NOTICE OF DETERMINATION UNDER SECTION 8 OF THE CIVIL AVIATION ACT 2012 – STANSTED AIRPORT

The Civil Aviation Authority has made the following determination under section 7 of the Civil Aviation Act 2012 (the CA Act).

The market power test set out in section 6 of the CA Act is not met in relation to airport operation services to passenger airlines (the passenger market) in the following airport areas located at Stansted Airport:

- the land, buildings and other structures used for the purposes of the landing, taking off, manoeuvring, parking and servicing of aircraft at the airport; and
- the passenger terminals.

Test A of section 6 of the CA Act has not been met by the relevant operator, namely Stansted Airport Limited. Tests B and C of section 6 of the CA Act cannot be met by the relevant operator, namely Stansted Airport Limited.

The airport area does not include any area in respect of which the CAA has made an operator determination under section 10 determining that Stansted Airport Limited does not have overall responsibility for the management of that area.

The reasons for this determination are set out in the document “Market power determination in relation to the passenger market at Stansted Airport –statement of reasons, CAP 1135.”

Any word or expression defined for the purposes of any provision of Part 1 of the CA Act shall have the same meaning when used in this notice.

Market power determination for passenger airlines in relation to Stansted Airport – statement of reasons

CAP 1135

Market power determination for passenger airlines in relation to Stansted Airport – statement of reasons

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The latest version of this document is available in electronic format at www.caa.co.uk/publications

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CHAPTER 1

Introduction

Purpose

1.1 This document sets out the reasons for the CAA's market power determination that the market power test for airport operation services to passenger airlines (the passenger market) is not met in relation to the core area of the airport area as defined in section 5(4) of the Civil Aviation Act 2012 (CA Act) comprising Stansted Airport.[1]

1.2 Section 3 of the CA Act prohibits the operator of a dominant area at a dominant airport from requiring payment of relevant charges without a licence. The CA Act only permits economic regulation of an airport operator and the granting of a licence by the CAA if all three components of the market power test set out in section 6 of the CA Act are satisfied. Those components are:

- Test A, which requires the CAA to establish whether the relevant operator has, or is likely to acquire, substantial market power (SMP) in a market for one or more types of airport operation service provided within all or part of the airport area.[2]
- Test B, which requires the CAA to establish that competition law does not provide sufficient protection against the risk that the relevant operator may engage in conduct that amounts to an abuse of that SMP.[3]
- Test C, which requires the CAA to establish that, for current and future users of air transport services, the benefits of regulating the relevant operator by means of a licence are likely to outweigh the adverse effects.[4]

1.3 In carrying out its assessment, the CAA is acting under its general duty to carry out its functions in a manner which it considers will further the

[1] The cargo processing areas were not considered here as they are relevant to the market for airport operational services to cargo-only services.

[2] Section 6(3) read together with sections 6(6) and 6(7) of the CA Act.

[3] Section 6(4) read together with sections 6(8) and 6(9) of the CA Act.

[4] Section 6(5) of the CA Act.

interests of passengers (and cargo owners[5]) regarding the range, availability, continuity, cost and quality of airport operation services. The CAA is also carrying out this function in a manner that it considers will promote competition in the provision of airport operation services (and, where appropriate, takes into account the regulatory needs and principles in the CA Act).[6]

1.4 This is the non-confidential version of this document and excisions from the text in the chapters and associated appendices are marked with [✂].

Structure of this document

1.5 Given the complexity and volume of evidence and economic analysis forming part of this document, it has been necessary to distil the CAA's principal findings and conclusions into the main body of this document.

1.6 The main chapters of this document set out the CAA's principal findings of fact and reasons as well as its final decision on each of the three Tests A, B and C. The supporting evidence, inferences, reasons and detailed economic analysis are to be found in the accompanying appendices and are an integral part of the CAA's reasoning. The main body of this document and the appendices should be read as a whole and the fact that the discussion of a particular issue appears in the appendices does not undermine its relevance or importance.

1.7 The remaining chapters and appendices of this document are:

- Chapter 2: Main findings and conclusions
- Chapter 3: Consultation history
- Chapter 4: Market definition – final decision
- Chapter 5: Test A: Market power – final decision
- Chapter 6: Tests B and C
- Chapter 7: Conclusion
- Appendix A: List of representations and evidence received
- Appendix B: Glossary

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5 For the purposes of this Determination, the CAA's assessment will be confined to passengers' interests. The determination of the market power test in relation to the cargo side of the market, which will include an assessment of the interests of cargo owners, is to be carried out in early 2014.

6 Section 1(1) of the CA Act, read together with sections 1(2), 1(3) and 1(4).

- Appendix C: The business of Stansted Airport Limited
- Appendix D: Evidence and analysis on market definition
- Appendix E: Evidence and analysis on competitive constraints: Airlines
- Appendix F: Evidence and analysis on competitive constraints by passenger switching
- Appendix G: Evidence and analysis on indicators of market power
- Appendix H: Evidence and analysis on indicators of market power – technical appendix
- Appendix I: Evidence and analysis on Test B
- Appendix J: Evidence and analysis on Test C.

CHAPTER 2

Main findings and conclusions

2.1 This statement of reasons considers whether the market power test (MPT) is met in relation to airport operation services to passenger airlines provided within all or part of the airport area of Stansted airport. Importantly, this statement of reasons does not consider whether the market power test is met in relation to airport operation services to cargo airlines, which the CAA is considering as part of a separate exercise.[7]

2.2 The CAA has defined the relevant product market as the provision of airport operation services to passenger airlines. The CAA has also defined the relevant geographic market to be Stansted, Luton and Southend.

2.3 The market definition has changed from that set out in the CAA's Stansted Market Power Assessment: developing our minded to position (the minded to Consultation), with the main changes being that the CAA now considers:

- There is a single product market for all passenger airlines rather than separate markets defined by airline business model.
- Gatwick does not lie within the relevant geographical market.

2.4 In coming to this decision, the CAA has had regard to its general duties under the CA Act and the relevant notices and guidance issued by the European Commission (EC) and the Office of Fair Trading (OFT) regarding the application and enforcement of the Chapter I and II prohibitions and Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU), herein referred to as the competition law notices and guidance.

2.5 Having analysed the above market, and taken due account of the competition law notices and guidance as well as the responses to the CAA's Stansted: Market Power Assessment, The CAA's Initial Views - February 2012 (the Initial Views), the minded to Consultation and the Stansted Market Power Assessment: consultation on relevant market developments, CAP 1104 (the additional Consultation), the CAA has decided that Stansted Airport Limited (STAL) does not have SMP. This decision has changed from that proposed in the minded to Consultation

7 The CAA's determination for cargo is expected to be released later this year.

and is consistent with the provisional view outlined in the additional Consultation.

2.6 The CAA has come to this conclusion as it considers that the evidence suggests that the combined constraint on STAL from a number of sources is sufficient to prevent STAL from having SMP. The considerations underpinning the CAA's decision include:

- Common ownership of the three largest airports (Heathrow, Gatwick and Stansted) existed for a considerable period of time under BAA and could have influenced competition among those airports: for example, BAA might not have operated or marketed its airports as substitutes for one another but, instead, it may have marketed them as complementary to one another to prevent growth at one airport cannibalising growth at another. MAG, because it is not faced with divestment and does not need to take account of the impact of its behaviour on profitability at Heathrow, may take a different strategic approach from that which BAA took at STAL.

- There is some capacity available at London airports that would allow inbound airlines, charters and inbound services of based airlines to switch in response to a small but significant non-transitory increase in prices. This includes off-peak capacity at Luton and Gatwick and peak period capacity at Southend.

- Based airlines could ground additional aircraft in response to an increase in airport charges.

- The evidence suggests that STAL's main airlines, easyJet and Ryanair, have countervailing buyer power (CBP). They account for substantial proportions of Stansted's passengers, 19 and 72 per cent of passengers respectively. easyJet sponsored Southend's entry in 2012 by moving 3 aircraft there from Stansted in an attempt to discipline STAL's annual increases in airport charges since 2008.

- While Ryanair's local substitution possibilities appear more limited, Ryanair appears to have buyer power. In February 2013, when STAL announced a proposal to increase airport charges by 6 per cent to take effect in May 2013, Ryanair threatened to reduce its core traffic. Ryanair then reinstated the capacity it had threatened to [✂]. The CAA considers that this suggests that Ryanair exercised buyer power.

- Both easyJet and Ryanair can allocate future capacity across their networks without the risk of competitive backfill[8] by other competing airlines and can credibly use, and have used this threat in negotiations with STAL to secure reductions and/or restrain increases in airport charges. Given the amount of spare capacity at Stansted (around 40 per cent), it seems likely that STAL's short term financial viability is acutely affected by easyJet's and Ryanair's allocation of current and future capacity, thereby giving them the potential to threaten to inflict commercial harm on STAL, which they have been able to use with effect in negotiations.

- Over the summer of 2013 easyJet and Ryanair concluded long term deals with STAL that offer lower prices for the airlines growing their traffic at Stansted. The prices under the growth deals are significantly lower than the 2013/14 price cap of £7.68 per passenger for Stansted and are within a range of what the CAA considers the competitive price for Stansted lies. The CAA considers that this is consistent with its assessment of the two airlines' buyer power.

- STAL has invested in a new terminal transformation project that it expects will increase retail spend per passenger. This is also likely to give STAL an incentive to increase passenger numbers by moderating its aeronautical charges.

2.7 There are, however, some uncertainties and the CAA's analysis could change if expected outcomes do not materialise. This has been a finely balanced decision, complicated by the recent change of ownership of STAL during the market power assessment process. A possible uncertainty, for example, is the robustness of the recently agreed long term deals between, amongst other airlines, STAL and easyJet and Ryanair, which have the potential for significantly lower charges for these airlines. These deals might not hold over the period April 2014 – March 2019 (the Q6 period) and in the event that the deals do not last, and the CAA considers that this is a material change of circumstances, the CAA may look at this market again.

2.8 In coming to this decision, the CAA has taken full account of the differences in market outcomes observed since Manchester Airports Group plc (MAG) acquired STAL in February 2013. However, there has only been a relatively short period over which the CAA has been able to assess MAG's approach to managing STAL and to come to its overall assessment on market power.

8 Competitive backfill occurs when there is the possibility that a vacated slot would be filled by a competitor.

2.9 The CAA has also considered the responses to the two consultations that it issued in respect of STAL.

- The majority of the six respondents to the minded to Consultation related to the passenger market supported the CAA's minded to view that STAL has SMP, although easyJet later changed its view. STAL did not agree with the CAA’s minded to findings. All stakeholders’ comments have been taken into account in the chapters and appendices of this document.
- The CAA received five responses to the additional Consultation related to the passenger market, from STAL, Ryanair, the Stansted Airport Consultative Committee (SACC), London First and GAL. STAL supported the CAA’s provisional view that Test A would not be met, suggesting that easyJet and Ryanair in particular might have more buyer power than was considered in the minded to Consultation. Ryanair and the SACC considered that the structure of the market had not changed materially and the deals did not provide any justification for the CAA changing its minded to Consultation conclusion that Test A was passed. London First and GAL considered STAL should not be subject to a licence. All stakeholders’ comments have been taken into account in the chapters and appendices of this document.

2.10 Having considered responses to both consultations and its own analysis, the CAA has decided that Test A is not met and STAL does not have, nor is likely to acquire, SMP in the relevant market over the Q6 period, 2014 to 2019. Its reasons for coming to this decision are set out in the chapters and appendices of this document.

2.11 The CAA's decision on Test B is also changed from that outlined in the minded to Consultation. As the CAA has concluded that STAL does not currently have nor is likely to acquire SMP in the relevant market (Test A), there can be no risk of STAL engaging in conduct that would amount to an abuse of that SMP. In circumstances where Test A is not met, Test B cannot be met.

2.12 Accordingly, there is no need to consider whether competition law provides sufficient protection against the risk that STAL may engage in conduct that amounts to abuse of SMP.

2.13 In relation to Test C, the CAA considers that the benefits of regulation by means of a licence are unlikely to outweigh the adverse effects because STAL does not have, nor is it likely to acquire SMP in the relevant passenger market at Stansted.

2.14 In reaching this conclusion, the CAA has taken into account the need to promote competition in the provision of airport operation services, economy and efficiency on the part of the airport operator. This Determination meets these needs by removing STAL from economic regulation, allowing it to compete (free from price regulation) by pursuing its own commercial strategy.

2.15 The CAA has also had regard to the regulatory principles in the CA Act and, in particular, that regulatory activities are targeted only at cases where action is needed and are carried out in a way which is transparent, accountable, proportionate and consistent. This Determination that the MPT test is not met and STAL should not therefore be subject to a licence is consistent with those regulatory principles.

2.16 As STAL has not met Test A, and Tests B and C cannot be met, the CAA finds that the market power test in section 6 of the CA Act is not met in relation to the passenger market.

CHAPTER 3

Consultation history

3.1 Since 1987, the operator of Stansted has been economically regulated by the CAA in accordance with the Airports Act 1986 (AA86). Under AA86, an airport operator with an annual turnover of at least £1 million required a 'permission to levy airport charges' at the airport.

3.2 When the Secretary of State issued the initial permission to levy airport charges, this included conditions that set maximum airport charges and required STAL's financial accounts to disclose additional information on costs and revenues.

3.3 It then fell to the CAA to re-set the price cap at subsequent five yearly intervals in accordance with the AA86, which also obliged the CAA to make a prior reference to the Competition Commission (CC) recommending the imposition of the price cap.

3.4 In the first two price control periods a separate price cap was not set for STAL. Rather, STAL was included in a price control covering all three BAA London Airports together. However, from 1997 STAL has been subject to its own price control separate from those imposed on Heathrow Airport Limited (HAL) and Gatwick Airport Limited (GAL).

3.5 While the CAA currently sets an average maximum yield per passenger that the airport operator is able to recover from published charges, the airport operator is able to set the level of individual charges as it considers appropriate to recover up to this maximum in line with its commercial interests. The effect of this is that where an airport operator has entered into bilateral arrangements with airlines at charges below the published tariff, the airport operator is then free to recover the revenue shortfall through increasing the charges paid by other airlines.

3.6 Because the price cap is expressed in terms of charges per passenger, the price cap distinguishes between charges paid for passenger flights and those paid for flights not carrying passengers, in particular all-freighter aircraft. Revenues from all-freighter aircraft are not taken into account in the price cap although the airport may not charge more for such aircraft than it would for an equivalent passenger aircraft.

3.7 In 2011, the CAA commenced a project to understand the extent and nature of market power held by the operators of the airports that were designated under AA86 and that are subject to price regulation, i.e. Heathrow, Gatwick, and Stansted.

3.8 The CAA decided to use its powers under AA86 to carry out a market power assessment in relation to STAL in response to a request from the airport operator itself. That request coincided with the transitional arrangements under the CA Act and the CAA considered it was more appropriate for the assessment to be consistent with its new primary duty to further users' interests and the market power test under the new CA Act rather than under the AA86.

3.9 In February 2012, the CAA published the Initial Views, which:

- Indicated that STAL enjoyed the least market power of the three airport operators being assessed and that while the evidence was insufficiently clear to reach a definitive view, it appeared that any position of market power would arise from the relative bargaining power of STAL and airlines during a relatively narrow peak period.
- Invited stakeholders comments on its proposals for market definition, indicators of market power and the presence or absence of significant market power in the markets identified.

3.10 In response to the Initial Views (including those for Gatwick and Heathrow), the CAA received seven written submissions and the non-confidential versions of those submissions were published on its website.[9]

3.11 In January 2013, the CAA published the minded to Consultation.[10] The Consultation was brought forward, ahead of that for Gatwick and Heathrow, at the request of STAL, due to the impending sale of STAL by BAA. In February 2013, this sale was completed, with MAG purchasing STAL.

9 The documents are available at: http://www.caa.co.uk/default.aspx?catid=78&pagetype=90&pageid=12275

10 These documents are available at: http://www.caa.co.uk/docs/78/FINAL%20STAL%20Market%20Power%20Assessment%20(Summary,Tests%20A,B,C).pdf

3.12 In the period between the release of the Initial Views and the minded to Consultation, the CAA:

- Undertook extensive evidence gathering and assessment, including through stakeholder engagement, empirical analysis and expert opinion.
- Refined its thinking on a number of issues, including market definition, competitive constraints and indicators of market power.

3.13 In the minded to Consultation, applying its judgement to conflicting evidence that was finely balanced, the CAA was minded to conclude that:

- Test A was met on the basis that STAL holds a degree of market power in the short-haul market (defined as aeronautical services for low cost carrier (LCCs) and charter airlines at Stansted, Luton, Southend and possibly Gatwick); such market power may currently be substantial and is likely to become substantial over the Q6 period.
- Test B was met as competition law would not provide sufficient protection against the abuse of that market power and some form of regulation might provide a more effective safeguard than competition law alone.
- Test C was met as the benefits for users of air transport services of regulating STAL by means of a licence would outweigh the adverse effects. Some form of licence regulation should apply, albeit proportionate to the specific situation of Stansted.

3.14 As the three components of the market power test were met in relation to an airport area, the CAA was minded to make a market power determination under section 7 of the CA Act. As a result of the airport area being dominant, it would be necessary for STAL to have a licence to charge for services provided in this area and any other area at the airport in respect of which STAL is the operator.[11]

3.15 In addition, as part of the minded to Consultation, the CAA welcomed representations, within a period of three months, on its views. The CAA also responded to requests from STAL for copies of specified underlying documents and evidence.

[11] Pursuant to section 3 of the CA Act.

3.16 On 30 April 2013, the CAA published for consultation its initial Q6 proposals for the economic regulation of Heathrow, Gatwick and Stansted (the Initial Proposals).[12]

3.17 The period for STAL to make representations to the CAA as part of the minded to Consultation was extended until 28 May 2013, to enable the MAG (as the new owners) to comment on the market power assessment in conjunction with the Initial Proposals.

3.18 The CAA received seven responses to the minded to Consultation, six of which were relevant to the STAL passenger airline market:

- easyJet.
- GAL.
- MAG (two submissions).
- Ryanair.
- London Southend Airport Company Limited (Southend).[13]

3.19 In October 2013, the CAA released the additional Consultation to seek stakeholders' views on the implications of the change in ownership of STAL and the subsequent observed change in STAL's commercial behaviour on the analysis of STAL's market power.

3.20 The CAA received seven responses to the additional Consultation, five of which were relevant to the STAL passenger airline market:

- London First.
- GAL.
- MAG.
- Ryanair.
- Stansted Airport Consultative Committee (SACC).[14]

12 This document is available at: http://www.caa.co.uk/docs/33/CAP%201031%20Economic%20regulation%20at%20Heathrow%20Gatwick%20and%20Stansted.pdf.

13 Non-confidential versions of these submissions were published on the CAA's website: http://www.caa.co.uk/default.aspx?catid=1350&pagetype=90&pageid=14785.

14 Non-confidential versions of these submissions were published on the CAA's website.

3.21 Further detail on the responses to these two consultations and the CAA's responses to the issues raised by stakeholders can be found in the chapters and appendices of this document.

3.22 A full list of stakeholders that responded to the Initial Views, the minded to Consultation and the additional Consultation can be found at appendix A.

CHAPTER 4

Market definition – final decision

Legal framework

4.1 Market definition is a key component of the market power test and is relevant for assessing:

- Whether STAL, as the operator of Stansted, has SMP in the relevant market for the purposes of Test A.
- Under Test B, whether there is a risk of abuse of that position.

4.2 Both these tests are applied by reference to the relevant market, i.e. a market for one or more types of airport operation services within the airport area.

4.3 In reaching its assessment, the CAA has had regard to:

- Its own guidance for the assessment of market power of airports (the Guidelines).[15]
- The applicable OFT and EC competition law notices and guidance, to which it must have regard under section 6(10) of the CA Act.[16]

4.4 Market definition is a useful tool for identifying, in a systematic way, the competitive constraints which the relevant operator faces and whether those constraints prevent it from operating independently of effective competitive pressure.[17]

4.5 However, there may be characteristics of the airport sector that make it difficult to define the market precisely. As explained in the Guidelines, the market power assessment should seek to analyse all the competitive

15 The CAA's April 2011, Guidance on the assessment of airport market power (the Guidelines), available via the CAA's website at: http://www.caa.co.uk/docs/5/Final%20Competition%20Assessment%20Guidelines%20-%20FINAL.pdf.

16 See OFT's Competition Law Guideline on Market Definition, December 2004 (OFT 403) and the EC's Notice on the definition of relevant market for the purposes of Community competition law (OJ 97 C 372, p. 3) (EC Market Definition Notice).

17 EC Market Definition Notice, paragraph 2.

constraints faced by STAL, regardless of whether they arise from within or outside the relevant market or markets.[18]

4.6 Market definition is not an end in itself. Rather, it is a key step in identifying the competitive constraints acting on a supplier of a given product or service. Market definition provides a framework for competition analysis. The exercise of market definition consists, in essence, of identifying the effective alternative sources of supply for the customers of the relevant operator in terms of the products or services supplied and their geographical location.[19]

4.7 The Guidelines state that, wherever feasible, the hypothetical monopolist test should be adopted as a useful starting point for defining the relevant market.[20] This test involves starting with the narrowest possible bundle of products or services and the smallest geographical area (normally those supplied by the operator in question) and assessing customers' switching reactions to a small but significant non-transitory increase in price (SSNIP) above the competitive level, generally considered as being 5 to 10 per cent. If the price increase is unprofitable, due to customers switching away to substitute products and areas (or other suppliers entering the presumed market), the test is repeated by widening the set of products and geographic area to include additional substitutes until the price increase is profitable. What is then left is the narrowest set of products and geographic area over which a hypothetical monopolist could profitably sustain prices 5 to 10 per cent above competitive levels.

4.8 Although the SSNIP test is a useful starting point, it is a framework for approaching market definition rather than a prescriptive methodology. It is intended to be carried out by reference to the competitive price level with the result that it is more difficult to apply where the prevailing price levels observed are not reasonably close to the competitive price. As the OFT observes, the test assumes that the hypothetical monopolist is not subject to economic regulation that might affect its pricing behaviour. The test also assumes that competitors' pricing strategies are competitive and that all players maximise profits. In addition, there may be other external

18 The Guidelines, paragraph 3.5. This is consistent with the approach adopted in the CC’s report on the supply of airport services by BAA in the UK, 19 March 2009 (CC's 2009 BAA Report), paragraphs 2.48 to 2.49.

19 EC Market Definition Notice, paragraphs 7 to 9 and 13 and the Guidelines, paragraphs 3.6 to 3.9.

20 The Guidelines, paragraphs 3.10 to 3.12; OFT 403, paragraphs 2.5 to 2.13 and EC Market Definition Notice, paragraphs 15 to 19.

considerations that might affect the uniformity and/or the profitability of the price increase.[21]

4.9 As a result, and as noted in the Guidelines, it is therefore rarely possible to apply the SSNIP test in a precise manner due its limitations as well as data and evidential restrictions.[22]

4.10 Given the particular circumstances relating to the historical common ownership and regulation of HAL, STAL and GAL, the CAA has been unable to carry out a formal SSNIP test. However, it has gathered a range of evidence, including catchment area analysis, passenger surveys, documentary evidence and the views of airlines and relevant airport operators on substitutability. This has been interpreted, so far as possible, within the hypothetical monopolist framework.

Product market

4.11 As defined in both EC[23] and OFT[24] guidance, a relevant product market comprises all those products and/or services that are regarded as interchangeable or substitutable by the consumer by reason of the products' characteristics, their prices and their intended use.

Geographic market

4.12 The geographic market *'comprises the area in which the undertakings concerned are involved in the supply of products or services and in which the conditions of competition are sufficiently homogeneous*.'[25]

4.13 The relevant geographic market area can be distinguished from neighbouring areas because the conditions of competition are appreciably different. In addition, it is important to recognise that, as airports serve a number of different users, there may be different relevant geographic markets for different groups of users.[26]

4.14 The assessment of competitive constraints for the geographic market definition will include an analysis of the ability of airlines to switch away from an airport as well as the potential for passengers to switch between airports, whether independently or by following a particular airline.

21 OFT 403, paragraph 2.10 to 2.11 and 5.4 to 5.6. See also the Guidelines, paragraphs 3.15 to 3.16 and 3.24 to 3.25.

22 The Guidelines, paragraph 3.13. See also the CC's 2009 BAA Report, paragraph 2.1.

23 EC Market Definition Notice, paragraph 7.

24 OFT 403, paragraph 2.5.

25 The Guidelines, paragraph 3.8 and EC Market Definition Notice, paragraph 8.

26 The Guidelines, paragraph 3.59.

Temporal markets

4.15 It is also possible to segment a market across time periods. In the case of airports, it may be relevant to differentiate across seasons or between different times of day and, in particular, between peak and off-peak periods. These temporal differences may be relevant where airlines and/or passengers do not regard different time slots as substitutes.[27]

Market definition

The minded to Consultation

4.16 Taking account of the statutory framework and the analysis in the minded to Consultation, the CAA was minded to conclude that the focal product market was one or more airport operation services supplied by STAL in the core area at Stansted. This was likely to consist of at least:[28]

- the use of the runway and taxiways;
- aerodrome Air Traffic Control (ATC[29]);
- aircraft parking;
- ramp handling services;
- fuel and oil handling;
- the provision of facilities for aircraft maintenance; and
- the provision of infrastructure needed for the provision of other airside and landside groundhandling services.[30]

27 The Guidelines, paragraph 3.54.

28 The minded to Consultation, p. 70.

29 Aircraft landing at Stansted only face charges from the airport operator for the aerodrome element of ATC. The approach service is provided by NATS (En route) Plc as part of the London terminal manoeuvring area (LTMA) and charged directly to airlines operating in this space. At airports outside of the LTMA, the approach service would be included within this bundle of activities. However, the CA Act formally excludes ATS as defined in the Transport Act 2000 from airport operation services. The ability to land and manoeuvre aircraft at and around an airport is also a key service that airport operators are required to provide as part of their services to airlines. In the UK these services are currently contracted by the airport operator with an air navigation service provider in a liberalised market. It is then up to the airport operator how they recover this cost in a similar manner to any other costs incurred; it is not a 'pass through' cost.

30 Ramp handling services, fuel and oil handling, and aircraft maintenance are groundhandling services as defined in Directive 96/67/EC. Groundhandling services are often provided by the airlines or to the airlines by third parties. However, the groundhandlers pay fees to the airport operator relating to use and access to infrastructure. In these cases, the airport charges would still

4.17 In addition, the CAA was minded to consider that airport operation services would include:[31]

- the provision of facilities for check-in;
- baggage handling;
- security screening;
- facilities for holding passengers between arriving at the airport and departure (holding passenger facilities);
- facilities for the processing of airline staff arriving and departing the airport (airline staff processing facilities); and
- the transit of passengers to and from the aircraft (in the case of a passenger airline) (passenger transit facilities) and the provision of facilities for the processing of cargo (in the case of an aircraft carrying cargo, either in bellyhold or as a cargo-only flight) (cargo processing facilities).

4.18 The CAA also considered that, based on the demand from airlines and the limited opportunities for supply side substitution by current commercial airports or new entrants in a reasonable timeframe, the product market should be segmented broadly on the basis of the following airline business models[32]:

- Aeronautical services supplied to short-haul LCC and charters operators.
- Aeronautical services supplied to full-service long-haul carriers and associated feeder airlines.
- Aeronautical services provided to cargo airlines.

4.19 On the balance of the evidence, including airports' and airlines' views, airline switching, route overlap, passenger catchment areas and passenger switching, the CAA was minded to consider that there were three distinct geographic markets[33], one for each of the product markets defined:

affect the airline through the charges levied on the groundhandlers.

31 The minded to Consultation, paragraph 4.27.

32 The minded to Consultation, paragraphs 4.32 to 4.52.

33 The minded to Consultation, paragraphs 4.53 to 4.150.

- The likely geographic market for LCCs and charters consisted of the services provided by STAL at Stansted and those similar services provided at Luton and Southend and possibly those at Gatwick.[34]
- The geographic market for full service carriers (FSCs) and feeder airlines consisted of at least the services provided by STAL at Stansted and likely similarly services provided at both Gatwick and Heathrow.[35]
- The geographic market for Cargo airlines consisted of services provided by STAL at Stansted.

4.20 The CAA was minded to consider that there was no relevant segregation of the market to reflect differing temporal markets for Stansted.[36]

The minded to Consultation - stakeholders' views

4.21 STAL had a number of concerns with the CAA's approach to market definition. In particular, STAL considered that[37]:

- The product and geographic market definitions were too narrow and inconsistent with the Guidelines, previous regulatory statements and wider competition law practice. STAL highlighted perceived inconsistencies between the CAA's approach and the analysis conducted by the CC in the BAA airports inquiry. STAL also considered that it was not reasonable to depart from the CC's position.
- The CAA had moved from its position of supporting a much wider geographic market definition in its Initial Views.
- The wrong level of the market had been assessed and the CAA often conflated the different levels of the market.
- The CAA had misdirected itself in its assessment of the multi-sided nature of the airport and had omitted to take proper account of commercial revenues and its implications for market definition.
- The CAA had not paid sufficient attention to marginal customers and their willingness to switch in the face of a 5 to 10 per cent price increase.

34 The minded to Consultation, paragraphs 4.156 to 4.162.

35 The minded to Consultation, paragraph 4.165.

36 The minded to Consultation, paragraph 4.126 to 4.131.

37 MAG, Civil Aviation Authority Stansted Market Power Assessment; Interim response of MAG to the CAA's minded to document, 24 May 2013.

4.22 STAL challenged the CAA's segmentation of the market between LCCs and FSCs on the basis that it had failed to recognise the competition and route overlaps between them. It also highlighted perceived inconsistencies between the CAA's analysis and the position set out in the Guidelines, previous decisions and regulatory assessments as well as with the EC.[38]

4.23 Airline stakeholders were broadly supportive of the CAA's overall position. Southend did not comment substantively on the CAA's findings.

4.24 easyJet, although supportive of the CAA's position, considered that the CAA had overlooked the critical distinction for the product market, namely services provided by STAL to point-to-point carriers and services to networked carriers.[39]

4.25 GAL noted that the CAA’s definition of the product market of services to LCCs and charters failed to take into account the reality of competition from and route overlaps with Full Service Carriers (FSCs), and which the CAA concluded were in a separate economic market; and noted a number of inconsistencies between the CAA’s approach to market definition and precedent.[40]

CAA views

4.26 With respect to STAL's concerns on the consistency of its market definition:

- The CAA does not consider that it is bound by its previous statements where the evidence or subsequent analysis suggests that its previous position should be changed. The CAA’s departures from previous positions should, however, be supported with evidence or argumentation. If the evidence leads to different conclusions to those made in the past, the CAA cannot hold itself bound by previous positions.

[38] GAL, CAA Stansted Market Power Assessment - Response from Gatwick Airport, reference Q5-050-LGW59, 21 May 2013 (GAL response to the STAL MPA) and GAL, CAA’s Gatwick Market Power Assessment: Response from Gatwick Airport Limited, reference Q5-050-LGW60, 26 July 2013 (GAL Response).

[39] easyJet: easyJet response to the CAA's minded to Consultation on Market Power on Stansted Airport, (easyJet response to the STAL MPA, paragraph 5) and easyJet response to CAA consultation on Gatwick airport market power, (easyJet response to the GAL MPA).

[40] GAL, CAA Stansted market Power Assessment – Response from Gatwick Airport, p. 2.

- Much of the material that STAL refers to was undertaken a significant time ago under different legislation and a different regulatory regime. A number of inconsistencies raised by STAL consider statements made by the CAA prior to the report by the CC into the joint ownership of the London airports and the judgments by the CAT that followed. It would therefore be inappropriate for the CAA to maintain previous positions that do not reflect the CC's analysis and the CAT's judgments.

- It would be negligent for the CAA not to take into account the approach and findings of the CC and the Competition Appeals Tribunal (CAT) in developing its thinking and assessment of the current market position of STAL. As such, the de-designation assessment of Stansted in 2007 and the comments made by the CAA in its initial considerations of the CC's investigation into BAA airports need to be considered in the appropriate context.

- It is widely accepted that market definition is a flexible tool that may alter depending on the question being asked. The CC's BAA airports investigation considered a wide question on the potential development of competition between the three BAA airports and sought to remove structural impediments to development of potential competition. The CC was not considering the narrower question that the CAA must consider under Test A, which is the particular market in which an individual airport operator operates.

- The divestment remedy imposed by the CC as a consequence of its Airports investigation did not bring an immediate and effectively competitive market into existence. The CC's expectation was for competition to develop over time.

- Merger case law highlighted by STAL is concerned with whether a merger will weaken current competition observed within a market. Similar to the fourth bullet point above, this material is not considering the narrower question that the CAA must consider under Test A.

- Since the publication of the Initial Views, the CAA has developed a substantial evidence base on which it has refined its thinking.[41]

[41] Details of the CAA's response to STAL's concerns with the minded to Consultation are available in the appendices that form part of this document.

Market definition – final decision

4.27 As noted earlier, although the SSNIP test is a useful starting point for defining the market, it is intended to be carried out by reference to the competitive price level. It is also rarely possible to apply the SSNIP test in a precise manner due its inherent limitations as well as data and evidential restrictions.[42]

4.28 Given the historical common ownership and regulation of HAL, GAL and STAL, the CAA has been unable to carry out a formal SSNIP test. However, the CAA has gathered evidence, including catchment area analysis, passenger surveys, documentary evidence and the views of airlines and relevant airport operators on substitutability to inform its analysis and this has been interpreted within the hypothetical monopolist framework.

4.29 The CAA has also carefully considered what price level it should use as a starting point for its analysis and has concluded that the current regulated prices are an appropriate benchmark (or proxy) for the following reasons:

- They are cost-based on the basis of an acceptable cost standard and are designed to allow the airport operator to earn a return consistent with the risk of its investment.
- They are the prices faced by airlines, groundhandlers and passengers. Their use therefore limits the risks involved in gathering evidence around or hypothesising about an abstract pricing level.
- Regulated prices have been used in several cases of market definition in regulated telecommunications markets across Europe. In particular, the EC has taken the view that regulated prices should be taken as the starting point for conducting a SSNIP test.

4.30 Taking account of the statutory framework, the analysis outlined in the minded to Consultation and the additional Consultation, responses to the both these consultation and using the current regulated price as starting point for its analysis, the CAA concludes that the relevant product market for STAL is the provision of airport operation services to passenger airlines. The geographic market includes those service provided by STAL at Stansted as well as those services provided at Luton and Southend by their respective operators.

4.31 The particular services provided within this market consists of a single bundle that consists of the following airport operation services:

[42] The Guidelines, paragraph 3.13. See also the CC's 2009 BAA Report, paragraph 2.1.

- the use of the runway and taxiways;
- aerodrome ATC;
- aircraft parking;
- the provision of access and infrastructure needed for the provision of other airside and landside groundhandling services;
- the provision of facilities for check-in;
- baggage handling;
- security screening;
- holding passenger facilities;
- airline staff processing facilities;
- passenger transit facilities;
- premium passenger facilities; and
- integrated transfer facilities.

4.32 The key rationale for the CAA's decision on the relevant market for STAL is summarised below.

Service bundle

4.33 The key rationale for the CAA's decision with respect to the service bundle is:

- The CA Act provides a useful starting point to identify the key service bundle. The CAA considers that the focal product is likely to consist of one or more of the airport operation services defined in section 68 of the CA Act.
- Given the various products and services that STAL provides to users of the infrastructure at Stansted, it is appropriate to determine a service bundle rather than individual products or services as:
  - These services are likely to form the key bundle of services that an airline would require to operate from an airport.

- An airline would be required to bear the costs of all or a significant number of these services to provide air transport services.[43]
- In deciding whether to land at an airport, an airline would take account of the total bundle of charges it is required to pay rather than focusing on any one charge in isolation (even though services may be priced individually by the airport operator to reflect different cost drivers).
- The market power test is applied to the operator of an airport area, which is defined in section 9(1) of the CA Act as the person having overall responsibility for the management of all of the area. In determining overall responsibility, the CAA is directed to have regard to the extent that the person controls the matters listed in section 9(4) of the CA Act, which include the type, price and quality of services provided in the area as well as access to the area. Accordingly, while recognising that STAL may not directly supply each individual service at Stansted, STAL has some degree of control, responsibility or influence on (amongst other things) the pricing of the services or the access to the relevant infrastructure as the airport operator.

4.34 The CAA considers that its approach to product market definition is consistent with the approach adopted by the CC in its consideration of product market definition for the BAA airports market reference.[44]

Retail, property and car parks

4.35 The key rationale for the CAA's decision with respect to retail, property and car parks is that:

[43] Air transport services are defined in the CA Act as a service for the carriage by air of passengers or cargo to or from an airport.

[44] Indeed, the CC's analysis highlights that where secondary products (i.e. aircraft parking fees and check-in) are constrained by the interaction with a primary product (i.e. landing of aircraft at the airport), it is generally accepted that they should be treated as a single product market. The CAA does not, at this time, consider it is analytically necessary to define primary and secondary products, as the CC did. For clarity, the CAA considers them as a whole.

- While it is encouraging to see STAL developing its commercial income through its terminal transformation project, it is ultimately the provision of routes by airlines that drives passenger numbers at the airport. In addition, it is not unreasonable to assume that airlines would consider the needs of their passengers while they are at Stansted and would demand a certain level of facilities and services from STAL to accommodate them.

- Commercial revenues are complementary to aeronautical revenues but do not exhibit the demand feedback that would be required in a multi-sided market. While the pricing of the aeronautical service bundle affects the overall passenger numbers at Stansted, which in turn affects STAL's commercial revenue, STAL's pricing of commercial services does not affect the overall demand of either passengers or airlines for the aeronautical bundle. The CAA considers that commercial revenues are complementary to aeronautical revenues rather than exhibiting the demand feedback that would be required if the market were a multi-sided market.

- In practice, the price for retail activities is unlikely to affect passengers' choice of an airline or airport in a significant way. Therefore, concessionaires' decisions are likely to be independent from decisions made by airlines in relation to aeronautical services and airlines' decision making and profitability is independent of that of the retail, property and car parks concessionaires.

- Based on the above, the CAA considers that there is a separate and distinct market for the provision of facilities for retail activities and car parks. This approach is consistent with the approach adopted by the CC with respect to these activities. [45]

Supply side product substitution

4.36 Supply side product substitution can take a number of forms including the conversion of military or general aviation airports in to one able to provide airport operation services to commercial aviation or the modification of a current commercial passenger airport to take large aircraft. The CAA considers that supply side substitution would be inhibited by:

[45] In outlining this, the CAA recognises that some services, for example, some long stay car parks, will be outside the airport area as defined in the determination.

- The substantial investment costs involved in supply side substitution would be of a level that would rule it out as a short-term response to a 5 to 10 per cent increase in airport charges. The CAA also considers that planning restrictions and other constraints mean that entry by or expansion of other airports is unlikely to occur within a reasonable time period.

- It would not be rational to consider that airlines would alter their fleets so as to be able to use an airport with lower operational capabilities as a response to a change in airport charges. This is due to the sunk costs present in the operation of their current fleets and the costs involved in acquiring and equipping new aircraft.

4.37 Therefore, supply side substitution would only occur based on currently available infrastructure.

Geographic market – demand side analysis

4.38 The key reasons for the CAA’s decision with respect to demand side analysis as it relates to the geographic market are:

- The evidence presented by the airport operators suggests a possible wide set of airports as potential substitutes. However, the closer airports are geographically, the greater the perceived competition by airport operators.

- While recognising the pan European nature of a number of STAL's largest customers, analysis of competition for European airports suggests this does not pose a sufficient constraint on STAL's pricing behaviour to warrant the extension of the geographic market to include European airports.

- The evidence from airlines shows a much narrower option of alternative airports for Stansted. It appears that there is not significant demand side substitution between the north and south London airports. However, between Stansted, Luton and Southend in the north there appears to be scope for both demand and supply side substitution.

- From a demand perspective, it appears that Stansted sits at the bottom of a hierarchy of London airports, in which substitution tends to be asymmetrical from Stansted to Gatwick in one direction only. This is supported by airlines' views and observed switching. Only one switch from Gatwick to Stansted has been observed to date. Airlines perceive them to have different catchment areas, location, surface links and different demand characteristics in terms of interlining[46] facilities and alliance links with other airlines.

- Catchment area analysis and passenger preference analysis (which have their limitations), suggest choice for passengers is not conclusive for the purposes of geographic market definition. However the CAA elasticity analysis[47] also strongly suggests that passengers are unlikely to exercise the possible choice available to them (as the passenger elasticity of demand estimates available are lower than the CAA's estimate of the critical level).

46 Interlining (also known as "interline ticketing") is a voluntary commercial agreement between individual airlines to handle passengers travelling on itineraries that require multiple airlines.

47 Elasticity analysis looks at the response of passenger demand to changes in the price of airport operation services.

Geographic market – supply side analysis

4.39 The key reasons for the CAA's decision with respect to supply side analysis as it relates to the geographic market are:

- With respect to the scope for geographic supply side substitution, there are a number of airports which have suitable infrastructure to compete with the facilities that STAL offers at Stansted, in particular Heathrow, Gatwick, Luton and Southend.
- There are a number of high and unique barriers to entry at Heathrow that prevent it from being a credible substitute for the service provided at Stansted, such that it is unlikely that some services would switch away from Stansted as a result of a 5 to 10 per cent price increase by STAL.
- Although there is capacity off peak and the CAA does not observe the same barrier to entry around access costs at Gatwick as it does at Heathrow, Gatwick appears to have significant capacity constraints in the key morning peak period which is critical for the LCC business model that predominates at Stansted. In the event of a 5 to 10 per cent price increase by STAL, Gatwick is unlikely to provide a sufficiently credible switching option for those airlines under current capacity constraints.
- Luton and Southend currently have the required infrastructure to compete with Stansted across a sufficient range of aircraft although the CAA recognises that capacity issues at Luton may limit this. In the event of a 5 to 10 per cent price increase by STAL, the airport operators at Luton and/or Southend could, within an appropriate timescale, alter their facilities to provide an alternative supply for an airline operating at Stansted.

Temporal markets

4.40 The key rationale for the CAA's decision with respect to supply side analysis as it relates to temporal markets is that while recognising that declared capacity at Stansted varies with both the time of day and the season, these changes do not affect the inherent competitive structure of the market between the seasons to the extent that the analysis would benefit from segmenting the market in this way. The CAA has also not seen evidence to suggest that passengers become more price sensitive between seasons. The CAA therefore considers that it is not appropriate to segment the market by time of day or season for its market definition.

4.41 The CAA’s identification of the relevant focal product and analysis of the key characteristics of demand and supply substitutability, airline and passenger substitutability and other market features which form the basis for this decision are set out in more detail in the appendices to this document.

CHAPTER 5

Test A: Market power – final decision

Legal framework

5.1 Market power is the ability, profitably, to sustain prices above the competitive level or restrict output or quality below competitive levels. The assessment of market power involves an analysis of the competitive constraints faced by STAL to see whether they are strong enough to prevent it from harming the process of competition.[48] Market power is not an absolute term but a matter of degree which varies according to the individual circumstances of the case.

5.2 As part of its assessment of market power, the CAA needs to identify the existence and the potential strength of the competitive constraints[49] from within and from outside the relevant market. It needs to do this to determine whether the relevant market is subject to effective competition or not.

5.3 In 2012, STAL had 63 percent of passengers in the relevant market (61 per cent of air transport movements), which would establish a rebuttable presumption of a position of SMP in the relevant market under European competition law. The Guidelines indicate that evidence on the market structure and market share is commonly used in competition assessments. Market power is more likely to exist if an operator has a persistently high market share over time compared to its nearest rivals.[50]

5.4 However, the Guidelines also note that market share is not sufficient in isolation to determine the intensity of competition in the relevant market as they are too static to shed light on the dynamics of the market. In particular:

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48 The OFT's Competition Law Guideline on Assessment of Market Power December 2004 (OFT 415), paragraphs 3.1 to 3.3.

49 The OFT describes competitive constraints as ‘market factors that prevent an undertaking from profitably sustaining prices above competitive levels’: see OFT 415, paragraph 1.2 and DG COMP’s Discussion Paper on the application of Article 82 to Exclusionary Abuses, paragraph 2.4.

50 The Guidelines, paragraph 4.2 and OFT 415, paragraphs 4.2 to 4.3.

- The difficulties in defining the market precisely might limit the reliance that could be placed on any given measure of market shares as an indicator of market power. It may be necessary to take account of constraints from outside the relevant market. In STAL's case, its market share is sensitive to Gatwick's inclusion in, or exclusion from, the geographic market. Including Gatwick would reduce STAL's share of the relevant market from 63 per cent to around 30 per cent.
- There are aspects of airport markets that may reduce the reliability of market shares as an indicator of market power. In particular, the differentiated nature of airports, both in terms of their facilities and services, but also in terms of their location and the differing degrees of their interdependent demand, can reduce the reliability of market shares as an indicator of market power.[51]

5.5 In the case of London airports, there are additional reasons why market shares may not be a reliable measure of the level of market power of airports. These include:

- Within the relevant market there are capacity constraints which affect different airports differently. For example, there are capacity constraints on basing additional aircraft at Luton. Outside the relevant market there is a constraint on peak time runway capacity at Gatwick.
- Common ownership of the three largest airports (Heathrow, Gatwick and Stansted) for a considerable period of time under BAA. For example, BAA might not have operated or marketed its airports as substitutes for one another but, instead, it may have marketed its airports as complementary to one another to prevent growth at one airport cannibalising growth at another. The level of substitutability of airports for different airlines can be influenced by (among other issues) infrastructure requirements, capacity constraints, strategic reasons and costs.

5.6 Notwithstanding these concerns, the CAA has calculated market share for STAL by reference to the market definition that it has adopted. In addition, the CAA has had regard to other market features, including buyer power, barriers to entry and the extent of potential competition through new entry and/or expansion.[52] In so doing, the CAA has analysed the likely reactions, both within and outside the relevant market, to any attempt by STAL to restrict output, increase prices above the competitive level and/or

[51] The Guidelines, paragraphs 4.5 to 4.9.

[52] See the Guidelines, paragraph 4.4 and chapters 5 to 7 and OFT 415, chapter 5.

reduce quality at Stansted below the levels that would be seen in a competitive market.[53]

5.7 The CAA has supplemented this analysis with analysis on other indicators of market power, including STAL's behaviour and performance, profitability measures, quality of service, efficiency and engagement with airlines.[54]

Market power

The minded to Consultation

5.8 Taking account of the analysis presented in the minded to Consultation, the CAA concluded that STAL may have SMP and was likely to acquire it over the Q6 period in the market for airport operation services to passenger airlines. The tightening of airport capacity across London over Q6 was thought likely to limit switching opportunities for STAL's airlines. Only easyJet was considered to have CBP.

5.9 The CAA considered that the underlying source of STAL's acquisition of substantial market power was the inherent attractiveness of the London market and its strategic importance to airlines, combined with capacity constraints in the London system. The Government had put on hold the expansion of the main London airports and the Airports Commission is not expected to issue its final report until summer 2015, while demand for air travel is expected to increase with improvement to the economic situation. This tightening of available capacity was expected to reduce the constraint posed by other London airports to STAL by reducing Stansted's airlines switching possibilities. While larger aircraft and better utilisation of slots may lead to some increases in capacity, the CAA considered that this would only be sufficient to keep pace with demand over the Q6 period.

5.10 The CAA considered that easyJet had CBP as evidenced by its sponsorship of the expansion of Southend but that Ryanair lacked alternative airports to switch to and consequently had less buyer power than its large share (around 70 per cent) of STAL's passengers would suggest.

5.11 The timescale required for adequate airport expansion/new entry into the relevant market was considered likely to be too long to impose a constraint in the short-term.

53 A discussion on the competitive price at Stansted is outlined in appendix G.

54 See the Guidelines, paragraphs 7.4 to 7.10 and OFT 415, paragraphs 6.5 to 6.7.

5.12 Over the Q6 period, due to improving economic conditions and the lack of significant capacity expansion, the CAA considered that STAL was likely to acquire SMP.

Stakeholders' views: the minded to Consultation

5.13 As outlined in chapter 3, the CAA received seven responses to the 'minded to' Consultation (two from MAG), six of which were relevant to the STAL passenger airline market. The key points in the main responses are outlined below.

Airport operators

5.14 MAG disagreed that STAL has market power in any of the markets considered by the CAA or that it is likely to acquire it. MAG disagreed with the CAA's evidence and reasoning in a number of key areas including:[55]

- On market definition, MAG questioned the segregation of the passenger airline product market between LCCs and charters and FSCs and feeder traffic and maintained that the geographical market was much wider, including other London, UK and European airports.
- MAG noted that the market definition departed from precedent, some of which is very recent and it considered that the CAA did not follow the analytical framework in its own Guidelines and there were perceived inconsistencies with the CAA's guidance and with previous regulatory decisions.
- MAG submitted that the treatment of the multi-sided nature of Stansted's business in the minded to Consultation failed to take fully into account the multi-sided relationship between its aeronautical activities and its non-aeronautical activities (such as retail concessions, car parking, advertising and property). Furthermore, MAG maintained that the multi-sided nature of Stansted's business leads to the conclusion that any market power that Stansted may otherwise have (or might acquire) as regards its airline customers is negated by the potential loss of revenues associated with a fall in passenger volumes.

[55] MAG, Civil Aviation Authority Stansted Market Power Assessment; Interim response of MAG to the CAA's minded to document, 24 May 2013.

- MAG agreed that easyJet had countervailing buyer power but considered that Ryanair had it too. MAG stated that Ryanair had switched existing services away from Stansted to other UK and continental European airports, and that it had allocated growth to airports other than Stansted. MAG stated that Ryanair can and does switch, and make credible threats to switch, away from Stansted. MAG considered that the multi-sided nature of STAL's business amplified the airlines' buyer power because a switch away from Stansted would involve a loss of non-aeronautical as well as aeronautical revenues.

- MAG considered that the CAA had overstated the likelihood of STAL acquiring SMP as it had failed to analyse the totality of competitive constraints at the margin. Also, in its view, the CAA had taken too negative a view of the future capacity availability at the main London airports that would be capable of accommodating aircraft switching away from Stansted.

- MAG's view was that the change in ownership of the airport meant that past evidence was not a reliable indicator of whether the new owners would have SMP.

5.15 Both MAG and GAL[56] considered that the CAA had been selective in its use of available evidence and prior analysis of other competent authorities.

Airlines

5.16 Ryanair broadly agreed with the CAA's position but considered that STAL currently has SMP rather than that it may have SMP.[57]

5.17 easyJet supported the CAA's finding that the market power test is met in relation to Stansted and that continued economic regulation is justified. However, it noted that with new ownership it is unclear whether the same approach that the previous owners adopted would be used going forward.[58] easyJet did not agree with the CAA's view that its sponsorship of the Southend's entry in 2012 was evidence that it had buyer power.[59]

56 GAL, CAA Stansted market Power Assessment – Response from Gatwick Airport, p. 4.

57 Ryanair, Ryanair's reply to the CAA's minded to decision on STAL's market power, section 1 paragraph 3.

58 easyJet, easyJet's reply to the CAA's minded to decision on STAL's market power, p. 1.

59 easyJet, easyJet's reply to the CAA's minded to decision on STAL's market power, p. 2.

5.18 easyJet revised its view of Stansted's market power, explained in a Stansted Airport Consultative Committee (SACC) letter dated 25 June 2013 to the CAA[60], which said that easyJet considered:

'that STAL does not have SMP over easyJet' and 'in consequence, from easyJet's perspective, STAL does not require economic regulation.'

The additional Consultation

5.19 MAG acquired STAL in February 2013. After the minded to consultation closed on 26 May 2013, STAL (under new ownership) agreed heads of terms for long term agreements at Stansted with a number of its passenger airlines, including easyJet[61] and Ryanair.[62]

5.20 At the broadest level, the terms of these agreements included reductions on current airport charges in return for growth in passenger numbers and other commitments. In the initial terms, the offered charges were below the current regulated price cap. The charges potentially available are at levels which the CAA previously considered to be within a range for the competitive level of charges (based on the analysis included in the minded to Consultation).[63]

5.21 In the additional Consultation, the CAA expressed a provisional view for the passenger market that the implication of the long term deals was that Test A would be failed, suggesting that easyJet and Ryanair in particular might have more buyer power than was considered in the minded to Consultation. The CAA consulted to seek stakeholders views on what the change in ownership of STAL and the resulting observed behaviour imply for the analysis of STAL's market power. The CAA received seven responses to the additional Consultation, five of which were relevant to the STAL passenger airline market.

Stakeholders' views: the additional Consultation

5.22 MAG agreed with the CAA's revised view that airlines' ability to negotiate prices that are significantly lower than the current regulatory price cap, provides compelling evidence that airlines at Stansted have buyer power.[64]

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60 Letter from SACC to CAA http://www.caa.co.uk/docs/78/SACCApr13.pdf

61 STAL, http://www.stanstedairport.com/about-us/media-centre/press-releases/easyjet-sign-long_term-deal-to-double-traffic-at-stansted

62 Ryanair, http://www.ryanair.com/en/news/ryanair-agrees-10-year-growth-deal-at-stansted

63 The minded to Consultation, paragraphs 6.38 to 6.69.

64 MAG response to CAA Stansted Market Power Assessment consultation on relevant market

5.23 However, MAG considered that the effect of the developments since January 2013 on Test A was much wider than the issue of countervailing buyer power. In particular, it considered that the new situation demonstrated the behaviour of a business operating in a competitive environment, and not one with SMP.[65]

5.24 MAG also drew the CAA's attention to its investment of approximately £40 million in the terminal transformation project and aspects of the deals it had concluded with airlines that it expected to increase significantly the level of retail income per passenger and therefore to incentivise it to lower airport charges to promote passenger growth.[66]

5.25 Ryanair and the SACC (with the exception of easyJet) considered that the deals did not provide any justification for the CAA changing the minded to Consultation conclusion that Test A was passed. Both considered that market power is a function of the underlying conditions in the relevant market and the recent agreements had not altered the fundamental issues, which demonstrate that STAL enjoys market power.[67]

5.26 SACC maintained that it was only when the CAA released the Initial Proposals in April 2013 that STAL realised that the only way for it to increase its revenues was through growth deals.[68]

5.27 In addition, Ryanair and the SACC considered that STAL had exercised its market power by getting easyJet and Ryanair to commit to very significant volume growth to achieve prices that are less than the current cap, which is above the competitive level. [69]

5.28 The SACC also considered that that continuation of regulation was necessary in case the deals needed to be renegotiated. [70]

developments, p. 8.

65 MAG response to CAA Stansted Market Power Assessment consultation on relevant market developments, p. 8.

66 MAG response to, CAA Stansted Market Power Assessment consultation on relevant market developments, p. 9.

67 Ryanair, Response Letter to the CAA, Re: Stansted Market Power assessment: consultation on relevant market developments, 11 November 2013; and Stansted ACC, Response Letter to the CAA, Re: Assessing the Market Power of Stansted Airport, 8 November 2013, p. 2.

68 Stansted ACC, Response Letter to the CAA, Re: Assessing the Market Power of Stansted Airport, 8 November 2013, p. 3.

69 Ryanair, Response Letter to the CAA, Re: Stansted Market Power assessment: consultation on relevant market developments, 11 November 2013. p. 2 and Stansted ACC, Response Letter to the CAA, Re: Assessing the Market Power of Stansted Airport, 8 November 2013, p. 4.

70 Stansted ACC, Response Letter to the CAA, Re: Assessing the Market Power of Stansted Airport,

CAA analysis

5.29 The CAA has considered all responses to the minded to Consultation and the additional Consultation as part of its decision making process.

5.30 In light of those responses, the CAA has reconsidered its view on market definition and now considers that there is a single relevant market for the provision of airport operation services to passenger airlines at Stansted and that the geographical scope of the market is the services provided at Stansted, Luton and Southend. STAL's concerns on market definition are considered in more detail in chapter 4.

5.31 Consistent with the CC's view[71], the CAA considers that European airports do not form part of the relevant market. LCCs have the ability to reallocate aircraft across their networks to achieve the best return on their assets and the CAA recognises that there may be some constraint on STAL's airport charges from this in the longer term. However, an LCC's decision to serve a local market is derived from passenger demand in that market.

5.32 Therefore, CAA does not consider that an increase in airport charges would lead an LCC to a decision that it should move its aircraft to serve passenger demand from outside the local market. The CAA does not consider that LCCs' fleets are fixed so that aircraft have to be used somewhere in the network. Rather, the CAA considers that airlines are able to adjust the size of their fleets more flexibly. Therefore, it seems unlikely that a consequence of an increase in airport charges at Stansted would be for airlines to decide to serve a different, distant market.

5.33 With respect to MAG's concern that the CAA has fundamentally misunderstood the theory of multi-sided platforms and that this has led it to define the relevant market too narrowly or underestimate the competitive constraint faced by STAL, the CAA does not agree. The CAA considers that non-aeronautical revenue is affected by the level of airport charges but the reverse is much less true. The CAA considers that, for practical purposes, the relationship can best be analysed as complementary rather than multi-sided.

Constraints: airline switching

8 November 2013.

[71] See: paragraph 3.8, BAA airports market investigation, Competition Commission 2009 and paragraph 181, BAA market investigation: consideration of possible material change of circumstance, Competition Commission 2011.

5.34 The CAA does not agree with MAG that it took a negative view of future capacity constraints across London airports. The CAA took account of all future infrastructure developments and other means of increasing airport capacity and used the central estimates of the latest (January 2013) Department for Transport (DfT) forecasts of aviation capacity and demand when formulating its view of how much capacity would be available in the future.

5.35 On MAG's concern that the cumulative effect of competitive constraints was not considered in its analysis, the CAA disagrees. While the reasoning on each issue was set out separately in the minded to Consultation, the cumulative effect of the constraints was considered in reaching its conclusion. This approach has been continued in this document.

5.36 The CAA also considers that it has taken due account of all the evidence, in reaching its view. In particular, it has considered whether evidence that pre-dates MAG's ownership of STAL is still relevant for the assessment of STAL's market power. The CAA has also been open to the view that, although there may not have been a material change in the competitive constraints faced by STAL since MAG became the owner, STAL's incentive to respond to them may be different to that which occurred under BAA because MAG may be able to take a longer term view.

5.37 BAA faced the prospect of having to divest the airport as a result of the CC's 2007 investigation. The prospect of having to sell STAL may have led BAA to have less incentive to respond to switching and threats to switch by airlines, because of the impact that any reactionary behaviour from STAL would have on profitability at Heathrow. By contrast, a new owner seeking to maximise its long run return, is likely to take a different strategic approach to Stansted and its profitability.

5.38 The strength of competition from airports within and outside the relevant market has also been considered by examining whether they would exert a sufficient constraint on STAL to prevent it increasing prices by 10 per cent. To do so, the CAA has examined whether airline or passenger switching would be effective in constraining an increase in airport charges.

5.39 The CAA has considered the means by which airlines could switch away from Stansted, including switching existing service and allocating volume growth to alternative airports, rebasing aircraft, reducing frequencies, and grounding aircraft. In addition, the CAA considered the types of switching costs that airlines would be likely to incur if switching away from Stansted.

5.40 The evidence suggests that the physical costs of Stansted airlines switching to another airport are not large. However, there are other sunk costs that would have to be replicated if an airline were to switch to another airport, such as marketing and promotional expenses and route maturity costs.

5.41 Airlines have also cited the strategic importance of London to their networks as a factor that would deter them from switching away. The strategic value that airlines attribute to London arises from a combination of factors. For example, for LCCs, the volume of demand in London allows a large number of routes to be operated from the same base, which results in efficient aircraft utilisation, as well as allowing them to churn routes to maintain their profitability and launch new routes with lower risk.

5.42 The evidence also suggests that airlines take a longer term view of the need to build and hold peak time slot holdings, which would inhibit any switching away.

5.43 On the availability of current capacity to which airlines could switch, London City cannot be used by the majority of aircraft that currently use Stansted. Furthermore the business models of airlines operating at the two airports are substantially different. The capacity constraints during the early morning peak at Luton and Gatwick also suggests that there is limited scope for the relocation of based aircraft from Stansted to these airports. However, non-peak capacity is available at both these airports and would allow Stansted inbound and charter traffic to switch to them. While Southend has significant spare capacity, its runway length makes it technically impossible for Ryanair to relocate its Stansted aircraft there.

5.44 Having considered future expansion plans of the London airports and other potential substitutes and forecasts of future demand for airport capacity, it is also unlikely that the scope for switching based aircraft using peak time slots will increase over the Q6 period.

5.45 At Luton the main constraint on basing new aircraft there is stand capacity, which is not expected to be expanded before 2019.

5.46 At Gatwick, although operational improvements may be capable of expanding capacity from its existing runway, these are expected to be sufficient only to keep pace with demand by existing airlines and not to increase spare capacity.

5.47 However, by contrast, inbound and charter traffic does not appear to face a capacity constraint to switching away from Stansted.

5.48 While it is possible to acquire slots at capacity constrained airports, this depends on finding a willing seller or merger partner. The CAA considers that the constraint exercised when an airline switches to a capacity constrained airport is likely to be less than when the competing airport has spare capacity. If a competing airport cannot expand its output then any demand displaced will be available to the switched-from airport.

5.49 Overall, the CAA considers that switching existing services to alternative London airports is likely to be easier for inbound and charter airlines (together representing around 9 per cent of Stansted’s traffic and services) than based aircraft because they have lower switching costs and can use capacity outside peak periods. However, the CAA recognises that in 2012 easyJet switched three based aircraft from Stansted to Southend, sponsoring its entry into the relevant market. The CAA considers that easyJet’s motivation behind this switch was to discipline STAL.

Constraints: Passenger switching

5.50 If airlines pass increased airport charges on to passengers they could constrain STAL by switching to another airport. The scale of passenger switching is likely to be highly dependent on the demand response of passengers to an increase in airport charges. However, airport charges are only approximately 10 to 20 per cent of an airline's operating costs. As such, a 10 per cent increase in airport charges might be passed through, at most, as a 1 to 2 per cent increase in LCC airfares. Also, airlines may not fully pass through cost increases in the short run.

5.51 Catchment area analysis suggests that a significant proportion of the airport's passengers is likely to be able to travel from at least two London airports. However, catchment area analysis does not indicate how passengers might react to an increase in an airport operator increasing its charges (their charge elasticity of demand (CED)).

5.52 The CAA has estimated the likely scale of actual marginal passenger switching and compared it against the critical loss of passengers required to make an increase in airport charges unprofitable. This analysis included the loss of aeronautical and non-aeronautical income from reduced passenger numbers caused by an increase in airport charges. Although subject to a degree of uncertainty, this analysis suggests that STAL is likely to be able to profitably increase its airport charges.

5.53 The CAA therefore considers that switching by marginal passengers as a short-run response to an increase in airport charges to airlines, as well as in the longer term, is unlikely of itself to be sufficient to constrain STAL to the point of making a 5 to 10 per cent increase in airport charges unprofitable.

Buyer power

5.54 Countervailing buyer power relates primarily (although not always) to the strength of a buyer in negotiations with sellers.[72] The existence of substantial spare capacity and lack of competitive backfill at Stansted is relevant to the assessment of buyer power as it means that promises of additional traffic or threats or actual withdrawal of capacity could have a material effect on the STAL's profitability (as it may not be easily replaced).

5.55 CBP is the power of airlines to offset the powers of the airport operator, whose allegedly superior powers are under consideration, and the important question is what degree of CBP is there, and (bearing in mind all the circumstances) does it operate to a sufficient extent so as to mean that there is no SMP. CBP is not an absolute concept in terms of its strength. It is a concept which embodies a possible range of strengths. In any case where it is relevant, the relevant question is whether there is any CBP, and if so how much and what effect does it have.[73]

5.56 Various factors will contribute to, or detract from, the power of the buyer, and they will have various strengths depending on the market in question.[74] The assessment of CBP is an assessment of how the market actually operates (or is likely to operate) on the true facts to see whether an airline has a real and effective bargaining position that is sufficient to counter the factors which would otherwise point in favour of an airport operator having SMP.

5.57 A key factor in the assessment of CBP in the relevant market is the presence of substantial spare capacity at Stansted. STAL report that Stansted is currently operating at around 61 per cent of its capacity. This means that STAL is substantially dependent on these airlines' business for its viability in the short run. The CAA acknowledged in the minded to Consultation that Ryanair's presence at Stansted was a deterrent to other LCCs operating from it, thereby increasing STAL's reliance on Ryanair over that suggested by its share of STAL's business.

72 See, for example, the OECD competition committee round table on buyer power and the contributions by OECD members to that debate, summarised in OECD (1998). The OFT and the EC Commission refer to buyer power in a bargaining framework at OFT (2004a), paragraph 6.2 and EC (2004a), paragraph 64.

73 See also *Hutchinson 3G v Ofcom* [2005] CAT 39, paragraphs 110 to 111.

74 *Hutchinson 3G v Ofcom* [2005] CAT 39, paragraph 111.

5.58 The degree of buyer power held by easyJet and Ryanair, STAL's two biggest airline customers, accounting for over 90 per cent of its passengers represents an important constraint to STAL having SMP in the market for airport operation services to passenger airlines. easyJet and Ryanair have exercised their negotiating position effectively and used their traffic allocation levels as a bargaining chip since MAG’s acquisition of STAL to either, in the case of Ryanair, prevent a purported increase in airport charges or, to secure lower charges on a long term basis in exchange for growth.

5.59 The amount of spare capacity available at Stansted and the lack of competitive back-fill facilitates these airlines being able to exercise buyer power through their decisions on whether or not to allocate growth of their fleets to Stansted.

5.60 easyJet enjoys a number of outside options for allocating aircraft across its London bases. easyJet demonstrated that it has buyer power by switching aircraft from Stansted to Southend in 2012 thereby sponsoring Southend’s entry into the relevant market. That level of switching is close to the level of the critical loss estimated by the CAA. Although it did not get an immediate reaction from BAA at the time, it has referred to Southend in its negotiations with the new owner, MAG. MAG has responded very quickly after its acquisition of STAL by negotiating reductions in airport charges. Other evidence suggests that easyJet used its ability to allocate growth across its network in negotiations with STAL.

5.61 Ryanair appears to lack options around London that would allow it to switch substantial volumes of existing based aircraft away from Stansted. However, the CAA considers that Ryanair has buyer power. It threatened to reduce its core traffic from 12.5 to 11.4 million passengers, a reduction of 1.1 million passengers or 9 per cent, from Stansted in February 2013, when STAL announced a proposal to increase airport charges by 6 per cent to take effect in May 2013. [✂]. Ryanair then reinstated the capacity it had threatened to remove. The evidence indicates that Ryanair’s reinstatement of capacity [✂]. The CAA’s view is that this suggests that Ryanair exercised buyer power.

5.62 Although there was a change of ownership in the interim with the new owners pursuing a different commercial strategy to BAA, the CAA considers that this incident displays a clear link between a threat to discipline STAL, and STAL’s response [✂], thereby indicating that Ryanair has CBP.

5.63 The CAA considers that easyJet and Ryanair’s high share of STAL's total passengers and their ability to allocate substantial amounts of volume growth away from STAL is sufficient to constrain STAL's airport charges to the great majority of its passengers and, offers some protection to the remainder of passengers. The CAA considers that easyJet has already exercised a degree of buyer power through its sponsorship of a substantial expansion of Southend in April 2012, using aircraft that were switched from Stansted.

5.64 easyJet and Ryanair's ability to exercise buyer power may also have been facilitated by the change of ownership of STAL early in 2013. The CAA considers that MAG, the new owner, has been more responsive to switching, including the allocation of future growth than BAA, which faced the prospect of having to divest the airport in the short term and to consider the implications of actions at Stansted for its profitability at Heathrow.

5.65 The availability of spare capacity gives it an incentive to moderate its airport charges to increase passenger numbers. STAL's investment in the terminal transformation project and other measures to increase the amount of non-aeronautical revenue at the airport accentuate that incentive.

5.66 Both easyJet and Ryanair recently agreed long-term deals with STAL that offer significantly reduced airport charges related to growth targets. Both deals involve significantly lower airport charges in return for volume growth, with the reduction applying to total traffic rather than just the increment. The CAA considers that the structure of these deals reinforces its view that the airlines used their ability to allocate growth in negotiations.

5.67 Overall, the CAA's view is that easyJet and Ryanair's buyer power has been sufficient to allow them to counteract any SMP that STAL might have. STAL's incentive to moderate airport charges to boost retail spend and switching by inbound and charter airlines add to this constraint on STAL attempting to increase prices above the competitive level.

5.68 The CAA considers that that Ryanair and easyJet have a degree of countervailing (to STAL's SMP) buyer power that has contributed to the long term deals on airport charges negotiated with these airlines. The easyJet and Ryanair deals are considered further in the appendices.

5.69 In relation to the assessment of buyer power, buyer power is more usually associated with an ability to achieve a reduction in prices on current volumes rather than a lower price for additional purchases. However, some of the growth required under the deals might be expected to happen in any case with an improvement in economic conditions over Q6.

5.70 Although, the CAA accepts that STAL is likely to have had multiple reasons for the deals rather than there being due to any single factor, the CAA considers that the substantial volume of spare capacity at Stansted and the absence of backfill by competitors affords Ryanair and easyJet a degree of buyer power through their ability to allocate growth to other airports and thereby harm STAL's business. It is not necessary for the airports, to which growth is allocated, to be part of the relevant market. As the CC noted:

'Where airlines can credibly threaten to move flights to other airports, this might also be a constraint even if those other airports are not viable substitutes for passengers.'[75]

5.71 Overall the CAA considers that the degree of countervailing buyer power held by Ryanair and easyJet has been sufficient to allow them to achieve prices that are consistent with what the CAA considers to be the range of the competitive price for Stansted over the Q6 period and that this, together with the documentary and other evidence suggest that STAL does not have SMP. The prices under the growth deals are significantly lower than the 2013/14 price cap of £7.68 per passenger for Stansted. Had MAG thought it profitable it could have continued to price to this cap and accepted a higher margin over a lower volume of future traffic.

Barriers to entry and potential competition

5.72 The CAA maintains its minded to Consultation position that entry and expansion by other airports would not be an effective response in constraining any SMP that STAL might have. Airport entry and expansion requiring major infrastructural development need planning consent. Given the current Government moratorium on airport expansion in the south east of England and the time taken to obtain planning permission, entry and expansion would not be effective in achieving an expansion of supply that would constrain an increase in STAL's airport charges over the medium term.

Future constraints

5.73 The CAA maintains its view, as set out in the minded to Consultation, that capacity will tighten across the London airports over the Q6 period. Therefore, the constraint from other London airports is likely to weaken as it is likely to be more difficult to switch both based and inbound capacity away from Stansted.

[75] CC, BAA airports market investigation, 200, paragraph 2.48c.

5.74 DfT aviation forecasts take account of major infrastructure developments that are expected to happen during the Q6 period that would have the effect of increasing capacity. The CAA considers that it is reasonable to rely on the DfT central forecasts rather than high or low scenarios in making its assessment of the tightening of capacity across London airports.

5.75 According to DfT forecasts, Luton is not forecast to be full until 2027 while Southend is forecast to be at 42 per cent capacity by 2020. Gatwick is expected to be full by 2020.[76] easyJet and Ryanair will also have the option of allocating growth away from Stansted into their European networks. Stansted itself is forecast to be at 69 per cent capacity by 2020.

5.76 Therefore, any CBP that these airlines have at present could reasonably be expected to persist over Q6. Given easyJet and Ryanair deals cover the entire Q6 period, locking in airport charges at levels that are consistent with the reasonable range of the competitive level confirms this view.

Other indicators of market power: pricing, service quality, profitability and efficiency

5.77 The recent change of ownership of STAL has complicated the CAA's assessment of whether behavioural indicators such as pricing, profitability, service quality and efficiency suggest whether or not STAL has SMP. Most of the evidence the CAA has considered to date relates to STAL under BAA ownership and the recent acquisition has not left sufficient time for the full implementation of the new owners (MAG's) commercial policies. The CAA has evaluated the limited evidence available to it at this time.

5.78 In STAL's case the CAA has not been able to draw any inferences about whether or not STAL has SMP from indicators such as profitability and service quality. They appear to be largely driven by the Q5 regulatory requirements.

5.79 While the past analysis of efficiency suggests a number of areas where inefficiencies have been identified by a number of studies undertaken by different consultants, there is not adequate history of information upon which to draw robust conclusions about Stansted's future operating and capital efficiency performance under the new ownership of MAG.

[76] Airports Commission discussion paper No1: Aviation demand forecasting, Figure 3.5, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/73143/aviation-demand-forecasting.pdf.

5.80 The evidence from the recent signing of the long term growth deals between Stansted and its main airline customers, including Ryanair and easyJet, suggests closer and more constructive engagement and commercial negotiation between STAL and its airlines customers than under BAA's ownership. The bilateral deals have been welcome and were advertised as a success story with public statements and declarations about their significance and value by all sides.

5.81 In the minded to Consultation, the CAA observed that STAL had been pricing at or close to the regulated cap for over 5 years[77] and had not offered any discounts to existing airlines since 2008.[78] According to an independent benchmarking study by Leigh Fisher, STAL had been pricing approximately £1 above the average level of comparator airports and approximately £1.50 above comparators subject to lighter regulation.[79] The CAA concluded that STAL's pricing was above the competitive level although it could not specify exactly how much.[80] The historical analysis of STAL's pricing behaviour suggests that it has been setting its prices close to the regulatory cap. However, the CAA considers that the prices contained within the easyJet and Ryanair growth deals appear to represent a significant departure from this.

5.82 The CAA considers that these deals should be considered as a product of the combined effect of the constraints on STAL as well as the new owners' changed behaviour and commercial strategy, including its interest in growing passenger numbers and its non-aeronautical income.

5.83 Both growth deals offer airport charges that are consistent with a range that might be consistent with a well-functioning market. Both have an initial 5-year term [✂]. The CAA considers that the duration of the deals suggests that the competitive constraints on STAL are sufficient to suggest that STAL does not have SMP nor is likely to acquire SMP over the Q6 period.

5.84 The above evidence provides a mixture of indications on whether STAL has or is likely to acquire SMP. Overall, the CAA considers that it has seen a significant change in behaviour from the new owners, which is underlined by deals covering the great majority of passengers using Stansted. The CAA considers that the airport charges in the deals are consistent with a well-functioning market.

77 Minded to Consultation, paragraph 6.67.

78 Minded to Consultation, paragraph 6.79 and 7.15

79 Minded to Consultation, paragraph 6.59.

80 Minded to Consultation, paragraph 6.62.

Final decision

5.85 Taking account of the analysis outlined in this document (including the appendices), the CAA has concluded that STAL does not have SMP in the relevant market of the provision of airport operation services to passenger airlines at Stansted, Luton and Southend, nor is it likely to acquire SMP over the Q6 period.

5.86 The CAA has reached this view after weighing up indicators that point in different directions:

- STAL has 63 per cent of passengers in the relevant market (61 per cent of ATMs), which would establish a rebuttable presumption of a position of SMP in the relevant market under European competition law. However, market shares alone may not be sufficient to establish a position of SMP. In STAL's case, its market share is sensitive to the inclusion of Gatwick in the relevant geographic market or not. The CAA considers that the consideration of aggregate competitive constraints, whether from within or outside the market, is more relevant to the assessment of SMP than market share figures.

- Critical loss analysis suggests that STAL would be able to increase airport charges if deregulated. The CAA estimated the critical loss for a 10 per cent increase in STAL's airport charges to be approximately three to five aircraft, representing between 1.3 and 1.5 million passengers per year. A higher loss would make a 10 per cent increase in airport charges unprofitable.

- Airlines can take a number of actions to switch away from Stansted including:

  - Allocating growth to other airports.

  - Moving based airlines to another airport.

  - Reducing frequencies.

  - Increasing groundings.

  - Switching inbound services to another London airport or wider.

- There is evidence of all of these strategies having been used by airlines at Stansted but the extent to which they have been in response to airport charges as opposed to other factors is difficult to ascertain.

- There are significant airline switching costs, including marketing, promotional and route maturity costs that would inhibit moving based aircraft to other London airports. These are sunk costs, which to the extent that they need to be replicated at alternative airports, can be considered switching costs. They are less pronounced for inbound traffic.
- While recognising LCCs' flexibility to allocate capacity across their network, the CAA does not accept that the relevant market is EU-wide. In addition, airlines stressed the importance to their networks of a strong London presence, making them reluctant to switch away.
- With the exception of Southend, there is a shortage of suitable capacity for based aircraft at competing airports. Considering the likely increase in demand against infrastructural and other developments to expand capacity over the Q6 period, this shortage is likely to persist or worsen over Q6. However, inbound airlines, charters and services could find capacity more easily.
- Due to the moratorium and other planning restrictions, entry and expansion by other airports are unlikely to happen on a sufficient scale and within a reasonable timeframe to constrain STAL's pricing.
- The CAA considers that easyJet has buyer power as evidenced by its sponsorship of Southend's entry. It moved 3 aircraft there in 2012 in response to STAL's increases in airport charges since 2008. The level of this switching is at the lower bound of the CAA's estimate of the critical loss. Since then, the new owners of STAL have agreed reductions in airport charges in the context of wider negotiations.
- The CAA also considers that Ryanair has buyer power. When STAL announced a proposal to increase airport charges by 6 per cent to take effect in May 2013. [✂]. Ryanair then reinstated the capacity it had threatened to remove. The evidence indicates that Ryanair's reinstatement of capacity [✂].
- The CAA considers that both Ryanair and easyJet may derive some buyer power from their ability to allocate growth across their networks, particularly given that growth is important to STAL in view of the extent of spare capacity at Stansted, which is close to 40 per cent underutilised. Airlines can credibly threaten to switch or reduce frequencies at Stansted without fear of competitive backfill which would render their threats counterproductive. Buyer power has been considered together with the other constraints to assess whether STAL holds SMP.

- STAL's pricing and other behaviour, since being taken over by MAG, appears to the CAA to be materially different to that when Stansted was held in common ownership under BAA. By contrast, under BAA's ownership, since Q4, STAL has priced at or close to the regulatory cap and has not offered discounts to existing airlines since 2008. Under new ownership, STAL has agreed long term deals with airlines representing 90 per cent of passengers at the airport at airport charges that the CAA considers to be in line with a reasonable range for the competitive price for Stansted. This compares to the position at the minded to Consultation, where the CAA concluded, on the basis of an independent benchmarking study by Leigh Fisher, that STAL was pricing approximately £1 above the range of its comparators.
- The CAA considers that the assessment of STAL's market power is finely balanced with different indicators suggesting different conclusions. The long term deals that STAL has concluded limiting current airport charges and their trajectory over Q6 appear to the CAA to be indicative of a combination of a behavioural change by the new owners to the constraints identified above, including in particular, the buyer power of Ryanair and easyJet and lead the CAA to conclude that, on the evidence available STAL does not have SMP. As the deals last for the duration of Q6, the CAA does not consider that STAL is likely to acquire SMP during this period.
- Overall the CAA considers that the degree of countervailing buyer power held by Ryanair and easyJet suggests that STAL does not have SMP. Each airline has effectively used its bargaining position and threatened to withdraw frequencies or allocate growth elsewhere to achieve prices that are consistent with what the CAA considers to be the range of the competitive price for Stansted over the Q6 period. The prices achieved corroborate documentary and other evidence that shows how easyJet and Ryanair have used their ability to threaten to harm STAL's overall financial position in negotiations resulting in reductions in prices by STAL.

5.87 The CAA's analysis of the key characteristics of demand and supply substitutability and other market features which form the basis for the CAA's decision are set out in more detail in the appendices.

Conclusion on Test A

5.88 In light of the CAA's findings on market definition, competitive constraints and indicators of market power, the CAA concludes that STAL does not have SMP in the relevant market and is unlikely to acquire it over the Q6 period.

CHAPTER 6

Tests B and C

Background

6.1 As outlined in chapter 1, section 3 of CA Act prohibits the operator of a dominant area at a dominant airport from requiring payment of charges without a licence. The CA Act only permits economic regulation of an airport operator and the granting of a licence by the CAA if all three components of the market power test set out in section 6 of the CA Act are satisfied.

6.2 Having determined that Test A of the market power test has not been met, this chapter briefly outlines the CAA's views on Tests B and C.

Test B conclusion

6.3 In the minded to Consultation, the CAA considered that given the potential detriment to users of air transport services and the difficulties in pursuing potential exploitative abuses, in light of the case law, that for STAL, ex post competition law was unlikely to be sufficient to curtail abusive behaviour.

6.4 The CAA has carefully considered the representations from stakeholders to the minded to Consultation and the additional Consultation. Test B requires a finding of SMP against which to assess the sufficiency of ex post competition law to protect against the risk of abuse of that SMP.

6.5 Since the CAA has found that STAL does not currently have nor is likely to acquire SMP in the relevant market over the Q6 period, there can be no risk of STAL engaging in conduct that would amount to an abuse of that SMP. In circumstances where Test A is not met, Test B cannot be met. Accordingly, there is no need to consider whether competition law provides sufficient protection against the risk that STAL may engage in conduct that amounts to abuse of SMP.

6.6 The CAA has therefore concluded that Test B is not met in respect of STAL over the Q6 period. More information on Test B is available in the appendices.

Test C conclusion

6.7 In the minded to Consultation, the CAA considered that, for users of air transport services, the benefits of licence regulation outweighed the adverse effects.

6.8 In the additional Consultation the CAA's provisional view was that the benefits of regulation by means of a licence would not outweigh the adverse effects, and that Test C was unlikely to be passed.

6.9 The CAA has carefully considered the representations from stakeholders. Its final conclusion on Test C is that the benefits of regulation by means of a licence are unlikely to outweigh the adverse effects because STAL does not have, nor is it likely to acquire SMP in the relevant passenger market at Stansted over the Q6 period. More information on Test C is available in the appendices.

CHAPTER 7

Conclusion

7.1 The CA Act prohibits the operator of a dominant area at a dominant airport from requiring payment of charges without a licence. The CA Act only permits economic regulation of an airport operator and the granting of a licence by the CAA if all three components of the market power test set out in section 6 of the CA Act are met.

7.2 Pursuant to its duties specified under the CA Act and having regard to the relevant:

- notices and guidance published by the EC about the application and enforcement of the prohibitions in Articles 101 and 102 of the TFEU;
- advice and information published under section 52 of the Competition Act 1998 (advice and information about the application and enforcement of the prohibitions in Part 1 of that Act and Articles 101 and 102 of the TFEU); and
- the advice and information published under section 171 of the Enterprise Act 2002 (advice and information about the operation of Part 4 of that Act);

and after having taken due account of the competition law notices and guidance as well as the responses to the Initial Views and the Consultation, the CAA has defined the relevant market as the provision of airport operation services to passenger airlines at Stansted, Luton and Southend.

7.3 In this relevant market, STAL provides the following airport operation services at Stansted:

- the use of the runway and taxiways;
- aerodrome ATC;
- aircraft parking;
- the provision of access and infrastructure needed for the provision of other airside and landside groundhandling services;
- the provision of facilities for check-in;
- baggage handling;

- security screening;
- holding passenger facilities;
- airline staff processing facilities;
- passenger transit facilities;
- premium passenger facilities; and
- integrated transfer facilities.

7.4 The CAA, having regard to its general duties under the CA Act and the relevant notices and guidance issued by the EC and the OFT regarding the competition law notices and guidance, has determined that STAL does not have SMP in the relevant passenger market and is unlikely to acquire it over the Q6 period. Consequently, the CAA determines that Test A of the CA Act is not met in relation to STAL.

7.5 The CAA's decision on Test B is that it cannot be met in respect of STAL, because in the absence of SMP, there can be no risk of STAL engaging in conduct that would amount to an abuse of that SMP. In circumstances where Test A is not met, Test B cannot be met. Accordingly, there is no need to consider whether competition law provides sufficient protection against the risk that STAL may engage in conduct that amounts to abuse of SMP.

7.6 The CAA has also determined that the benefits to current and future air transport users of licence regulation do not outweigh any adverse affects. Consequently, the CAA has determined that Test C of the CA Act is not met.

Market power determination for passenger airlines in relation to Stansted Airport – statement of reasons

CAP 1135

Market power determination for passenger airlines in relation to Stansted Airport – statement of reasons

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NOTICE OF DETERMINATION UNDER SECTION 8 OF THE CIVIL AVIATION ACT 2012 – STANSTED AIRPORT

The Civil Aviation Authority has made the following determination under section 7 of the Civil Aviation Act 2012 (the CA Act).

The market power test set out in section 6 of the CA Act is not met in relation to airport operation services to passenger airlines (the passenger market) in the following airport areas located at Stansted Airport:

- the land, buildings and other structures used for the purposes of the landing, taking off, manoeuvring, parking and servicing of aircraft at the airport; and
- the passenger terminals.

Test A of section 6 of the CA Act has not been met by the relevant operator, namely Stansted Airport Limited. Tests B and C of section 6 of the CA Act cannot be met by the relevant operator, namely Stansted Airport Limited.

The airport area does not include any area in respect of which the CAA has made an operator determination under section 10 determining that Stansted Airport Limited does not have overall responsibility for the management of that area.

The reasons for this determination are set out in the document "Market power determination in relation to the passenger market at Stansted Airport –statement of reasons, CAP 1135."

Any word or expression defined for the purposes of any provision of Part 1 of the CA Act shall have the same meaning when used in this notice.