

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

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

The market power test set out in section 6 of the CA Act is met in relation to the following airport areas located at London Gatwick Airport:

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

Tests A to C of section 6 of the CA Act have been met by the relevant operator, namely Gatwick Airport Limited.

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

The reasons for this determination are set out in the document “Market power determination in relation to Gatwick Airport – statement of reasons, CAP 1134.”

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

Market power determination in relation to Gatwick Airport – statement of reasons



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Table of contents

Chapter 1: Introduction

Chapter 2: Main findings and conclusion

Chapter 3: Consultation history

Chapter 4: Market definition – final decision

Chapter 5: Test A: Market power – final decision

Chapter 6: Tests B and C

Chapter 7: Conclusion

Appendix A: List of representations and evidence received

Appendix B: Glossary

Appendix C: The business of Gatwick Airport Limited

Appendix D: Evidence and analysis on market definition

Appendix E: Evidence and analysis on competitive constraints: Airlines

Appendix F: Evidence and analysis on competitive constraints by passenger switching

Appendix G: Evidence and analysis on indicators of market power

Appendix H: Evidence and analysis on indicators of market power – technical appendix

Appendix I: Evidence and analysis on Test B

Appendix J: Evidence and analysis on Test C

CHAPTER 1

Introduction

Purpose

- 1.1 This document sets out the reasons for the CAA's market power determination that the market power test is met in relation to the core area of the airport area as defined in section 5(4) of the Civil Aviation Act 2012 (CA Act) comprising London Gatwick Airport (Gatwick).¹
- 1.2 Section 3 of the Civil Aviation Act 2012 (the CA Act) prohibits the operator of a dominant area at a dominant airport from requiring payment of relevant charges. The CA Act only permits economic regulation of an airport operator and the granting of a licence by the CAA if all three components of the market power test set out in section 6 of the CA Act are satisfied. Those components are:
- Test A, which requires the CAA to establish whether the relevant operator has, or is likely to acquire, substantial market power (SMP) in a market for one or more types of airport operation service provided within all or part of the airport area.²
 - Test B, which requires the CAA to establish that competition law does not provide sufficient protection against the risk that the relevant operator may engage in conduct that amounts to an abuse of that SMP.³
 - Test C, which requires the CAA to establish that, for current and future users of air transport services, the benefits of regulating the relevant operator by means of a licence are likely to outweigh the adverse effects.⁴

¹ The CAA considers that GAL has overall responsibility for the management of the airport area, consisting of the facilities at Gatwick airport, with the exception of the aircraft maintenance facilities, pursuant to the CAA's operator determination under section 10 of the Act.

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

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

⁴ Section 6(5) of the CA Act.

- 1.3 In carrying out its assessment, the CAA is acting under its general duty to carry out its functions in a manner which it considers will further the interests of passengers and cargo owners regarding the range, availability, continuity, cost and quality of airport operation services. The CAA is also carrying out this function in a manner that it considers will promote competition in the provision of airport operation services (and, where appropriate, takes into account the regulatory needs and principles in the CA Act).⁵
- 1.4 This is the non-confidential version of this document and excisions from the text are marked with [§<].

Structure of this document

- 1.5 Given the complexity and volume of evidence and economic analysis forming part of this statement of reasons, it has been necessary to distil the CAA's principal findings and conclusions into the main body of this document.
- 1.6 The main chapters of this statement of reasons document set out the CAA's principal findings of fact and reasons as well as its final decision on each of the three Tests A, B and C. The supporting evidence, inferences, reasons and detailed economic analysis are to be found in the accompanying appendices and are an integral part of the CAA's reasoning. The main body of the document and the appendices should be read as a whole and the fact that the discussion of a particular issue is reserved to the appendices does not undermine its relevance or importance.
- 1.7 The remaining chapters and appendices of this document are:
- Chapter 2: Main findings and conclusion
 - Chapter 3: Consultation history
 - Chapter 4: Market definition – final decision
 - Chapter 5: Test A: Market power – final decision
 - Chapter 6: Tests B and C
 - Chapter 7: Conclusion

⁵ Section 1(1) of the CA Act, read together with section 1(2), 1(3) and 1(4).

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

CHAPTER 2

Main findings and conclusions

- 2.1 The CAA has defined the relevant market as the provision of airport operation services to passenger airlines, limited to those services provided at Gatwick.
- 2.2 This market definition has changed from that set out in the CAA's Consultation on Gatwick market power assessment CAP 1052 (the Consultation).
- The CAA no longer considers that it is appropriate for the relevant market to be segmented by airline business model. While there are differences in the business models for low cost carriers (LCCs) and full service carriers (FSCs), there is no clear demarcation line between these models, especially with respect to demand for specific facilities at Gatwick. Furthermore, especially at Gatwick, LCCs and FSCs indicated that passengers could easily switch between their services.
 - In light of the unified product market, the CAA has also refined its view on the relevant geographic market. In particular, given the capacity constraints at Heathrow, airlines interested in operating there are unlikely to be able to switch to that airport in practice.
 - The north London airports Luton and Stansted are not included in the relevant market as Gatwick is the preferred airport of operation for airlines. These north London airports are a less preferred option for airlines than operations from Gatwick as neither has the necessary facilities and each has a weaker catchment area and lower connecting passenger feed. In addition, Gatwick is considered by many airlines as the default airport for holiday flights, because of its large catchment area and tour operator support networks.
- 2.3 In coming to this decision, the CAA has had regard to its general duties under the CA Act and the relevant notices and guidance issued by the European Commission (EC) and the Office of Fair Trading (OFT) regarding the application and enforcement of the Chapter I and II prohibitions and Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU), (the competition law notices and guidance).

2.4 Having analysed the above markets, and taken due account of the competition law notices and guidance as well as the responses to the CAA's Gatwick – Market Power Assessments, the CAA's Initial Views – February 2012 (the Initial Views) and the Consultation, the CAA has decided that Gatwick Airport Limited (GAL) has substantial market power (SMP) in this market, which is expected to persist over the period April 2014 – until at least March 2019 (Q6). This decision is unchanged from that proposed in the Consultation.

2.5 The CAA has come to this conclusion as it considers that the evidence suggests that:

- There are sufficient barriers which limit the ability of airlines to switch from Gatwick in response to a small but significant non-transitory increase in prices.
- Airlines are not able to credibly threaten to switch away from Gatwick to discipline GAL's pricing behaviour. This is the result of a number of factors including capacity constraints, presence of backfill and the credibility and effectiveness of alternative switching options. To the extent that there is marginal switching, it is of insufficient volume to discipline the airport's behaviour.
- Although there is capacity at the north London airports, these airports are a less preferred option for airlines than operations from Gatwick as they do not have a combination of the necessary facilities. With respect to Heathrow, the evidence from airlines suggests that it is a preferred airport to Gatwick. However, there are a number of high barriers to entry, due to capacity constraints, which prevent effective switching to Heathrow as a reasonable response to a price increase at Gatwick
- The timescale required for adequate airport expansion/new entry to accommodate sufficient switching is likely to be too long to impose a constraint in the short-term.
- The indicators of market power, when considered as a whole, suggest that GAL has SMP and that this will continue going forward.
- The likely underlying source of GAL's market power stems from its unique characteristics (in terms of density of leisure routes, wealth of catchment, and facilities). This is supported by the inherent attractiveness of the London market combined with capacity constraints in the London system, which limits credible switching alternatives for airlines and thus the airlines' buyer power.

- GAL's market power is likely to increase from the expected tightening of capacity constraints across the south east of England over the Q6 period. This tightening can be expected to affect GAL's pricing behaviour. While larger aircraft and better utilisation of slots may help to address capacity constraints in the short term, the timescale required for adequate airport expansion/new entry to accommodate sufficient switching is likely to be too long to impose a constraint in the short term.

2.6 In the future, the CAA's analysis could change as its assessment is context and time specific and depends on market conditions, which are subject to change. For example, the recent change of ownership of Stansted Airport Limited (STAL) may, over time, result in a greater competitive constraint on GAL. The outlook for the economy is uncertain though improving and future Government policy in relation to new capacity in the south east of England could be changed. Moreover, as GAL's customers and airlines operate in a market that is characterised by change, the business models operating at Gatwick could also change, as could passenger preferences.

2.7 The Government has also put on hold the expansion of the main London airports and the Airports Commission, which is examining how additional UK airport capacity needs can be met in the short, medium and long term, is not expected to issue its final report until summer 2015. The CAA considers that any change in Government policy after the release of the Airport Commission's final report may take some time to be implemented and that any significant capacity expansion would not be expected until after 2025. Over the Q6 period, due to improving economic conditions and the lack of significant capacity expansion, the CAA considers that GAL's SMP will endure.

2.8 Four of the five respondents to the Consultation supported the CAA's finding that GAL has SMP. Only GAL did not agree with this finding. GAL, in its response to the Consultation, expressed concern on a number of matters, including:

- Flaws with the CAA's market definition.
- Perceived inconsistencies with the CAA's previous statements and precedents established by other regulators.
- The failure to consider aggregate competitive constraints.

- 2.9 The CAA, having carefully considered all of the issues that GAL raised in relation to the CAA's analysis in its responses to the Consultation and the CAA's own analysis, has not changed its overarching view that GAL has SMP, although some of its underlying analysis has changed. In coming to this view the CAA has reconsidered the market definition for GAL (including perceived inconsistencies) and the associated (individually and combined) constraints that could constrain GAL. The CAA's reasoning is discussed in more detail in the chapters and appendices of this document.
- 2.10 In relation to Test B, the CAA concludes that ex post application of competition law will not provide sufficient protection against the risk of GAL abusing its SMP. In reaching that conclusion, the CAA has had regard to the competition law notices and guidance as well as the regulatory principles in the CA Act.
- 2.11 The risk associated with finding that GAL has SMP is that higher prices, reduced choice or poorer service quality levels could result if GAL was not subject to economic regulation. The CAA does not consider that it can assume that these will not have a negative effect on users, even if some price rises might be absorbed by airlines. The CAA also considers it is likely that GAL will continue to face investor pressure to keep prices as high as possible.
- 2.12 Ex post competition law, whether under the Competition Act 1998 or the Enterprise Act 2002, is not well adapted to preventing conduct which amounts to abuse of SMP in the form of excessive pricing or reduced service quality. This is principally because the case law reveals the difficulty of establishing what might constitute infringing conduct.
- 2.13 There are also considerable challenges for the users of air transport services, particularly passengers, who are affected by this kind of abuse in bringing challenges or seeking damages based on competition law. This limits the likely deterrent effect of competition law.

- 2.14 The CAA has a duty to apply Test B in a way that will further the interests of users under section 1(1) of the CA Act and it considers that it cannot be confident that a conclusion that competition law would be sufficient to protect passengers against the abuse of SMP by GAL, or would adequately further their interests in the range, availability, continuity, cost and quality of operation services or do both.
- 2.15 Where the market is impaired by the existence of SMP which brings with it the risk of abuse by the holder of that SMP, effective remedies need to be specific, timely and able to be flexed over time. The CAA has concluded that in relation to GAL, competition law cannot readily offer these remedies. In such circumstances, it is appropriate and proportionate to look to regulatory controls.
- 2.16 The CAA's decision on Test B is unchanged from that proposed in the Consultation.
- 2.17 In relation to Test C, the CAA considers that, taking account of the interests of current and future users of air transport services, particularly their demands in terms of stable supply of high quality airport services at affordable cost, the benefits of licence regulation outweigh any adverse effects.
- 2.18 As the market power assessment has been undertaken in parallel to CAA's Q6 review of the form of regulation for GAL after April 2014, the CAA considers that these unique circumstances allow it to assess Test C on the basis of both licence regulation in general as well as on the specific form of licence regulation which it considers to be most appropriate for GAL, in this case GAL's proposed commitments backed by a licence and monitoring framework.
- 2.19 The CAA has assessed the merits of the licence-backed commitments (LBC) Licence and licence regulation against the no commitments counterfactual (no licence at all) as well as an alternative counterfactual, based on GAL's commitments ("the Commitments Counterfactual").
- 2.20 The CAA considers that there are a number of incremental benefits from LBC Licence:
- The CAA considers that the price of the commitments at RPI+0 per cent in the blended yield scenario is in excess of the CAA's assessment of a fair price. By backing the commitments with a licence the CAA would ensure that charges are consistent with the fair price, and that any pass through of the costs of a second runway is in users' interests.

- A licence would provide increased incentives on efficiency from the tighter control on prices, the controls placed on the pass through of second runway costs, the potential to review the capital plan to ensure it is in users' interests, and the greater threat of tighter regulatory controls.
- A licence would provide benefits to service quality from the ability of the CAA to investigate repeated service quality failures and enforce the commitments in passengers' interests.
- A licence would provide benefits to investment, from the CAA's ability to monitor the investment programme and should problems arise from the flexibility of the commitments, the CAA can investigate and consider whether to introduce additional licence conditions.
- A licence would provide other benefits in terms of operational and financial resilience.

2.21 In all, a LBC Licence will provide a more certain environment for the airport and its airlines and passengers.

2.22 The CAA acknowledges that licence regulation could have adverse effects for example in terms of direct costs of management and regulation staff as well as indirect costs of management distraction and crowding out of a more commercial approach. However, the CAA considers that licence-backed commitments would minimise any costs and potential distortions.

2.23 The CAA therefore considers that its decision on Test C (together with its decisions on Tests A and B) will enable GAL to deliver high standards of service quality at reasonable cost and will promote the efficiency and long-term investment in airport services under a stable regulatory framework.

2.24 The CAA has also had regard to the regulatory principles in the CA Act and, in particular, that regulatory activities are targeted only at cases where action is needed and are carried out in a way which is transparent, accountable, proportionate and consistent. It considers that a well designed licence-based regulatory regime that imposes transparent, proportionate and consistent regulatory obligations (remedies) on GAL, having a position of SMP in the relevant market, and backed up by effective remedies in the event of a breach, is consistent with UK and European experience as the most effective way to promote competition, economy, efficiency and quality of service.

- 2.25 The CAA's decision on Test C is unchanged from that proposed in the Consultation.
- 2.26 Given Tests A, B and C are met by GAL the CAA has determined that the market power test in section 6 of the CA Act is met in relation to Gatwick.
- 2.27 The effect of this positive determination is that GAL is to be regarded as the operator of a dominant airport for the purposes of section 5 of the CA Act and, pursuant to section 3, its operator; GAL is required to have a licence before it can lawfully require payment of any relevant charges in respect of airport operation services.
- 2.28 The CAA is consulting separately on the proposed terms and conditions of the licence to be imposed on GAL and they are expected to come into force by 1 April 2014.

CHAPTER 3**Consultation history**

- 3.1 Since 1987, the operator of Gatwick has been economically regulated by the CAA in accordance with the Airports Act 1986 (AA86). Under AA86, an airport operator with an annual turnover of at least £1 million requires a permission to levy airport charges at that airport.
- 3.2 When the Secretary of State issued the initial permission to levy airport charges, this included conditions that set maximum airport charges and required GAL's financial accounts to disclose additional information on costs and revenues.
- 3.3 It then fell to the CAA to re-set the price cap at subsequent five yearly intervals in accordance with AA86, which also obliged the CAA to make a prior reference to the CC.
- 3.4 In the first two price control periods there was a separate price cap on GAL. In the third period, there was a single cap covering both Heathrow Airport Limited (HAL) and GAL but with the proviso that charges at Heathrow should rise by at least 1 per cent per annum more than those at Gatwick. From the fourth control period onwards there has been a separate price cap on GAL.
- 3.5 While the CAA currently sets an average maximum yield per passenger that the airport operator is able to recover, the airport operator is able to set the level of individual charges as it considers appropriate to recover up to this maximum in line with its commercial interests. The effect of this is that where the airport operator has entered into bilateral arrangements with airlines at charges below the published tariff the airport operator is not then free to recover the revenue shortfall through increasing the charges paid by other airlines.
- 3.6 As the price cap is expressed in terms of charges per passenger, the price cap distinguishes between charges paid for passenger flights and those paid for flights not carrying passengers, in particular all-freighter aircraft. Revenues from all-freighter aircraft are not taken into account in the price cap although the airport operator may not charge more for such aircraft than it would for an equivalent passenger aircraft.

- 3.7 In 2011, the CAA commenced a project to understand the extent and nature of market power held by the operators of the airports that were designated under AA86 and that are subject to price regulation, i.e. Heathrow, Gatwick and Stansted.
- 3.8 In February 2012, the CAA published the Initial Views⁶ and in this document the CAA:
- Indicated that GAL enjoyed a particularly strong market position in some market segments. For example, the CAA indicated that GAL has a relatively strong market position when competing for point-to-point (low cost carrier and charter airline) services serving passengers in the south east of England and outbound holiday passengers.
 - Invited stakeholders' comments on its proposals for market definition, indicators of market power and the presence or absence of SMP in the markets identified.
- 3.9 In response to the Initial Views, the CAA received three written submissions, and the non-confidential versions of these submissions were published on its website.⁷
- 3.10 In May 2013, the CAA published the Consultation.⁸
- 3.11 In the period between the publication of the Initial Views and the publication of the Consultation the CAA:
- Undertook extensive evidence gathering and assessment. Including stakeholder engagement, empirical analysis and expert opinion.
 - Refined its thinking on market definition, competitive constraints and indicators of market power.

⁶ In January 2012 the CAA published the Initial Views Summary. Both documents are available at <http://www.caa.co.uk/docs/5/MarketAssessmentsJan12.pdf>

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

⁷ See: <http://www.caa.co.uk/default.aspx?catid=78&pagetype=90&pageid=12275>

⁸ This document is available at: [http://www.caa.co.uk/docs/33/CAP%201052%20Consultation%20on%20Gatwick%20market%20power%20assessment%20\(p\).pdf](http://www.caa.co.uk/docs/33/CAP%201052%20Consultation%20on%20Gatwick%20market%20power%20assessment%20(p).pdf)

- 3.12 In the Consultation, the CAA indicated that it was minded to conclude that:
- Test A was met on the basis that GAL has SMP in the market for airport operation services in two markets:
 - The provision of airport operation services for LCCs and charter airlines covering a geographic market that is limited to Gatwick but unlikely to include Luton and Stansted.
 - The provision of airport operation services for FSCs and associated feeder traffic, covering a geographic market that includes Gatwick and Heathrow.
 - Under Test B, competition law would not provide sufficient protection against the abuse of that market power.
 - Test C was met as the benefits, for users of air transport services, of regulating GAL by means of a licence would outweigh the adverse effects.
- 3.13 As the three components of the market power test were met in relation to an airport area, the CAA was minded to make a market power determination under section 7 of the CA Act. As a result of the airport area and airport being dominant, it would be necessary⁹ for GAL to have a licence to charge for services provided in this area and any other area at the airport in respect of which GAL is the operator.
- 3.14 As a result of the airport area and airport being dominant, it would be necessary¹⁰ for GAL to have a licence to charge for services provided in this area and any other area at the airport in respect of which GAL is the operator.
- 3.15 On 30 April 2013, the CAA published for consultation its initial proposals for the economic regulation of Heathrow, Gatwick and Stansted (the Initial Proposals).¹¹
- 3.16 On 3 October 2013, the CAA published for consultation its final proposals for the economic regulation of Heathrow, Gatwick and Stansted (the Final Proposals).¹²

⁹ Pursuant to section 3 of the CA Act.

¹⁰ Pursuant to section 3 of the CA Act.

¹¹ These documents are available at:

<http://www.caa.co.uk/default.aspx?catid=78&pagetype=90&pageid=12275>.

- 3.17 The CAA received five responses to the Consultation on GAL, these were from:¹³
- GAL;
 - British Airways (BA);
 - easyJet;
 - Gatwick Airport Consultative Committee (GACC); and
 - Virgin Atlantic Airways (VAA).
- 3.18 Further detail on the responses to the Consultation and the CAA's responses to the issues raised in those responses can be found in the chapters and appendices of this document.
- 3.19 In late November 2013¹⁴, the CAA was formally made aware that GAL had entered into commercial negotiations with airlines under the proposed regulatory commitments framework (see appendix G). The drafting of the contractual heads of terms (which make the agreements contingent on the CAA's proposed form of regulation coming into existence), the opinions gathered from airlines and the structure of the proposed regulation indicate that these negotiations are a product of the regulatory process and if GAL were not to be regulated by a licence, the CAA considers that these deals would not stand. In addition, it is unclear that GAL would have sought to enter such negotiations had this regulation not been proposed. Therefore there is circularity in the argument for taking account of these agreements with in the MPD. The CAA considers that these agreements do not impact its considerations under test A.
- 3.20 In January 2014, the CAA also released a document outlining the CAA's reasons for making an operator determination for the purposes of section 10 of the CA Act. As part of that operator determination, the CAA will determine who has overall responsibility for management of the airport area comprising Gatwick Airport.¹⁵
- 3.21 A full list of respondents to the Initial Views and the Consultation can be found at appendix A to this document.

¹² This document is available from the CAA's website:

<http://www.caa.co.uk/docs/33/CAP%201103.pdf>

¹³ Non-confidential versions of these submissions were published on the CAA's website:

<http://www.caa.co.uk/default.aspx?catid=1350&pagetype=90&pageid=14784>.

¹⁴ GAL, email to Iain Osborne from Kyran Hanks, 21 November 2013 at 17:12.

¹⁵ This document is available on the CAA's website.

CHAPTER 4

Market definition – final decision

Legal framework

- 4.1 Market definition is a key component of the market power test and is relevant for assessing
- Whether GAL, as the operator of Gatwick, has SMP in the relevant market for the purposes of Test A.
 - Under Test B, whether there is a risk of abuse of such a position.
- 4.2 Both these tests are applied by reference to the relevant market, i.e. a market for one or more types of airport operation services within the airport area.
- 4.3 In reaching its assessment, the CAA has had regard to:
- Its own guidance for the assessment of market power of airports (the Guidelines).¹⁶
 - The applicable OFT and EC competition law notices and guidance, to which it must have regard under section 6(10) of the CA Act.¹⁷
- 4.4 Market definition is a useful tool for identifying, in a systematic way, the competitive constraints which the relevant operator faces and whether those constraints prevent it from operating independently of effective competitive pressure.¹⁸

¹⁶ The CAA's April 2011, Guidance on the assessment of airport market power (the Guidelines), available via the CAA's website at:
<http://www.caa.co.uk/docs/5/Final%20Competition%20Assessment%20Guidelines%20-%20FINAL.pdf>.

¹⁷ See OFT's Competition Law Guideline on Market Definition, December 2004 (OFT 403) and the EC's Notice on the definition of relevant market for the purposes of Community competition law (OJ 97 C 372, p. 3) (EC Market Definition Notice).

¹⁸ EC Market Definition Notice, paragraph 2.

- 4.5 However, there may be characteristics of the airport sector that make it difficult to define the market precisely. As explained in the Guidelines, the market power assessment should seek to analyse all the competitive constraints faced by GAL, regardless of whether they arise from within or outside the relevant market or markets.¹⁹
- 4.6 The CAA does not regard market definition as an end in itself, but rather as an economic framework within which to analyse the competitive effects of market definition to support and inform the CAA's regulatory policy.²⁰ The exercise of market definition consists, in essence, of identifying the effective alternative sources of supply for the customers of the relevant operator in terms of the products or services supplied and their geographical location.²¹
- 4.7 The Guidelines state that, wherever feasible, the hypothetical monopolist test should be adopted as a useful starting point for defining the relevant market.²² This test involves starting with the narrowest possible bundle of products or services and the smallest geographical area (normally those supplied by the operator in question) and assessing customers' switching reactions to a SSNIP above the competitive level, generally considered as being 5 to 10 per cent. If the price increase is unprofitable, due to customers switching away to substitute products and areas (or other suppliers entering the presumed market), the test is repeated by widening the set of products and geographic area to include additional substitutes until the price increase is profitable. What is then left is the narrowest set of products and geographic area over which a hypothetical monopolist could profitably sustain prices 5 to 10 per cent above competitive levels.

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

²⁰ The Guidelines, paragraphs 1.4, 3.3 and 3.4. See also OFT 403, paragraphs 2.1 and 2.6 and the EC Market Definition Notice, paragraph 2.

²¹ EC Market Definition Notice, paragraphs 7 to 9 and 13 and The Guidelines, paragraphs 3.6 to 3.9.

²² The Guidelines, paragraphs 3.10 to 3.12; OFT 403, paragraphs 2.5 to 2.13 and EC Market Definition Notice, paragraphs 15 to 19.

- 4.8 Although the SSNIP test is a useful starting point, it is a framework for approaching market definition rather than a prescriptive methodology. It is intended to be carried out by reference to the competitive price level with the result that it is more difficult to apply where the prevailing price levels observed are not reasonably close to the competitive price. As the OFT observes, the test assumes that the hypothetical monopolist is not subject to economic regulation that might affect its pricing behaviour. The test also assumes that competitors' pricing strategies are competitive and that all players are profit maximising. In addition, there may be other external considerations that might affect the uniformity and/or the profitability of the price increase.²³
- 4.9 As a result, and as noted in the Guidelines, it is therefore rarely possible to apply the SSNIP test in a precise manner due its limitations as well as data and evidential restrictions.²⁴
- 4.10 Given the particular circumstances relating to the historical common ownership and regulation of GAL and the other major London airports, Heathrow and Stansted, the CAA has been unable to carry out a formal SSNIP test. However, it has gathered a range of evidence, including catchment area analysis, passenger surveys, documentary evidence and the views of airlines and relevant airport operators on substitutability. This has been interpreted, so far as possible, within the hypothetical monopolist framework.

Product market

- 4.11 As defined in both EC²⁵ and OFT²⁶ guidance, a relevant product market comprises all those products and/or services that are regarded as interchangeable or substitutable by the consumer by reason of the products' characteristics, their prices and their intended use.

²³ OFT 403, paragraph 2.10 to 2.11 and 5.4 to 5.6. See also The Guidelines, paragraphs 3.15 to 3.16 and 3.24 to 3.25.

²⁴ The Guidelines, paragraph 3.13. See also the CC's 2009 BAA Report, paragraph 2.1.

²⁵ EC Market Definition Notice, paragraph 7.

²⁶ OFT 403, paragraph 2.5.

Geographic market

- 4.12 The geographic market *'comprises the area in which the undertakings concerned are involved in the supply of products or services and in which the conditions of competition are sufficiently homogeneous.'*²⁷
- 4.13 The relevant geographic market area can be distinguished from neighbouring areas because the conditions of competition are appreciably different. In addition, it is important to recognise that, as airports serve a number of different users, there may be different relevant geographic markets for different groups of users.²⁸
- 4.14 The assessment of competitive constraints for geographic market definition will include an analysis of the ability of airlines to switch away from an airport as well as the potential for passengers to switch between airports, whether independently or by following a particular airline.

Temporal markets

- 4.15 It is also possible to segment a market across time periods. In the case of airports, it may be relevant to differentiate across seasons or between different times of day and, in particular, between peak and off-peak periods. These temporal differences may be relevant where airlines and/or passengers do not regard different time slots as substitutes.²⁹

Market definition – the Consultation

- 4.16 Taking account of the statutory framework and the analysis in the Consultation, the CAA was minded to conclude that the focal product market was one or more airport operation services supplied by GAL in the core area at Gatwick, which was likely to consist of at least:³⁰
- the use of the runway and taxiways;
 - aerodrome Air Traffic Control (ATC³¹);

²⁷ The Guidelines, paragraph 3.8 and EC Market Definition Notice, paragraph 8.

²⁸ The Guidelines, paragraph 3.59.

²⁹ The Guidelines, paragraph 3.54.

³⁰ The Consultation, paragraphs 5.9 to 5.10.

³¹ Aircraft landing at Gatwick will only face charges from the airport operator for the aerodrome element of ATC. The approach service is provided by NATS (En Route) Plc as part of the London terminal manoeuvring area (LTMA) and charged directly to airlines operating in this space. At airports outside of the LTMA, the approach service would be included within this bundle of activities. It should be noted, however, that the CA Act formally excludes ATS as defined in the

- aircraft parking;
- ramp handling services;
- fuel and oil handling;
- the provision of facilities for aircraft maintenance;
- the provision of infrastructure needed for the provision of other airside and landside groundhandling services;³²
- the provision of facilities for check-in;
- baggage handling;
- security screening;
- facilities for holding passengers between arriving at the airport and departure (holding passenger facilities);
- facilities for the processing of airline staff arriving and departing the airport (airline staff processing facilities);
- the transit of passengers to and from the aircraft (in the case of a passenger airline) (passenger transit facilities); and
- the provision of facilities for the processing of cargo (in the case of an aircraft carrying cargo, either in bellyhold or as a cargo-only flight) (cargo processing facilities).

4.17 In addition, for FSCs and associated feeder airlines the CAA was minded to consider that aeronautical services will include³³:

- access to additional airport infrastructure to allow for facilities such as lounges and priority security lanes for premium passengers (premium passenger facilities); and

Transport Act 2000 from airport operations services. The ability to land and manoeuvre aircraft at and around an airport is also a key service that airport operators are required to provide as part of its services to airlines. In the UK these services are currently contracted by the airport operator with an air navigation service provider in a liberalised market. It is then up to the airport operator how they recover this cost in a similar manner to any other costs incurred, it is not a 'pass through' cost.

³² Ramp handling services, fuel and oil handling, and aircraft maintenance are groundhandling services as defined in Directive 96/67/EC. Groundhandling services are often provided by the airlines or to the airlines by third parties. However, the groundhandlers pay fees to the airport operator relating to use and access to infrastructure. In these cases the airport charges would still affect the airline through the charges levied on the groundhandlers.

³³ The Consultation, paragraph 5.34.

- airport facilities to transfer connecting passengers and their baggage between aircraft without the passengers leaving the airport, such as a transfer baggage system (integrated transfer facilities).

4.18 The CAA also considered that, based on the demand from airlines and the limited opportunities for supply side substitution by current commercial airports or new entrants in a reasonable timeframe, the product market should be segmented broadly on the basis of the following airline business models³⁴:

- Aeronautical services supplied to LCCs and charters.
- Aeronautical services supplied to FSCs and associated feeder airlines.

4.19 On the balance of the evidence of airport operators and airlines' views, airline switching, route overlap, passenger catchment areas, passenger switching and the CAA's analysis of such evidence, the CAA was minded to consider that there were two distinct geographic markets, one for each of the product markets that it had defined.³⁵

- For LCCs and charters the geographic market consisted of Gatwick and did not include Luton and/or Stansted or other regional airports.
- The evidence on the geographic market for FSCs and associated feeder traffic airlines was, however, less clear. The CAA considered that the geographic market could consist of either just Gatwick, or it may include Heathrow. However, in either case, the CAA considered that the constraints that Heathrow posed on GAL were likely to be asymmetric.

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

³⁴ The Consultation, paragraphs 5.61 to 5.63.

³⁵ The Consultation, paragraphs 5.220 to 5.225.

³⁶ The Consultation, paragraphs 5.233 to 5.237.

Stakeholders' views

- 4.21 GAL, in response to the Consultation, noted that:
- It agreed with the CAA that it was not appropriate to segregate the market based on passenger groups.
 - It did not consider that it was appropriate for the airport market to be segregated on the basis of airline business model as there was a generic market for 'aeronautical services to airlines and ground handlers'.
 - It considered that if segregation on business model were to be maintained that, at the very least, the FSC and associated feeder traffic market should extend to include Stansted, given available infrastructure there.
 - The CAA had not taken sufficient account of precedent with respect to the geographic scope of the market and had not sufficiently explained why it had departed from the precedent in this area.
 - The CAA had relied too heavily on passenger elasticity of demand³⁷ analysis and had not placed sufficient weight on the evidence it had presented in chapter 8 of the Consultation.
 - The CAA had misdirected itself in its assessment of the multi-sided nature of the airport and its implications for market definition.
- 4.22 BA and easyJet both supported the CAA's overall position on the market power assessment for GAL but considered that the product market definition should be widened. Both stakeholders considered the distinction between the business models of airlines is increasingly blurred and is somewhat artificial, especially at Gatwick.
- 4.23 VAA also contested the CAA's position on market segmentation by business model, although it considered its business model fitted clearly into the FSC business model.
- 4.24 GACC did not comment directly on the market definition but supported the CAA's overall findings on the level of market power held by GAL.

³⁷ The relevant elasticity is passengers' price elasticity of demand (PED) with respect to airport charges.

CAA views

4.25 With respect to GAL's concerns on the consistency of the CAA's market definition with precedent:

- The CAA does not consider that it is bound by its previous statements where the evidence or subsequent analysis suggests that its previous position should be changed. The CAA's departures from previous positions should, however, be supported with evidence or argumentation. If the evidence leads to different conclusions to those made in the past, the CAA cannot hold itself bound by previous positions.
- Much of the material that GAL refers to was undertaken a significant time ago under different legislation.
- A number of inconsistencies raised by GAL consider statements made by the CAA prior to the report by the CC into the joint ownership of the London airports and the judgments by the CAT that followed. It would therefore be inappropriate for the CAA to maintain previous positions that do not reflect the CC's analysis and the CAT's judgments. As such, the de-designation assessment of Stansted in 2007 and the comments made by the CAA in its initial considerations of the CC's investigation into BAA airports need to be considered in the appropriate context.
- It is widely accepted that market definition is a flexible tool that may alter depending on the question being asked. The CC's BAA airports investigation considered a wide question on the potential of the development of competition between the three BAA airports and sought to remove structural impediments to development of potential competition. The CC was not considering the narrower question that falls to the CAA under Test A, which is whether or not the airport operator has or is likely to acquire SMP in the particular market(s), in which it operates.
- The CAA's analysis is consistent with the CC's analysis but there are key differences in the questions asked under the respective legislation. Because of these differences, it does not follow that the divestment remedy imposed by the CC equates to an effectively competitive market in the short term – this is a point that was recognised by the CC.
- The divestment remedy imposed by the CC as a consequence of its airports investigation did not bring an immediate and effectively competitive market into existence. The CC's expectation was for competition to develop over time.

- The merger case law highlighted by GAL is concerned with whether a merger will weaken current competition observed within a market. This material is not considering the narrower question that falls to the CAA under Test A.
- Market definition is a time sensitive and context specific exercise. It is based on an analysis of the structure of the market and competition prevailing at a particular point in time.³⁸ Hence, an assessment will change over time as market circumstances evolve. A prior finding of dominance by the EC or a National Competition Authority (or even a national court) is therefore not binding.³⁹
- Since the publication of the Initial Views, the CAA has collected an extensive evidence base and cannot be expected to continue to hold the same views where new evidence points to the contrary.⁴⁰

Market definition – final decision

- 4.26 As noted earlier, although the SSNIP test is a useful starting point for defining the market, it is intended to be carried out by reference to the competitive price level. It is also rarely possible to apply the SSNIP test in a precise manner due its inherent limitations as well as data and evidential restrictions.⁴¹
- 4.27 Given the historical common ownership and regulation of GAL and the other major London airports, Heathrow and Stansted, the CAA has been unable to carry out a formal SSNIP test. However, the CAA has gathered evidence, including catchment area analysis, passenger surveys, documentary evidence and the views of airlines and relevant airport operators on substitutability to inform its analysis and this has been interpreted within the hypothetical monopolist framework.

³⁸ Bellamy & Child, EU law of competition, paragraph 10.018.

³⁹ For example, the EC has to start new analysis on the condition of competition in course of making new decisions: '*in the course of any decision applying Article 86 of the Treaty the Commission must define the relevant market again and market a fresh analysis of the conditions of competition which will not necessarily be based on the same considerations as those underlying the previous finding of a dominant position.*' Source: Case T-125/97 Coca-Cola v Commission [2000] ECR ii-1733, paragraph 82.

⁴⁰ Details of the CAA's response to GAL's concerns with the Consultation are available in the appendices that form part of this document.

⁴¹ The Guidelines, paragraph 3.13. See also the CC's 2009 BAA Report, paragraph 2.1.

- 4.28 The CAA has also carefully considered what price level it should use as a starting point for its analysis and has concluded that the current regulated airport charges are an appropriate benchmark (or proxy) for the following reasons:
- They are cost-based on the basis of an acceptable cost standard and are designed to allow the airport operator to earn a return consistent with the risk of its investment.
 - They are the prices faced by airlines, groundhandlers and passengers. Its use therefore limits the risks involved in gathering evidence around or hypothesising about an abstract pricing level.
 - Regulated prices have been used in several cases of market definition in regulated telecommunications across Europe. In particular, the EC has taken the view that regulated prices should be taken as the starting point for conducting a SSNIP test.
- 4.29 The CAA has found the submission and evidence provided by BA, easyJet, GAL and VAA on the scope of the relevant product market helpful.
- 4.30 Taking account of the statutory framework, the analysis outlined in the Consultation, responses to the Consultation and a starting point for the SSNIP that is the current regulated price, the CAA concludes that the relevant market for GAL is the provision of airport operation services to passenger airlines and that market limited to the services provided at Gatwick.
- 4.31 The particular service provided at Gatwick consists of a single product that consists of at least the following airport operation services:
- the use of the runway and taxiways;
 - aerodrome ATC;
 - aircraft parking;
 - the provision of access and infrastructure needed for the provision of other airside and landside groundhandling services;
 - the provision of facilities for check-in;
 - baggage handling;
 - security screening;
 - holding passenger facilities;

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

4.32 The CAA is aware of a number of deals to attract and grow airline traffic at Stansted, concluded by STAL over the months since Manchester Airport Group (MAG) took ownership in early 2013. These deals, which cover around 95 per cent of the passengers at Stansted, including the passengers covered by the two largest airlines at the airport (Ryanair and easyJet), are discussed in the market power assessment for STAL.⁴² While recognising that GAL may be facing greater competitive forces, the CAA considers that STAL operates in a different market. The CAA regards the deals at STAL and the recent developments at GAL (such as the easyJet slot purchase) as evidence that airlines are developing Gatwick and Stansted as complementary operations not substitutes and that the signing of these deals does not alter the overarching themes and specific concerns provided by the airlines on the market position of GAL.

4.33 The key rationale for the CAA's decision that the relevant market for GAL is the provision of airport operation services to passenger airlines that is limited to Gatwick is summarised below.

Product market – product bundle

4.34 The key rationale for the CAA's decision with respect to the product bundle is:

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

⁴² This document is available on the CAA's website.

- An airline would be required to bear the costs of all of these services to provide air transport services.⁴³
- In deciding whether to land at an airport, an airline would take account of the total bundle of charges rather than focusing on any one charge in isolation (even though services may be priced individually by the airport operator to reflect different cost drivers).
- The market power test is applied to the operator of an airport area, which is defined in section 9(1) of the CA Act as the person having overall responsibility for the management of all of the area. In determining overall responsibility, the CAA is directed to have regard to the extent that the person controls the matters listed in section 9(4) of the CA Act, which include the type, price and quality of services provided in the area as well as access to the area. Accordingly, while recognising that GAL may not directly supply each individual service at Gatwick, GAL has some degree of control, responsibility or influence on the pricing of the services as the infrastructure operator. The CAA also considers that its approach is consistent with the CC's approach in its consideration of product market definition for the BAA airports market reference.⁴⁴

*Product market – retail, property and car parks*⁴⁵

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

- Retail, property and car parks are not part of the relevant product market for this analysis. The CAA considers that it is more appropriate to define a separate and distinct market for the provision of facilities for retail activities and car parks. This approach is consistent with the approach adopted by the CC with respect to these activities.

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

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

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

- It is ultimately the decision by airlines' to provide services from Gatwick that drives passenger numbers at Gatwick. Airlines also take account of the needs of their passengers while they are at Gatwick and would therefore demand a certain level of facilities and services from GAL to accommodate this.
- Commercial revenues are complementary to aeronautical revenues rather than exhibiting the demand feedback that would be required in a multi-sided market. While the pricing of the aeronautical service bundle affects the overall passenger numbers at Gatwick, which in turn affects GAL's commercial revenue, GAL's pricing of commercial services at Gatwick does not affect the overall demand of either passengers or airlines for the aeronautical bundle.
- In practice, the price for retail activities is unlikely to affect passengers' choice of an airline or airport in a significant way. Therefore: (1) concessionaires' decisions are likely to be independent from decisions made by airlines in relation to aeronautical services; and (2) airlines' decision making and profitability is independent of that of the retail, property and car parks concessionaires.

Product market – other segmentations

4.36 The key rationale for the CAA's decision with respect to other segmentation is:

- While recognising that connecting passengers may be more price sensitive and face a different set of airports to choose from, it is not necessary to define a separate product market for connecting passengers as they consume a similar bundle of airport operation services to origin and destination (O&D) passengers. This position is consistent with the relevant case law (which has not segregated the market by connecting and O&D passengers). In cases where segregation has been considered it has been left open. GAL agrees with the CAA's position not to segment the market by passenger groups.
- Evidence was presented in response to the Consultation on the closeness of competition between the varying airline business models where they are in direct competition at an airport. Given this evidence, the identification of separate markets, segmented by airline business model is no longer appropriate. In reaching this conclusion the CAA is mindful that there are still significant operational differences between airline business models that affect their substitution opportunities.

- The CAA received no further representation on its decision to consider a separate cargo market at Gatwick and considers that there is no merit in developing an independent definition for cargo services at Gatwick. Further cargo is unlikely to effect the choice of airlines and users to purchase airport operation services at Gatwick given its size, and as it is not an essential service for airline operation as demonstrated by the operational requirements LCC business model and its prevalence at Gatwick. Consequently, it does not consider cargo separately within the analysis..

Product market – supply side product substitution

4.37 The key rationale for the CAA's decision with respect to supply side product substitution is:

- The substantial investment costs involved in supply side substitution would be of a level that would rule it out as a short term response to direct airport competition. Planning restrictions and other constraints also mean that entry or expansion of other airports is unlikely to occur within a reasonable time period.
- It would not be rational to consider that airlines would alter their fleets as a response to a change in airport charges due to the sunk costs present in their current fleets and the costs involved in acquiring and equipping new aircraft.
- Supply side substitution would therefore only occur based on currently available infrastructure.

Geographic market – demand side analysis

4.38 The key rationale for the CAA's decision with respect to demand side analysis as it relates to the geographic market is:

- The evidence presented by the airport operators suggests a possible wide set of airports as potential substitutes. The evidence from HAL of direct comparison between Heathrow and Gatwick suggests that Heathrow may be a higher quality product to that offered by GAL.
- While recognising the pan European nature of a number of GAL's largest customers, analysis of available evidence on competition for European airports suggests this does not pose a sufficient constraint on GAL's pricing behaviour to warrant the extension of the geographic market.

- The evidence from airlines shows a much narrower option of alternative airports for Gatwick. It appears that there is a very strong brand at Gatwick that differentiates it from other airports. However, it does not appear that there would be significant demand side substitution away from Gatwick to the north London airports. In addition, the evidence suggests that there would be a significant shift of demand to Heathrow. The evidence also suggests that airlines would switch from Gatwick to Heathrow even with current price differences.
- From a demand perspective, it appears that Gatwick sits in the middle of a hierarchy, in which substitution tends to be from Gatwick to Heathrow and to Gatwick from the north London airports. This is supported by airlines' views and observed switching.
- While both catchment area analysis and passenger preference analysis (which have their limitations) suggest choice for passengers departing the airport this is not conclusive for the purposes of geographic market definition. CAA elasticity analysis strongly suggests that passengers are unlikely to exercise the possible choice available to them (as the passenger elasticity of demand estimates available are lower than the CAA's estimate of the critical level).

Geographic market – supply side analysis

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

- With respect to the scope for geographic supply side substitution, there are a number of airports which have suitable infrastructure to compete with the facilities that GAL offers at Gatwick, in particular Heathrow and Stansted.
- However, given the current level of capacity constraints at Heathrow (there are a number of high and unique barriers to entry at Heathrow), this prevents Heathrow from being a credible substitute for services provided at Gatwick. As such, airlines at Gatwick could not easily switch to Heathrow as a result of a 5 to 10 per cent price increase by GAL.

- London City and Southend currently do not have the requisite infrastructure to compete with Gatwick across a sufficient range of aircraft. Additionally, capacity at Luton is a further limiting factor. As a result, in the event of a 5 to 10 per cent price increase by GAL the airport operators at London City, Luton and/or Southend could not, within an appropriate timescale, alter their facilities to provide an alternative supply for services for an airline operating at Gatwick.
- While both the supply side and passenger analysis suggests that all the London airports are potential substitutes (especially those with sufficient infrastructure to compete over the aircraft in the 75 to 100 tonne maximum takeoff weight), and there is ample capacity at Stansted such that sufficient capacity could be switched from Gatwick, demand side analysis shows the services that GAL offers at Gatwick are highly differentiated from other services available at the other London airports, which suggests a market that is limited to Gatwick.⁴⁶

Temporal markets

4.40 The key rationale for the CAA's decision with respect to supply side analysis as it relates to temporal markets is:

- While recognising that the declared capacity at Gatwick varies with both the time of day and the season and its pricing policy, the CAA considers that these changes do not affect the inherent competitive structure of the market between the seasons to the extent that the analysis would benefit from segmenting the market in this way. The CAA has also not seen evidence to suggest that passengers become more price sensitive between seasons. The CAA therefore considers that it is not appropriate to segment the market by time of day or season for its conclusions on market definition.

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

⁴⁶ In particular, the north London airports Luton and Stansted are not included in the relevant market as Gatwick remains the preferred airport of operation in terms of its location and other demand characteristics. For example, these north London airports are a less preferred option for airlines than operations from Gatwick as they do not have a combination of the necessary facilities and/ or they have a weaker catchment area and lower connecting passenger feed. In addition, Gatwick is considered by many airlines as the default airport for holiday flights, with its large catchment area and tour operator support networks.

CHAPTER 5

Test A: Market power – final decision

Legal framework

- 5.1 Market power is the ability, profitably, to sustain prices above the competitive level or restrict output or quality below competitive levels. The assessment of market power involves an analysis of the competitive constraints faced by the operator to see whether they are strong enough to prevent it from harming the process of competition.⁴⁷ Market power is not an absolute term but a matter of degree which varies according to the individual circumstances of the case.
- 5.2 As part of its assessment of market power, the CAA needs to identify the existence and the potential strength of the competitive constraints⁴⁸ within the relevant markets. It needs to do this to determine whether the relevant markets are subject to effective competition or not.
- 5.3 The Guidelines indicate that evidence on the market structure and market shares is commonly used in competition assessments. Market power is more likely to exist if an operator has a persistently high market share over time compared to its nearest rivals.⁴⁹
- 5.4 However, the Guidelines also note that market shares are not sufficient in isolation to determine the intensity of competition in the relevant market. In particular:
- The difficulties in defining the market precisely might limit the reliance that could be placed on any given measure of market share as an indicator of market power. It may be necessary to take account of constraints from outside the relevant market.

⁴⁷ OFT's Competition Law Guideline on Assessment of Market Power December 2004 (OFT 415), paragraphs 3.1 to 3.3.

⁴⁸ The OFT describes competitive constraints as 'market factors that prevent an undertaking from profitably sustaining prices above competitive levels': see OFT 415, paragraph 1.2 and DG COMP's Discussion Paper on the application of Article 82 to Exclusionary Abuses, paragraph 2.4.

⁴⁹ The Guidelines, paragraph 4.2 and OFT 415, paragraphs 4.2 to 4.3.

- There are aspects of airport markets that may reduce the reliability of market share as an indicator of market power. In particular, the differentiated nature of airports can reduce the reliability of market shares as an indicator of market power.⁵⁰

5.5 In the case of the London airports, there are additional reasons why market share may not be a reliable measure of the level of market power of airport operators, including:

- Long-term capacity constraints at Heathrow and, to a lesser extent, at Gatwick. As stated in OFT guidance, where competitors are unable to increase output substantially because of capacity constraints, *'the undertaking would be in a stronger position to increase prices above competitive levels than an otherwise identical undertaking with a similar market share operating in a market where its competitors were not close to full capacity'*.⁵¹
- Common ownership of the three largest airports (Heathrow, Gatwick and Stansted) for a considerable period of time under BAA. For example, BAA might not have operated or marketed its airports as substitutes for one another but may have marketed its airports as complementary to one another to prevent growth at one airport cannibalising growth at another.
- The level of substitutability of airports for different airlines can be influenced by (among other issues) infrastructure requirements, capacity constraints, strategic reasons and costs.

5.6 Notwithstanding these concerns, the CAA has calculated market shares for GAL by reference to the market definition that the CAA adopted based on the evidence available. In addition, the CAA has had regard to other market features, including buyer power, barriers to entry and the extent of potential competition through new entry and/or expansion⁵². In so doing, the CAA has analysed the likely reactions, both within and outside the relevant market, to any attempt by GAL to restrict output, increase prices above the competitive level and/or reduce quality at Gatwick below the levels that would be seen in a competitive market.⁵³

⁵⁰ CAA, Guidance on the assessment of airport market power, April 2011, paragraphs 4.5 to 4.7.

⁵¹ OFT, Assessment of market power, Understanding competition law, paragraph 4.4.

⁵² See The Guidelines §4.4 and chapters 5 to 7 and OFT 415, chapter 5.

⁵³ A discussion on the competitive price at Gatwick is outlined in chapter 4.

- 5.7 The CAA has also supplemented this analysis with other indicators of market power relating to the operator's behaviour and performance, including profitability measures, quality of service, efficiency and engagement with airlines and the effect of regulation to date.⁵⁴

Market power – the Consultation

- 5.8 Taking account of the analysis in the Consultation the CAA concluded that GAL had SMP in the two relevant markets that it had defined.
- 5.9 The CAA considered that the most likely underlying source of GAL's market power was the inherent attractiveness of the London market and its strategic importance to airlines, combined with capacity constraints in the London system, which limit the number and size of available alternatives.
- 5.10 The CAA also considered that GAL was likely to benefit from the expected tightening of capacity constraints across the south east of England over the Q6 period. This tightening can be expected to affect GAL's pricing behaviour. While larger aircraft and better utilisation of slots may help to address capacity constraints in the short term, the timescale required for adequate airport expansion/new entry to accommodate sufficient switching is likely to be too long to impose a constraint in the short term.
- 5.11 In addition (as noted in chapter 2), the Government has put on hold the expansion of the main London airports and the Airports Commission is not expected to issue its final report until summer 2015. As such, over the Q6 period, due to improving economic conditions and the lack of significant capacity expansion, the CAA considered that GAL's SMP was likely to endure.

Stakeholders' views

- 5.12 As outlined in chapter 3, the CAA received five submissions to the Consultation.
- 5.13 GAL considered, among other issues, that:
- The CAA's market definitions, at both the passenger and airline levels, are flawed and not supported by the facts or by precedent, some of which is very recent, and neither does the CAA, despite it purporting to do so, follow the analytical framework in its own Guidelines.

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

- The CAA had disregarded relevant evidence in a number of areas, including evidence relating to the competitive price level.
- The CAA had not undertaken an adequate analysis of marginal and aggregate competitive constraints.
- The CAA has introduced new lines of argument with inadequate explanation and in contradiction to its own and others' precedent. This is the case in its analysis of airline route overlaps and the 'strategic importance' of London.
- The CAA had over-stated the impact of capacity on competition, in ways which are inconsistent with the findings of the CC's recent decision in relation to material changes in circumstances, which found that capacity constraints would not undermine the ability of the former BAA airports to compete with each other, and inconsistent with the previous views of the CAA.
- The CAA has not factored into its assessment the additional constraints due to airports being multi-sided platform markets, and appeared to have not understood the concept fully.
- The CAA's analysis of indicators of market power was inappropriate and misjudged in a number of respects.

5.14 The GACC agreed with the CAA's analysis that the limited ability for airlines to switch away from Gatwick facilitated GAL being able to increase prices, act in an uncompetitive manner and not suffer a material loss in profits. The GACC also strongly agreed with the CAA's finding that there was no evidence to suggest that any airlines can exert any degree of buyer power over GAL.⁵⁵

5.15 BA agreed with the CAA's assessment of market power at Gatwick (regardless of its position on market definition). In coming to this view, BA noted that:

- The severe capacity constraints at Heathrow limited its (and other airlines') ability to credibly threaten to switch away from Gatwick.

⁵⁵ GACC, Response to CAA document: Consultation on Gatwick market power assessment.

- The capacity constraints at Gatwick and the valuable nature of its landing slots at Gatwick to airline business models result in the backfill of vacated slots. It also noted that GAL's market position was illustrated by Flybe's exit from Gatwick following year-on-year increases in charges and that GAL was not constrained by Flybe's exit as the slots were sold to easyJet.
- Its ability to swap routes between Gatwick and Heathrow had limited impact on GAL's behaviour. In swapping routes, it continues to use the same aircraft and slots so there is no disciplinary effect on the airport operator at either airport.
- It disputed the CAA's consideration that switching costs associated with the physical relocation of aircraft were low.

5.16 easyJet supported the CAA's analysis of competitive constraints at Gatwick and the limited ability of airline switching to constrain GAL. It agreed that allocating volume growth would have limited impact on GAL given the excess demand for early morning slots and limited capacity at other airports. It also considered that the option to use other switching methods to discipline GAL was limited.

5.17 VAA agreed with the CAA's assessment of market power at Gatwick. It noted that Heathrow was the only credible alternative airport but that it is capacity constrained. VAA also considered that the various forms of switching were not vigorous enough to constrain GAL's pricing. It also agreed with the CAA that switching costs for based aircraft were high and that the network effects present, due to connecting traffic, at Gatwick were important for route viability.

CAA views

5.18 The CAA notes all responses to the Consultation (and other submissions) and has considered them as part of its decision making process.

5.19 With respect to GAL's concern on market definition, the CAA, having considered the responses to the Consultation, now considers that the relevant market is the provision of airport operation services to passenger airlines and that this market is limited to the services provided at Gatwick. The CAA notes the various concerns that have been raised by GAL on this issue but, for the reasons outlined in chapter 4 (and appendix D), considers that its definition is appropriate.

- 5.20 With respect to GAL's concern that the CAA has fundamentally misunderstood the theory of multi-sided platforms and/or has underestimated the competitive constraint, the CAA does not agree. Non-aeronautical revenue can be treated as complementary to the aeronautical revenue.
- 5.21 On GAL's concern that the CAA has not considered the cumulative effect of competitive constraints in its analysis, the CAA also disagrees. While the reasoning on each issue was set out separately in the Consultation, the cumulative effect of constraints has been considered in reaching its conclusion. This approach of looking at different competitive constraints individually and as a whole is in line with the Guidelines and has been continued in this document including the attached appendices.
- 5.22 Evidence also shows that the viable switching opportunities for airlines at Gatwick are limited. Although there is capacity at the north London airports these airports are clearly a less preferred option for airlines than operations from Gatwick, either because they do not have the necessary facilities, runway length, feeder traffic or wealthy catchment area. With respect to Heathrow, the evidence from airlines clearly suggests that it is a preferred airport to Gatwick. However, the evidence also clearly shows that there are a number of high barriers to entry for airlines at Gatwick which prevent effective switching to Heathrow in response to a price increase.
- 5.23 Connected to the above, the CAA agrees with GAL's finding that there is the possibility of some expansion of capacity at Heathrow. However, there is not sufficient available capacity at Heathrow to expand new operations or to allow for significant switching. As such, the credibility of any constraint posed by Heathrow on GAL's pricing policy is, for the foreseeable future, limited.
- 5.24 In addition, with respect to GAL's concerns that there was a lack of marginal route analysis, the CAA recognises that more information on this issue would be beneficial to its analysis. The CAA therefore sought additional data from the airlines and has undertaken appropriate analysis of marginal routes to inform its decision.
- 5.25 On the CAA's use of prevailing prices in its analysis (a price GAL considers is significantly below the competitive price level), the CAA continues to consider that the use of the prevailing regulated price as the starting point of its analysis is reasonable. The CAA's analysis, supported by studies from two independent consultants, suggests that GAL's pricing is within the range that could be considered competitive. Therefore, the

CAA's consideration of switching, the importance of London, elasticities and critical loss analysis is based on an appropriate starting price.

- 5.26 With respect to GAL's concern that the analysis on the indicators of market power was inappropriate and misjudged, the CAA considers that the indicators can provide useful information to inform an assessment of market power, particularly when a number of them are pointing to the same conclusion.

Final decision

- 5.27 Taking account of the analysis outlined in this document (including the appendices), the CAA has concluded that GAL has SMP in the provision of airport operation services to passenger airlines at Gatwick.

- 5.28 The CAA considers that airlines, in response to an increase in airport charges or decline in service quality, are unlikely to be able to credibly threaten GAL with switching to alternative airports to such a degree that they would be able to effectively discipline GAL's pricing behaviour. The CAA has come to this view considering the individual and cumulative effect of a number of issues, including:

- Significant costs to switching.
- Risk of competitive backfill to vacated slots.
- Tightening capacity.
- Lack of credible supply alternatives.
- Lack of countervailing buyer power.
- An insufficient response from passengers as a result of GAL's pricing to discipline its behaviour.
- Other indicators of market power, including market shares, efficiency, pricing, and engagement and commercial negotiations.

- 5.29 In particular, the basis for the CAA's finding of SMP in the market for the provision of airport operation services to passenger airlines at Gatwick is that:

- GAL has 100 per cent of the market (irrespective of whether it is measured by passenger numbers or ATMs) and that this market share establishes a rebuttable presumption of a position of SMP in the relevant market. However, the CAA recognises that market share alone may not be sufficient to establish a position of SMP.

- FSCs reducing marginal frequencies or removing routes and LCCs rebasing aircraft appears to be the most likely type of switching that airlines might undertake in an attempt to constrain GAL's pricing. However the costs associated with this are likely to outweigh any benefits that might arise from constraining a 5 to 10 per cent price increase.
- Switching costs appear to be on a continuum with large based airlines facing higher costs at one end and smaller inbound operations bearing lower costs at the other. However, this is a generalisation and some small inbound operators may face costs similar to the large based carriers if the Gatwick routes are their only service into the UK.
- The network effects from the connectivity at Gatwick are likely to contribute an additional switching cost to a number of airlines at Gatwick (airlines with significant levels of connecting passengers represent around a third of GAL's passenger base).
- There is an additional constraint imposed on airlines serving London, given its unique mix of features.
- Viable switching opportunities for airlines at Gatwick are limited. While there is capacity at the north London airports, these airports are clearly a less preferred option for airlines than operations from Gatwick, either because they do not have the necessary facilities, runway length, feeder traffic or (wealthy) catchment area. With respect to switching to Heathrow, the evidence suggests that it is a preferred airport to Gatwick. However, the evidence also shows that there are a number of high barriers to entry, including the cost and availability of slots, which prevent effective switching to Heathrow as a reasonable response to a price increase.
- While the use of larger aircraft and relatively small scale expansion is possible at Heathrow, the timescale required for adequate airport expansion/new entry to accommodate sufficient switching is likely to be too long to impose a constraint on GAL's pricing over the Q6 period.
- Department for Transport (DfT) and GAL passenger forecasts suggest that over the next five years the tightening of capacity constraints across the London airports are likely to result in an increase in the degree of market power. In addition, with the Airports Commission plan to report final proposals in 2015, it is highly unlikely that any new capacity will be available before 2025 at the earliest;

- With respect to countervailing buyer power, some airlines have a sufficient share of GAL's business to suggest that they might have buyer power. However, the evidence suggests that these airlines have limited ability to credibly threaten to switch sufficient capacity away from Gatwick that would give them buyer power in their negotiation of terms with GAL. This is the result of a number of factors including the capacity constraints, presence of backfill and the credibility and effectiveness of alternative switching options.
- The CAA is aware that GAL is negotiating having signed a number of bilateral agreements with its airlines under the regulatory commitments framework and considers that these agreements do not impact its considerations under test A. The CAA considers that these agreements would form part of the overall regulatory settlement for GAL and it is unclear whether they would have resulted absent regulatory intervention. Therefore there is circularity in the argument for taking account of these agreements into account in the decision on the MPD.
- On balance, the indicators of market power, particularly GAL's performance with respect to efficiency, pricing, engagement of its customers into its decision making process and its behaviour in relation to commercial negotiations confirm rather than rebut the presumption of SMP that the market shares would initially suggest would be present.

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

Conclusion on Test A

5.31 In light of the CAA's findings on market definition, competitive constraints and indicators of market power, the CAA concludes that GAL currently has SMP in the relevant market and that its market power is unlikely to be eroded over the Q6 period.

CHAPTER 6

Tests B and C

Background

- 6.1 As outlined in chapter 1, section 3 of CA Act prohibits the operator of a dominant area at a dominant airport from requiring payment of charges without a licence. The CA Act only permits economic regulation of an airport operator and the granting of a licence by the CAA if all three components of the market power test set out in section 6 of the CA Act are satisfied.
- 6.2 Having determined that Test A of the market power test has been met, this chapter briefly outlines the CAA's views on whether or not Tests B and C are also met.

Test B conclusion

- 6.3 In the Consultation, the CAA considered that given the potential detriment to users of air transport services and the difficulties in pursuing potential exploitative vertical abuses, in light of the case law, that for GAL, competition law was unlikely to be sufficient to curtail abusive behaviour.
- 6.4 The CAA has carefully considered the representations from stakeholders to the Consultation. Its final conclusion is that competition law does not provide sufficient protection against the risk that GAL may abuse the substantial market power identified in the CAA's consideration of Test A.
- 6.5 The detailed reasoning and evidence supporting its conclusion on Test B are set out in appendix I on an issue by issue basis.

Test C conclusion

- 6.6 In the Consultation, the CAA considered that the benefits of licence regulation outweighed the costs to air transport users.
- 6.7 The CAA has carefully considered the representations from stakeholders.

- 6.8 The detailed reasoning and evidence for its conclusion on Test C are set out in appendix J on an issue by issue basis. The CAA's judgement is that the benefits of licence regulation are likely to outweigh the adverse effects, whether by reference to a licence-backed commitments (LBC) Licence or Licensing Generally.
- 6.9 In summary form, the CAA's reasons are as follows.
- As the market power assessment has been undertaken in parallel to CAA's Q6 review of the form of regulation for GAL after April 2014, the CAA considers that these unique circumstances allow it to assess Test C on the basis of both licence regulation in general as well as on the specific form of licence regulation which it considers to be most appropriate for GAL, in this case GAL's proposed commitments backed by a licence and monitoring framework.
 - The CAA has assessed the merits of the LBC Licence and licence regulation against the No Commitments Counterfactual (no licence at all) as well as an alternative counterfactual, based on GAL's commitments ("the Commitments Counterfactual").

Commitments Counterfactual

Benefits of a LBC Licence compared to commitments

- 6.10 The CAA has taken account of the benefits of existing legislation, in terms of the ACRs, AGRs and competition law. The CAA considers that the legislation provides limited protection against the risk of abuse of SMP in terms of price, efficiency, service quality and investment.
- 6.11 On the Commitments Counterfactual, the CAA concludes that a LBC Licence will contain the same advantages as the commitments in terms of flexibility, commerciality and increased certainty from the 7-year period. However it will also provide additional benefits over and above the commitments as incorporating the commitments within a statutory framework will address a number of concerns with the commitments.
- 6.12 The CAA has identified the following benefits of a licence which are presented under subheadings.

- **Price:** GAL's commitments price of RPI+0.0 per cent per year based on the blended average rate resulting from its published rate and rates under concluded bilateral contracts is above the CAA's assessment of a fair price forecast as part of the Q6 review. The CAA considers that in the absence of a licence GAL will be able to increase prices leading to a detriment to users. By backing the commitments with a licence the CAA will be able to monitor and intervene, if GAL does not reduce prices in line with the fair price. In that way, it can ensure that charges that are actually applied are consistent with the fair price and if necessary modify them accordingly. In addition, the commitments include a pass through of the costs of a second runway which could result in significant costs to users without due regulatory safeguards that the costs are efficient and incurred in users' interests. Under the monitoring regime the CAA will continue to ask GAL to undertake a shadow RAB calculation in case there is a need to re-introduce tighter regulation. Consequently, licence regulation is likely to provide additional benefits in this area by not allowing price increases that would not be in the general interest of passengers or which would be detrimental to competition.

- **Efficiency:** The impact of the commitments on efficiency is likely to be mixed, with benefits from retaining the gains from efficiency improvements for longer (at least seven years, compared to typically five years from licence regulation), but adverse effects from a looser control on prices. However, the CAA considers that a LBC Licence would have incremental benefits as it would encourage lower prices to be charged under the commitments and therefore provide greater incentives for GAL to be efficient. The CAA considers licence regulation would create greater efficiency incentives for the airport operator than competitive pressure, as GAL has SMP (and hence the competitive pressure to improve efficiency would be weak). The additional benefits of a LBC Licence approach include additional incentives from the threat of regulation, possibility to ensure the efficiency of pass through costs and possibility to introduce licence controls if inefficiency is identified.

- Service quality: The commitments include much the same service quality regime as used for Q5 although they do not include bonuses paid by airlines. However, the limits placed on the total rebates, the absence of rebates if failures continue for more than six months in a financial year and the offsetting impact of airline service quality failures might reduce GAL's liability for repeated service quality failures, which may act against passengers' interests. Again, the LBC Licence would enable the CAA to oversee GAL's service quality performance and intervene to modify or enforce the licence where appropriate.
- Investment: The commitments do not include a commitment to any outputs from the capital plan apart from maintaining the service quality regime and a commitment to a minimum spend of £100 million per year over the term of the commitments. While some investment will be required to meet service quality requirements, other investments would bring wider benefits. Given the position of the SMP of the airport operator there is a risk that some beneficial enhancements for passengers would not be taken forward. The consultation arrangements are also less onerous than those under the Q5 settlement. Licence-backed commitments would provide benefits from allowing the CAA to intervene if capital investment that was in passengers' interests was not being taken forwards.
- More specifically, licence-backed commitments would provide additional benefits in terms of operational and financial resilience.

Enforcement of a licence compared to commitments

- 6.13 For commitments to be an effective substitute for licence regulation they must be clear and enforceable so that airlines and other stakeholders have confidence that the benefits GAL say would accrue from the commitments would be delivered in practice. Those benefits must also further the interests of passengers and cargo owners as the 'users' are protected by the CAA's statutory duties.
- 6.14 The CAA considers that GAL's current proposal to include commitments in the CoU raises a number of concerns about the substance and enforceability of the provisions. In particular, the CAA is concerned that the CoU (including the commitments) would be enforceable by airlines only. As such, they will not deliver as much benefit to passengers and cargo owners, as their interests might not always align with those of the airlines.

- 6.15 This would compare to a licence enforceable by the CAA which has a statutory duty to further the interests of passengers and cargo owners. Licence-backed commitments will enable the CAA to have regulatory oversight so that it can enforce the commitments directly in passengers' interests and ensure that the commitments promote competition as appropriate.
- 6.16 In addition, the CAA is concerned about the potentially slow speed of any response to failures to comply with the commitments and any issues that might arise could allow user detriment to persist for some time unchecked. The process of re-introducing licence regulation may take two to three years. These issues could be avoided under licence regulation, where new licence conditions could be introduced relatively quickly.
- 6.17 By incorporating the terms of the commitments within the statutory licensing framework, the CAA would have a range of regulatory and enforcement measures, for example by either enforcing the commitments as a condition of the licence itself or modifying and/or introducing new licence conditions as required (subject to the safeguard of appeals). In appropriate cases, the CAA would be entitled to proceed with interim remedies or to impose penalties for a breach. A licence is therefore likely to lead to a quicker, more efficient resolution of issues. Importantly, a breach of the licence-backed commitments could lead to a directly actionable right of damages for any person affected by the breach (including passengers and cargo owners as well as airlines). Accordingly, there are real benefits from the licence framework in terms of enforcement and deterrence that are not provided by the voluntary contractual commitments on their own.

Adverse effects of a licence to users compared to the Commitments Counterfactual

- 6.18 A licensing approach will entail direct costs of staff and consultancy associated with a regulatory review. GAL estimated its costs of the existing RAB-based regulatory regime are around £8 million per year, mainly incurred in consultation. The CAA considers that these costs are overstated and could be half that estimated by GAL. In addition there would be CAA costs, estimated to be around £1 million per year, and airline costs of up to £1 million per year. These costs of regulation would be significantly reduced under the LBC Licence, where the main incremental costs would be to the CAA from monitoring, and where appropriate enforcing the regime.

- 6.19 Commitments without a licence are unlikely to be cost-free and the potential cost savings would be significantly reduced and perhaps eliminated if there is not effective partnership working between GAL and the airlines, and if there were numerous complaints to the CAA under competition law or the ACRs/AGRs. Airline feedback on the commitments has, at best, been mixed.
- 6.20 Licence regulation also carries potential adverse effects in the form of management distraction, and the creation of perverse incentives, for example potential distortions to capex incentives under a RAB-based framework, or the potential for regulatory gaming. Commitments on their own could avoid management distraction as their enforcement would be linked to commercial negotiations. They could also avoid potential distortions to competition and have the advantage that bilateral contracts are more likely under commitments. However, all of these advantages would still be available under the LBC Licence as GAL would have the same, if not greater incentives to agree bilateral contracts.
- 6.21 The adverse effects of licence regulation would be minimised under the LBC Licence, as the focus would remain on the airport operator and airline relationship and the main focus of the licence and CAA involvement would be to enforce the commitments or address problems that arose, minimising perverse incentives and regulatory gaming. For these reasons, the CAA considers that licence-backed commitments are more proportionate than the alternative of a full RAB licence and will minimise any costs and potential distortions to competition.

Balancing and proportionality assessment

- 6.22 Overall, the CAA welcomes GAL's commitments proposal. However, the CAA is not sufficiently convinced that the enforceability of and the substantive terms of the commitments proposal assures benefits to passengers and cargo owners to a sufficient degree. Further, the CAA does not consider that the revised commitments offer sufficient protection against the potential abuse of SMP, in particular through excessive pricing, inefficiency, inferior service quality or investment by reference to the topics most commonly addressed by economic regulation.

6.23 Against this the CAA has considered the potential adverse effects of the LBC Licence in terms of the direct costs, distortions to incentives, management distraction and crowding out of a more commercial approach etc. The CAA notes that these adverse effects are minimised through licence-backed commitments given the focus of the regime on the airport operator-airline relationship and the focus of the licence is to ensure the regulatory oversight and enforceability of the commitments. Overall, the CAA's judgement is that the benefits of licence-backed commitments are likely to outweigh the adverse effects.

Benefits and adverse effects of licence regulation in general compared to commitments

6.24 The benefits of licence regulation compared to commitments are similar to the benefits of the specific form of licence-backed commitments. In particular licence regulation will provide benefits in terms of:

- enforceability from the ability to enforce in passengers' interests, allow important protections in the CA Act such as the right of appeal to the CMA, facilitate timely regulatory intervention and allow a range of regulatory and enforcement measures;
- the ability to set tighter controls on prices than available under the commitments, increase efficiency from the threat of regulatory action and regulatory scrutiny of cost pass throughs in particular second runway costs;
- service quality in particular from the ability to undertake enforcement action for repeated service quality failures;
- investment incentives from ensuring that investment is undertaken in passengers' interests; and
- improved operational and financial resilience.

- 6.25 Against these benefits have to be weighed the adverse effects. These would include the direct costs of licence regulation, which based on GAL's estimates of its own costs could be £10 million, although the CAA considers that GAL's estimates are substantially overstated. In addition the CAA notes that commitments themselves are not costless and cost savings would be reduced if not removed if the regime breaks down. Licence regulation can also encourage regulatory gaming, although it would not necessarily lead to any more gaming than normal commercial negotiations, and could crowd out a commercial approach, although the CAA notes that is unlikely to happen entirely and the bilateral contracts that are currently under discussion are somewhat linked to the CAA's regulatory proposals. Licence regulation can also cause management distraction, although even under RAB-based regulation this is unlikely to significantly impact on operational staff. Licence regulation can also distort incentives, for example the potential distortions to incentives on capex from RAB-based regulation.
- 6.26 The CAA considers that the appropriate form of regulation will depend on the circumstances of an individual airport operator and in particular the risks of abuse.
- 6.27 Overall, at a high level of generality, the CAA considers that a licensing regime offers the potential for substantial benefits for passengers over the commitments, in terms of enforceability, price, efficiency, investment incentives and other impacts. There will also be adverse effects to some degree. The extent depends on the model of licensing adopted. Any particular model of licence regulation would have to satisfy the CAA's general duties, including that of targeted, necessary and proportionate intervention. The CAA has identified one particular means of licence regulation amongst the range of possibilities, in respect of which it has concluded that the benefits are likely to outweigh the adverse effects, namely the LBC Licence. The CAA has therefore concluded that the benefits of licence regulation in general are likely to outweigh the adverse effects in the circumstances of the present case.

The alternative counterfactual: No Commitments

- 6.28 For completeness, the CAA has briefly considered the alternative counterfactual under which GAL does not maintain those commitments, the "No Commitments Counterfactual".

- 6.29 The commitments clearly offer substantial benefits for users, even if not backed by a licence. On the face of it, users are significantly worse off on the No Commitments Counterfactual than under the Commitments Counterfactual. The CAA has noted above the limited protection afforded to users by Existing Regulation and competition law.
- 6.30 Thus, overall, the benefits of regulation (under either the LBC Licence or Licensing Generally scenarios) are likely to be much greater when compared to the No Commitments Counterfactual than under the Commitments Counterfactual.
- 6.31 The CAA accepts, however, that the direct costs of regulation are likely to be higher on the No Commitments Counterfactual than under the Commitments Counterfactual. This is because the commitments themselves cover a range of matters (including price and service standards) that would, or might otherwise form part of licence regulation, although these costs should be lower than the costs of the existing regulatory regime, not least due to the lower capex consultation requirements.
- 6.32 The CAA's judgement is that, compared to the situation under Existing Regulation with no commitments in place, the benefits of licence regulation would be likely to outweigh its adverse effects under either the LBC Licence or Licensing Generally scenario.

Conclusion

- 6.33 Overall, having regard to all the costs and benefits above, whether on a quantitative or qualitative basis, the CAA considers that Test C is met in relation to GAL as the airport operator and that, from the perspective of passengers, the benefits of regulating GAL by means of a licence are likely to outweigh the adverse effects.

CHAPTER 7**Conclusion**

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

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

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

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

7.3 This market comprises the following airport operation services provided at Gatwick:

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

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

7.4 The CAA, having regard to its general duties under the Act and the relevant notices and guidance issued by the EC and the OFT, has determined that GAL has SMP in the relevant market and that this is expected to persist over the Q6 period. Consequently, the CAA determines that Test A of the CA Act is met in relation to GAL.

7.5 The CAA has also determined that competition law alone is unlikely to provide sufficient protection against the risk that GAL may abuse the substantial market power identified in the CAA's consideration of Test A. That is, the CAA has determined that Test B has been met.

7.6 In addition, the CAA has determined that the benefits to current and future air transport users of licence regulation outweigh any adverse affects. That is, the CAA has determined that Test C of the CA Act is met.

7.7 Given that Tests A, B and C are met in relation to GAL, being the operator of the airport area of Gatwick, the CAA has determined that the market power test in section 6 of the CA Act is met.