Consumers and Markets Group

Summary of Responses to the Market Power Test Consultation

CAP 1432

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Enquiries regarding the content of this publication should be addressed to: economicregulation@caa.co.uk

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Chapter 1

Introduction

Draft guidance

1.1 In December 2015, we consulted on a draft of our 'Market Power Test 'Guidance – Draft'[1] (Draft Guidance).

1.2 The Draft Guidance explained our powers under the Civil Aviation Act 2012 (CAA12) to apply the Market Power Test (MPT) to make Market Power Determinations (MPDs).

1.3 The Market Power Test consists of three parts:

- Test A - consider whether an airport operator has substantial market power (SMP).
- Test B - consider whether competition law does not provide sufficient protection against the risk of abuse of the SMP.
- Test C - consider whether the benefits of regulating the airport operator by means of a licence outweigh the adverse effects.

1.4 If we make an MPD that determines an airport operator meets the Test, we are required to regulate that airport operator by means of a licence.

Consultation responses

1.5 The consultation on the Draft Guidance closed on 12 Feb 2016 and the following Stakeholders responded:

- Heathrow Airport Ltd (HAL);
- Gatwick Airport Ltd (GAL);
- IATA;
- Ryanair;

[1] The consultation document is available at www.caa.co.uk/cap1355 and the Draft MPT Guidance is available at www.caa.co.uk/cap1354

- British Airways plc (BA);
- easyJet; and
- Virgin Atlantic Airways (VAA).[2]

1.6 We appreciate and thank stakeholders for the time that they have taken to consider and respond to the Draft Guidance. Stakeholders' comments on how we proposed to apply the Test in the future allowed us to ensure that the final Market Power Test Guidance (Guidance) is more practical in explaining how we will apply our powers. For instance, where the Draft Guidance was not as clear as we intended, we have revised the drafting to improve its clarity.

1.7 This 'Summary of Responses to the Market Power Test Guidance CAP 1432' (Responses document) sets out the comments received and explains our response to those comments and how we reflected them in the Guidance. The Guidance is published alongside this document at www.caa.co.uk/CAP1432.

1.8 Where we have not changed the wording from the Draft Guidance in response to stakeholders' comments, we have explained why in this document with our reasons.

Structure of this responses document

1.9 The following chapters of this Responses document discuss the comments Stakeholders' made and our responses to those comments, including how we have amended the Guidance.

- Chapter 2 reviews responses on the process to decide when to launch undertake MPDs, and how we will undertake MPDs;
- Chapter 3 discusses responses to our approach to Test A – Market definition and market power;

[2] A non-confidential version of these responses can be found at www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Licensing-and-price-control/Airport-Market-Power-Assessment/

- Chapter 4 covers responses to our approach to Test B – Adequacy of competition law;
- Chapter 5 contains responses to our approach to Test C – Adverse Effects and Benefits of licence regulation; and
- Chapter 6 considers comments that were not directly focused on the detail of the Guidance.

Chapter 2

Process and approach to conducting MPDs

Introduction

2.1 This chapter considers the responses related to process and approach we proposed in the Draft Guidance for conducting an MPD.

2.2 It covers the key issues raised by respondents to the consultation:

- When we will deviate from the Guidance;
- Standard of proof;
- Initiating an MPD;
- Material Change of Circumstances;
- Timetable for considering a request to make an MPD;
- Timetable and stages for completing an MPD; and
- Confidentiality.

When we will deviate from the Guidance

What we proposed

2.3 Paragraph 1.3 of the Draft Guidance stated that from time to time, given the specific circumstances of a particular case, we may need to deviate from the Guidance and that we would explain the rationale for deviating from the Guidance in any report we published.

Stakeholder comments

2.4 HAL was concerned that the caveat "*we may need to deviate from this Guidance*" could significantly compromise the value of the Guidance. HAL considered that as the Draft Guidance is high level and largely principles-based, it did not consider we would ever be a need to depart from it. If such a need may arise, the circumstances should be specifically flagged in advance.

Our response and final policy

2.5 While it is our intention to publish robust Guidance that we do not need to depart from, we cannot always consider every possibility in Guidance. As such, it is appropriate to include a caveat to the Guidance because we must assess each case on its own facts. Where appropriate, we will explain why we have adopted a specific approach which may deviate from the Guidance. We have amended the Guidance to clarify this point.

Standard of proof

What we proposed

2.6 Paragraphs 2.33 to 2.35 of the Draft Guidance stated that we are required to make our assessment on the balance of probabilities. However, the weight of evidence required to satisfy this standard would depend on the particular circumstances of each MPD.

2.7 In referring to a CAT judgement[3], we said that overall, the judgment reaffirmed that a specialist investigative body has a broad discretion over the use of its internal resources and the handling of various aspects of its investigations.

Stakeholder comments

2.8 HAL suggested that the Draft Guidance could be more consistent in describing the appropriate standard of proof we will require when regulating. It suggested that the phrase "*presumption of innocence*" taken from the Competition Appeal Tribunal (CAT) judgment should be interpreted as a presumption that regulation should not be imposed unless there is specific, relevant and sufficient evidence that the tests for imposing regulation have been satisfied. It also suggested that it would be appropriate for us to expressly set out this position in the Draft Guidance, rather than referring to the CAT judgment.

3 Makers UK Limited v Office of Fair Trading [2007] CAT 11, paragraph 46

2.9 HAL stated that in other parts of the Draft Guidance we appeared to adopt positions that are difficult to reconcile with the presumption that specific evidence is required to meet the tests.

2.10 GAL questioned whether these paragraphs had any relevance to Guidance on the MPT. It stated that there is no potential finding of "*guilt*" under the MPT and citations referring to the "*presumption of innocence*" do not seem appropriate.

Our response and final policy

2.11 This section of the Draft Guidance was seeking to clarify that we will need to exercise our discretion in the light of relevant decisions of the CAT and the Courts.

2.12 In this context, we are required to exercise our functions in accordance with our duties under CAA12.

2.13 While the assessment that we make in preparing an MPD does not imply any finding of "*guilt*", we consider that this standard of proof is appropriate given that imposing the obligation to hold an economic licence in order to be able to charge for services is clearly a serious matter that restricts the commercial freedom of the airport in question. As such, an MPD should only be made on the basis of sufficient evidence.

2.14 We consider that the balance of probabilities test allows for the use of regulatory judgement and that to require specific, relevant and sufficient evidence for every aspect of our determinations would go beyond the standard of proof required.

2.15 We have amended the wording in the 'Standard of Proof' section to refer to the requirements of CAA12 and to provide greater clarity.

Initiating an MPD

What we proposed

2.16 Paragraphs 3.2 to 3.4 of the Draft Guidance stated the circumstances when we would undertake an MPD.

2.17 Paragraphs 3.7 to 3.8 of the Draft Guidance explained that we expect the parties who request an MPD to be able to provide a well reasoned request containing information relevant to the analysis.

Stakeholder comments

2.18 HAL considered stated that the Draft Guidance provides almost no indication of when we may consider it appropriate to conduct an MPD.

2.19 IATA stated that increased transparency on price and quality of service is required, in order to make it easier to detect when an airport may be in position of market power such that an MPD is required or when an abuse of market power is taking place, as well as improving performance results.

2.20 IATA suggested that relying on third parties directly (who are impacted by an MPD) to request initiation of an MPD can lead to a low number of requests. An airline that is under the market power of an airport may not be aware that the airport is abusing its market power or may hesitate to initiate a request for an MPD if it is concerned about retaliatory action by the airport.

2.21 easyJet noted that while we are not required to make an MPD for an airport with less than 5 million passengers, it would be helpful if the Guidance stated that we would be willing to consider making an MPD at an airport with fewer than 5 million passengers if there was the potential for significant harm to passengers.

Our response and final policy

2.22 Where CAA12 gives us the discretion to undertake an MPD, it does not specify any criteria on that discretion. However, we must have regard to the regulatory principles in Section 1(4) of CAA12, namely that our

regulatory activities should be transparent, accountable, proportionate and consistent, and targeted only at cases where action is needed.

2.23 We consider it would be inappropriate to go beyond CAA12 to state that we would be willing consider making an MPD based on predetermined criteria.

2.24 However, on the specific point regarding airports with fewer than 5 million passengers we would consider a well reasoned request.

2.25 We will be available to discuss any aspect of an airport operator's or an interested party's market power concerns about an airport operator.

2.26 We have clarified in the Guidance that we will be available to discuss market power concerns.

Material Change of Circumstances

What we proposed

2.27 Paragraphs 3.5 to 3.6 of the Draft Guidance stated that "*material change of circumstances*" is not defined in the legislation, and that it is a matter of regulatory judgement as to whether there has been a material change of circumstances.

Stakeholder comments

2.28 HAL accepted that we may be unwilling to exhaustively explain in advance all circumstances in which an MPD will be undertaken, or when a material change in circumstances exists. However, it urged us to provide more detailed guidance, for example explaining the types of legal precedents we would be likely to consider relevant when determining whether a material change of circumstances has occurred.

2.29 GAL stated that:

- the Guidance should reflect (what it considered to be the clear steer from the Competition Commission (CC)) that the development of competition would be a material change of circumstances, and that

we should not set an unduly high bar in applying the "*material change of circumstances*" test.

- it suggested that instead of stating that "*We consider that a change of circumstances needs to be material in areas that are likely to be relevant to Tests A to C*", that we change the words "*needs to be*" in this quote so that they read: "*would exist if the change is, or the changes together are*". It indicated that this change would make clear that this is a sufficient, rather than a necessary, test.
- a material change of circumstances is one of fact; rather than of "*regulatory judgement*".

2.30 While IATA noted the difficulties associated with describing what events constitute a material change in circumstances, it considered that it would be beneficial if we could describe what market outcomes would be observable when a material change of circumstances had occurred.

2.31 VAA stated in determining when to launch an MPD, it would welcome some greater clarity on how a material change of circumstances is defined.

2.32 Ryanair considered that when its long-term contract with Stansted Airport Limited (STAL) concludes, there is a real danger that STAL will raise prices, as regulation will not be in place to protect it. Such a circumstance, Ryanair contended, would result in a substantial change in market conditions such that we would need to undertake a new assessment of STAL's market power in time for STAL to be regulated when its deal with Ryanair expires.

Our response and final policy

2.33 While we appreciate that it could be beneficial to stakeholders if we could provide greater detail on what constitutes a material change of circumstances, CAA12 does not define this and we maintain that for us to attempt to do so would be inappropriate. Indeed we consider that market participants are better able to identify circumstances that may constitute a

material change of circumstances and, having done so, can use them in making a case to us.

2.34 We suggest that any stakeholder who is considering whether or when to make a request, arranges a meeting to discuss this with us. This would enable us to consider a specific set of circumstances rather than attempt to set-out a wide range of possible parameters that could hinder rather than assist stakeholders, would be unlikely to be complete and which could rapidly be superseded.

2.35 We have, however, amended the wording of the Guidance to state that "We consider that a change of circumstances would be more likely to be found where the change is, or the changes in aggregate are material in areas that are likely to be relevant to Tests A to C."

2.36 We recognise that assessing whether a material change of circumstances has occurred is based on a specific set of factual circumstances. We have clarified in the Guidance that determining whether there has been a material change of circumstances is a matter of "*regulatory judgement based on the specific circumstances under consideration"*.

2.37 We also refer stakeholders to Competition and Markets Authority (CMA) Guidance related to merger remedies and decisions that have been made where the question of whether there has been a material change of circumstances has been considered.

2.38 The CMA's 'Remedies: Guidance on the CMA's approach to the variation and termination of merger, monopoly and market undertakings and orders' CMA11[4] covers the CMA's approach to the variation and termination of merger, monopoly and market final undertakings and orders. The CMA's approach includes considering whether there has been a change of circumstances.

[4] CMA11 'Remedies: Guidance on the CMA's approach to the variation and termination of merger, monopoly and market undertakings and orders' August 2015, which is available from: www.gov.uk/government/publications/remedies-Guidance-on-the-cmas-approach-to-the-variation-and-termination-of-merger-monopoly-and-market-undertakings-and-orders

2.39 Listed below are a selection of CMA decisions that considered whether there had been a material change of circumstances. The examples noted are, with one exception, in industries other than aviation and all were considered under other legislation. However they may assist stakeholders to understand how such assessments have been made. The examples are:

- Competition Commission (CC) BAA Market Investigation - Consideration of possible material changes of circumstances - 19 July 2011.[5] The CC considered that it had a duty to assess whether there had been an MCC since the preparation of its report;
- CMA - Review of FirstGroup undertakings - Final report - 20 April 2016.[6] The CMA reviewed the undertakings in relation to the completed acquisition by FirstGroup plc of SB Holdings Ltd. The MCC was related to a change in competitive conditions in the relevant market;
- CMA - Rough gas storage undertakings review - Final report 22 April 2016.[7] A review of the undertakings given in December 2003 by Centrica Storage Limited (CSL) and Centrica, in relation to the completed acquisition by Centrica of Dynegy Storage Limited and Dynegy Onshore Processing UK Limited ('the undertakings'). The MCC was related to reduced performance of a gas storage facility;
- CMA - Provisional decision on the CMA's review of the Performing Right Society Limited undertakings - 23 March 2016.[8] The Performing Right Society Limited (PRS) gave undertakings in February 1997 following an investigation by the Monopolies and Mergers Commission (MMC). The CMA reviewed the undertakings

5 BAA Market Investigation - Consideration of possible material changes of circumstances - 19 July 2011, which is available from: webarchive.nationalarchives.gov.uk/20140402141250/http:/www.competition-commission.org.uk/our-work/directory-of-all-inquiries/baa-airportsf

6 CMA Review of FirstGroup undertakings - Final report - 20 April 2016, which is available from: www.gov.uk/cma-cases/firstgroup-undertakings-review

7 CMA Rough gas storage undertakings review - Final report 22 April 2016, which is available from: www.gov.uk/cma-cases/rough-gas-storage-undertakings-review

8 CMA - Provisional decision on the CMA's review of the Performing Right Society Limited undertakings - 23 March 2016, which is available from: www.gov.uk/cma-cases/performing-right-society-undertakings-review

to consider whether the undertakings remained appropriate, or needed to be varied or superseded, by reason of a change in circumstances. The MCC was related to the introduction of a new EU directive;

- CMA Review of old merger remedies: The CMA reviewed approximately 70 merger remedies.[9] The MCC was in most cases a change in the market conditions or market structure.

Timetable for considering a request to make an MPD

What we proposed

2.40 Paragraphs 3.9 to 3.12 of the Draft Guidance explained the process for requesting an MPD.

Stakeholder comments

2.41 IATA stated that it was not clear how the prioritisation criteria would be applied in deciding whether to undertake an MPD.

2.42 easyJet noted that while it recognised that the decision on a request to make an MPD may not be simple, and as such that it could take up to six months, it considered that in other cases an assessment may be relatively simple. It would be helpful if we stated that we would aim to progress a decision in as quick a time frame as possible within the overall timeframe of six months.

2.43 BA considered that the timetable of six months was excessive. It added that the timetable only commenced after the requesting party had submitted its final submission. It was not clear whether the requesting party or the CAA or both determine whether and when a submission may be considered final. BA suggested that the Guidance should be more explicit as to when, and by whom, a request may be considered final.

[9] CMA – Review of structural merger undertakings given before 1 January 2005, which is available from: www.gov.uk/cma-cases/review-of-structural-merger-undertakings-given-before-1-january-2005

Our response and final policy

2.44 We have clarified this section in the Guidance by separating out:

- the process for those requests where we have discretion on whether to undertake an MPD;
- the process for those requests where we are required to undertake an MPD; and
- the timing on when we will complete our assessment and issue our response to the request.

2.45 Where we are required to undertake an MPD, the prioritisation criteria apply to deciding **when** we would commence an MPD; they do not apply to deciding **whether** to undertake an MPD. So the decision for considering the request would be straightforward.

2.46 However, where we have discretion on whether to undertake an MPD, the prioritisation criteria would apply both to deciding **whether** to undertake an MPD and **when** we would commence an MPD (if we decide to undertake the MPD). We have clarified this in the Guidance.

2.47 Deciding when a submission is final is a matter for discussion between the parties requesting an MPD and ourselves. Starting the consideration process from the date of the final submission ensures we have a complete submission before we commence our process. It is designed to:

- allow the parties making the submission to have the opportunity to provide additional information or analysis, where appropriate, once they have discussed their proposed submission with us; and
- make the overall process more efficient so that we complete only one consideration process, which is not later delayed by additional information from the requesting party that is submitted after we have commenced our process.

2.48 We envisage that the decision on when a submission is final will be made jointly by the parties making the submission and ourselves. We have not amended the Guidance on this point.

2.49 Considering whether to commence the process of making an MPD is a significant commitment of resources by the affected stakeholders, including ourselves and as such requires that we exercise appropriate diligence in making such a decision. The six month estimate allows for the time it will take to consider a request including; setting out the project plan and analytical framework, gathering necessary information, analysing and assessing information along with our internal review and decision making processes.

2.50 We have amended the wording in the Guidance to state that we will complete our assessment of a request as quickly as possible and where it is possible to complete in less than six months, we will do so.

Timetable and stages for completing an MPD

What we proposed

2.51 Paragraphs 3.14 to 3.27 of the Draft Guidance stated that:

- We aim to publish an MPD decision within 18 months of commencement of our MPT assessment. However, there may be instances where we need to depart from this.
- We will publish and send the airport operator that is the subject of the MPD and other key stakeholders a specific timetable for each MPD.
- Where we need to depart from it, we will publish that change and notify the stakeholders of it, together with the reasons why we are doing so.

Stakeholder comments

2.52 HAL noted that our aim to complete the process and publish an MPD within 18 months is less than half the length of time it has taken us to complete the process to date. HAL suggested that a failure to meet this target (or to conduct a poor process in order to meet this target) would ultimately be less conducive to regulatory certainty than a longer but more

realistic target. HAL considered that it may be more appropriate for us to adopt an indicative timeframe:

- which industry players can have full confidence that we will be able to meet, except in exceptional circumstances; and
- which will not compromise the integrity and quality of the decision-making process.

2.53 GAL stated that:

- In paragraph 2.45 of the Draft Guidance, we said that, in some cases, we may decide to begin the process of developing a licence alongside the MPD. GAL considered that the two processes should be sequential to guard against the risk that the ongoing work on the licence conditions taints the MPD.
- 18 months should be the very outside limit to publish an MPD decision. It suggested we could informally apply an approach similar to that under the Enterprise Act 2002, where we would adopt a 12 month limit that could be extended if required by a maximum of six further months.

2.54 IATA considered that to minimise the timescales, we adopt a simplified MPT that could expedite the MPD process through leveraging airport benchmarking of quantitative data while not compromising on the robustness of the consultation process. It added that benchmarking could also be used to identify when MPDs may be needed.

2.55 VAA welcomed the clear distinction between when we will be gathering information and when we would consult on our assessment. It stated that this would be helpful in determining how to resource its response to particular stages of the assessment process.

2.56 VAA stated that in conjunction with our indicative timetable to complete future MPDs within 18 months, there is a need to ensure that the process remains robust, and that flexibility is allowed if a longer period is deemed necessary.

Our response and final policy

2.57 Respondents expressed concern about the timescales to complete an MPD – both whether 18 months was too long and not long enough. We developed the timescale based on the process and stages we set out in the Guidance, and taking into account our experience of completing the first MPDs. We acknowledged in the Draft Guidance that there are situations where we may need to depart from this; however our opinion remains that we could and will aim to complete an MPD within 18 months. This period is consistent with the CMA's current timetable for conducting Market Investigation References, which we would see as an analogous exercise.

2.58 The process explained in the Draft Guidance is designed to:

- allow key stakeholders to be aware of the process and timetable, including allowing for any specific circumstances that may affect it; and
- maintain the integrity and quality of the decision-making process.

2.59 CAA12 does not allow us to adopt a simplified MPT assessment. That said we consider that the process and stages we have developed will allow us to expedite making future MPDs.

2.60 Section 50 of CAA12 allows us to require that information is provided to us where we reasonably require it to carry out our functions related to the regulation of dominant airports. As such we can gather benchmarking or comparative data where we consider that it is appropriate. However, where we have discretion about whether to undertake an MPD, we are more likely to consider gathering such data as part of undertaking an MPD, instead of to assist us to decide whether to undertake an MPD.

2.61 We agree with GAL's comment about paragraph 2.45 of the Draft Guidance and we have deleted it from the Guidance. We would normally expect a sequential process. Instead we refer the reader to Chapter 7 of the Guidance which sets out the process we will follow once an MPD has been made.

Confidentiality

What we proposed

2.62 Paragraphs 3.28 to 3.29 of the Draft Guidance stated that:

- We acknowledge the importance parties attach to their confidential information. With that in mind, and to ensure compliance with the relevant legal provisions, we have developed internal processes to ensure that we handle confidential information with care.
- Confidential material is accessed only by staff and external expert advisers to the CAA who are allocated to the MPD to which the information relates and is only shared more widely, where to do so would, in our view, be appropriate in the circumstances.

Stakeholder comments

2.63 GAL said that that Draft Guidance stated that confidential information will only be "*shared more widely, where to do so would, in our view, be appropriate in the circumstances*". GAL asserted that this was a vague and unconstrained approach, given that the confidential information might be very sensitive. GAL suggested that the Guidance more closely reflects the provisions concerning confidential information in Section 59 and Schedule 6 of CAA12.

2.64 BA suggested that rather than stating we would only share information more widely "*where to do so would, in our view, be appropriate in the circumstances*" that it would be more appropriate and reassuring if we were to reference the processes set out in our Guidance on the treatment of confidential information as set out in CAP1235: Guidance on the Application of the CAA's Competition Powers, Chapter 4 Information gathering and disclosure.

Our response and final policy

2.65 Section 59 and Schedule 6 of CAA12 are applicable to information received by us under CAA12 irrespective of confidentiality, and are relevant to sharing it outside of the CAA.

2.66 We have developed this section to refer to the relevant provisions of CAA12 to provide more detail on the treatment of confidential information.

2.67 We have amended the wording on sharing information to make clear that confidential material would only shared more widely in compliance with the legal requirements placed on us.

Chapter 3

Test A – Market definition and market power

Introduction

3.1 Test A is that we consider whether the relevant operator has, or is likely to acquire, SMP in a market, either alone or taken with such other persons as we consider appropriate.[10]

3.2 This chapter considers stakeholders' responses in relation to Test A. It covers the key issues raised by respondents to the consultation:

- previous guidance and discussion papers;
- level of detail in the Guidance;
- time-period of the forward-looking assessment;
- bundling of airport operation services products and services;
- Hypothetical Monopolist Test and the competitive price level;
- geographic market definition;
- temporal markets;
- role/weight of upstream and/or downstream constraints;
- assessment of market power; and
- airport behaviour under regulation.

Previous guidance and discussion papers

What we proposed

3.3 Paragraphs 3 and 4 of the 'consultation document' which accompanied the Draft Guidance[11], acknowledged that in April 2011, before CAA12 was enacted, we had published 'CAA guidance on the assessment of airport market power'. That document was prepared in anticipation of CAA12

10 Section 6(3) CAA12.

11 'Draft guidance on the application of the Market Power Test under the Civil Aviation Act 2012: Consultation', CAP 1355, which is available from www.caa.co.uk/CAP1355

coming into force and did not cover all elements of the Test set out in CAA12.

3.4 During 2013 and 2014 we conducted MPDs covering the Heathrow, Gatwick and Stansted airports.[12] The Draft Guidance, on which we consulted, largely reflected the framework we used for these MPDs.

Stakeholder comments

3.5 GAL noted that the papers we had prepared on market power prior to the enactment of the CAA12 have been withdrawn. It stated that the 2011 guidance usefully added to the general guidance referred to in Section 6(10) of CAA12 and was the direct result of the large body of work carried out prior to publication of the 2011 guidance, including liaising with industry working groups, passenger research, papers by leading experts and discussion papers on areas such as catchment overlap and empirical methods. GAL considered that the previous guidance had a good grounding in competition law and was underpinned by economic analysis and should be reflected in the new Guidance. It considered that there was no good reason why such previous guidance should be dispensed with absent some fundamental change or development.

3.6 HAL considered that the Draft Guidance represented a step backwards from previous guidance, by seeking to preserve our flexibility and providing less, rather than more, regulatory certainty to the industry. In its response, HAL also referred to the lack of detail in Draft Guidance on Test A which it considered provided less regulatory certainty.

3.7 BA suggested we were vague on what factors we would take into account for the purposes of market definition and assessment of market power and requested more detailed guidance from us on this.

3.8 IATA considered that the Guidance should clearly specify which factors the Test will take into account and how we intend to assess these factors and what methods would be used.

[12] The 2014 MPDs are available from www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Licensing-and-price-control/Airport-Market-Power-Assessment/

3.9 VAA recognised that the Draft Guidance went "*into less detail in order to be able to consider all types of evidence submitted to the CAA by stakeholders*".

Our response

3.10 The most important point to note is that the Draft Guidance reflects the framework we used for the MPDs that we made in 2014.

3.11 While we appreciate that stakeholders may want further detail, we found that the content of the 2011 Guidance was not as helpful as we had expected in completing the 2014 MPDs. In completing the 2014 MPDs, we found that some elements of the 2011 guidance were overly detailed and did not have generic application. These factors were key to our decision to not repeat that detail. Instead, we refer to the relevant detailed Guidance on market power and market definition prepared by the CMA and the European Commission (EC).[13]

3.12 It is also the case that any new assessment of SMP will be both airport- and time-specific, reflecting the circumstances affecting or likely to affect the airport operator in question at the time the assessment is made. As a result, the factors we will take into account in making the assessment will vary by airport and over time and will, therefore, be different for each MPD. This means that guidance which sets out greater detail would, in practice, convey only a sense of certainty over the factors that we would consider that would not (and could not) necessarily be translated directly into our practice in conducting an individual MPD. That said, we are mindful of the need to identify at an early stage of conducting an MPD, the factors that will be relevant to that case. We will, therefore, when we decide to commence an MPD, consider, in dialogue with key stakeholders, what issues or aspects of an airport's operation would benefit from more detailed analysis. To help with this, as we explain in the Guidance, we would welcome early conversations with anyone who is

[13] The CMA and the European Commission (EC) guidance are available from www.gov.uk/topic/competition/competition-act-cartels and ec.europa.eu/competition/antitrust/legislation/legislation.html

an interested party[14] about a possible MPD of an airport area. The list of evidential requirements that we have added to the Guidance as Appendix A also gives an indication of the sorts of factors that may be relevant in a particular case.

3.13 With respect to the previously developed discussion papers, we note that these remain a matter of record. We expect to develop these and other stand-alone discussion papers to cover particular issues relevant to the assessment of market power at airports if we consider that is important for us to do so in order to discharge our functions effectively.

Level of detail in the Guidance

What we proposed

3.14 As noted above, compared with the 2011 document[15], the Draft Guidance placed more emphasis on the relevant notices and guidance issued by the EC and the CMA and provided a more generic framework for market power assessment, consistent with the 2014 MPDs.

Stakeholder comments

3.15 HAL noted that the Draft Guidance provided much less detail, about the process we will follow, than in the 2011 guidance for implementing Test A, which they thought represented a step backwards, creating regulatory uncertainty and in contradiction to better regulation principles.

3.16 GAL considered that more detailed guidance is necessary now and cannot be deferred for future MPDs because the methodology in the Guidance will affect the question of whether there is a material change of circumstances (MCC).

3.17 BA, VAA and IATA suggested that the Draft Guidance was insufficiently detailed on the factors we would take into account in Test A and asked for further guidance. VAA said it would be helpful to have further information

[14] The operator of the airport area or another person whose interests are likely to be materially affected by the determination.

[15] We prepared guidance in 2011 on the assessment of airport market power.

on what information we would find most useful for the purposes of carrying out MPDs. For example, they stated that they hold a plethora of data on slot access, substitutability and feeder traffic, for example, that they would be happy to share with us.

Our response and final policy

3.18 The Draft Guidance on the assessment of SMP is indeed shorter than the one issued previously and that was a conscious decision.

3.19 In doing so, we noted that previous guidance was issued before any MPDs had been carried out and before CAA12 was enacted. It remains our view that an approach based on our 2014 MPDs and generic guidance (i.e. relevant notices and guidance issued by the EC and the CMA) provides the industry with a better understanding of how we are likely to approach the assessment of market power in practice.

3.20 Furthermore we do not consider that such brevity leads to regulatory uncertainty. Generic EC and CMA guidance is well established and provides a good grounding for the definition of relevant markets and for the assessment of market power. Furthermore, the Draft Guidance covered the vast majority of the topics covered in the 2011 guidance but stopped short of discussing how we *may or may not* conduct a specific piece of analysis and apply particular methodologies. As indicated above, our experience in completing the 2014 MPDs and looking at how such assessments are carried out in other sectors is that the more detailed aspects of analysis are likely to be case specific and that guidance which is too detailed will create more uncertainty and maybe unduly burdensome.

3.21 We would expect, in the early stages of a particular MPD, to engage with the airport operator and other relevant stakeholders on the analytical framework and the key evidential needs required for that particular MPD.

3.22 We have therefore also added to the Guidance, at Appendix A, a list of possible initial evidential requirements that we would expect to request from airport operators and other relevant stakeholders for the purposes of

conducting an MPD. This list is by no means exhaustive, but we hope it provides a good starting point for stakeholders' wishing to prepare submissions to us for the purposes inputting into an MPD.

3.23 As noted above, we would also expect to prepare or commission discussion papers (not formal guidance) to discuss methodologies that could be used in the assessment of market power at airports if we consider that is important in order to discharge our functions effectively.

3.24 With regard to determining whether an MCC has occurred since a previous MPD, we consider that the starting point for such request is not so much the methodology for Test A, B or C in the Guidance but whether there has been a material change of circumstances. This is likely to be specific to each individual decision. It is for the stakeholder requesting the new MPD to provide the necessary evidence of changes and explain the materiality of the changes to the three Tests for each particular case.

3.25 Other than the draft list of evidence noted above, we have not amended the Guidance on this point.

Time-period of the forward-looking assessment

What we proposed

3.26 The assessment of market power is both a current and forward-looking assessment. For the Test to be met the airport must either have SMP now or to be likely to acquire it in the future. This is explained in paragraph 4.6 of the Draft Guidance. The Draft Guidance did not stipulate the time-frame for this forward-looking assessment (nor does CAA12).

Stakeholder comments

3.27 HAL considered that we should stipulate the time-frame the assessment is intending to cover. In HAL's view, we should conduct our assessment with a long-term view of at least 7 years (5-year regulatory period + 2 years for the MPD process).

3.28 easyJet suggested it would be helpful if we described how we would determine (in an MPD) which future period would be relevant. easyJet suggested that a starting point for such period could be the period over which an economic licence might reasonably be expected to apply.

Our response and final policy

3.29 While we agree with stakeholders that a good starting point for establishing a timeframe to look into the existence of SMP in the possible future is the length of the airport in question's regulatory period, we note that such period both varies from airport to airport and is not prescribed by CAA12.

3.30 Therefore we consider it is best for the Guidance to leave open the precise definition of timeframe for each particular MPD, based on the evidence available to it at the time.

3.31 We note, however, that even though any MPD will look at a specific future timeframe, this does not mean that any MPDs will not remain valid beyond such timeframe. We are only required to conduct new MPDs if we consider there has been an MCC since the last MPD. In addition, if we consider that there has been an MCC, irrespectively of the timescale over which the previous MPD looked forward, we will consider conducting a new MPD.

3.32 We have not amended the Guidance on this point.

Bundling of airport operating services products and services

What we proposed

3.33 In our Draft Guidance we considered that generally, for the purposes of market definition for Test A, "*we will start by looking at a broadly generic bundled product that is sold to airlines*". However, we may depart from this general position, depending on the parameters of the request to carry out the MPD, legislation and available evidence.

Stakeholder comments

3.34 GAL agreed with our approach to consider the overall bundle of airport operation services (AOS) services as a starting position for market definition. It disagreed however with the possibility set out in the Draft Guidance of separating markets by groups of customers or by time.

3.35 HAL disagreed with the Draft Guidance approach to use a bundle of AOS services as a starting point for market definition. HAL argued that this approach is not consistent with EC and CMA guidance. HAL considered that narrow focal products would be the correct starting point for the assessment and would allow us to reflect the differences in competitive conditions between (for example) surface origin and destination segments, and connecting/transfer sections of the passenger population.

Our response and final policy

3.36 We continue to consider that a bundle of AOS provided to airlines is a suitable starting point for market definition for the purposes of MPDs and reflects the nature of the Test as set out in the Act and the binary question of whether an airport should be subject to economic regulation or not. This is in contrast to the approach we would take in investigating complaints under the competition prohibitions. In our guidance on our approach to our concurrent competition powers, CAP 1235 'Guidance on the Application of the CAA's Competition Powers'[16], we noted that: *"Although there are some parallels between making MPDs and in investigating complaints under the competition prohibitions, there are also some important differences between them. For instance, when assessing market power at an airport as a whole, we will usually consider the overall bundle of AOS services and then determine the relevant market in which the airport offers those services. In comparison, when assessing complaints under the competition prohibitions, we need to start by determining a product market relevant to the complaint in question. This may be much narrower than the total range of services offered at an*

[16] CAP1235 'Guidance on the Application of the CAA's Competition Powers' is available from: www.caa.co.uk/cap1235

airport e.g. *it could relate to groundhandling or forecourt access at an airport or airports."*[17]

3.37 We also consider, as stated in the Draft Guidance that, in some cases, it may be appropriate to depart from this general position, if the evidence points us in a direction where a different starting position would lead us into a different conclusion on Test A.

3.38 We noted in the Draft Guidance that evidence of the ability and willingness of airports to differentiate or discriminate between customer groups as part of their business model and in their management structures could lead us to consider separating the starting point product market into narrower markets. As such, the conclusions on market definition and choice of focal product should be driven by the evidence presented in each case.

3.39 We have not amended the Guidance on this point.

Hypothetical Monopolist Test and the competitive price level

What we proposed

3.40 Paragraph 4.24 of the Draft Guidance noted that there are often practical difficulties in applying the Hypothetical Monopolist Test (HMT). In particular it noted that that the HMT 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 an assessment of the competitive price.

Stakeholder comments

3.41 GAL noted that the competitive price level at which the HMT should be conducted is not necessarily the regulated price. GAL considered that the

[17] Paragraph 2,6, CAP1235 'Guidance on the Application of the CAA's Competition Powers' is available from: www.caa.co.uk/cap1235

competitive level may be higher than the regulated price, given the scarcity value of well-located airport assets.

3.42 easyJet, while agreeing that the determination of the competitive price level is an important issue for MPDs, considered that this question is a debate for an individual MPD and not for the guidance framework. easyJet would prefer that the Guidance did not discuss the extent to which the regulated price may or may not be the competitive price.

3.43 IATA stated some of the known drawbacks of the HMT (a small but significant non-transitory increase in price (SSNIP) test) and encouraged us to develop other quantitative methods for assessing market power. IATA said that it is in the process of developing "*rapid market power assessments based on quantitative measures*".

Our response and final policy

3.44 The Draft Guidance did not assume that the regulated price or prevailing prices are always at the competitive price level. However, the Draft Guidance noted the potential limitations, of which this is one, in applying the hypothetical monopolist test in a precise manner.[18] We agree that this is an issue to be discussed in each specific MPD, taking into account the available evidence at the time and not as part of the Guidance.

3.45 We do not consider, however, that we need to amend the Draft Guidance in response to stakeholders' comments.

Geographic market definition

What we proposed

3.46 The Draft Guidance made a high-level statement that geographic definition will analyse airlines and passengers' ability to switch from the airport.

[18] This is in line with, for example, the CMA Guidance on Market Definition (OFT403), paragraph 2.5 onwards, which is available from www.gov.uk/government/publications/market-definition

Stakeholder comments

3.47 Both HAL and GAL considered that we should provide further guidance explaining how we might undertake the required analysis of geographic market definition.

3.48 In particular, GAL noted the importance of geographic market definition in the context of airport services and in previous assessments. It also contrasted the CC's conclusions, in the BAA Market Investigation 2009 report, that Heathrow, Gatwick and Stansted airports were significant actual or potential competitors with our conclusions on the 2014 MPDs that took on a narrower approach to geographic market definition.

Our response and final policy

3.49 The approach we take for geographic market definition and its outcome will depend on the specific circumstances and available evidence for each MPD. We agree with GAL that the detailed downstream assessment of catchment in the London and South East market carried out both by the CC in 2009 and in our 2014 MPDs was of significant importance. However this type of assessment may not be necessary to the same level of detail in other potential cases. We do not consider it is necessary to go into further detail in the Guidance above and beyond the generic provided, for example, by the CMA.[19]

3.50 We have not amended the Guidance on this point. However, as noted above, we expect to develop stand-alone discussion papers to cover particular issues relevant to the assessment of market power at airports if we consider that is important for us to do so in order to discharge our functions effectively.

[19] See CMA's guidance on market definition (OFT403), which is available from www.gov.uk/government/publications/market-definition

Temporal markets

What we proposed

3.51 The Draft Guidance in paragraph 4.22 noted the possibility of segmenting markets across time periods, as in the case of airports, it may be relevant to differentiate across seasons or between peak and off-peak times of the day.

Stakeholder comments

3.52 HAL considered it entirely appropriate that we consider whether to define markets on a temporal basis and considered that this could result in more proportionate and differentiated regulation.

3.53 IATA noted that the distinction in the time periods for airlines' decision to serve a market and of passengers' decision to travel can increase switching costs to airlines but also has an impact on passenger preferences for airport choice.

Our response and final policy

3.54 We note HAL's view on temporal markets which we do not think imply any change to the Draft Guidance. However as with the consideration of the focal product, in order to consider segmenting the market in this way, we would expect evidence of the ability and willingness of airports to differentiate or discriminate between time periods as part of their business model and in their management structures.

3.55 In addition, we would also remind stakeholders that the definition of particular markets does not necessarily mean that, if regulation of an airport operator is required (the Test is met with respect to relevant market at an airport), that regulation will only be targeted at *that* particular relevant market. For example, it may be necessary or more practical and effective to regulate airport charges across all time periods, even if the airport operator only had SMP in some of the periods. That is to say that

the precise form of regulation is a separate question from those we are required to consider in making MPDs.[20]

3.56 We agree with IATA that the analysis of the timeframes needed for airlines and passengers decisions to switch airports affect the competitive constraints faced by airport operator and will need to be taken into account in the overall assessment. That is, however, not an issue directly relevant for the definition of temporal markets where the key consideration is the ability of airport operators to differentiate (prices, for example) across different time periods.

3.57 We have not amended the Guidance on this point.

Role/weight of upstream and/or downstream constraints

What we proposed

3.58 The Draft Guidance stated, in paragraphs 4.21 and 4.33, that the assessment of competitive constraints faced by an airport operator included an analysis of the airlines' ability to switch away from an airport as well as the potential for passengers/owners of cargo to switch between airports, whether independently, or by following a particular airline.

Stakeholder comments

3.59 HAL considered that the Draft Guidance on market definition failed to reflect our primary duty to protect consumers. In HAL's view, the interests of airlines and those of passengers diverge. HAL stated that while an airline can "*face very high barriers to 'switching' airports*", passengers have a different set of choices between airlines and airports when flying to a destination. HAL goes on to say that the assessment of competition must be directed at downstream markets and that wholesale markets (i.e. the relationship between airports and airlines) should only be considered insofar as it directly affects the interest of passengers.

[20] See, for example, section 18 (1) of CAA12

Our response and final policy

3.60 We are committed to our primary duty to protect users of air transport services (passengers and those with rights in cargo). We agree with HAL's assessment that downstream consumers can, in some circumstances, show more willingness to switch than airlines. However, we consider that both airline and customer switching remain relevant for the purposes of Test A in that switching by an airline provides a different constraint in terms of granularity and timing from passenger switching.

3.61 Test A, and the MPT as a whole, is an intermediate step to protect consumers' interests but it is not always a direct way to protect their interests. We therefore do not agree with the view that we should *only* look at downstream markets in defining markets or in assessing market power. Instead, we consider that in Test A, we should look at both upstream and downstream markets in order to examine all the competitive constraints faced by the airport operator.

3.62 We have not amended the Guidance on this point.

Assessment of market power

What we proposed

3.63 The Draft Guidance contained a description of the assessment of market power in MPDs in paragraphs 4.27 to 4.36. In those, we stated that we will seek to identify the existence and evaluate the strength of all competitive constraints faced by the airport operator, both from within and outside the relevant market. We also listed a (non-exhaustive) set of factors, market features and indicators that are likely to be relevant for the assessment of whether an airport operator has, or is likely to acquire SMP.

Stakeholder comments

3.64 HAL considered that the high level list of factors that affect the assessment of market power should have been more detailed. In particular the assessment of market power (and airline buyer power)

should take into account historic and future airline behaviour, prices and profitability, economies of scope and scale, sunk costs at an airport, elasticities of demand, evidence of exclusionary behaviour, etc.

3.65 GAL suggested that the Guidance should expressly state that the assessment of market power should take account of the constraints in aggregate with the consequence that a series of constraints may mean that an airport does not have market power even though none of the constraints taken individually would be sufficient to support such a conclusion.

3.66 IATA noted that benchmarking of airport performance based on price and quality of service as well as operational and financial performance can serve as an input to assessing whether significant market power is being abused.

Our response and final policy

3.67 We agree with HAL that the assessment of competitive constraints faced by the airport operator (which are relevant both for market definition and for the assessment of market power) should look at airline data, behaviour and the incentives they face at the airport. We have added a section discussing such items in our list of "*possible initial evidence requirements*".

3.68 Likewise we agree that we should look at all of the competitive constraints faced by the airport, as already reflected in the Draft Guidance. However, carrying out different separate analyses of market power may also lead to double counting the constraints faced by the airport. We agree with GAL that the assessment of market power is an aggregate and holistic one that will require consideration of all the evidence available and will require some judgement. This has been clarified in the relevant section of the Guidance.

Airport behaviour under regulation

What we proposed

3.69 In the Draft Guidance, in paragraph 4.36, we noted that where the airport operator is already subject to economic regulation, this will need to be taken into account in assessing the airport operator's behaviour.

Stakeholder comments

3.70 GAL suggested that, in doing so, it would be useful to distinguish between "*traditional*" regulation and regulation that is supportive of contractual commitments agreed between an airport and its airline base. It added that under more flexible forms of regulation, more of the airport's behaviour can be attributed to the airport than to regulation.

Our response and final policy

3.71 We agree that when looking at airport operator's behaviour and performance both the *existence* and the *form* of economic regulation are important considerations for the purposes of the assessment of airport market power. We have amended the Guidance to clarify this.

Chapter 4

Test B – Adequacy of competition law

Introduction

4.1 Test B requires that we consider whether competition law does not provide sufficient protection against the risk that the relevant operator may engage in conduct that amounts to an abuse of the SMP that is identified in Test A.[21]

4.2 We considered the comments from stakeholders in the following areas:

- focus on air transport users when assessing the extent of protection;
- independence of Test B from Test A;
- sufficient protection against the risk of abuse;
- the Enterprise Act 2002 markets regime;
- the role of case law in assessing Test B; and
- action by us and the CMA in the aviation sector.

4.3 These points and our response are set out in the sections below.

Focus on users of air transport services

What we proposed

4.4 Paragraphs 5.3 to 5.7 of the Draft Guidance set out our general approach when we assess the extent of protection provided by competition law. Specifically, paragraph 5.5 stated that we are required to assess "*the adequacy of competition law from the perspective of 'users'*" in accordance with our general duty.

[21] Section 6(4) read together with sections 6(8) and 6(9) of CAA12

Stakeholders comments

4.5 GAL considered that Test B does not explicitly require an assessment from the perspective of users. They contrast this with Test C where "*users*" are specifically mentioned.

4.6 IATA welcomed our focus on users and considered that airlines provide a good proxy for users in this context.

4.7 HAL suggested that the Draft Guidance offered no explanation of how we will assess the detriment to consumers of not implementing *ex-ante* regulation. They said that the Draft Guidance appeared to reflect an assumption that detriment to airlines automatically and necessarily represented a detriment to passengers and cargo owners.

Our response and final policy

4.8 Section 1 CAA12 requires us, in carrying out our functions, to further the interests of users of air transport services regarding the range, availability, continuity, cost and quality of airport operation services. Therefore, although Test B does not specifically mention users, we are required to assess Test B taking into account this duty. As a result, in carrying out our functions in relation to assessing "*sufficient protection*" as part of Test B, we are required to have regard to who would be protected against the risk of abuse. We consider this to be users of air transport services as defined in CAA12.

4.9 Similarly, while the interests of passengers and airlines may, in many circumstances, be aligned, we agree with HAL that they may not be necessarily the same. In our 'Strategic themes for the review of Heathrow Airport Limited's charges (H7)', we said, in the context of engaging consumers in the next price for Heathrow airport, that airlines' commercial interests may not always be aligned with the interests of passengers, and that the interests of consumers and airlines may diverge.[22]

[22] CAP1383a 'Strategic themes for the review of Heathrow Airport Limited's charges ("H7") – Technical Appendices' March 2016, paragraph 5.6, which is available from

4.10 However, we agree that for Test B, it is more appropriate to present our general approach in the context of our statutory duties. This is important as the interests of users of air transport services may not be always the same as the interests of airlines or other intermediaries. Accordingly we have removed paragraphs 5.5 and 5.6 from the Draft Guidance. Instead we have expanded what was paragraph 5.3 in the Draft Guidance to encompass the following text: "*In doing so we will conduct the analysis in the light of our primary duty to further the interests of users of air transport services*".

Independence of Test B from Test A

What we proposed

4.11 Paragraph 5.4 of the Draft Guidance set out the relationship between Test B and Test A. We noted that, although they are separate Tests, if Test A is not met, there is no SMP which would necessitate conducting the assessment set out in Test B. We also noted that we would conduct our assessment in the light of our considerations under Test A.

Stakeholder comments

4.12 Both GAL and HAL stated that the way the Draft Guidance was presented meant that Test B would have no meaning as an independent Test. In particular, they considered that the Draft Guidance appeared to start from a presumption of insufficiency of competition law.

4.13 GAL suggested that the Draft Guidance, having identified excessive pricing and reduced service as giving rise to the greatest likelihood of abuse and as the types of abuse with which competition law is least well equipped to deal, makes it difficult to envisage circumstances in which Test A would be met but Test B would not.

4.14 HAL considered that the Draft Guidance started from the assumption that competition law would not be sufficient; which it considered was

www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Licensing-and-price-control/Heathrow-price-control-review-H7/

inappropriate. It argued that the approach to Test B should better reflect our duty to act in a way that is proportionate and "*targeted only at cases where action is needed*".

Our response and final policy

4.15 Test A and Test B are standalone Tests that are assessed independently while recognising that the outcome from Test A forms the basis for the conduct that is assessed in Test B.

4.16 We do not agree with GAL and HAL that the Draft Guidance would mean that Test B was meaningless. The discussion of different types of abuse sought to communicate that:

- we *would* largely expect the risk of potential exclusionary and discriminatory abuses to be dealt with via competition law; and
- we would spend *less* time assessing the potential risks from these types of abuses.

4.17 This means that the potential for exploitative abuses would be our main focus in assessing Test B. This does not, however, mean that we would necessarily find competition law to provide insufficient protection against the risk of these types of abuse.

4.18 We have made a number of minor changes throughout the wording on Test B to bring greater clarity on the relationship between Test A and B regarding the above points.

Sufficient protection against the risk of abuse

What we proposed

4.19 Paragraph 5.1 of the Draft Guidance set out that Test B is that we consider whether competition law provides sufficient protection against the risk that the relevant operator may engage in conduct that amounts to an abuse of that SMP.

4.20 Paragraphs 5.12 to 5.15 of the Draft Guidance illustrated some behaviours that may be considered an abuse.

4.21 Paragraphs 5.21 of the Draft Guidance noted that:

- We considered that it is in relation to exploitative abuses involving excessive prices and/or reduced service levels where there is the greatest likelihood of an abuse occurring, against which competition law may not give sufficient protection.
- There is likely to be a range of price (or service quality degradation) between what we may seek to regulate (as a proxy for the competitive price) and what may be defined as "*excessive*" or "*abusive"* under competition law. This could result in a "*creeping abuse*" that is to the detriment of user of air transport services.

Stakeholder comments

4.22 GAL stated that we were in error to say that "there is likely to be a range of price (or service quality degradation) between what we may seek to regulate (as proxy for the competitive price) and what may be defined as "excessive" or "abusive under competition law." GAL contended that if an airport operator's prices were within a range of prices above the competitive level that were not excessive, they would not be abusive under competition law, and Test B would not be met.

4.23 GAL also encouraged us to consider an approach that focused on real world specific examples rather than the hypothetical.

Our response and final policy

4.24 Test B does not require that we assess specific examples of detriment to users arising from the risk of abuse. Test B asks whether competition law is sufficient to protect against the **risk** of abuse. Therefore we focus on the risk that abuse may take place, rather than considering specific detriments to users or whether they may actually constitute an abuse (rather than giving rise to the risk of abuse).

4.25 While for an excessive pricing abuse, it may be necessary "*to show that prices are significantly above the 'competitive' benchmark*", excessive pricing is not the only pricing abuse under competition law. It is trite law that the categories of abuse are never closed.

4.26 We do not, therefore, agree that Test B only requires an assessment of specific examples of abusive conduct. Any circumstances or conduct that may increase the *risk* of abuse can be relevant to our assessment of Test B. As such conduct that may not in itself be abusive could nevertheless make the risk of an abuse more likely by, for example, establishing a new baseline. Such circumstances, which we have identified as increasing the potential for a "*creeping abuse*", will remain relevant to our assessment of Test B. We do not, in any case, consider that for exploitative abuses, the case law is settled sufficiently to provide certainty in advance as to what is or is not abusive, particularly in relation to either price or service quality: whether particular conduct is abusive (or gives rise to the risk of abuse) will depend on the particular circumstances of each case.

4.27 However we agree with GAL that the wording of what was paragraph 5.21 of the Draft Guidance required amendment as it implied that where we find that there is a risk of abuse we would always regulate to remove that risk. The assessment of whether the benefits of regulation are likely to outweigh the adverse effects is considered in Test C.

4.28 We have amended this paragraph in the Guidance to remove the reference to regulation.

The Enterprise Act 2002 markets regime

What we proposed

4.29 Paragraph 5.9 and 5.10 of the Draft Guidance stated that the Chapter II prohibition in the CA98 and/or Article 102 of the Treaty on the Functioning of the European Union (TFEU) would be the most relevant legal rules we would have regard to when assessing whether competition law provides adequate protection against the risk of abuse.

Stakeholder comments

4.30 HAL considered that we should also include the markets regime in the Enterprise Act 2002 (EA02). It noted that the markets regime has been used frequently to deal with behavioural as well as structural issues and that the markets regime remains relevant even though it considers features that give rise to an adverse effect on competition rather than detecting abuses of SMP.

Our response and final policy

4.31 Our Draft Guidance did not explicitly exclude the markets regime. Instead it provided an indication of the weight we would place on the different competition law tools.

4.32 We accept that structural and behavioural issues have been tackled and behavioural remedies imposed under the markets regime. However, the markets regime is a broader tool which examines the causes of why particular markets may not be working well.

4.33 We also agree that actions, such as those taken by the CC in the breakup of BAA Ltd, may have led to an overall reduction in the risk of abuse. However, we consider it does not necessarily follow that the remedy has reduced the risk of abuse of any remaining market power.

4.34 Furthermore we maintain our position that CAA12 is designed to give CA98 more weight as the Test assesses the risk of abuse of SMP rather than a risk to effective competition. Sufficient protection against the risk of abuse is more likely to be provided by the legislation designed with that in mind, i.e. CA98.

4.35 We have modified what was paragraph 5.9 of the Draft Guidance to make the Guidance clearer:

"*Competition law also includes the market provisions in the EA02*. *However, we consider that the market provisions are not designed to guard against the risk of an abuse of dominance*. *Instead market investigations under EA02 examine the causes of why particular markets may not be working well, rather than seeking to determine whether an*

abuse of a dominant market position under CA98 has occurred. *We will therefore place less weight on arguments relating to the ability of the EA02 markets regime to protect against abuse.*"

The role of case law in assessing Test B

What we proposed

4.36 Paragraphs 5.17 to 5.25 of the Draft Guidance discussed case law as it related to Test B. We set out case law to illustrate the likelihood of the successful application of competition law and linked this to risk that abuse may be prevented.

Stakeholder comments

4.37 HAL stated that considering prior case law was misguided as there is nothing in CAA12 that compels us to consider prior case law. HAL stated that we should consider the degree of protection provided by competition law, as follows:

- The potential for future cases. HAL noted that the Consumer Rights Act 2015 significantly changed the application of competition law in the UK; as such the past is not a suitable guide to the future.
- Competition proceedings may lead to positive outcomes other than enforcement decisions which protect users, such as settlement or commitments. HAL argued that the paucity of case law in a particular area may encourage settlement.

4.38 HAL also suggested that consideration of the resources of parties to take action under competition law is not relevant to Test B.

4.39 In addition HAL noted that the Draft Guidance provided a different framework to that for the telecoms market. In telecoms, Ofcom[23] conducts a high level assessment of whether competition law would be sufficient before imposing SMP remedies in a market not identified by the

[23] Ofcom is the independent regulator and competition authority for the UK communications industries

EC as susceptible to *ex-ante* regulation. Ofcom's approach does not rely on whether there is specific case law, instead it addresses fundamental reasons why competition law rather than *ex-ante* remedies may or may not be appropriate in particular circumstances,

4.40 GAL stated that the CAA12 does not direct us to assess the quality of case law. Instead we should focus on the likelihood of detection, enforcement and the consequences in assessing Test B.

4.41 IATA considered that we cannot assume that the presence of successful case law is an indication that competition law is sufficient. In particular, IATA pointed to the costs of enforcement and a lack of transparency in pricing.

4.42 Virgin said that we should be aware of the ability for parties to manipulate remedies, even when competition law has been applied.

Our response and final policy

4.43 We maintain that the existence of successful competition law enforcement case law is an important element of our assessment under Test B, as it illustrates the likelihood of detection and enforcement of particular abuses. In addition case law provides precedent which may have a deterrent effect. However we agree that the Test is forward looking and should take into account current and future developments in relevant legislation and case law, including private action cases under CA98. We also agree that action under competition law may provide protection even where a procedure does not result in a formal enforcement decision or judgement from a Court.

4.44 Case law and the legal framework are ever evolving and we will take account of changes, including legislative changes, as they emerge over time.

4.45 We have considered how other competition authorities and regulators undertake market power assessments, in particular where they apply a similar framework to us and where there are parallels to the aviation

industry. While there are parallels between the EU telecoms framework and the MPT framework, there are also differences. For instance, the EU telecoms framework is highly prescriptive in terms of the approach to adopt for a market assessment and follow on *ex-ante* remedies. We do not seek to impose such rigidity in our guidance as airports are heterogeneous in nature and we need to be responsive to the particular facts of any matter before us.

4.46 Finally, given that we are required to assess Test B with respect to sufficient protection against the risk of abuse, the time that an investigation may take and the resources required are relevant. In this light there are likely to be a number of competition complaints that are not investigated under the competition law rules because they do not fall within administrative priorities due to the prioritisation assessments[24] that are taken by competition authorities including ourselves.[25]

4.47 We have amended the Guidance to clarify that we will take relevant existing and future case law, and legislative changes into account in assessing Test B.

Action taken by us and the CMA against airports

What we proposed

4.48 Paragraph 5.25 of the Draft Guidance stated that: "As well as general case law, we will consider prior competition law action we have taken against the particular airport for which we are undertaking the MPD. We do not, however, consider that if an infringement has been found against the airport operator that it automatically demonstrates that competition law is necessarily an effective tool which protects against the risk of abuse."

[24] 'Prioritisation Principles for the CAA's Consumer Protection, Competition Law and Economic Regulation Work' CAP1233, May 2015 is available from www.caa.co.uk/CAP1233

[25] For example the CMA, which has its own Prioritisation Principles, which are available from www.gov.uk/government/publications/cma-prioritisation-principles

Stakeholder comments

4.49 GAL considered that this paragraph is too narrow and that we should consider all forms of prior enforcement affecting airports.

Our response and final policy

4.50 We would agree that what was paragraph 5.25 in the Draft Guidance was unclear in its meaning. We take account of case law generally, including action we and other relevant authorities and the Courts take. This is covered earlier in the chapter of the Guidance on Test B.

4.51 This paragraph has been deleted from the Guidance.

Chapter 5

Test C - Adverse effects/benefits of regulation

Introduction

5.1 This chapter considers the responses related to Test C.

5.2 Test C is that we consider whether, for users of airport transport services, the benefits of regulation are likely to outweigh the adverse effects.

5.3 It covers the key issues raised by respondents to the consultation:

- qualitative and quantitative data;
- nature of the assessment;
- what the counterfactual should be;
- specific licence conditions;
- how extant agreements are considered;
- benefits and adverse effects of economic regulation;
- our *ex-ante* regulation and *ex-post* powers;
- assessing which powers provide greater benefits over adverse effects; and
- assessing competition law under Test B and Test C.

Qualitative and quantitative data

What we proposed

5.4 Paragraph 6.5 of the Draft Guidance explained that CAA12 does not dictate a particular method of impact assessment; instead that:

- the assessment may be based on a combination of qualitative and quantitative data depending upon the available data; and
- we will exercise our regulatory judgement in weighing those factors to apply Test C.

Stakeholder comments

5.5 HAL said we appeared to consider the impact assessment exercise to be primarily one of judgment. It considered we should seek to minimise the scope for judgement by, for example, commissioning suitable research and using our formal information gathering powers.

Our response and final policy

5.6 We agree that we should seek to gather the best available evidence to use in exercising our judgement. We will consider commissioning suitable research and will use our formal information gathering powers. We explained in paragraph 3.18 and paragraphs 3.25 to 3.27 of the Draft Guidance that we will use our formal information gathering powers as we consider appropriate in order to complete our assessments of the three Tests.

5.7 We have added to the Guidance in Chapter 3 and in Chapter 6 on Test C that we may conduct or commission research to aid our assessment with the objective of quantifying the adverse effects and benefits where we consider this appropriate.

Nature of the assessment

What we proposed

5.8 Paragraph 6.13 of the Draft Guidance explained that we will have regard to the regulatory principles in CAA12 and the duty not to impose or maintain regulatory burdens which we consider to be unnecessary. These provisions, taken together, in essence, build in a proportionality exercise to Test C to ensure that when we are considering *ex-ante* regulation via a licence we should incorporate a presumption that a licence would proportionate to the issues identified in the other Tests.

Stakeholder comments

5.9 HAL agreed that we should assess whether the benefits of regulating an operator by means of a licence are likely to outweigh the adverse effects

by way of an impact assessment, balancing the cost and benefits of regulatory intervention. It also agreed that the conclusion in the Draft Guidance that CAA12 requires a "*proportionality exercise to … ensure that ex-ante regulation via a licence is only imposed where it is suitable, necessary and proportionate*".

5.10 However, it considered that some aspects of the Draft Guidance appeared inconsistent with best practice in Impact Assessments, for example: the EC's Better Regulation Guidelines (2015), Chapter III of which sets out Guidelines on Impact Assessments; HM Treasury's Green Book: Appraisal and Evaluation in Central Government; and best practice and guidelines from other regulators such as Ofcom. It also considered that the Draft Guidance did not adequately address all steps in an impact assessment process.

Our response and final policy

5.11 Assessing whether the benefits of regulating the relevant operator by means of a licence are likely to outweigh the adverse effects is different from the impact assessments that are carried out when introducing new legislation or regulation. We need to comply with the requirements of CAA12 which require us to assess the specific generic question of whether the benefits of regulating the relevant operator by means of a licence are likely to outweigh the adverse effects. CAA12 does not, unlike for example the telecoms framework, create a specific linkage between the assessment of market power and the form of regulation as part of the MPD process.

5.12 Similarly Test C does not require that we complete an impact assessment in the manner that HAL has suggested. We are not required to undertake an assessment of policy proposals or of a range of options when conducting the MPD. We do not agree that the MPD process is the appropriate time to consider different options for the form of regulation. We would, instead, consider the appropriate form of regulation and the potential scope of licence conditions, when we consider what the licence

granted under CAA12 will contain, if the MPD found that the Test was met. This is explained in Chapter 7 of the Guidance.

5.13 We have not amended the Guidance on this point.

What the counterfactual should be

What we proposed

5.14 The Draft Guidance in paragraphs 6.14 to 6.19 'Making the comparison' explained that:

- If we are making an MPD of an airport whose operator does not have an economic licence, we would make a comparison between the status quo (an airport without a licence) and an airport regulated by means of a generic economic licence (the counterfactual).
- If we were making an MPD for an airport whose operator already holds an economic licence, we would make a comparison between the likely behaviour of the airport operator without the licence and a generic economic licence (the counterfactual).
- Assessing Test C against an unknown counterfactual may be challenging.
- The exact nature of the non-licence counterfactual will depend on the particulars of the operation of the airport in question.

Stakeholder comments

5.15 GAL considered that where an airport operator has an economic licence, the relevant counterfactual should be that particular licence rather than a generic licence. It considered that Test C could be met when considering a generic licence, but that it might not have been met had the airport operator's actual licence been considered as the counterfactual. It suggested that in that scenario, the airport operator could continue to be subject to its existing licence even if the adverse effects of that particular licence outweighed the benefits.

5.16 HAL stated that the Draft Guidance correctly stated that the counterfactual is not a situation without regulation at all, but instead one that considers the application of competition law and other regulatory tools. It goes on to add that these tools may well achieve all or much of the benefits of economic regulation via a licence with fewer or lower disadvantages.

Our response and final policy

5.17 We consider the generic comparison framework set out in the Draft Guidance is correct. As discussed above we consider that a generic licence is the appropriate counterfactual as Test C considers the binary question about whether economic regulation should be imposed or not, rather than the question of what the form of regulation should be in a particular circumstance.

5.18 In response to the point made by GAL, if we were to determine that Test C was met, on the basis of a generic licence, for an airport operator who already held a licence, this would imply a need to go on to review whether or not the existing licence was appropriate given the outcome of the new MPD. Given our general duty not to impose or maintain unnecessary burdens and the requirement that licence conditions should be necessary or expedient to guard against the abuse of SMP, in this situation it would be appropriate for us to review the existing conditions in the licence.

5.19 We have clarified this in Chapter 7 of the Guidance.

Specific licence conditions

What we proposed

5.20 In paragraphs 6.8 to 6.13 of the Draft Guidance we set out what conditions a licence may contain. We also explained that Test C does not require that we apply the test by reference to a specific set of licence conditions.

Stakeholder comments

5.21 IATA suggested that we should evaluate and consult on the merits of a specific set of licence conditions either as part of Test C or alternatively as a standalone consultation.

5.22 VAA noted that while there is some indication of what may be included in a "*generic licence*", greater detail on what a generic licence would look like at the particular airport in question would be appreciated at the time of the assessment.

Our response and final policy

5.23 Test C does not require that we have a specific set of licence conditions in order to conduct the assessment. In fact to do so would reverse the logical order of CAA12, where we are required to determine if an airport operator should be regulated (by applying the MPT) and only once that has been determined, do we consider specific licence conditions, if they are needed. In the Guidance, we have provided as much detail as we consider is appropriate on what a generic licence would contain. We have not modified this section of the Guidance.

5.24 If a licence was necessary once we had made an MPD, a specific set of licence conditions would be the subject of a separate development and consultation process. Chapter 7 of the Guidance sets out the process we would follow, including developing licence conditions for an airport operator who meets the MPT. To make this clearer, we have added wording to the 'Making the comparison' section in Chapter 6 of the Guidance to explain that if the MPT is met then the specific licence conditions for the airport operator would be developed or its existing licence reviewed. This wording cross refers readers to Chapter 7 'Once an MPD has been made'.

How extant agreements are considered

What we proposed

5.25 In paragraph 6.18 of the Draft Guidance we stated that the behaviour of a licensed airport operator under its current economic licence, for example where "*it has developed extant agreements with third parties that are not linked to regulation through its current or any potential future economic licence*" would be considered to be part of the likely behaviour of an airport operator without an economic licence.

Stakeholder comments

5.26 GAL suggested that the test of "not linked to" is too narrow, instead it would be better as "extant agreements with third parties that exist independently of regulation through its current or any potential future economic licence".

Our response and final policy

5.27 We have amended the wording of the Guidance to state that we would take into account the behaviour that the airport operator had exhibited under its current economic licence "*for example where it has developed agreements with third parties that exist independently of regulation through its current or any potential future economic licence*".

Benefits and adverse effects of economic regulation

What we proposed

5.28 Paragraphs 6.20 to 6.23 of the Draft Guidance explained the factors to consider in assessing the benefits and adverse of economic regulation by a licence. Examples of each identified category of benefits and adverse effects were included to provide additional clarity for readers of the Guidance.

5.29 Paragraph 6.24 to 6.26 of the Draft Guidance explained that we need to weigh the comparative merits of *ex-post* powers (through competition law, and other sectoral powers) as a sufficiently effective alternative to *ex-ante*

regulation under a licence. The Draft Guidance then explained the scope of *ex-ante* licence regulatory powers and *ex-post* powers.

Stakeholder comments

5.30 GAL considered that under the Draft Guidance (paragraphs 6.20 to 6.25); it is difficult to envisage circumstances where Test C would not be satisfied. Yet Parliament clearly intended Test C to be of practical significance (not as a test that would always be satisfied if Test A were satisfied).

5.31 GAL stated that in paragraph 6.20 of the Draft Guidance:

- We said that one of the benefits of economic regulation is that "*prices charged are cost-reflective*". GAL suggested that this assumed the form of economic regulation and is contrary to a generic set of licence conditions. GAL also stated that CAA12 Act only empowers us to regulate the prices to prevent an abuse of SMP and we are only authorised to prevent the charging of abusively excessive prices.
- We identified (unqualified) benefits from economic regulation but by contrast, the only (unqualified) adverse effect is time and expenditure on the regulatory process and the other factors are subject to the more tentative "*other potential*" wording. There should be specific references to cost rigidity, potential displacement of commercial relationships and interface costs.

5.32 BA suggested if we ensure that licence regulation has incentives that are properly aligned with efficiencies; then we can avoid an adverse effect of distracting management.

5.33 IATA considered that we had not provided sufficient detail to explain how the various impact areas will be considered from the perspective of consumer benefit. Furthermore, the criteria should explicitly consider the impact of economic regulation in avoiding distortions in the (downstream) airline market.

Our response and final policy

5.34 This section of the Draft Guidance seems to have inadvertently created a misunderstanding about the assessment process that we intend to adopt. Paragraphs 6.20 to 6.23 included examples of possible/potential benefits and adverse effects, rather than seeking to identify, in advance of a specific assessment, what any assessed benefits and adverse effects would be. We have amended these paragraphs to ensure that the wording in the bullet points provide examples of possible benefits and adverse effects rather than predetermined outcomes of any assessment. In addition we have revised the format of this section to improve its clarity.

5.35 In the Draft Guidance we stated that one of the possible benefits of regulation was that it could ensure prices are cost-reflective. We were not stating what regulation would do in every instance, but rather we were indicating a matter that it could address. This point has been clarified in the final Guidance.

5.36 However, it is not correct that CAA12 only authorises us to prevent the charging of abusively excessive prices. CAA12 provides that an airport operator's operating licence may include factors that we consider necessary or expedient having regard to our duties under CAA12. We have not amended the Guidance on this point.

5.37 While we intend to align any regulation with the behaviours desired, we cannot expect to have as much information about the business being regulated as the business itself. As such any regulation, regardless of how well it is aligned, can be expected to cause some management distraction. We are mindful of this issue in the manner in which we carry out our duties under CAA12. We have not amended the Guidance on this point.

5.38 While in assessing Test C, we would carry out our work from the perspective of passengers and those with rights in cargo; we agree that this was not clear enough in chapter 6 of the Draft Guidance. We have added wording to the Guidance to make this clear.

5.39 While we may assess possible distortions in the (downstream) airline market indirectly, Test C does not explicitly include a requirement to avoid distortions in the airline market. While the interests of passengers and airlines may, in many circumstances, be aligned, they are not necessarily the same. In our 'Strategic themes for the review of Heathrow Airport Limited's charges (H7)', we said, in the context of engaging consumers in the next price for Heathrow airport, that airlines' commercial interests may not always be aligned with the interests of passengers, and that the interests of consumers and airlines may diverge.[26] We have not amended the Guidance on this point.

Our *ex-ante* regulation and *ex-post* powers

What we proposed

5.40 The Draft Guidance in paragraphs 6.24 to 6.28 set out what *ex-ante* regulation encompasses and what our *ex-post* powers encompass. This was to ensure clarity of these terms when they are considered later in the chapter.

Stakeholder comments

5.41 HAL expressed concern that the Draft Guidance appears to start from the position that regulatory intervention via a licence is generally preferable.

5.42 IATA stated that the reference to *ex-post* measures is centred on remedies that are available through competition law. The Guidance should make clear what other *ex-post* remedies, if any, will be considered by us.

[26] CAP1383a 'Strategic themes for the review of Heathrow Airport Limited's charges ("H7") – Technical Appendices' March 2016, paragraph 5.6 which is available from www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Licensing-and-price-control/Heathrow-price-control-review-H7/

Our response and final policy

5.43 The Draft Guidance described the range of our *ex-post* powers; which include competition law and other *ex-post* powers such as the ACRs[27] and the AGRs.[28]

5.44 These paragraphs were largely aimed at explaining our *ex-ante* regulation and our *ex-post* powers; rather than seeking to state the possible benefits or adverse effects of these powers. We do not assume that regulatory intervention via a licence is generally preferable.

5.45 Clarification has been added to the Guidance to make clear that these paragraphs are descriptive.

Assessing which powers provide greater benefits over adverse effects

What we proposed

5.46 Paragraph 6.39 of the Draft Guidance outlined the factors we will take into account in assessing whether *ex-ante* regulation or *ex-post* powers provide greater benefits over adverse effects for passengers and those with rights in cargo.

Stakeholder comments

5.47 HAL was concerned that this paragraph contained a number of flaws and appeared to make prejudgements to justify the imposition of licence-based regulation.

Our response and final policy

5.48 This paragraph posed questions on items that we will consider in a Test C assessment; it was not designed to provide answers to any individual assessment, to prejudge outcomes or to justify imposing regulation by means of an economic licence.

27 ACRs are the Airport Charges Regulations 2011

28 AGRs are the Airport (Groundhandling) Regulation 1997

5.49 Clarification has been added to the Guidance on how we will assess Test C in terms of the difference between *ex-ante* regulation and *ex-post* interventions.

Assessing competition law under Test B and Test C

What we proposed

5.50 Paragraph 2.32 of the Draft Guidance stated that "*Competition law is a key element in the assessment of Test B and Test C, although each Test has a different focus*". The Draft Guidance then explained the difference in the way competition law was assessed under the two Tests.

Stakeholder comments

5.51 GAL suggested that paragraph 2.32 of the Draft Guidance incorrectly expressed Test C as whether an economic operating licence has more benefits than our non-licence powers (including competition law).

5.52 IATA stated that Test B considers the extent to which competition law is sufficient to protect against the risk of abuse of dominant position, and therefore, there is no need to repeat the comparison with competition law under Test C, if Test B had found competition law to be insufficient.

Our response and final policy

5.53 We agree with GAL that this section does not cover all of Test C. This section was not seeking to explain Test C in detail, but to reflect on the different focus in how competition law is assessed in Test B and Test C.

5.54 We do not accept the point made by IATA. Test B and Test C both include competition law, as such it is necessary to consider competition law under both Test at B and C. Even if we consider competition law is insufficient protection against the risk of abuse of SMP it will still, along with other sectoral legislation, form the baseline against which an airport operator would conduct itself in the absence of economic regulation.

5.55 We have removed this section from the Guidance and instead clarified the different focus of how competition law is applied in the two Tests in the chapter on Test B.

Chapter 6

General comments

Introduction

6.1 This chapter discusses comments stakeholders made that were not directly focused on the detail of the Guidance.

6.2 The comments covered are:

- consultation approach;
- application of the MPT;
- de-regulatory path; and
- licence imposes least possible regulatory burden.

Consultation approach

What we proposed

6.3 In paragraph 1.7 of the Draft Guidance we said that:
"Stakeholders' comments will allow us to ensure that this guidance is useful to them in explaining how we will apply our powers."

Stakeholder comments

6.4 HAL stated that it assumed we were not intending to suggest that we were only concerned with clarity of expression (rather than a consultation on the substance of our approach), and expected we would take full account of stakeholders' comments and make appropriate substantive changes to the Guidance.

Our response

6.5 Our intention was not to suggest we were only concerned with clarity of expression. We were seeking to separate the Draft Guidance on our how we will approach using our powers from the powers and duties given to us by CAA12.

6.6 Our intention, to take account of stakeholders' comments, and make appropriate changes to the Guidance, is clarified in the 'Draft guidance on the application of the Market Power Test under the Civil Aviation Act 2012: Consultation' (consultation document) which accompanied the Draft Guidance.[29] In paragraph 7 of the consultation document, we said: *"The remainder of this paper summarises the draft guidance and raises some questions stakeholders may particularly want to consider in any response*. *You are not, however, restricted to commenting on these issues and we would welcome views on any aspect of this draft Guidance."*

6.7 This is also evident from the rest of this Responses document which explains how we have addressed the comments we received from stakeholders.

Application of the MPT

Stakeholder comments

6.8 Ryanair, while supporting the Draft Guidance on the factors that indicate market power, said that our MPD for 'Stansted Airport Limited's services to passengers' in 2014[30] was misguided in concluding that STAL did not meet the MPT. Ryanair stated that the long-term bilateral contracts that airlines agreed with STAL in 2013 did not indicate that the airlines had countervailing buyer power. Rather, it indicated STAL's willingness to negotiate as a strategic regulatory response in the early days of Manchester Airports Group plc's (MAG's) ownership of STAL and after we had published our 'minded to MPD'[31], where we concluded STAL met the MPT and would need to be regulated.

29 'Draft guidance on the application of the Market Power Test under the Civil Aviation Act 2012: Consultation', CAP1355, which is available from www.caa.co.uk/CAP1355

30 Market power determination for passenger airlines in relation to Stansted Airport – statement of reasons, January 2014, CAP1135, which is available from www.caa.co.uk/CAP1135

31 Stansted Market Power Assessment: Developing our 'minded to' position, January 2013, which is available from: www.caa.co.uk/WorkArea/DownloadAsset.aspx?id=4294972547 (PDF)

6.9 Ryanair considered that the underlying market conditions which, in its view, give STAL SMP have not changed. These conditions included the continued importance of London to airlines' networks and the capacity constraints at London airports, which Ryanair considered mean that STAL still enjoys SMP, and that the airlines that use Stansted airport have no ability to restrict STAL's SMP.

6.10 While Ryanair currently has a long-term contract, it expressed concern STAL could raise prices once its deal expires, as regulation will not be in place to protect it. Such a circumstance, Ryanair contended, would result in a substantial change in market conditions such that we would need to conclude that STAL has SMP and required regulation.

6.11 In conclusion, Ryanair stated that to ensure market conditions and competition are not distorted in such an event, we must undertake a new MPD of STAL in time to allow for it to be regulated when the Ryanair contract with STAL expires.

Our response

6.12 In 2014 we found MPD that the Test was not met in relation to airport operation services to passenger airlines (the passenger market) at Stansted airport. As a result, we were required to deregulate it.

6.13 However, we acknowledge the concerns that Ryanair has about the market conditions in which it operates.

6.14 We will continue to be available to discuss any aspect of Ryanair's or another airline's operation at STAL or another UK airport where it has competition concerns or market power concerns.

De-regulatory path

Stakeholder comments

6.15 GAL considered that the Guidance should reflect the path to deregulation that is evident in CAA12 and the CC's report into BAA and should provide practical guidance on how the general guidance published by the

European Commission and the CMA will be applied under the MPT. It noted that:

- Under CAA12, Section 1(3) requires that, in performing our duties under Section 1(2) and (3) we must have regard to a list of considerations, one of which is that "*regulatory activities should be targeted only at cases in which action is needed"*. Section 104 imposes a duty on us not to impose or maintain unnecessary regulatory burdens and the inclusion by Parliament in the Market Power Tests of Tests B and C.
- The CC's report on BAA resulted directly in Gatwick, Heathrow and Stansted airports being in separate ownership and it underpins CAA12. In its report, the CC stated: "*we strongly support the reduction and in due course the removal of regulation, as competition develops*."[32] It expected regulation to continue only for a "*transitional period at Gatwick and Stanste*d"[33] but said that it was "*difficult to predict precisely how and with what speed competition will develop*" and that, accordingly, there "*may*" need to be some form of regulation beyond Q5[34].[35] As it turned out, we determined that GAL did need some form of regulation beyond Q5; but GAL considered that the Guidance should better reflect the deregulatory intent of Parliament in CAA12 and the CC's intent that regulation should be removed as competition develops.

Our response

6.16 The CC's report in March 2009 on 'BAA airports market investigation'[36] recommended that separate ownership of the airports owned by BAA would be likely to increase competition between them, which could in turn lead to a reduction in regulation of these airports. The CC report may

32 Para 10.344.

33 Para 10.339.

34 The fifth quinquinniem, or price review, period.

35 Para 10.338.

36 CC report on 'BAA airports market investigation', March 2009, which is available from webarchive.nationalarchives.gov.uk/20140402141250/http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2009/fulltext/545.pdf

have expressed a preference for the eventual reduction and removal of economic regulation but it also included caveats and conditions around when this could happen. The CMA 2016 report on 'BAA airports: Evaluation of the Competition Commission's 2009 market investigation remedies' confirmed this. It stated that "*much of the benefit envisaged by the CC was based on the expected future development of up to two additional runways in the South-East*. *This in turn was expected to result in further increases in competition and could lead to progressive deregulation*. *It is clear from the 2009 report that benefits from removing common ownership were expected increase over time as the prospect of adding capacity was realised*. *It was also envisaged that price controls at Gatwick and Stansted at least would be withdrawn as competition develops and that this deregulation would lead to further benefits*. *In general the CC expected benefits to accrue over the course of 30 years, facilitated by significant investment in new infrastructure*."[37]

6.17 Subsequently and as a result of the recommendations of the CC report, Parliament enacted CAA12 which established that we should carry out MPDs to determine if an airport operator would be regulated.

6.18 While the CC review considered whether competition could be increased by separate ownership; the MPDs are designed to consider the balance of risks that the CC discussed on the degree of competitive pressure that airport operator is facing and the rationale for continued economic regulation.

6.19 We consider that the enactment of CAA12 was the Government's response to implementing the regulatory recommendations in the CC's report on 'BAA airports market investigation'. In any event, our role in respect of regulation is bounded by the duties and powers given to us by Parliament. We can only, therefore, carry out our MPDs in accordance with the duties placed on us under CAA12. As GAL noted, these include the requirement to act only where it is needed (Section 1(4)), and not to

[37] Paragraph 3.26 of the CMA 2016 report on 'BAA airports: Evaluation of the Competition Commission's 2009 market investigation remedies', May 2016, which is available from www.gov.uk/cma-cases/baa-airports-evaluation-of-remedies

impose undue burdens in carrying out our general duty under Section 1 of CAA12.

Licence imposes least possible regulatory burden

Stakeholder comment

6.20 HAL stated that the need to ensure that any regulation that is imposed, via a licence imposes the least possible regulatory burden, requires that we act proportionately and that we complete an impact assessment. Where different conditions could be adopted, it considered that we should generally prefer the one that involves the least intervention and the lowest cost.

Our response

6.21 Our primary duty under Section 1 of CAA12 is to further the interests of passengers and those with a right in cargo (cargo owners) regarding the range, availability, continuity, cost and quality of airport operation services. Our powers under Section 18 of CAA12 allow us to include conditions that we consider necessary or expedient to guard against the risk of abuse of the SMP found in an MPD, and conditions that we consider are necessary and expedient having regard to our duties under Section 1 of the CAA12.

6.22 We will, therefore, always include conditions that best fulfil these requirements. In doing so, we will balance methods of achieving these requirements to ensure that we are consistent with our duty under Section 104 of CAA12 not to impose or maintain unnecessary burdens and that we have regard to all of our other duties under Section 1 of CAA12, including being proportionate and targeted, and securing that the licence holder is able to finance its licensed activities.

6.23 However, as explained in the Test C chapter, this is a step that would be carried out after the completion of any MPD. We have not changed the Guidance.