position under Article 102 of the Treaty on the Functioning of the European Union and/or the Chapter II prohibition in the Competition Act 1998, in particular where it involves the application of dissimilar conditions to equivalent transactions with other trading parties, thereby putting them at a competitive disadvantage¹³; and
- the need for discrimination to be unreasonable under section 41 will turn, at least in part, on whether there is an objective justification for discriminatory conduct. Similarly, under competition law, discriminatory conduct which might otherwise constitute an abuse of a dominant position may be objectively justified and hence not infringe competition law¹⁴.

3.4. Flybe's complaint therefore raises issues which are comparable to issues which may arise under competition law in these respects, and the CAA will have regard to the framework of competition law where relevant¹⁵.

¹³ Case law has also developed the proposition that discrimination can also involve the application of similar conditions to unequal transactions (see paragraph 3.13).

¹⁴ This refers to the concept of objective justification developed by the European Court and Commission. See for example Case 27/76 *United Brands v Commission* [1978] ECR207, paragraphs 189-192. The right of a dominant company to take proportionate steps to protect its position is an aspect of this.

¹⁵ For completeness, the CAA notes that, although not relevant to this case, the course of conduct specified in the remaining limb of section 41(3)(a) is that an airport operator has unfairly exploited its bargaining power relative to users of the airport generally. This is akin to a complaint of abuse of dominant position.

- 3.5. In considering whether conduct that is otherwise discriminatory is objectively justified, the CAA will have regard to the market power of the party alleged to have carried out a course of conduct and to the effect of the conduct on competition. In *United Brands*, it was held that even if the possibility of a counter-attack (in that case by a refusal to supply) is acceptable, that counter-attack must still be proportionate to the threat taking into account the economic strength of the undertakings confronting each other. Where the degree of market power is greater, the risk of harm must be greater and therefore the justification must be more clearly demonstrated to be proportionate¹⁶.
- 3.6. Similarly, conduct which has significant negative effects on competition will require stronger and more cogent justification. In *British Airways*¹⁷, the Court of Justice stated that the assessment of the economic justification for conduct (in that case, a system of discounts or bonuses) is to be made on the basis of the whole of the circumstances of the case, including whether the exclusionary effect arising from the conduct in question which is disadvantageous for competition may be counterbalanced, or outweighed, by advantages in terms of efficiency which also benefit the consumer. This decision indicates that the degree of harm must be balanced against the potential benefits from efficiency enhancements¹⁸. It follows that the greater the negative effects of the conduct in question, the greater the strength of the justification required to outweigh those effects. A similar approach is set out in the European Commission's Guidance Communication on Article 102¹⁹.
- 3.7. The CAA considers that this approach properly reflects its statutory duties, and in particular, the duty to further the reasonable interests of users, including both airlines and passengers. Harm to the competitive process between airlines will adversely affect not only the airline or airlines concerned, but also passengers, who are likely to benefit from competition between airlines, both in terms of price and service offering. In assessing the effect on competition, the CAA may have to take into account whether the airline in question is an efficient user of the airport's facilities.
- 3.8. If the CAA finds that GAL has pursued the course of conduct alleged, it can, if it thinks fit, impose conditions to remedy or prevent the adverse effects of that course of conduct. The CAA notes that it has a power, and not a duty, to impose a remedy in such circumstances.
- 3.9. In considering whether (and if so how) to exercise its power to impose a remedy, the CAA will have regard to (1) whether the airport operator in question has substantial market power and (2) the effect of the course of

¹⁶ *United Brands*, above paragraph 190.

¹⁷ Case C-05/04P *British Airways plc v Commission* [2009] ECR I-9291 paragraph 86.

¹⁸ This is an approach favoured by some competition economists. See for example W. Bishop "Price discrimination under Article 86: Political Economy in the European Court" 1981 44 MLR 282, 286-8.

¹⁹ Communication from the Commission – Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, 2009/C45/02.

conduct on competition and consumers. The CAA considers that this approach reflects and is consistent with its statutory duties. In addition, the CAA also notes that:

- its starting assumption is that to impose a condition on an airport operator without substantial market power would be likely to cut across its duty to impose minimum restrictions. Airport operators without such market power are less likely to act unreasonably against users, as the users are more likely to respond to such conduct by using an alternative airport. The CAA will therefore consider whether an operator has substantial market power before imposing any remedy. (As noted above, the degree of market power is also relevant to a finding that conduct is harmful and therefore likely to be found to be unreasonable within the terms of section 41 as it will affect the strength of objective justification needed to offset any harm as set out at paragraph 3.5 above); and
- whilst harm to competition may militate in favour of the imposition of a remedy, an absence of harm or potential harm to competition is a relevant consideration in the context of its duty only to impose minimum restrictions.

3.10. In addition to considering the effect on competition, the CAA will also consider whether any other aspect of its statutory duties has a bearing on the imposition of a remedy.

3.11. Accordingly, the approach taken in this decision is as follows:

- first, to consider whether Flybe is a particular user of Gatwick and whether operators of small aircraft are a class of users at Gatwick;
- second, to consider whether GAL's new charging structure constitutes discrimination against all operators of small aircraft at Gatwick (as a class of users of Gatwick) or Flybe (as a particular user of Gatwick);
- third, to consider the objective justification advanced by GAL, and some of the criticisms made of it by Flybe;
- fourth, to consider the effect of GAL's new charging structure on competition and passengers; and
- fifth, to draw conclusions, having regard to the CAA's statutory duties as a whole.

User and class of user

3.12. Users of airports are defined in section 82(1) of the Act. The definition encompasses both airlines operating at the airport and passengers who use the air transport services operating from the airport. As an airline operating at Gatwick, Flybe is a user of the airport. In its complaint, Flybe defined the users affected by GAL's alleged unreasonable discrimination as 'airlines who

provide domestic regional services into Gatwick with aircraft whose capacity is below 120 seats'²⁰. This is a detailed definition that specifies both the destination at the other end of the route and the size of the aircraft. There is no one definitive categorisation of aircraft size. ACL uses nine categories in its start of season reports. These could be split into three bands, of which 0-149 seats could be classified as 'small'. However, although alternative definitions of a class of user could be used, the CAA does not consider that using an alternative definition would make a material difference to its deliberations in this case²¹. The CAA used Flybe's definition in its provisional decision. In its response to the CAA's provisional decision GAL said that it did not consider that the class of user used by the CAA was necessarily the correct definition. However, it agreed that using an alternative definition would not make a material difference.

- 3.13. The CAA, therefore, uses Flybe's definition of 'airlines who provide domestic regional services into Gatwick with aircraft whose capacity is below 120 seats' as a class of users of the airport, which includes Flybe and Aurigny.

Has GAL discriminated against any class of users of the airport or any particular user?

- 3.14. Price discrimination for the purposes of section 41 can cover applying dissimilar terms for transactions which are equivalent in terms of cost of supply or similar terms for transactions which are dissimilar in terms of cost of supply²². The effect of such discrimination can affect the ability of the dominant supplier's rivals to compete effectively or they can affect the customer's ability to compete where the difference in treatment raises its cost in comparison with its competitors²³. Discrimination thus defined can be directed at a user or class of user.
- 3.15. The transaction being considered by the CAA in this case is the levying of a charge for the use of Gatwick's runway. The CAA did consider whether the relevant transaction is the wider use of Gatwick's facilities associated with an air transport movement. This is because an airline operating a passenger carrying aircraft cannot choose just to use the runway and pay landing charges. Both it and its passengers also have to use other airport facilities and consequently it has to pay other airport charges. However, the issue in section 41 in relation to a designated airport is not one of compliance with the price cap nor necessarily an examination of the totality of airport charges. It

²⁰ At the hearing, Flybe mentioned that the line which GAL had drawn between the winners and losers was around 156 seats. This tied in with Flybe's analysis comparing its 4 frequency a day operations using a 78 seat Q400 with easyJet's twice a day operations using a 156 seat A319. However, Flybe did not consider it would make a material difference whether small aircraft were defined with 120 or 156 seats.

²¹ The CAA will use the shorthand 'operators of small aircraft' to describe this class of users in the remainder of the document.

²² *Deutsche Lufthansa AG v ANA – Aeroports de Portugal SA* (Case C-181/106).

²³ For example, Case T-229/94 *Deutsche Bahn AG v Commission* [1997] 4 CMLR 220 and *Alpha Flight Services v Aeroports de Paris* [1998] OJ L230/10 [1998] 5 CMLR 611.

requires the CAA to consider whether in relation to any relevant activity the airport operator has adopted a course of conduct which unreasonably discriminates against a particular user or class of users. As set out in paragraph 1.13, section 36(1) sets out a number of relevant activities and landing of aircraft is one of those specified. It is GAL's conduct in relation to the landing charge which is the focus of Flybe's complaint and should therefore be the transaction which must be assessed to establish whether it is equivalent for both small and large aircraft.

3.16. As shown below in Table 1 GAL's landing charges are differentiated by time period (Summer peak, Summer off-peak and Winter), by noise category, and, to some extent, by aircraft weight with different charges for aircraft falling within different weight bands. Landing charges are highest for aircraft operating in the Summer peak, for aircraft in noisier categories and for larger aircraft. Conversely landing charges are lower for aircraft operating in the Winter, for quieter category aircraft and for lighter aircraft. No respondent has raised any concerns about varying charges by noise category.

Table 1 – Gatwick Airport landing charges from 1 April 2011 to 31 March 2012

£	Chapter 2 & non-certificated	Chapter 3 high	Chapter 3 base	Chapter 3 minus	Chapter 4
Summer Peak					
	4,769.56	2,384.78	1,589.85	1,430.87	1,351.37
Summer off-peak					
Less than 16 tonnes	462.54				
Less than 50 tonnes	1,387.62	693.81	462.54	416.29	393.16
Greater than 50 tonnes	1,565.49	782.74	521.83	469.65	443.55
Winter					
Less than 16 tonnes	462.54				
Less than 50 tonnes	1,387.62	693.81	0	0	0
Greater than 50 tonnes	1,565,49	782.74	0	0	0

Source: GAL – Conditions of Use: including airport charges 1st April 2011

3.17. Flybe's particular complaint was about GAL's Summer peak landing charge which, unlike the Summer off-peak charge, is not differentiated by aircraft weight. The same price, therefore, is applied to the landing of a small aircraft as to the landing of a large aircraft with the same noise classification. This

would not be discriminatory if the landing of a small aircraft is equivalent to the landing of a large aircraft in terms of the costs imposed on the airport operator. However, if these are not equivalent transactions, GAL's charges could be considered discriminatory. The CAA has been provided with no evidence on whether the costs imposed on GAL by aircraft of differing sizes are materially different, but the CAA considers that a smaller aircraft that does not require the full use of the runway is likely to impose lower costs than a larger aircraft that requires a longer runway to be provided and maintained²⁴. That GAL does differentiate its landing charges by aircraft weight to some extent at off-peak times implies that GAL might consider there to be a cost difference. This suggests that GAL's common charge in the peak directly discriminates against operators of small aircraft.

- 3.18. Information provided by GAL showed that when setting its charges it expected landing charges for Flybe and Aurigny to increase proportionally less than landing charges for other Gatwick airlines, as their flights were less concentrated in peak times than services of other airlines. However, because of their use of small aircraft carrying fewer passengers than the average Gatwick flight²⁵, landing charges account for a higher proportion of total airport charges paid by Flybe and Aurigny than they do for other airlines. Furthermore operators of small aircraft will have to recover the fixed landing charge in the peak from a smaller number of passengers than operators of larger aircraft. As GAL only increased landing charges and not the other elements of airport charges in 2011/12 GAL expected Flybe and Aurigny would face higher proportionate increases in their total airport charges than other airlines. This is consistent with the view that the new proposed landing charges do not reflect the accounting cost of supply. As GAL's changes to its airport charges affected both Flybe and Aurigny to a similar extent, the CAA does not consider that any discrimination would be against Flybe as a particular user of the airport.
- 3.19. In its decision of September 2012 the CAA provisionally concluded that GAL's landing charges discriminated against operators of small aircraft.
- 3.20. In its response to the provisional decision, GAL said that the CAA should take into account opportunity costs when considering direct discrimination. The CAA's approach, however, has been to consider accounting costs when considering direct discrimination. If it finds discrimination it then goes on to look at whether there is an objective justification for the airport operator's conduct. The CAA has considered opportunity costs in the context of the issue of objective justification which appears to be logical as they are not as

²⁴ The ICAO Airports Economics Manual (Doc 9562) says that aircraft weight is an 'accepted parameter to reflect how wear and tear and use of airport-provided facilities tend to increase as the weight of aircraft increase' (paragraph 5.15).

²⁵ The average number of passengers on Flybe's Gatwick flights were: 58 (in 2009), 55 (in 2010) and 58 (in 2011). In comparison the average number of passengers on all Gatwick flights in these same years were respectively 132, 134 and 138.

tangible as accounting costs, and, therefore, has not taken account of opportunity costs in deciding whether GAL's charges are discriminatory. In practice, at what stage the CAA considers opportunity costs does not make a difference to its decision on whether an airport operator has unreasonably discriminated. This is the test in section 41(3)(a).

- 3.21. The CAA, therefore, finds that GAL's landing charges discriminate against operators of small aircraft at Gatwick.
- 3.22. The CAA must now go on to consider whether this discrimination is unreasonable in terms of section 41(3). This requires considering whether there is a legitimate reason for the discrimination in the charging structure.

Does GAL have an objective justification for its charging structure?

- 3.23. In this section the CAA discusses GAL's proposed objective justification for its new charging structure, and a number of the criticisms made of it by Flybe. First, the CAA needs to consider whether GAL is in a position of substantial market power.

Is GAL in a position of substantial market power?

- 3.24. In its September 2011 consultation, the CAA said that it had worked on the presumption that GAL had substantial market power while it remained an operator of an airport designated by the Secretary of State for price control. In January 2012, the CAA published its initial views on a more up-to-date assessment of GAL's market power²⁶. The CAA's view was that while GAL appeared to still hold substantial market power on the basis of the evidence currently available, it was not able to come to a definitive finding at that stage of its assessment, and that there were a number of issues it needed to assess further.
- 3.25. GAL said it did not have substantial market power. Given the airport's sale by BAA to GIP, GAL thought it would be irrational for the CAA to assume it had substantial market power based on its current designation status and without a detailed assessment.
- 3.26. Flybe thought that GAL was a dominant operator in relation to certain classes of its customers who were effectively captive, including airlines such as Flybe who provided domestic regional services into Gatwick with aircraft with less than 120 seats. It said that slot constraints at Heathrow meant that it could not move its Gatwick services to Heathrow. Furthermore, none of Luton, Stansted or London City were effective substitutes for its Gatwick services. Ryanair and the States of Guernsey also thought that GAL had substantial market power. In its response to the CAA's provisional decision Flybe said

²⁶ 'Gatwick – Market power assessment - non-confidential version: the CAA's initial views' (February 2012) on the CAA website at <http://www.caa.co.uk/docs/5/GatwickMarketPowerAssessment.pdf>.

that the CAA had, in setting out its approach to section 41 cases, cited the case of *United Brands* in saying that the degree of market power affected the risk of harm and, therefore, the need to clearly demonstrate the objective justification²⁷. Flybe also said that as the CAA had not analysed the degree of GAL's market power, it could not properly assess the degree to which the objective justification is proportionate to it.

- 3.27. For the purposes of considering the effects of GAL's charging structure the CAA continues to presume that GAL has substantial market power. The CAA rejects Flybe's argument that it cannot reach a conclusion on unreasonable discrimination without carrying out a detailed assessment of GAL's degree of market power. The CAA's analysis has been carried out on the basis of an assumption which is favourable to Flybe, namely that the degree of market power held by GAL is substantial.

GAL's objective justification

- 3.28. GAL argued that its airport charges were objectively justified as it needed to make efficient and effective use of its single runway – a scarce resource²⁸. GAL thought that increased utilisation of its runway would improve its profitability within the current price control period as its fixed costs would be spread over more passengers. Furthermore, GAL said that as a rational commercial company it would make decisions it expects will be profitable for it. It therefore had a strong incentive to ensure greater efficiency.
- 3.29. It was common ground between GAL and Flybe that GAL's justification could be a proper objective justification. The CAA agrees. However, Flybe argued that GAL's objective was theoretical and that while GAL's intent might have been reasonable, it might not achieve its aim²⁹. In its response to the provisional decision, Flybe said there was little evidence that the charging policy would achieve the desired effect.
- 3.30. In considering the effects of GAL's charges, the CAA considers that it would be unreasonable to expect GAL to be able to forecast with complete accuracy the effects of its charging policy when that policy is introduced. The CAA is also mindful that it is not possible to distinguish completely the effects of GAL's revised pricing structure from other factors influencing the level of GAL's traffic since 1 April 2011. The CAA therefore considers that the existence of an objective justification does not depend on whether there is evidence that the policy has in practice led to a more efficient and effective use of Gatwick's runway. Rather, the CAA will consider whether GAL, when it was setting its charges for 2011/12, had a reasonable expectation that this would be the effect. The CAA has taken account of evidence relating to the

²⁷ See paragraph 3.4 of the CAA's provisional decision and paragraph 3.5 of this document.

²⁸ See GAL's response to the CAA's September 2011 consultation.

²⁹ At the hearing Flybe said 'that the justification for the discriminatory pricing is in reality a theoretical justification confined to a general statement of principle rather than adequately based on evidence that is specific and relevant to this case.'

position following the introduction of the new charges. The CAA's approach to this issue is consistent with the approach to objective justification under competition law. In the context of Article 102, the Commission has stated that where efficiencies are put forward by a dominant undertaking as justification for a course of conduct challenged as abusive, the efficiencies must have been, or have been *likely to be*, realised as a result of the conduct³⁰. The European Court recently referred to efficiency gains "*likely to result from the conduct under consideration*" (emphasis added) in the context of examining price discrimination³¹.

- 3.31. In considering whether the justification put forward by GAL is likely to be realised the CAA has looked at:
- if there is evidence of excess demand;
 - whether GAL's approach would be frustrated by the existing systems of slot allocation; and
 - what does experience so far tell us about the likely achievement of GAL's objective.

Is there evidence of excess demand?

- 3.32. GAL considered that the main evidence of excess demand for slots was data supplied by ACL showing that for the Summer 2010 season more slots were requested by airlines at the initial submissions stage of the slot allocation process than were available. The CAA spoke to ACL who said that airlines sometimes bid for slots that they do not subsequently use, perhaps because they could not obtain a slot at the other end of the route, or the demand does not materialise for the route as expected. However, even after taking such actions into account, ACL thought there was evidence of excess demand for Gatwick slots particularly during the morning peak in Summer.
- 3.33. Flybe thought that if there was excess demand for slots there would be a secondary market for them. ACL said that there was currently modest amounts of trading at Gatwick, with slots traded for modest sums. For example, the value of a slot pair at Heathrow is reportedly around £10-20m+ but is less than £1m at Gatwick. Many Gatwick slots are also not traded for a monetary value. ACL mentioned that Adria Airways had tried to sell Gatwick slots it obtained after selling Heathrow slots. Adria had tried to link the value of the slots at Gatwick to those at Heathrow. However, this did not work, as

³⁰ Communication from the Commission – Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, 2009/C45/02, paragraph 30.

³¹ Case C-209/10 *Post Danmark A/S v Konkurrencerådet*, paragraph 42

"In that last regard, it is for the dominant undertaking to show that the efficiency gains likely to result from the conduct under consideration counteract any likely negative effects on competition and consumer welfare in the affected markets, that those gains have been, or are likely to be, brought about as a result of that conduct, that such conduct is necessary for the achievement of those gains in efficiency and that it does not eliminate effective competition, by removing all or most existing sources of actual or potential competition."

the price was reportedly excessive for Gatwick, the slots were not traded and were returned to the slot pool. ACL also said that it would appear that a proportion of slot trades are undertaken by an airline to ensure that the slots do not return to the airport's slot pool and potentially be acquired by their competitors. Instead, airlines trade these types of slots with their strategic partners. The European Commission's 2011 report looked at the slots that easyJet had obtained since 2006 (a period in which its Gatwick slot holding had doubled). Of the new slots, the Commission's consultants (Steer Davies Gleave) estimated that 37% came from the acquisition of GB Airways; 18% from secondary trading and 44% were new incumbent (pool) slots. Evidence from slottrade.aero (the UK slot trading platform) shows that, following a peak in the number of slots traded per week between the Winter 2008 and Summer 2010 traffic seasons, both the number of slots traded and the number of transactions have exhibited a return to its average level³². The current modest level of trading suggests that the current level of excess demand, which may be influenced by recent economic conditions, may not be as much as it was previously. It nonetheless provides support for the contention that there is some excess demand.

- 3.34. At the hearing, GAL said it was aware of airlines that could not obtain all the slots they wanted to use at Gatwick. Subsequently, at the CAA's request, GAL provided the CAA with examples of airlines that had told the airport in confidential business development discussions that they would increase their services at Gatwick if they could obtain more morning peak slots at the airport. These services would have mainly been used on European short haul routes.
- 3.35. As mentioned in paragraph 2.33, in its response to the CAA's provisional decision Flybe said that the CAA had committed a breach of natural justice by using the evidence from ACL and GAL (on its confidential business development discussions) without making it available to Flybe for comment. Flybe also said that the CAA's failure to question the credibility of this evidence was naive. Flybe thought the evidence should be disregarded entirely.
- 3.36. The CAA does not believe it has committed a breach of natural justice. The CAA included a report of its discussions with ACL in its provisional decision so that the parties had the chance to consider it and comment on it in their submissions on the provisional decision. Flybe did comment on the evidence from ACL in its submission. The CAA does not accept that it should not put any weight on ACL's comments. Despite Flybe's contentions, the CAA considers that ACL has experience of airline bids for slots and is aware that an airline may have a strategic purpose in bidding for slots that it subsequently does not use. Given its experience of the slot allocation

³² <http://www.slottrade.aero/slot-trading-volumes.asp>.

process including airline bidding for slots, the CAA does not agree with Flybe that ACL cannot be expected to assess with any degree of accuracy the degree of excess demand. On the contrary, the CAA considers that ACL is well placed to comment on whether there is excess demand and its evidence should be treated accordingly. For example, ACL recognised that airlines may have different motives for bidding for slots and reflected this in its comments. The CAA, therefore, has not disregarded the evidence from its discussions with ACL.

- 3.37. The CAA also does not accept that it should disregard GAL's evidence from its business development meetings with airlines. As GAL mentioned the meetings at the hearing the CAA requested further information from GAL to substantiate GAL's comments. The CAA recognises that GAL's evidence is a subjective account of conversations whereas ACL's input was based on statistical data. The CAA notes that GAL is a party to the case, whereas ACL is not. Given these factors the CAA attaches less weight to GAL's evidence than to ACL's evidence. The CAA is aware that it must consider carefully how much weight it gives to confidential information, but it does not consider that it is unable to take such information into account at all. The CAA considers that airline business development plans are by their nature confidential and cannot be shared with their competitors, anymore than the evidence that Flybe gave in confidence at the hearing can be shared with GAL or other airlines. The CAA also does not accept Flybe's contentions that GAL has no knowledge or experience of airlines adopting negotiating positions during discussions and that therefore evidence based on such exchanges cannot be treated as objectively verifiable evidence of demand for airport infrastructure. On the contrary, the CAA considers that GAL has experience of negotiating with airlines and is able to assess the veracity of airline intentions in its discussions with them based on past experience and its general market knowledge. The CAA has also considered whether there is any reason to treat the evidence of discussions with airlines as unreliable and giving no indication of real demand, and has concluded that the evidence does show demand. The CAA, therefore, has not disregarded the evidence from GAL's business development discussions with airlines. However, it attaches less weight to GAL's evidence than it does to ACL's evidence and gives weight to GAL's evidence to the extent that it corroborates ACL's evidence.
- 3.38. ACL statistics and GAL's business development discussions with airlines show there is some excess demand for slots at Gatwick at some times of the day and year. Taking this evidence together, the CAA concludes that GAL reasonably came to the view that there was excess demand for peak slots at the airport when it set its airport charges for 2011/12.

Will GAL's attempt to achieve an efficient and effective use of its runway be frustrated by the existing system of slot allocation?

- 3.39. It is common ground that the slot allocation system reduces the effects of GAL's charging structure on increasing the efficient use of peak slots. Flybe said that if there was a well-functioning slot market, the shift of services from peak to off-peak would be facilitated. However, this was not the case and therefore a peak pricing policy would have to take into account the deficiencies of the current system. GAL recognised that the current slot mechanism was far from ideal and leads to significant inefficiencies in the use of scarce capacity. It said the system introduced stickiness in the market particularly as there was value to airlines of retaining their slots at peak periods. However, GAL thought that the stickiness would be reduced by GAL's charging policy as airlines would be less inclined to retain slots as they would face higher charges for slots at congested times, and did not believe that the slot allocation system undermined the objective rationale behind the revised structure of charges. Its position was that its changes to its charging policy could contribute to improving liquidity. The CAA agrees with GAL that the stickiness in the slot allocation system is not absolute and that it would not prevent a more efficient use of Gatwick slots, although the time period required for the effects of the incentives in the structure of charges to be realised could be longer and the effects might not be so fully realised than if there was a more efficient allocation system.
- 3.40. GAL also mentioned at the hearing that the transfer of slots is only one mechanism by which airlines might respond to the efficiency incentives created by GAL's airport charges. Other mechanisms include: discontinuing inefficient services, encouraging greater passenger numbers on existing services, and using larger aircraft. In its response to the provisional decision, Flybe said that although these alternatives provided a superficially attractive argument, in reality GAL could have no confidence that they would work. Flybe mentioned that airlines took these actions anyway and there was no linear relationship between these mechanisms and the outcomes GAL was seeking. The CAA does not consider that Flybe's comments show that GAL was being unrealistic in assuming that airlines could use the mechanisms referred to in response to GAL's charges. The CAA notes that Flybe agreed that airlines could, and in practice do, use these other mechanisms, although Flybe thought there was no guarantee that they will use them in response to GAL's changes to landing charges. The CAA, therefore continues to consider these mechanisms as feasible airline responses to GAL's charges that would not be affected by stickiness in the slot allocation system.
- 3.41. The CAA, therefore, concludes that it was reasonable for GAL to consider that the existing system of slot allocation would not frustrate its attempt to achieve an efficient and effective use of its runway.

What does experience so far tell us about the likely achievement of GAL's objective?

3.42. Although the CAA is primarily looking at GAL's expectations when it set its charges for 2011/12 it is also relevant to look at the effects of the changes. GAL provided figures showing that there had been small increases in the average number of seats per aircraft movement, passengers per plane, and load factors in recent years. This is shown in Table 2.

Table 2 – Average passengers per aircraft, load factor and aircraft size 2009 to 2011

	Movements	Terminal passengers	Total seats	Passengers per plane	Load factor	Seats per Air Transport Movement (ATM)
2009	245,247	32,369,935	41,611,905	132	78%	170
2010	233,499	31,348,114	39,857,961	134	79%	171
2011	244,370	33,639,957	41,955,412	138	80%	172

Source: GAL

3.43. Data published by ACL, based on its allocation of runway slots, also shows a gradual increase in the number of seats per air transport movement during the summer period between 2009 and 2012. Slots allocated for Summer 2012 indicate an average of 174 seats per ATM. In its response to the provisional decision, Flybe said that there had been no discernible shift towards the use of larger aircraft. The CAA agrees with Flybe that the data does not suggest that GAL's revised charges structure has yet had a major impact on Gatwick traffic. However, the CAA considers that instead the previous trends of small year on year increases in passengers per movement have continued. It would be wrong to read too much into these figures as the effects of GAL's charging policy are likely to take time to materialise. However, the figures so far are consistent with GAL's objective and, therefore, do not suggest that GAL's expectations were unreasonable.

3.44. The latest passenger numbers for Gatwick (to the end of December 2012) show overall passenger numbers at the airport rising by 1.7% in 2012. Passengers on UK and Channel Islands routes rose by 2.6% in the same period. The figures are not conclusive. They are influenced by many factors as well as GAL's structure of charges, and, as mentioned above, the effects of the charges re-structuring have not fully worked through yet. However, the figures show an increase in passengers on domestic (and Channel Islands) routes and not a decline as predicted by Flybe, Aurigny and the States of Guernsey.

3.45. Taken together, experience since the revised charges came into force does not show much discernible effect so far from the charges. However, there is

no evidence that the CAA has seen that would suggest that GAL's expectations of the effects of its charges were unreasonable or unrealistic.

Conclusion on objective justification

3.46. In conclusion the CAA has found evidence of excess demand at peak times which suggests that GAL's objective justification for its charges re-structuring was reasonable and not merely theoretical. Whilst the inefficiencies in the current slot allocation system are likely to slow the pace of change to a more efficient utilisation of Gatwick's runway they do not seem likely to prevent the change altogether. Experience since the re-structuring indicates that there have not been any major differences in Gatwick's traffic characteristics, as the slow increase in runway utilisation over recent years has continued. Passenger numbers on domestic and Channel Islands routes have grown faster than total passenger numbers over the last 12 months. Overall, the CAA considers that GAL's proposed objective justification for the changes in its structure of charges is reasonable and supported by the evidence³³.

Conclusion on whether GAL has unreasonably discriminated against a class of user or any particular user of the airport

3.47. The CAA has previously concluded that GAL's landing charges discriminate against operators of small aircraft at Gatwick. However, the CAA has found that GAL had a reasonable objective justification for its charges and has concluded that its landing charges did not **unreasonably** discriminate against operators of small aircraft at Gatwick.

3.48. The CAA has not found that GAL's conduct was unreasonably discriminatory. This is sufficient to dismiss Flybe's case without considering the effects of GAL's charges. In its response to the CAA's provisional decision, Flybe emphasised its views that GAL's charging structure entrenched discrimination between different business models and permitted unfair and discriminatory increases on costs for Flybe. For completeness in the following section the CAA examines how GAL's charges have affected Flybe, competition between airports, competition between airlines, and regional services in order to address Flybe's comments and also those from regional interest groups that GAL's charges have had detrimental effects.

The CAA 1999 decision on a complaint about airport charges paid by domestic airlines at Heathrow.

3.49. As mentioned in paragraph 2.34, Flybe thought that the CAA should examine the parallels in the CAA's 1989 decision on a complaint by British Midland,

³³ In its response to the CAA's provisional decision Flybe said that the CAA's overall assessment of objective justification was inconsistent. This was because, Flybe argued, that the CAA had moved from finding that "there was no evidence that...GAL's expectations...were unreasonable or unrealistic" to finding that GAL's charges were 'reasonable and supported by the evidence'. That is the CAA moves from the evidence denying the negative to it supporting the positive. However, the CAA considers that Flybe's argument is flawed. The finding that 'there was no evidence' is with respect to the effects of GAL's charges so far, and not with respect to excess demand where the CAA found positive evidence supporting GAL's charges.

Dan Air, Air UK and Manx about increases in airport charges faced by domestic airlines at Heathrow. The airlines, which all operated on domestic routes, complained that their airport charges (both landing charges and peak passenger charges) had increased at a much greater rate than the average faced by Heathrow airlines. The increases in charges for the complainants ranged from over 10% to over 36%, whilst the aggregate increase for all airlines was a little over 4%. The CAA found that Heathrow Airport Limited's (HAL's) charges were based on the economic costs imposed on it by airlines, but they also reflected the airport operator's managerial judgement about the quantum and pace of change in the charges. The CAA said that if the increases in charges had been wholly or largely justifiable by changes in economic costs which could be readily identified to all parties then it was unlikely that it would have sought an undertaking or imposed a condition on HAL. However, the CAA found it unreasonably discriminatory that very large increases in charges should, as a result of HAL's managerial judgement, be imposed on individual airlines who have very little means of avoidance in the short term. In response to the CAA's finding, HAL offered, and the CAA accepted, an undertaking limiting the amount by which airport charges levied on any individual airline could increase to no more than twice the average amount allowed by the price control.

- 3.50. The CAA agrees that there are similarities between the 1989 case and the present case as both concerned changes to the structure of airport charges that affected airlines using small aircraft on domestic routes more than other airlines. However, there are also some material differences between the cases. The 1989 case involved passenger charges as well as landing charges and in 1989 Heathrow was in common ownership with Gatwick, Stansted and other airports whilst Gatwick is now under separate ownership. Importantly, since 1989, the CAA has published guidance on how it will investigate an airport operator's conduct under section 41 (see paragraph 1.16). It said it would adopt an approach consistent with the OFT's guidelines on the application of competition law, except where the circumstances of a particular case or the CAA's powers and duties under the Act in relation to that case suggest it should follow a different approach. In this case the CAA sees no reason why it should follow a different approach. Overall, the CAA is satisfied that it has applied the correct analytical framework to Flybe's complaint and in the circumstances of the case has found that the discrimination is not unreasonable.
- 3.51. Even if the CAA had not found GAL's charges to be objectively justified and had found unreasonable discrimination, the CAA would have, consistent with OFT guidelines and competition case law, looked at whether the conduct produced adverse effects on competition or consumers. (The guidelines and case law have evolved considerably since 1989.) As mentioned in paragraph 4.22 the CAA has found no such adverse effects.

Peak pricing

- 3.52. The CAA has seen no evidence that the peak/off-peak differential has been unreasonably discriminatory. One point made by the respondents was that GAL's landing charges did not reflect its true peak during July and August. However, at the hearing GAL produced evidence showing that movements at peak times were relatively constant during the Summer season. In contrast off-peak movements and passenger numbers were more concentrated in July and August. This evidence supports GAL's decision to levy peak landing charges at peak times of the day throughout the Summer season and not just during July and August.
- 3.53. The CAA accepts Thomas Cook's view that any airline operating a greater programme in the Summer than the Winter would be more adversely affected by GAL's peak pricing than other airlines. The CAA also accepts Thomas Cook's observation that many of its customers would not travel at a different time of the year as they are constrained by the dates of school holidays as to when they can travel, so that Thomas Cook (and airlines with similar passenger characteristics) would be unable to change the timing of their operations significantly. However, not all airlines have the same passenger characteristics as Thomas Cook, and the CAA expects the change in the structure of charges to have some impact on the distribution of flights across the year. Furthermore, the CAA considers that GAL can justifiably reflect in its charges the costs (including opportunity costs) that airlines operating in peak periods impose on the airport.
- 3.54. The CAA notes Thomas Cook's argument that the higher peak charges would lead to windfall income for GAL. However, as a price capped airport operator GAL cannot increase its average revenue per passenger from airport charges, although it can increase its total revenue from airport charges if it can increase its passenger numbers. Otherwise increased income at peak times would have to be counterbalanced by reduced income in off-peak periods. Any additional profit would be limited to the current price control period given the existing single till revenue yield regulation³⁴.

³⁴ The CAA, however, is currently considering whether to regulate and what form its economic regulation should take after the current price control expires on 31 March 2014.

4. The effects of GAL's re-structuring of charges

4.1. This section considers how GAL's charges have affected Flybe, competition between airports, competition between airlines, and regional services.

How has GAL's conduct affected Flybe?

4.2. Flybe compared the 83% increase in landing charges it had faced since the start of the current Q5 price control period on 1 April 2008³⁵ to the 50% increase it said a competitor using larger aircraft would have faced over the same time³⁶. At the hearing, Flybe said that it had responded to the increase in charges by reducing the size of aircraft it used on some of its Gatwick routes (from 118 to 88 seats) to cut the other costs of operating these routes. Flybe said that the discrimination in the charges structure at Gatwick was not present at other large UK airports³⁷.

4.3. GAL said that Flybe's numbers were misleading as:

- the comparisons included Flybe operating in the peak for 75% of its landings whilst its competitor was in the peak for only 50% of its landings;
- the time period was longer than that relevant to the current complaint; and
- they should have looked at total airport charges paid instead of just landing charges.

4.4. GAL produced alternative figures that adjusted for these three factors. These figures compared the increased landing charges for Flybe and a competitor (both operating half of their flights in the peak) from 2010/11 to 2011/12. Flybe's charges increased by 11% whilst its competitor's charges increased by 7%. The difference, therefore, was much smaller than that mentioned by Flybe.

4.5. The CAA agrees with two of GAL's reasons for why it considers Flybe's numbers to be misleading. The CAA agrees that where there is excess demand for peak slots, it is not unreasonable to expect an airline that operates three peak flights and one off-peak flight in a day should face higher prices than a competitor airline that flies the same number of passenger seats but does so operating one peak and one off-peak flight. The CAA also considers that GAL was right to question Flybe's use of relative price

³⁵ This is the increase in landing charges paid per departing passenger between 2007/08 and 2011/12 across all Flybe's operations at Gatwick. The increase was not spread evenly across the years, there were two step-changes from 2007/08 to 2008/09 and 2010/11 to 2011/12.

³⁶ Flybe's figures compared the amount paid in landing charges by an operator of a Q400 Dash 8 aircraft (with 78 seats making four landings a day) with charges paid for an A319 (with 156 seats making two landings a day).

³⁷ Prior to the hearing Flybe produced figures comparing the amount paid in landing charges and per passenger charges by operators of a Q400 Dash 8 aircraft (with 78 seats making 4 landings a day) with charges paid for an A319 (with 156 seats making 2 landings a day) at the eight largest UK airports. The figures showed charges on the Q400 would be 60% greater than for the A319 at Gatwick. The difference in charges paid was much less at the other airports. The largest difference showed the operator of a Q400 paying 8% more than the operator of a A319.

increases going back to April 2008 when Flybe's complaint only covered GAL's charges since April 2011. The CAA, however, does not accept GAL's argument that the comparison should be between the total airport charges paid (that is passenger charges and aircraft landing charges as well as landing charges). The complaint is about landing charges and not aircraft charges in total. The CAA, therefore, agrees with GAL that Flybe's figures overstate the effect that GAL's changes to the charges which are the subject of this complaint have had on them. Accepting GAL's use of an equal proportion of peak and off-peak charges and in looking only at the increase in 2011/12 Flybe's landing charges increased by 22% whilst the landing charges paid by its competitor increased by 19%.

- 4.6. The analysis above shows how the effects on Flybe vary according to the assumptions behind the figures used. However, more fundamental to the consideration of this complaint is that section 41 is not about ensuring that no airline user, or class of airline users, faces a higher increase than another user, or class of users. Section 41 is about whether there is unreasonable discrimination, and as mentioned in paragraph 3.47, the CAA has found that GAL has not unreasonably discriminated against operators of small aircraft. The CAA made a similar point in its May 2011 decision on Ryanair's appeal against GAL's check-in and baggage charges where it said that a policy of avoiding sharp price shocks would not be a justification for a structure of charges that was discriminatory.

Has GAL's conduct harmed or tended to distort competition between airports?

- 4.7. There is no evidence to suggest that GAL's conduct has had an adverse effect, or has tended to have an adverse effect, on the effective competition between it and its horizontal competitors in the relevant market for airport services. Accordingly the CAA does not consider this question any further.

Has GAL's conduct harmed competition between airlines?

- 4.8. In cases of alleged discrimination by an undertaking in an upstream market against a player in a downstream market (such as by airport operators against an airline), it would be of particular concern to a regulator (whether applying ex ante sectoral powers or ex post competition law principles) if the company in the upstream market is trying to leverage its market power in that market into the downstream market so as to favour its own activities in the downstream market. However, GAL does not operate in the downstream airline market so it has no obvious pecuniary interest in favouring one particular airline over another with a similar operation, in terms of increasing profits it might make in that downstream market. However, GAL does have an interest in attracting larger aircraft with more passengers as they provide higher profits for the airport where the additional revenue, derived from both aeronautical charges and commercial activities, exceeds the incremental costs of handling the additional passengers. The additional profit would be

limited to the current price control period given the existing single till revenue yield regulation. However, this limitation might not remain in the future as the CAA is currently considering whether GAL should continue to be price regulated and, if so, the form the regulation should take.

- 4.9. In its response to the CAA's provisional decision, Flybe said that GAL's charges entrenched discrimination between business models where Flybe was putting the same capacity in the market through 78 seater aircraft (Dash Q400) as a competitor using 156 seater aircraft (A319), but the cost to Flybe of delivering that capacity at Gatwick was 60% more than the cost to the competitor. Flybe thought this was discrimination between business models that distorted competition in the airline market.
- 4.10. The CAA does not accept that the amount of the increase in landing charges paid by Flybe since 2008 is a relevant consideration for looking at the effects of GAL's charges in 2011/12. However, the CAA has looked at how Flybe has performed on its Gatwick routes compared to other airlines on the same city pair route in this period³⁸. Table 3 shows a mixed picture, on half of the ten routes³⁹ that Flybe currently operates at Gatwick it has increased its market share since 2008/09 (or the time when the route commenced operation if later) whilst it lost market share on the other half. (On one of the routes where it has lost market share, Guernsey, it lost market share to Aurigny which also operates small aircraft at Gatwick.) Flybe's overall passenger numbers on these ten routes were 9.4% higher in 2011/12 than in 2008/09. In contrast on services by other airlines at Gatwick, or by Flybe or other airlines from other London airports passenger numbers fell by 15.6% in this period. These figures do not show that Flybe has necessarily suffered a competitive disadvantage at least in terms of market share since 2008. In 2011/12, the first full year of the new charging structure, Flybe gained market share on six of the ten routes. Flybe's passenger numbers on these routes increased by 6.7% whilst passenger numbers for other airlines (or for Flybe from other airports) decreased by 10.9% in 2011/12.

³⁸ The figures are calculated using Gatwick, Heathrow, Stansted, Luton and London City as the airports serving London.

³⁹ Flybe closed its route to Aberdeen from 28 October 2012.

Table 3 – Number of terminal passengers (in thousands) and market shares of Flybe's Gatwick routes from 2008/09 to 2011/12

Destination	London airport	Airline	2008/09		2009/10		2010/11		2011/12	
			pax	pax share						
Aberdeen	LGW	Flybe	130	14%	138	15%	123	14%	122	12%
	LGW, LHR, LTN	3 others	781		761		769		880	
Belfast City	LGW	Flybe	185	18%	221	20%	219	20%	251	32%
	LHR, STN, LTN	4 others	835		905		873		546	
Jersey	LGW	Flybe	235	46%	264	46%	226	40%	230	39%
	LGW, LTN	2 others	273		312		332		355	
Newcastle	LGW	Flybe	100	14%	110	16%	93	14%	95	16%
	LHR, STN	2 others	640		599		559		486	
Guernsey	LGW	Flybe	193	53%	184	50%	167	46%	154	40%
	LGW, STN	1 other	170		185		196		231	
Inverness	LGW	Flybe	143	43%	126	40%	115	39%	117	36%
	LGW, LTN	1 other	189		185		183		211	
Isle of Man	LGW	Flybe	145	75%	123	58%	125	63%	126	65%
	LTN, LCY	2 others	47		88		75		68	
Nantes	LGW	Flybe	-		-		18	28%	48	46%
	LGW, STN, LCY	4 others	149		32		48		55	
Newquay	LGW	Flybe	8	5%	71	41%	79	73%	99	100%
	LGW, STN, LCY	3 others	146		101		29		-	
Bergerac	LGW	Flybe	4	3%	4	3%	6	6%	8	9%
	STN, LTN	1 other	107		107		97		84	

Source: CAA statistics

4.11. The CAA, therefore, has not seen evidence showing that GAL's pricing policy has adversely affected competition between Flybe and other airlines at Gatwick, or tends to distort competition between Flybe and other airlines at Gatwick.

Has GAL's conduct affected regional passengers?

4.12. The CAA's duties under section 39 of the Act include 'furthering the reasonable interests of users of airports in the UK'. At the hearing Flybe described a class of users who could be harmed by GAL's charging policies as passengers who prefer the high frequency business model operated by Flybe and Aurigny. Such passengers would mainly be those on domestic routes from Gatwick (including to the Channel Islands and Isle of Man).

4.13. In its September 2011 consultation the CAA said that it should not use section 41 to pursue goals of regional connectivity. Instead it had to apply section 41 against its section 39 duties. The CAA noted that the Government could address regional concerns through alternative mechanisms such as public funding via Regional Development Funds or through Public Service Obligations. At the hearing Flybe accepted that section 41 was not about

promoting regional connectivity, but did not see why it could not be used to prevent regional connectivity from being eroded from its current level.

- 4.14. If GAL's charges achieve its objective of reducing the number of small aircraft operating in peak periods at Gatwick, passengers who want to travel to, or from, Gatwick at peak times on routes served by small aircraft may suffer harm unless another service is available to them. An alternative service may be provided by the same airline deploying larger aircraft, by another operator on the same route, or may be offered at another London airport. Further, even if another peak service is available, passengers may face higher fares if competition on the route is reduced. However, as these flights carry a relatively small number of passengers, and only some of those passengers are likely to value the benefits of a peak service sufficiently to feel obliged to pay the higher peak fares, there may only be a small number of passengers who suffer harm.
- 4.15. The above analysis only considers harm to a section of existing customers for the type of service that Flybe and similar operators have been offering at the relevant times. In evaluating whether discrimination is unreasonable such that intervention is warranted by the regulator, the CAA considers that it is reasonable to look at the overall likely effect on the interests of users.
- 4.16. If other services replace those that are lost at peak times, the passengers on the new services will benefit, thus reducing the net harm. As the new services might be expected to carry more passengers than those displaced, given the incentives created by the airport operator's structure of charges, the number of passengers benefiting from the change in services would be expected to be higher than the number that suffer harm. A judgement of whether there has been harm could in principle take into account more than the number of passengers involved, as the value that the passengers attach to the lost services may differ from the value attached to the new services. Fares paid give some indication of the value that a passenger attaches to a service. However, information on fares paid is not always available, and the fares that will be paid by passengers on new services is unknown. Given this lack of data, the CAA considers the best available measure for passenger benefit (or harm) is likely to be passenger numbers at the airport. As mentioned in paragraph 3.43, passenger numbers at Gatwick have increased in the past twelve months. Furthermore, domestic (and Channel Islands) passenger numbers have risen faster than have total passengers⁴⁰. These figures could reflect many factors, nevertheless they do not show evidence of harm to Gatwick's passengers on domestic and Irish routes.
- 4.17. The CAA does not agree with the States of Guernsey that it cannot take into account the interests of future users of the airport in reaching its decision in this case. There is no distinction in the Act between airlines currently

⁴⁰ Source: GAL December 2012 passenger numbers.

operating at the airport and passengers on their services, and airlines and passengers that want to use the airport in future. In reality, the CAA can only affect outcomes for passengers who have not yet flown, whether these passengers are intending to use the airport on the next day or the next year. The CAA does not consider that its decision gives hypothetical users of an airport in China flying to the UK precedence over actual users within the UK.

- 4.18. The analysis above deals with total passenger harm (or benefit). The CAA has also looked at the impact on some individual routes. These are set out below. Since the introduction of the new charges structure Flybe ceased its routes to Leeds Bradford, Dusseldorf and Aberdeen. The Leeds Bradford and Dusseldorf routes had the lowest load factors of Flybe's routes, only 38% and 44% respectively over the 12 months to April 2011⁴¹. Although some passengers will have been harmed by Flybe's withdrawal from these routes, the CAA notes that Flybe was not a major player to Dusseldorf, its market share on the city pair to London being below 10%, and that British Airways will commence a new service from Heathrow to Leeds Bradford in December 2012.
- 4.19. When the European Commission considered IAG's acquisition of bmi, the Commission looked at the situation on the London-Aberdeen city pair. The Commission's figures showed that Flybe's Gatwick traffic accounted for 10% to 20% of passengers on the city pair. Although this is a reduction in service for Aberdeen, particularly for those who want to use Gatwick, the proportionate effect on traffic on the city pair is relatively small. However, slots at Heathrow have been given to Virgin to operate an Aberdeen route (replacing the previous bmi Heathrow-Aberdeen service), and this will mean there will be three airlines competing on the city pair (British Airways, easyJet and Virgin).
- 4.20. The CAA considered whether Flybe serves a distinct population of customers who might suffer particular harm. Table 4 below shows the characteristics of Flybe's passengers taken from CAA survey data. Whilst Flybe carried a slightly greater proportion of business and a slightly lower proportion of connecting passengers than other airlines on its city pair routes, the differences were only marginal. In addition, the proportion of connecting passengers in Table 4 includes passengers who "self-connect", purchasing two different tickets rather than an intra- or inter-lining ticket. Due to the largely point-to-point nature of airline business models at Gatwick (with the possible exception of a comparatively small leisure-oriented network operated by British Airways), the loss of the most marginal domestic or short haul routes from Gatwick appears unlikely to lead to significant (if any) substitution

⁴¹ In its response to the CAA's provisional decision Flybe said that GAL's view that Flybe's withdrawal from these two routes was due to the new charging structure from 1 April 2011 was inaccurate. Flybe said that the new charging structure began in 2010 and that the 2011 charges exacerbated rather than introduced problems on routes which had performed better and in any case sustainably until 2011 even with quite low load factors. The CAA accepts that Flybe knows why it withdrew from routes, however, this does not alter the CAA's conclusions.

activity by long haul airlines away from the airport⁴². Flybe does carry a higher proportion of UK nationals than its competitors on these routes. However, overall the data does not show that Flybe's passengers have materially different characteristics than those carried by its competitors and, therefore, does not suggest they represent a distinct set of passengers.

Table 4 – High level passenger profile on Flybe's Gatwick routes and routes to the same airports from all London airports 2011

	Non-connecting passengers	Business passengers	UK nationals	Observations
Flybe	68%	42%	89%	965
All other airlines	65%	39%	74%	4,182

Source: CAA statistics

4.21. The CAA examined Flybe's passenger share of the city pair routes in 2011 to see whether there were areas which would not be served if Flybe ceased its Gatwick services⁴³. The results, in Figure 1 below, showed:

- Flybe's passenger share was over 50% on three routes: Isle of Man, Leeds Bradford and Newquay. On each of these routes in 2012 other airlines have either started, or announced they are going to start, services to Gatwick or another London airport⁴⁴.
- Flybe's market share was over 40% on four more routes: Guernsey, Inverness, Jersey and Nantes⁴⁵.
- Flybe was a minor provider on four routes. Its market share was under 20% for Aberdeen, Bergerac, Dusseldorf and Newcastle.

4.22. Overall the figures show that whilst Flybe operates to a number of destinations from Gatwick, there are no routes it alone serves, or on which it

⁴² In its response to the CAA's provisional decision Flybe said that the CAA based this conclusion on a backward-looking assessment of airline business models and the behaviour of connecting passengers. Flybe thought that domestic connectivity might become more important if Gatwick attracts more long haul services. The CAA accepts that this might be the case, but considers that it is not unreasonable for GAL to hold the view that Gatwick would remain a predominantly point-to-point airport in future.

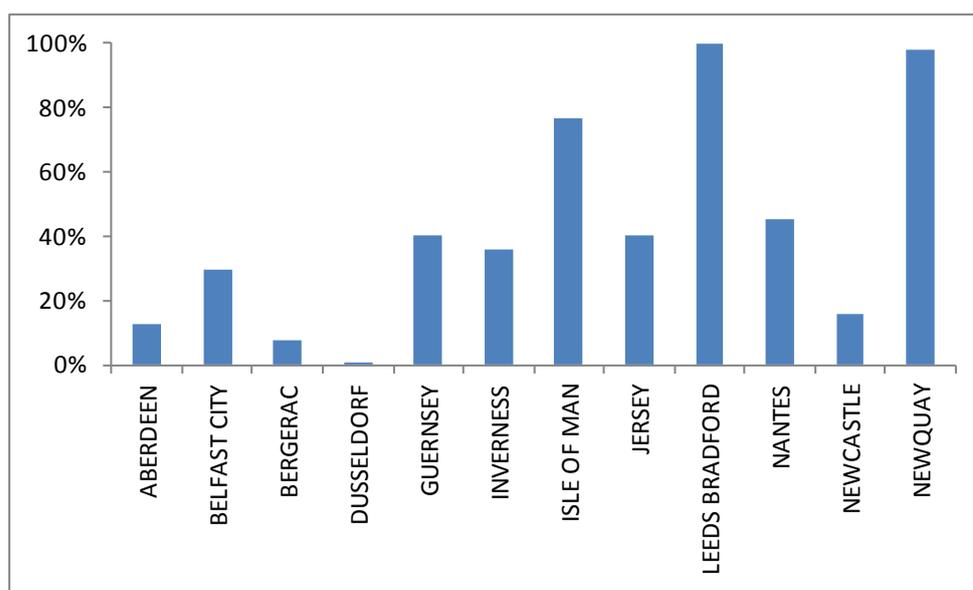
⁴³ In its response to the CAA's provisional decision Flybe said that the CAA should analyse for each route whether and to what degree the various London airports are substitutes for each other. The CAA does not agree. There is well established case law for considering airline competition issues are on a city pair basis rather than using particular airports. For example, as mentioned in paragraph 4.18, in the European Commission's 2012 consideration of the International Airline Group's acquisition of bmi. Given that the CAA's decision on the case is based on GAL's objective justification for its charges, rather than on whether regional passengers have suffered harm, the CAA does not consider that such a detailed analysis would be warranted.

⁴⁴ British Airways started a new route to the Isle of Man from London City in May 2012 whilst easyJet commenced Gatwick to the Isle of Man service in October 2012. As mentioned in paragraph 4.17, British Airways commenced a new service from Heathrow to Leeds Bradford in December 2012. On 6 December 2012, easyJet announced that it would be starting a thrice weekly service from Southend to Newquay in Summer 2013.

⁴⁵ The CAA notes that although Flybe's market share for Guernsey is only 40%, the combined share of its and Aurigny's Gatwick routes is over 90%.

has been announced that other services will be commenced. However, on Newquay the alternative to Flybe's Gatwick route will not be operating every day so will only be of limited use to business passengers. Furthermore, there are new routes opening to domestic destinations, albeit operated by airlines with different business models.

Figure 1 – Flybe share of passengers on London city pairs – 2011



Source: CAA statistics

4.23. Overall, the CAA has not seen any evidence so far suggesting that regional passengers have markedly suffered harm from GAL's amendments to its structure of charges. It is possible that some passengers have suffered harm, but the numbers involved would appear to be low, and the number of passengers that will benefit from GAL's re-structuring may well be higher especially in the longer term.

Conclusion on effects

4.24. The CAA has examined the effects of GAL's prices on Flybe, competition and on regional passengers. The CAA did not find evidence that GAL's structure of charges materially harms or tends to harm either the competitive process or regional passengers.

5. CONCLUSIONS

5.1. The CAA has concluded that GAL's charges re-structuring was objectively justified and has seen no evidence that GAL's structure of charges materially harms or tends to harm competition either between airports or between airlines. The CAA considers that the balance of evidence does not show that consumers as a whole have suffered, or are likely to suffer, harm from the charges. The discussion below considers these conclusions in the context of the CAA's section 39 duties which it must follow when investigating airport operator conduct under section 41. The duties are considered in turn below.

Does GAL's conduct further the reasonable interests of users of airports within the United Kingdom?

5.2. GAL's revised charging structure has led to the charges paid by Flybe and other operators of small aircraft increasing by more than some of their competitors. However, charges paid by other airlines (who arguably make more efficient use of Gatwick's constrained facilities) have increased by a lower proportion. Whilst some of Flybe's passengers might face increased fares or reduced frequencies, the evidence so far does not suggest that the number of passengers affected has been or would be large. If Flybe does withdraw from routes, or reduces its frequency on them, the CAA would expect that other operators or routes would take their place. Passengers on these new routes would benefit from them. The CAA has seen no evidence so far that would suggest that GAL's revised charging structure has damaged the interests of users overall (both airlines and passengers). To the extent that GAL's policy leads to higher passenger numbers at the airport as intended this is likely to further the reasonable interests of airport users.

Does GAL's conduct promote the efficient, economic and profitable operation of the airport?

5.3. GAL argued that its airport charges would lead to a more efficient and economic use of Gatwick's runway. All parties agreed that GAL's charging policy might lead to a more efficient and economic use. Flybe thought that GAL's justification might be merely theoretical and would not produce the predicted use in practice. However, the evidence suggests that there is excess demand for Gatwick's runway at peak times and that it was reasonable for GAL to expect that its charges would lead to a more efficient and economic use.

5.4. In conclusion, the CAA considers that GAL's re-structuring of its airport charges is likely to promote the efficient, economic and profitable use of the airport.

To encourage investment in new facilities at airports in time to satisfy anticipated demands by the users of such airports

- 5.5. Neither party argued that GAL's charging structure has much effect upon investment. If GAL's charges result in larger aircraft carrying more passengers using the airport, investment in new capacity could be required to accommodate the additional passengers. However, any effect is unlikely to materialise in the short term, and, if it does materialise, its magnitude is likely to be small.

6. DECISION

- 6.1. It does not appear to the CAA that in implementing a revised charging structure on 1 April 2011 GAL pursued a course of conduct described in section 41(3) of the Act and specifically it did not adopt a pricing policy which unreasonably discriminated against a class of users of the airport or any particular user.
- 6.2. The CAA's duty to impose minimum restrictions only comes into play when deciding whether to impose a condition on an airport operator that has pursued one of the courses of conduct specified in section 41. As the CAA has not found that GAL has unreasonably discriminated against Flybe or operators of small aircraft, the CAA does not therefore need to consider imposing a condition on GAL.
- 6.3. The CAA recognises that the effects of GAL's pricing policy may take some time to materialise and notes that GAL recognised the risk that the structure of charges could create too strong incentives such that inefficient outcomes occurred (e.g. where previously utilised slots might remain unused for significant periods of time). The CAA, therefore, welcomes GAL's commitment to keep the effects of the structure of charges under review.

R Gander

for the Civil Aviation Authority

17 January 2013