

Market Power Test Guidance

CAP 1433



Published by the Civil Aviation Authority, 2016

Civil Aviation Authority,
Aviation House,
Gatwick Airport South,
West Sussex,
RH6 0YR.

You can copy and use this text but please ensure you always use the most up to date version and use it in context so as not to be misleading, and credit the CAA.

First published August 2016

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

The latest version of this document is available in electronic format at www.caa.co.uk, where you may also register for e-mail notification of amendments.

Contents

Contents.....	1
Chapter 1.....	5
Introduction	5
Chapter 2.....	7
Legal framework.....	7
Relevant definitions.....	7
Airport operation services.....	7
Airport area	8
Core area	8
Dominant airport.....	9
Operator determination	9
The MPT	10
Test A.....	11
Test B.....	11
Test C.....	12
Application of the tests	13
Our general duty	13
Regulatory principles.....	14
Standard of proof	14
Process for appeals.....	16
Once an MPD has been made	16
Chapter 3.....	17
Market power determination process	17
Initiating an MPD.....	17

Material change of circumstances	18
Requesting an MPD	18
Timetable and stages	21
Notice of commencement.....	21
Timetable	21
Stages	21
Powers to gather information	24
Confidentiality.....	24
Requirements under CAA12	24
Data Protection Act 1998 principles	25
Freedom of Information Act 2000.....	26
Our internal processes	26
Chapter 4.....	28
Test A: Market definition and market power	28
Our general approach	28
How Test A is met	29
Our approach to market definition for MPDs	30
Defining the relevant market	31
General	31
The Hypothetical Monopolist Test	32
Product and geographic market	34
Assessing market power	35
Summary.....	38
Chapter 5.....	39
Test B: Adequacy of competition law	39
Our general approach	39
Competition law.....	40

The concept of abuse.....	41
Types of abuse most relevant to the assessment of Test B	42
Competition law remedies	44
Summary	44
Chapter 6.....	46
Test C: Adverse effects/benefits of regulation.....	46
Our general approach	46
<i>Ex-ante</i> licence regulation and <i>ex-post</i> powers	47
<i>Ex-ante</i> licence regulation	47
<i>Ex-post</i> powers	49
Making the comparison	52
Airport operator that does not hold an economic licence.....	53
Airport operator that holds an economic licence	53
Areas considered under Test C.....	54
Benefits of economic regulation	54
Adverse effects of economic regulation.....	55
Assessing <i>ex-ante</i> licence regulation and <i>ex-post</i> powers	57
Summary	58
Chapter 7.....	60
Once an MPD has been made	60
Introduction	60
Once an MPD has been made	60
If the MPT is met by an operator without a licence.....	60
If the MPT is met by an operator with a licence.....	61
If the MPD concludes that the MPT is not met	63
Sectoral regulation and subsequent MPDs	63
Appendix A	65

Possible initial evidential requirements..... 65

Chapter 1

Introduction

- 1.1 The Civil Aviation Act 2012 (CAA12) requires that we, the CAA, regulate an airport operator by means of an economic licence if the Market Power Test (MPT) set out in section 6 of CAA12 is met. This document sets out how we intend to apply the MPT and make Market Power Determinations (MPDs) under sections 6 and 7 of CAA12.
- 1.2 This Guidance also outlines our powers under CAA12 to make determinations on which entity has overall responsibility for the management of an airport area (called operator determinations and referred to in this Guidance as ODs).¹
- 1.3 We are providing this Guidance to illustrate how we are likely to proceed in conducting MPDs and ODs. It provides a framework of relevant considerations we are likely to take into account. We will have regard to this Guidance when carrying out ODs and MPDs. However, it is not intended to be applied rigidly. We must assess each case on its own facts and, where appropriate, we will explain why we have adopted a specific approach which may deviate from this guidance.
- 1.4 This Guidance is based on the practical understanding that we have gained from the MPDs we made in 2014², and applicable Competition and Markets Authority (CMA) and European Commission (EC) competition law notices and guidance. We will amend and update this Guidance, as appropriate, to reflect learning and changes in best practice.

¹ The CAA can make an operator determination to determine whether an operator of an airport area has or does not have overall responsibility for the management of all of that area, pursuant to sections 9-11 of the Civil Aviation Act 2012.

² We published four MPDs in January and March 2014. The MPDs we have undertaken are available from: www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Licensing-and-price-control/Airport-Market-Power-Assessment/
We now regulate Heathrow and Gatwick airports through licences. These licences came into effect on 1 April 2014. The licences are available from: www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Licensing-and-price-control/Airport-economic-licensing-and-price-control/

- 1.5 This Guidance is not a definitive statement of the law, nor is it a substitute for individual parties seeking their own legal advice on the application of CAA12.
- 1.6 Earlier guidance that we published in 2011, on assessing market power of airports³, prior to the enactment of CAA12 has been withdrawn.⁴
- 1.7 This document is structured as follows:
- Chapter 2 sets out the high level test and process for appeals;
 - Chapter 3 outlines the process we intend to apply to undertaking an MPD;
 - Chapter 4 sets out particular issues relating to Test A of the MPT;
 - Chapter 5 sets out particular issues relating to Test B of the MPT;
 - Chapter 6 sets out particular issues relating to Test C of the MPT;
 - and
 - Chapter 7 explains what happens after an MPD has been made.

³ 'Guidance on the assessment of airport market power' April 2011

⁴ See paragraph 2.6 of the CAA's 'CAP 1235 Guidance on the Application of the CAA's Competition Powers', published in May 2015, which is available from: www.caa.co.uk/CAP1235

Chapter 2

Legal framework

2.1 This chapter explains the legal framework for MPDs and ODs, and the process for appealing those determinations. It is set out in the following sections.

- Relevant definitions;
- Operator determination;
- The MPT;
- Application of the tests;
- Process for appeals; and
- Once an MPD has been made.

Relevant definitions

2.2 There are a number of phrases used within this document that are drawn directly from the legislation. These definitions are set out below.

Airport operation services

2.3 “*Airport operation services*” (AOS) refers to a group of services provided at an airport for a variety of purposes including⁵:

- the landing and taking off of aircraft;
- the manoeuvring, parking or servicing of aircraft;
- the arrival or departure of passengers and their baggage;
- the arrival or departure of cargo;
- the processing of passengers, baggage or cargo between their arrival and departure;
- the arrival or departure of persons who work at the airport; and
- permitting a person to access or use land that forms part of an airport or facilities at an airport for any of the above.

⁵ Section 68(1) CAA12 and 68(5) CAA12

2.4 In particular, AOS includes⁶:

- groundhandling services described in the Annex to Council Directive 96/67/EC of 15 October 1996 on access to the groundhandling market at Community airports (as amended from time to time);
- facilities for car parking; and
- facilities for shops and other retail businesses.

2.5 AOS does not include⁷:

- air transport services;
- air traffic services; or
- services provided in shops or as part of the other retail businesses.

Airport area

2.6 The “*airport area*” means an area that consists of or forms part of an airport.⁸ The airport area bounds the scope of an MPD finding and feeds through to any licence imposed in the light of it. Broadly speaking, an airport area is the physical area of the airport. This may consist of all or part of the airport campus and potential sites that are physically separated from the airport campus. It includes areas of land and buildings or other structures in part or as a whole.

Core area

2.7 The “*core area*”, is a subset of the wider airport area and effectively covers the facilities that are essential to the operation of an airport in relation to an airport. It means:

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

⁶ Section 68(3) CAA12

⁷ Section 68(4) CAA12

⁸ Section 6(7) CAA12

Dominant airport

2.8 A “*dominant airport*” means an airport where we have made a determination that all or part of its core area is considered to be dominant.⁹

Operator determination

2.9 The operator of an airport area is the entity with overall responsibility for the management of all of the airport area.

2.10 Section 10 of CAA12 set outs how we may make an OD to determine whether, in a particular case, a person has overall responsibility for the management of an airport area.

2.11 We must make an OD if we are asked to do so by the entity that has control over the area.¹⁰ However, we do not have to do so if:

- we have previously made an OD to the effect that the entity requesting the determination does or does not have overall responsibility for the management of the airport area;
- we have not published a notice withdrawing that determination; and
- we consider that there has not been a material change of circumstances since that determination.¹¹

2.12 The requirement also does not apply if we consider that it is possible to ascertain whether the entity has overall responsibility for the management of the area from:

- information that is in the public domain; and
- information that is in the entity's custody or under the entity's control.¹²

⁹ Section 5(1) and 5(2) CAA12

¹⁰ Section 10(5) CAA12

¹¹ Section 10(6) CAA12

¹² Section 10(7) CAA12

- 2.13 In circumstances where we have discretion, we will only undertake such a determination where we consider the situation as presented is not clear.
- 2.14 We may treat a request for an OD in respect of an airport area as if it were:
- a number of requests in respect of a number of airport areas that consist of or include different parts of that area; or
 - a request in respect of an area that includes all of that area.¹³
- 2.15 In making an OD, we must have regard to:
- any regulations made about ODs; and
 - the extent of control the entity has over the types of services that are or may be provided in the area, the prices that are or may be charged for services provided in the area, the quality of services provided in the area, access to the area, and the development of the area.¹⁴
- 2.16 As soon as practicable after making an OD, we must:
- publish a notice of the determination; and
 - send a copy of the notice to the entity in respect of whom the determination was made and to such bodies representing airport operators or providers of air transport services as we consider appropriate.¹⁵

The MPT

- 2.17 CAA12 prohibits the operator of a “*dominant airport*” from levying charges for the use of its facilities without an economic licence issued by us.¹⁶ An airport operator is considered dominant if we make a determination that

¹³ Section 10(8) CAA12

¹⁴ Section 104(4) CAA12

¹⁵ Section 11 CAA12

¹⁶ Section 3 CAA12

the MPT is met in relation to the airport or part of the airport (the airport area) and publish a notice of that determination.¹⁷

2.18 There are three components of the MPT - Test A, Test B, and Test C. These are set out in section 6 of CAA12. Each component must be met for us to make a determination that an airport operator is the operator of a dominant airport.

Test A

2.19 Test A requires that we consider whether the relevant operator, either alone, or taken with such other persons as we consider appropriate, has, or is likely to acquire, substantial market power (SMP) in a market for one or more types of AOS provided within all or part of the airport area.¹⁸

2.20 Test A is met if¹⁹:

- the market is for one or more of the types of AOS provided in the airport area (or for services that include one or more of those types of service); and
- geographically the market consists of, or includes all or part of, the airport area.

2.21 The test must be conducted on the basis of the prevailing regulatory regime absent any licence regulation imposed by us. Presently we would, therefore, not attempt to remove any effects from the Airport Charges Regulations 2011 (ACRs) or the Airport (Groundhandling) Regulation 1997 (AGRs) or other general legislation that is applicable to the operation of an airport when conducting the test.

Test B

2.22 Test B requires that we consider whether competition law does not provide sufficient protection against the risk that the relevant operator may engage in conduct that amounts to an abuse of that SMP.²⁰

¹⁷ Section 5 CAA12

¹⁸ Sections 6(3), 6(6), and 6(7) CAA12

¹⁹ Section 6(6) CAA12

- 2.23 For the purposes of Test B, conduct may, in particular, amount to an abuse of SMP if it is conduct described as an abuse of a dominant market position in section 18(2)(a) to (d) of the Competition Act 1998.²¹
- 2.24 In Test B, “*competition law*” means²²:
- Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU);
 - Part 1 of the Competition Act 1998 (CA98); and
 - Part 4 of the Enterprise Act 2002 (EA02) (market investigations).
- 2.25 Although Test B is a separate test, it cannot be divorced from Test A, because, to apply it, we must have already determined that the relevant operator has or is likely to acquire SMP in the relevant market under Test A. If the operator does not have and is not likely to acquire SMP, there can be no risk that the operator will abuse it.

Test C

- 2.26 Test C requires that we consider whether, 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.²³ For the purposes of this test:
- the relevant operator is “*the person who is the operator of the airport area at the time the test is applied*”; and
 - ‘users of air transport services’ (users) are passengers or those with a right in cargo and include future users of such services.
- 2.27 As with Test A, we will assume the prevailing regulatory regime is in place.
- 2.28 Test C does not expressly require that we apply this test by reference to a specific set of regulatory licence conditions. Such a requirement would

²⁰ Section 6(4) read together with sections 6(8) and 6(9) of CAA12

²¹ Section 6(4) and Section 6(8) CAA12

²² Section 6(9) CAA12

²³ Section 6(5) CAA12

reverse the logical structure of CAA12 and would require the determination of individual licence conditions before the decision on whether to grant a licence is made.

Application of the tests

- 2.29 In applying tests A to C, we must have regard to²⁴:
- relevant notices and guidance published by the EC about the application and enforcement of the prohibitions in Articles 101 and 102 of the TFEU;
 - relevant advice and information published under section 52 of the CA98 (advice and information about the application and enforcement of the prohibitions in Part 1 of CA98 and Articles 101 and 102 of the TFEU); and
 - relevant advice and information published under section 171 of the EA02 (advice and information about the operation of Part 4 of that Act).
- 2.30 The case law referred to in this Guidance is that which existed at the time this Guidance was prepared. However, we would take into account both existing case law and expectations around future developments in terms of competition law enforcement.
- 2.31 Each of these tests is discussed in the following chapters. However there are a few points in common that require clarification.

Our general duty

- 2.32 In carrying out our assessment, we will act under our general duty to carry out our functions in a manner which we consider will further the interests of users²⁵ regarding the range, availability, continuity, cost and quality of AOS, including any guidance issued by the Secretary of State. We will

²⁴ Section 6(10) CAA12

²⁵ Taken to mean users of air transport services including passengers and those with rights in cargo

also carry out this function in a manner that we consider will promote competition in the provision of AOS (and have regard to the matters that we are required to by section 1 of CAA12).

Regulatory principles

2.33 We must also have regard to the regulatory principles in section 1(4) of CAA12, namely that our regulatory activities should be transparent, accountable, proportionate and consistent, and targeted only at cases where action is needed. In addition, it must also comply with our statutory duty under section 73 of the Regulatory Enforcement and Sanctions Act 2008 to avoid the imposition on operators of dominant airports of regulatory burdens that we consider to be unnecessary.

Standard of proof

2.34 We are required to make our assessment on the balance of probabilities. The weight of evidence required to satisfy this standard will depend on the particular circumstances of each MPD.

2.35 The CAT has defined the standard of proof in competition cases as follows:

“the standard of proof is the civil standard, the balance of probabilities, taking into account the gravity of what is alleged ... The standard is not akin to the criminal standard but the evidence must be sufficient to convince the Tribunal in the circumstances of the particular case, and to overcome the presumption of innocence to which [the parties are] entitled.”^{26,27}

²⁶ Makers UK Limited v Office of Fair Trading [2007] CAT 11, paragraph 46

²⁷ In a more recent judgement by the CAT, the CAT considered how far the Competition and Markets Authority (CMA) ought to pursue any particular aspect of its two year market investigation into the supply of private medical healthcare. The CAT found that the weight to be given to an aspect of the investigation in a particular context was very much a matter for the CMA, as the expert investigating body. It stated that the CMA was lawfully entitled, in the exercise of its investigative discretion, to decide not to pursue a particular dimension of its market investigation any further. To have done so might have jeopardised its ability to comply with its legal duty to produce its report within the statutory timetable. The CMA was entitled to have regard, as it did to ‘the constraints on time and resources available for investigation overall.’ The CAT also considered the weighing of evidence, which may point in different directions.

1228/6/12/14 AXA PPP Healthcare Limited - Judgment [2015] CAT 5 13 March 2015

- 2.36 While the assessment that we make in preparing an MPD does not imply any finding of “*guilt*”, we consider that this approach to the civil standard of proof is appropriate given that imposing the obligation to hold an economic licence in order to be able to charge for services is clearly a serious matter that restricts the commercial freedom of the airport in question. As such, an MPD should only be made on the basis of sufficient and convincing evidence.
- 2.37 This approach is consistent with our duty under Section 1 (4) of CAA12 that our:
- regulatory activities should be carried out in a way which is transparent, accountable, proportionate and consistent; and
 - (particularly), regulatory activities should be targeted only at cases in which action is needed.
- 2.38 This is also consistent with the Government’s Principles for Economic Regulation, which reflect that:
- “Economic regulation, as with most forms of regulation, imposes costs on regulated companies. These costs derive from the regulatory cost the regulators impose on their sectors and the administrative cost of running the regulatory institutions. Costs in these sectors tend to be passed through to end consumers. It is important that they are proportionate and outweighed by the benefits achieved for consumers. Cost minimisation might, however, not always be efficient, as lowering costs can sometimes lead to foregoing bigger benefits to consumers.”²⁸*
- 2.39 Having said that, as a specialist investigative body, we have a broad discretion over the use of our internal resources and the handling of various aspects of our work.

²⁸ Paragraph 40 of ‘Principles for Economic Regulation’, April 2011, which is available from: www.gov.uk/government/publications/principles-for-economic-regulation

Process for appeals

- 2.40 Schedule 1 of CAA12 sets out the process for appeals against MPDs and ODs.
- 2.41 Appeals may be made to the Competition Appeal Tribunal (CAT) against an MPD in respect of an airport area by:
- a person who is the operator of the area at the time the determination is made; and
 - any other person whose interests are materially affected by the determination.
- 2.42 Appeals may be made to the CAT against an OD by a person who is the subject of an OD.

Once an MPD has been made

- 2.43 If an MPD determines that the MPT is met by an airport operator in relation to an airport area, then that airport operator will require an economic licence in order to be able to levy charges.
- 2.44 Establishing and modifying licence conditions is a separate process from an MPD. We will develop and consult on licence conditions in line with Better Regulation principles. However this does not form part of the MPD process.
- 2.45 Further details on what happens after an MPD has been made are outlined in Chapter 7, and when a future MPD could be considered is outlined in the next Chapter.

Chapter 3

Market power determination process

3.1 This chapter outlines our general process and approach to conduct an MPD. It is set out in four sections:

- initiating an MPD;
- timetable and stages;
- powers to gather information; and
- confidentiality.

Initiating an MPD

3.2 We have discretion to conduct an MPD whenever we consider it appropriate to do so.²⁹ This means that we can initiate an MPD at any time.

3.3 In addition, we are required to make an MPD and therefore apply the MPT³⁰ where all of the following factors are met:

- we are asked to do so either by the operator of the airport area or another person whose interests are likely to be materially affected by the determination³¹;
- the area is located at an airport that has over 5 million annual passengers³² at the time the request is made; and
- the area consists of or includes all or part of the core area of the airport.³³

²⁹ Section 7(1) CAA12

³⁰ Section 7(2) CAA12

³¹ Section 7(2) CAA12

³² Sections 7(4) CAA12 which states that an airport is a large airport during a calendar year if, in the previous calendar year, the number of passenger movements at the airport exceeded 5 million

³³ Section 7(1)-(4) CAA12

- 3.4 However, we may decide not to apply the MPT and make an MPD even if these factors are met. This course of action is open to us in circumstances where we have previously made an MPD and consider that there has not been a material change of circumstances since that MPD.³⁴

Material change of circumstances

- 3.5 Material change of circumstances is not defined in the legislation. We consider that a change of circumstances would be more likely to be found where the change is, or the changes in aggregate are material in areas that are likely to be relevant to Tests A to C. Several relevant changes could be considered together with pre-existing circumstances when determining whether or not a new MPD should be completed.³⁵
- 3.6 Determining whether there has been a material change of circumstances is matter of regulatory judgement based on the specific circumstances under consideration. In making such a judgement, we will refer to decisions made by other UK competition authorities where they have assessed whether a material change of circumstances has occurred in other circumstances.

Requesting an MPD

- 3.7 As noted, interested parties have the ability to request an MPD.
- 3.8 In requesting an MPD, we expect the parties to be able to provide a well reasoned request containing information relevant to the analysis that we will have to undertake. This is especially the case where a request is being made for an MPD of an airport area where we have previously made a determination. In these cases, we would expect, in particular, information to be provided that demonstrates why a material change of circumstances has taken place. To facilitate this, we welcome early contact from a party considering making such a request.

³⁴ Section 7(5) CAA12

³⁵ In our 'Discussion paper on the regulatory treatment of issues associated with airport capacity expansion' CAP 1195 in June 2014, we considered some capacity expansion related events that could, at first glance, suggest a material change of circumstances may have occurred. This is available from: www.caa.co.uk/CAP1195

- 3.9 A well reasoned request should contain the following information:
- the name of the airport operator and airport in question;
 - the services provided that are relevant to the request;
 - the likely scope of the market, which, as a minimum, is the list of the assumed competitors and/or competing products;
 - where requesting a further determination, the nature and scope of the material change of circumstances and how this may have an impact on the conclusions previously reached; and
 - any issues that the airport operator or interested party considers are relevant to their request.
- 3.10 We will be available to discuss any potential request that an airport operator or an interested party may have.

Where we have discretion about whether to undertake an MPD

- 3.11 As explained in the earlier section 'Initiating an MPD', there are circumstances where we have discretion about whether or not to undertake an MPD.
- 3.12 In those circumstances, following the receipt of the request and a review of any further relevant information, we will within six months of the receipt of the final submission by the party concerned, issue our response. We will complete our consideration of the request as quickly as possible, and where it can be completed in less than six months, we will do so.
- 3.13 Our consideration of the request will include applying prioritisation framework to decide whether undertaking an MPD would fit within our administrative priorities. The prioritisation framework enables us to make the best use of resources to address issues in the interests of aviation consumers and to produce the greatest benefits for consumers. Details of our framework are explained in the 'CAA's prioritisation framework for consumer protection, competition and economic regulation issues'.³⁶

³⁶ The 'CAA's prioritisation framework for consumer protection, competition and economic regulation issues', which is available from: www.caa.co.uk/cap1233

- 3.14 The response will set out the following points:
- how we intend to respond to the request - no action, undertaking an MPD immediately or at some future date or other action;
 - the reasoning behind our decision; and
 - next steps as appropriate.

Where we are required to undertake an MPD

- 3.15 As explained in the earlier section 'Initiating an MPD', there are circumstances where we are required to undertake an MPD.
- 3.16 In those circumstances, following the receipt of the request, we will within six months of the receipt of the final submission by the party concerned, issue our response. We will complete our consideration of the request as quickly as possible, and where it can be completed in less than six months, we will do so.
- 3.17 The response will set out the following points:
- how we intend to respond to the request - undertaking an MPD immediately or at some future date;
 - the reasoning behind our decision; and
 - the steps as appropriate.

When to undertake an MPD

- 3.18 When we decide to undertake an MPD (whether it is a requirement to do so or we have exercised our discretion to undertake it), we will apply our prioritisation framework to decide when to commence an MPD. See paragraph 3.13 above.
- 3.19 During our consideration of the request, we may contact the airport operator and other relevant parties to obtain information from them and their view, in particular, on whether a material change of circumstances has taken place.

Timetable and stages

Notice of commencement

3.20 Following a response stating that we will undertake an MPD, we will publish on our website a notice of the commencement of an MPD assessment.

Timetable

3.21 We aim to publish an MPD decision within 18 months of commencing our assessment. While our aim is to complete this process within 18 months, there may be instances where we need to depart from this. For example, we may be undertaking more than one MPD at the same time, although there may be synergies there will also be critical differences that may extend the timescale. There may also be complexities that were not foreseen at the start of the determination process or commercial developments that occur during the process that mean we need to take longer than 18 months to complete an MPD.

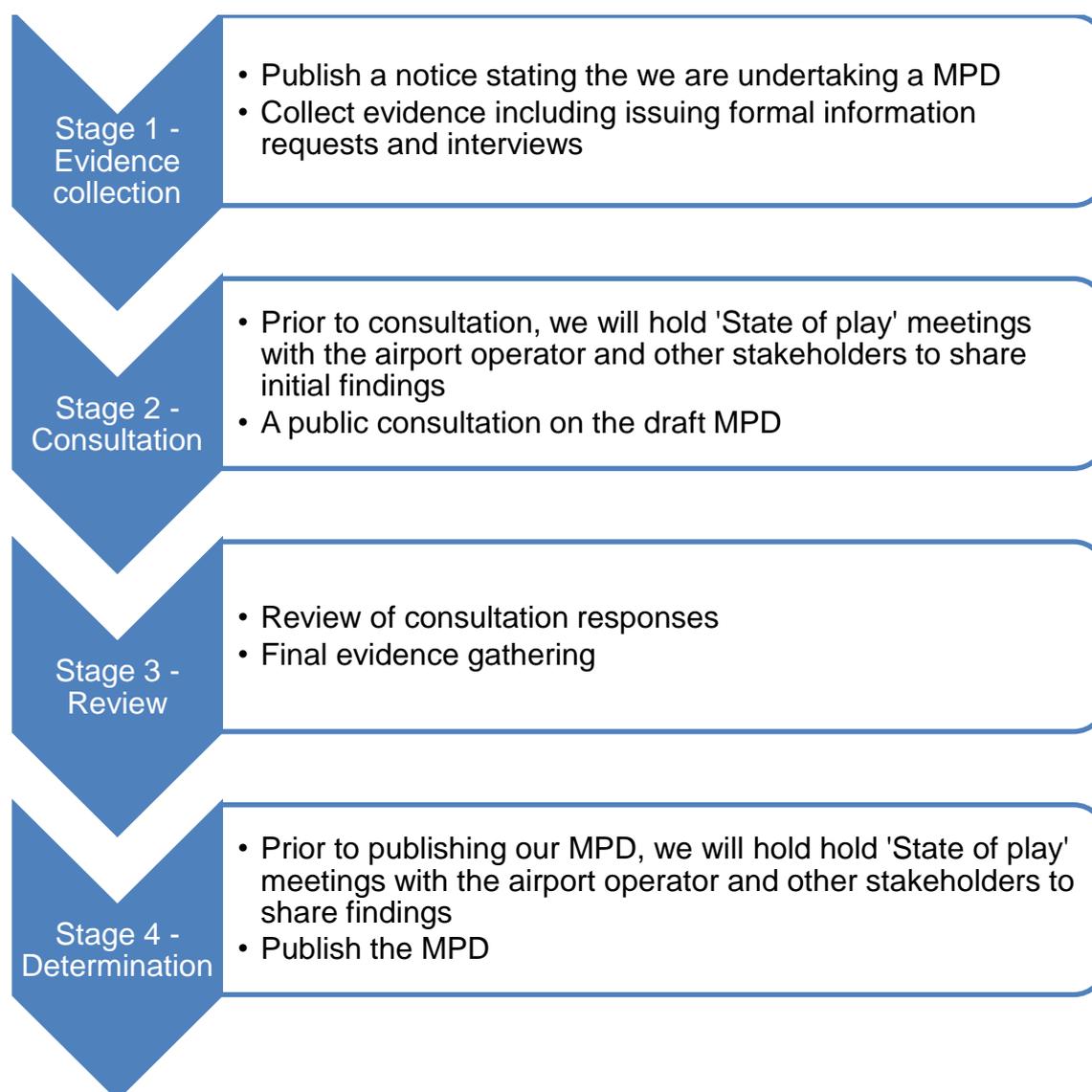
3.22 We will publish and send the airport operator that is the subject of the MPD and other key stakeholders a specific timetable for each MPD and we will engage with them on the analytical framework and the methodologies we intend to apply. Where we need to depart from the timetable, we will publish that change and notify the stakeholders of this, together with the reasons why we are doing so.

Stages

3.23 In achieving this timetable, our aim is to follow clear stages, to assist in meeting the timetable and to reduce uncertainty for the industry.

3.24 This is set out in Figure 1.

Figure 1: Generic MPD stages



Source: CAA

3.25 We intend to spend Stage 1 gathering evidence and performing initial analysis. To assist in minimising the time needed for this stage, we will issue data requests using our formal information gathering powers, which are outlined in the section 'Powers to gather information' below. We will discuss with the airport operator what reports/research they may be commissioning and we may also commission research to aid our assessment.

3.26 Appendix A contains a list of possible initial evidential requirements that we would expect to request from airport operators and other relevant stakeholders for the purposes of conducting an MPD. This list is by no

means exhaustive, but it provides a starting point for stakeholders wishing to prepare submissions to us for an MPD.

- 3.27 Stage 2 and Stage 4 involve holding update meetings with the airport operator and other key stakeholders to update them on our current thinking. It is likely that the update meeting at stage 2 will focus more on the assessment of Test A. The results of these meetings will feed into our further analysis.
- 3.28 Our aim is to minimise the need for extensive update meetings and consultation phases. We recognise, however, that particular circumstances (e.g. developments that occur while the assessment is underway that could materially affect the outcome of the MPD) may mean it is sensible to have additional engagement with key stakeholders.
- 3.29 In Stage 2, we will consult on a draft MPD. This will cover our initial assessment against all three tests. We will keep the consultation period as short as possible to maintain progress on the MPD, while allowing stakeholders time to comment.
- 3.30 In Stage 3, we will review the consultation responses and collect any final evidence if it is needed. We intend to publish all non-confidential responses to the draft MPD on our website as soon as possible after the consultation has concluded. This allows all stakeholders to be kept informed about the information we have received.
- 3.31 Stage 4 will include final update meetings and publishing the MPD. Following the final update meetings, there will only be a limited opportunity for parties to submit new evidence and for us to take account of such evidence.
- 3.32 Given that our aim is to complete an MPD within 18 months, it is our expectation that stakeholders will support this process and meet the deadlines set for information requests and consultations. The stages are designed to separate the evidence gathering stages from the consultation on the draft MPD stage. We will endeavour to take account of all representations made. We will not, however, take account of commentary

provided after consultation deadlines have been reached unless the parties can demonstrate that this is new evidence that could not reasonably have been submitted to us earlier.

Powers to gather information

- 3.33 We have powers to gather information under section 50 of CAA12.
- 3.34 Under section 50 of CAA12, we may require a person to provide information, or a document that we reasonably require, to carry out our functions in relation to the regulation of operators of dominant airports.³⁷
- 3.35 To exercise this power, we must issue a notice which specifies the information or document(s) we require. The notice may not require a person to provide information or documents that the person could not be compelled to provide in evidence in civil proceedings.

Confidentiality

Requirements under CAA12

- 3.36 Section 59 of CAA12 states that we are not required to publish or otherwise disclose any information which we are satisfied is:
- commercial information, the disclosure of which would, or might in our opinion, significantly harm the legitimate business interests of an undertaking to which it relates, or
 - information relating to the private affairs of an individual, the disclosure of which would, or might in our opinion, significantly harm the individual's interests.
- 3.37 Schedule 6 of CAA12 (which is backed by criminal sanctions) sets out the restrictions we have on disclosing information if the information was obtained under our powers to carry out our functions related to the regulation of dominant airports, and it relates to the affairs of an individual

³⁷ Chapter 1 CAA12

or to a particular business. Such information must not be disclosed during the lifetime of the individual, or while the business continues to be carried on, unless:

- disclosure is made with the consent of the individual, or the person for the time being carrying on the business³⁸;
- information is already available to the public in circumstances which do not breach the rules set out in that Schedule³⁹; or
- information is disclosed for the purposes of civil proceedings⁴⁰; or
- information is disclosed for the purposes of carrying out our functions or the functions of other specified parties or for the purposes of specified UK or European legislation.⁴¹

Data Protection Act 1998 principles

3.38 The Data Protection Act 1998 (DPA98) controls how personal information relating to individuals is used so that individuals are treated fairly. Where we process such data, we must comply with the data protection obligations set out in the DPA98.

3.39 Where we propose to share personal information about an individual with another organisation, the DPA98 requires that we inform the individual that their information may be shared, so the individual can choose whether to object.

3.40 A person may request a copy of any information that we hold about that person in whatever format. If that person is not satisfied with our response, they may complain to the Information Commissioner's Office (ICO). For more information, see our website.⁴²

³⁸ Paragraph 2 of Schedule 6 of CAA12

³⁹ Paragraph 3 of Schedule 6 of CAA12

⁴⁰ Paragraph 4(1)(b) of Schedule 6 of CAA12

⁴¹ Paragraph 5 of Schedule 6 of CAA12 sets out certain circumstances where the requirement to not disclose does not apply

⁴² Our General Privacy Notice is available at: www.caa.co.uk/Our-work/About-us/General-privacy-notice/

Freedom of Information Act 2000

- 3.41 The Freedom of Information Act 2000 (FOIA00) gives people access to information held by public authorities. Where we receive a valid request under FOIA00, we must respond within 20 working days. We must (i) inform the applicant whether we hold any information which falls within the scope of their request and, if we do, (ii) provide that information, unless an exemption applies.
- 3.42 Our website explains how to make a request for information under FOIA00.⁴³ Any person not satisfied with our refusal to provide the requested information may seek a review by us of that refusal. There is a further right to complain to the ICO if that person is not satisfied with the outcome of the review.

Our internal processes

- 3.43 We acknowledge the importance parties attach to their confidential information. With that in mind, and to ensure compliance with the relevant legal provisions which include Section 59 and Schedule 6 of CAA12, the DPA98 and the FOIA00, we have developed internal processes to ensure that we handle confidential information with care.
- 3.44 We store electronic copies of confidential material on a secure CAA database. We also operate a clear desk policy so that printed confidential material is locked away at the end of each working day.
- 3.45 When providing submissions or supplying information to us, for example in response to an information request, parties should identify which of the information is confidential and give reasons why its disclosure would significantly harm their interests. We do not accept blanket or unsubstantiated confidentiality claims. We will carefully consider these explanations, having regard to the relevant legal considerations, before we decide whether to disclose the information concerned. We may consider that the information concerned is not confidential or we may

⁴³ How to make a freedom of information request is outlined on our webpage about The Freedom of Information Act 2000, which is available at: www.caa.co.uk/Our-Work/Information-requests/Freedom-of-Information/

agree that it is confidential but we may consider that the need to disclose the information, for example for reasons of procedural fairness and due process, outweighs the interests of the party which requests that the information is kept confidential.

- 3.46 Confidential material received from parties is accessed only by staff and external expert advisers to the CAA who are allocated to the MPD to which the information relates.
- 3.47 Confidential material is only shared more widely, where, in our view, to do so would, be appropriate in the circumstances, and in compliance with the legal requirements placed on us.

Chapter 4

Test A: Market definition and market power

- 4.1 This chapter sets out our approach to assessing Test A.
- 4.2 Test A is that the relevant operator has, or is likely to acquire, SMP in a market, either alone or taken with such other persons as we consider appropriate.⁴⁴
- 4.3 This chapter is set out as follows:
- our general approach;
 - how Test A is met;
 - our approach to market definition for MPDs;
 - defining the relevant market;
 - assessing market power; and
 - summary.

Our general approach

- 4.4 Test A is, in essence, an assessment of market power and therefore there is some interplay between Test A and our role as a competition authority.
- 4.5 We have published guidance on our approach to our concurrent competition powers, CAP 1235 'Guidance on the Application of the CAA's Competition Powers'.⁴⁵ In CAP1235, we noted that:
- “Although there are some parallels between making MPDs and in investigating complaints under the competition prohibitions, there are also some important differences between them. For instance, when assessing market power at an airport as a whole, we will usually consider the overall bundle of AOS services and then determine the relevant market in which the airport offers those services. In comparison, when assessing*

⁴⁴ Section 6(3) CAA12

⁴⁵ CAP1235 'Guidance on the Application of the CAA's Competition Powers' is available from: www.caa.co.uk/cap1235

complaints under the competition prohibitions, we need to start by determining a product market relevant to the complaint in question. This may be much narrower than the total range of services offered at an airport e.g. it could relate to groundhandling or forecourt access at an airport or airports.”⁴⁶

- 4.6 However, as with our approach to applying competition law, in assessing market definition and market power for the purposes of Test A, we intend to have regard to applicable CMA⁴⁷ and EC⁴⁸ competition law notices and guidance.^{49,50}

How Test A is met

- 4.7 A is met if⁵¹:
- the market is a market for one or more of the types of AOS provided in the airport area (or for services that include one or more of those types of service); and
 - geographically, the market consists of or includes all or part of the airport area.
- 4.8 As illustrated in Figure 2, we consider that Test A will be met in two distinct ways and that if either of these is met, then Test A is met:
- firstly, Test A is met if we find sufficient evidence that the airport operator **has SMP now**; or

⁴⁶ Paragraph 2,6, CAP1235 'Guidance on the Application of the CAA's Competition Powers' is available from: www.caa.co.uk/cap1235

⁴⁷ The CMA took over the duties of the Competition Commission (CC) and the Office of Fair Trading (OFT) from 1 April 2014. Further information on the CMA and its guidance is available from www.gov.uk/cma

⁴⁸ Further information on the EC's notices and guidance is available from ec.europa.eu/competition/index_en.html

⁴⁹ See for example:
CMA's Competition Law Guideline on Market Definition, December 2004 (OFT 403)
CMA's Competition Law Guidance on Assessment of Market Power, December 2004 (OFT 415);
European Commission's notice on the definition of relevant market for the purposes of Community competition law, EC 97/C 372/03 (EC Market Definition Notice).

⁵⁰ We are required to have regard to those notices and guidance under section 6(10) of CAA12

⁵¹ Section 6(6) CAA12

- secondly, Test A is met if we find sufficient evidence that the airport operator is **likely to acquire SMP** in the future.

Figure 2: Illustration of how Test A is met

Evidence found	Scenario 1	Scenario 2	Scenario 3	Scenario 4
SMP now	Yes	Yes	No	No
SMP in the future	Yes	No	Yes	No
Test A	Met	Met	Met	Not met

Source: CAA

- 4.9 However, where SMP is likely to diminish over time, such that we do not consider it is likely that the airport operator will have SMP in the future, this will also be considered in our assessment of the other tests.⁵²

Our approach to market definition for MPDs

- 4.10 When conducting our assessment, in defining the focal product in respect of which the airport area may have SMP, we will begin by looking across a bundle of goods and services and, where necessary, review differing subsets of products or services at the airport. We do not intend to start from a product-by-product inspection of the airport operator's position unless there is good reason to do so. This work would increase regulatory burden and may be of limited benefit, given the purpose of the analysis, as explained in paragraph 4.5. Instead, we propose to take a higher-level view of the airport operator's general market position.

- 4.11 As a starting point for the assessment, we will also be guided by the parameters of the request to carry out the MPD and by how the airport operator organises and charges for its services. We will also take into account the relevant legislation, in particular, whether the product or products in relation to which it may have SMP, are provided within the

⁵² In this case, it is possible that competition law may be able to provide sufficient protection against the risk of abuse of SMP or that the benefits of regulation are less likely to outweigh its adverse effects.

core area. Generally, we will start by looking at a broadly generic bundled product that is sold to airlines.

- 4.12 It may then be appropriate for us to consider focusing on non-aeronautical products to complement or further our analysis of aeronautical products. The extent to which we will look at non-aeronautical segments of AOS will depend on the terms of reference of the MPD and on the availability of evidence and concerns regarding the existence of SMP in non-aeronautical markets (i.e. in markets where airlines are not the airport operators' direct customers).

Defining the relevant market

General

- 4.13 Market definition is a key component of the MPT. We will assess whether:
- an airport operator has SMP in the relevant market for the purposes of Test A; and
 - there is a risk of abuse of that SMP under Test B.
- 4.14 In line with CMA and EC guidance, we consider market definition is primarily a 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.⁵³ Furthermore, 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, therefore any assessment may change over time as market circumstances evolve.
- 4.15 Likewise, we also consider that, as in the EC guidance, market definition is not an end in itself. Rather, it is a key step in identifying the competitive constraints on a supplier of a given product or service. The market

⁵³ EC Market Definition Notice, paragraph 2

definition exercise 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.⁵⁴

- 4.16 However, there may be characteristics of the airport sector that make it difficult to define the market precisely. In Test A, we will therefore analyse all the competitive constraints faced by the airport operator, regardless of whether they arise from within or outside the relevant market or markets as we have defined them.⁵⁵

The Hypothetical Monopolist Test

- 4.17 Wherever feasible, the hypothetical monopolist test will be adopted as a starting point for defining the relevant market.⁵⁶ This test involves starting with the focal product or service and the smallest geographical area (normally that supplied by the operator in question) and assessing customers' switching reactions to a small but significant non-transitory increase in price (SSNIP) above the competitive level⁵⁷, generally considered as being 5 to 10 per cent. If the price increase is unprofitable⁵⁸, due to marginal customers switching away to substitute products and areas (or other suppliers entering the presumed market), the test is repeated by widening the 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

⁵⁴ EC Market Definition Notice, paragraphs 7 to 9 and 13

⁵⁵ 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

⁵⁶ CMA's Competition Law Guideline on Market Definition, December 2004 (OFT 403), paragraphs 2.5 to 2.13 and EC Market Definition Notice, paragraphs 15 to 19

⁵⁷ Where prices are likely to differ substantially from their competitive levels, caution must be exercised when dealing with the evidence on switching patterns as such evidence may not be a reliable guide to what would occur in normal competitive conditions. See CMA's Competition Law Guideline on Market Definition, December 2004 (OFT 403), paragraph 5.6

Where the airport is already price regulated, there may be a reasonable argument that the regulated price is already sufficiently close to the competitive price to be a basis to perform the hypothetical monopolist test.

⁵⁸ For this, we take into account all the revenue streams of the airport operator. For example, it may be that if passengers switch away in response to a SSNIP on aeronautical services, the airport operator can lose revenues and profits on related non-aeronautical services.

hypothetical monopolist could profitably sustain prices 5 to 10 per cent above competitive levels.

4.18 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 an assessment of the competitive price. As the CMA 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 prices outside the hypothetical monopolist's control are held at the competitive level. In addition, there may be other external considerations that might affect the uniformity and/or the profitability of the price increase.⁵⁹

4.19 As a result, it is therefore rarely possible to apply the SSNIP test in a precise manner due to its limitations as well as data and evidential restrictions.⁶⁰ That said, CMA guidelines⁶¹ allow us to use this framework to define a plausible or most likely market where the competitive assessment is shown to be largely unaltered by which market definition is adopted:

“In practice, defining a market requires balancing various types of evidence and the exercise of judgement. However, it is not an end in itself. Where there is strong evidence that the relevant market is one of a few plausible market definitions, and the competitive assessment is shown to be largely unaltered by which one of these market definitions is adopted, it may not be necessary to define the market uniquely.”

4.20 Given the particular circumstances of the case, we may be unable to carry out a formal SSNIP test either fully or at all. However, we will seek to

⁵⁹ CMA's Competition Law Guideline on Market Definition, December 2004 (OFT 403), paragraphs 2.10 to 2.11 and 5.4 to 5.6

⁶⁰ See the CC's 2009 BAA Report, paragraph 2.1

⁶¹ See CMA's Competition Law Guideline on Market Definition, December 2004 (OFT 403) paragraph 2.14

gather a range of evidence on substitutability and interpret it, so far as possible and appropriate within the hypothetical monopolist framework.

Product and geographic market

- 4.21 We would refer to EC⁶² and CMA⁶³ guidance in defining the relevant product market and geographic market. This Guidance should be read in conjunction with the relevant CMA and EC guidance.
- 4.22 In particular, we consider that the product market comprises all those products and/or services that are regarded as interchangeable or substitutable for the focal product by the consumer by reason of those products' characteristics, their prices and their intended use.
- 4.23 We note that where a hypothetical monopolist (see above) would, or would be able and likely to, price discriminate significantly between groups of customers, each of these groups may form a separate market.⁶⁴
- 4.24 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.*"⁶⁵
- 4.25 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, if they are considered a separate product market.
- 4.26 The assessment of competitive constraints as part of the geographic market definition will include an analysis of the ability of airlines to switch away from an airport as well as the potential for passengers/owners of

⁶² EC Market Definition Notice, paragraph 7

⁶³ CMA's Competition Law Guideline on Market Definition, December 2004 (OFT 403), paragraph 2.5

⁶⁴ CMA's Competition Law Guideline on Market Definition, December 2004 (OFT 403), paragraph 3.9

⁶⁵ EC Market Definition Notice, paragraph 8

cargo to switch between airports, whether independently, or by following a particular airline.

- 4.27 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. We may assess whether different temporal markets for AOS exist in the context of an individual MPD.

Assessing market power

- 4.28 Market power is the ability, profitably, to sustain prices above the competitive level or restrict output or quality below competitive levels. It is explained in case law as “*an undertaking shall be deemed to have significant market power if, either individually or jointly with others, it enjoys a position equivalent to dominance, that is to say a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers*”.⁶⁶ As with market definition, the assessment of market power involves an analysis of whether the competitive constraints identified in the market are strong enough to prevent market power from harming the process of competition, or alternatively whether there are barriers to these competitive constraints.⁶⁷
- 4.29 Market power is, therefore, not an absolute term but a matter of degree, which varies according to the individual circumstances of the case. As part of our assessment of market power, we need to identify the existence and the potential strength of the competitive constraints⁶⁸ from within and

⁶⁶ CMA's Competition Law Guidance on Assessment of Market Power, December 2004 (OFT 415), paragraph 2.8 and Case 27/76 United Brands v Commission [1978] ECR 207. This definition has been used in other cases.

⁶⁷ CMA's Competition Law Guidance on Assessment of Market Power, December 2004 (OFT 415), paragraphs 3.1 to 3.3

⁶⁸ CMA's Competition Law Guidance on Assessment of Market Power, December 2004 (OFT 415) describes competitive constraints as 'market factors that prevent an undertaking from

from outside the relevant market. We need to do this to determine whether the airport operator is subject to effective competition or not.

- 4.30 Evidence on market structure and market share is commonly used in competition assessments. Market power is more likely to exist if an operator has a persistently high market share over time compared to its nearest rivals.^{69,70}
- 4.31 However, we note that market shares are not sufficient, in isolation, to determine the intensity of competition in the relevant market as they are too static to shed light on the dynamics of the market. For example:
- the difficulties in defining the market precisely might limit the reliance that could be placed on any given measure of market shares as an indicator of market power;
 - the differentiated nature of airports, both in terms of their facilities and services, but also in terms of their location and the differing degrees of their interdependent demand, can reduce the reliability of market shares as an indicator of market power since alternatives, whether inside or outside the market definition, may be imperfect substitutes; and
 - capacity constraints at alternative airports will affect the extent to which those airports are able to provide competitive constraints to the airport operator.
- 4.32 Notwithstanding these concerns, we will seek to calculate market shares by reference to the market definition adopted.

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

⁶⁹ CMA's Competition Law Guidance on Assessment of Market Power, December 2004 (OFT 415), paragraphs 4.2 to 4.3

⁷⁰ In line with case law, dominance can be presumed in the absence of evidence to the contrary if an undertaking has a market share persistently above 50 per cent. Furthermore, it is unlikely that an undertaking will be individually dominant if its share of the relevant market is below 40 per cent, although dominance could be established below that figure if other relevant factors (such as the weak position of competitors in that market and high entry barriers) provided strong evidence of dominance. See paragraph 2.12 of CMA's Competition Law Guidance on Assessment of Market Power, December 2004 (OFT 415).

- 4.33 We will also seek to identify the existence, and evaluate the strength, of all competitive constraints faced by the airport operator. These are market factors that prevent the airport operator from raising prices significantly above – and/or lowering quality significantly below – competitive levels, and can be factors both within and outside the relevant market.
- 4.34 In so doing, we may consider factors such as:
- the specific barriers to airline switching. For example, this can include the costs of moving a route away from the airport or the network benefits of airline co-location at an airport;
 - the extent to which passengers are prepared to use other airports' route networks or not travel in response to a price increase by the airport operator;⁷¹ and
 - any attempts by the airport operator to restrict output, increase prices above the competitive level and/or reduce quality at the airport below the levels that would be seen in a competitive market.
- 4.35 Other relevant factors may include market features, such as:
- possible countervailing buyer power by airlines;
 - prevailing capacity constraints at the airport and at neighbouring airports and barriers to entry; and
 - the extent of potential competition being introduced through new entry and/or expansion of airport capacity.⁷²
- 4.36 We will look to supplement this with analysis on other available indicators of market power, including the airport operator's behaviour and performance, profitability measures, quality of service, efficiency and

⁷¹ Since often passengers do not pay airport charges directly, as these are levied on airlines, this substitution mechanism is an indirect one.

⁷² CMA's Competition Law Guidance on Assessment of Market Power, December 2004 (OFT 415), chapter 5

engagement with airlines⁷³ in order to assess whether the airport operator has, or is likely to acquire, SMP in the relevant market.

- 4.37 We note that, where the airport operator is already subject to economic regulation, this (the existence of economic regulation and its form) will need to be taken into account as regulation will be influencing the airport's behaviour and performance, as well the prices that it has charged in the past.
- 4.38 We will consider all of the available evidence and exercise our judgment in making this assessment.

Summary

- 4.39 Test A considers whether the relevant operator has, or is likely to acquire, SMP in a market for one or more types of AOS provided within all or part of the airport area, either alone or taken with such other persons as we consider appropriate.⁷⁴
- 4.40 We make our assessment having regard to all of the evidence obtained and our general duties under CAA12 and the relevant notices and guidance issued by the EC and the CMA regarding the competition law notices and guidance.
- 4.41 In conducting Test A, we will seek to define a relevant market and assess the market share of the operator. In assessing market power we will assess the strength of the competitive constraints faced by the airport operator, which could arise from within and from outside the relevant market(s) identified. We will also consider other available indicators of the airport operator's behaviour and performance.

⁷³ CMA's Competition Law Guidance on Assessment of Market Power, December 2004 (OFT 415), paragraphs 6.5 to 6.7

⁷⁴ Section 6(3) read together with sections 6(6) and 6(7) CAA12

Chapter 5

Test B: Adequacy of competition law

5.1 Test B is 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.

5.2 This chapter is set out as follows:

- our general approach;
- competition law;
- the concept of abuse; and
- summary.

Our general approach

5.3 Where Test A is met, we are required under Test B to consider whether competition law provides sufficient protection against the risk of abuse of that SMP.⁷⁵ In doing so we will conduct the analysis in light of our primary duty to further the interests of users of air transport services.

5.4 Although Test B is a standalone test, its application is dependent on whether we have already determined that the relevant operator has SMP in a relevant market. If Test A is not met, there is no market power in relation to which we can make an assessment under Test B. Under Test B, we must consider the existence and extent of the risk of the relevant operator engaging in an abuse of that position in the relevant market and how best to prevent it.

5.5 We will conduct our assessment in the light of our considerations under Test A (i.e. where the SMP and therefore the risk of the abuse of that power may lie), and whether that risk is mitigated by competition law. In

⁷⁵ Section 6 CAA12

assessing this, we will consider, but not be limited to considering, the potential and likelihood of:

- public enforcement action by us or other relevant authorities;
- private enforcement action by relevant companies (i.e. airlines or groundhandlers); and
- private enforcement action by private individuals or groups of private individuals.

Competition law

- 5.6 Test B focuses solely on the effectiveness of competition law.⁷⁶
- 5.7 Competition law is a key element in the assessment of Test B and Test C, although each Test has a different focus. Test B focuses on the effectiveness of competition law to address potential abuses of an airport operator's SMP, when we have found that an airport operator has SMP at an airport. It assesses the risk of addressing various forms of anti-competitive behaviour. Case law illustrates how competition law has been used and how effective it has been but does not give a complete answer to this test. In Test C (as discussed in the next chapter), competition law is part of the ex post powers available to us regardless of whether an airport operator is or is not economically regulated by us.
- 5.8 The competition law provisions include the CA98 prohibition and Articles 101 and 102 of TFEU whether enforced by us⁷⁷, the CMA, the Commission or by interested third parties bringing private actions before the courts.
- 5.9 Competition law also includes the market provisions in the EA02.⁷⁸ However, we consider that the market provisions are not specifically designed to guard against the risk of an abuse of dominance. Instead

⁷⁶ Competition law is defined in section 6(9) of CAA12 to include Articles 101 and 102 TFEU, the Chapter I and II prohibitions in the CA98 as well as Part 4 of the EA02 (market investigations)

⁷⁷ CAP 1235 - 'Guidance on the Application of the CAA's Competition Powers', available from www.caa.co.uk/CAP1235

⁷⁸ Part 4 EA02

market investigations under EA02 seek to examine the cause of why particular markets may not be working well, rather than seeking to determine whether an abuse of a dominant market position under CA98 has occurred. We will, therefore, place less weight on arguments relating to the ability of the markets regime to protect against abuse.

- 5.10 We consider that it is the Chapter II prohibition and/or Article 102 TFEU that are designed to and would be used to address an abuse of dominance and, therefore, are most relevant for the assessment under Test B.
- 5.11 Likewise the ACRs and the AGRs are applicable and may protect against some forms of abuse but these do not form part of “*competition law*” as defined in Test B.⁷⁹ Therefore, we will not take account of these powers in the assessment of Test B. However, we will give appropriate consideration to their role in the regulatory framework as part of Test C.

The concept of abuse

- 5.12 In competition law, a dominant company has a special responsibility not to allow its conduct to impair undistorted competition in the relevant market.⁸⁰ It is not the position of dominance or SMP itself that is prohibited, but the undertaking using that position to prevent or distort the effective competition in the market.
- 5.13 Section 6(8) of CAA12 clarifies that conduct may, in particular, amount to an abuse of SMP if it is conduct that is described in the Chapter II prohibition in section 18 of CA98. Section 18(2)(a) to (d) of CA98 contains an illustrative list of exploitative and/or exclusionary behaviour.⁸¹

⁷⁹ Examples include the Groundhandling Directive (GHD) implemented in the UK as the Airports (Groundhandling) Regulations 1997 and the Airport Charges Directive (ACD) (implemented as the Airport Charges Regulations 2011)

⁸⁰ Case 322/81 *Michelin v Commission* [1983] ECR 3461, paragraph 57

⁸¹ The types of abuse listed include unfair or excessive pricing, unfair trading conditions, market limitation or production limitation, discrimination and making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of the contracts.

- 5.14 Likewise, the Court of Justice of the European Union has defined the term abuse in the following way:
*“An objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on basis of the transaction of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition.”*⁸²
- 5.15 As such, an abuse under competition law is broader than, and not limited to, the illustrative abuses set out under Section 18(2)(a) to (d) of CA98. Any particular observed behaviour should be assessed as to whether or not it is abusive on its own merits.⁸³

Types of abuse most relevant to the assessment of Test B

- 5.16 We will assess the relevant types of abuse on a case by case basis. However, there are a number of high level points that we consider will be common to most assessments of Test B.
- 5.17 Over the years, there have been a number of competition law cases taken at both a domestic and European level against airports.⁸⁴ These indicate that an airport operator is an undertaking for the purposes of competition law and that they can be found to be dominant and to have abused that dominance.
- 5.18 The case law and indeed the legal framework will continue to evolve over time. Present case law illustrates that competition law has been successfully applied in what could broadly be considered as “vertical

⁸² Case 85/76 Hoffmann-La Roche [1979] ECR 461

⁸³ This reflects the position established in European case law that the categories of abuse set out in Article 102 are not exhaustive: see Case 6/72 Continental Can v Commission [1973] ECR 215

⁸⁴ Commission decision 95/364/EC, Commission decision 1999/199/EC, Commission decision 1999/198/EC, Commission decision 98/513/EC; T-128/98, C-82/01 Commission decision 98/190/EC, Purple Parking & Anor v Heathrow Airport Limited [2011] EWHC 987 (Ch) and Arriva the Shires Ltd v London Luton Airport Operations Ltd [2014] EWHC 64 (Ch)

exclusion” cases, where the airport is active in the upstream market for AOS but also has a presence or stake in the downstream market for air transport or other services. The defining feature of these cases is that they all involved the airport leveraging its market power to the advantage of either its own subsidiary in a downstream market, or a closely aligned party.⁸⁵

- 5.19 We consider, therefore, that for these vertical exclusionary behaviours, there are likely to be sufficient precedents available from other industries including those that are similarly regulated (such as telecoms or utilities) which could be relied on as relevant authorities in assisting us to challenge exclusionary behaviour by airports under CA98 or Article 101/102 TFEU. Competition law is, therefore, likely to be sufficient to deal effectively with the risk of such abuses.
- 5.20 Similarly, there are a number of cases relating to discriminatory abuses, including at airports. The range of competition law precedents are likely to be sufficient to deal effectively with the risk of such abuses.
- 5.21 We are therefore likely to place less weight on arguments that competition law is insufficient to deal with this type of abuse.
- 5.22 Conversely, we consider it is in relation to exploitative abuses involving excessive prices and/or reduced service levels that there is the greatest likelihood of abuse occurring where competition law may not give sufficient protection. We will therefore examine the potential risks from these types of abuse more closely in applying Test B.
- 5.23 In particular, the case law that exists in this area provides different approaches on how to identify excessive prices and service quality based abuses. Additionally there is likely to be a range of price (or service quality degradation) between the competitive price and what may currently be defined as “*excessive*” or “*abusive*” under competition law.

⁸⁵ The early European cases are typified by a strong single market imperative. These cases in the main consist of a state owned airport supporting state owned airlines.

This could result in a “*creeping abuse*” that is to the detriment of users of air transport services.

Competition law remedies

- 5.24 It is not only the ability to apply and enforce competition law that needs to be considered under Test B but also the deterrent effect of remedies available, which may have a deterrent effect along with the reputational impact of being found to have breached one of the competition law prohibitions.
- 5.25 The main remedy used is a financial penalty. Financial penalties are calculated in line with the CMA guidance on penalties. Financial penalties can be up to 10 per cent of the company's relevant global turnover.⁸⁶ Where an infringement is found, financial penalties can provide a strong incentive not to infringe the prohibitions, and to reinforce the considerations on exclusionary and discriminatory abuses.
- 5.26 Other remedies available are behavioural in nature, such as directions to bring an infringement to an end, accepting binding commitments to change behaviour, considering settlements offered to us and applying for directors' disqualification orders. Behavioural remedies usually need to be monitored and compliance assured on an ongoing basis. These remedies can take time to implement and to change behaviours. As such, they have parallels with regulatory rules imposed by a licence.

Summary

- 5.27 Test B considers whether competition law does not provide sufficient protection against the risk that the relevant operator may engage in conduct that amounts to an abuse of that SMP.⁸⁷

⁸⁶ The CMA's Competition Law Guideline on Appropriate CA98 penalty calculation, September 2012 (OFT423) is available from www.gov.uk/cma

⁸⁷ Section 6(3) read together with sections 6(8) and 6(9) CAA12

- 5.28 Test B presupposes a finding of SMP against which to assess the sufficiency of competition law to protect against the risk of abuse of that SMP.
- 5.29 In assessing Test B, we will have regard to our primary duty to air transport users. In doing so we consider that where an airport operator seeks to use its market power for exclusionary behaviour, competition law is likely to be sufficient to protect against such practices. However, where an airport operator seeks to use its market power for exploitative behaviour, (which could be observed as pricing behaviour whether or not amounting to excessive pricing, or service quality reduction), competition law may be less likely to be able to deal with these consumer detriments (whether actually abusive or not). We will therefore focus our analysis in this area.

Chapter 6

Test C: Adverse effects/benefits of regulation

- 6.1 Test C is that, for users of air transport services, the benefits of regulating the relevant operator by means of a licence are likely to outweigh the adverse effects.
- 6.2 This chapter is set out as follows:
- our general approach;
 - *ex-ante* licence regulation and *ex-post* powers;
 - making the comparison;
 - areas considered under Test C;
 - assessing *ex-ante* licence regulation and *ex-post* powers; and
 - summary.

Our general approach

- 6.3 We view Test C as an analysis of the adverse effects and the benefits to the users of air transport services of imposing or maintaining regulation.
- 6.4 Generally, Test C is a balancing exercise between the benefits of a licence imposed on the relevant airport operator and a situation where there is no licence. If there were no licence, the behaviour of the airport would be constrained only by existing market forces and general regulatory (non-licence) provisions.
- 6.5 CAA12 does not dictate a particular method of impact assessment and, as a result, such assessment may be qualitative or quantitative or a combination of both depending upon the availability of the relevant data. We will follow best practice in undertaking the assessment. Where it is reasonably practicable to quantify the respective benefits and adverse effects, we will do so. We will use our formal information gathering powers and we may conduct or commission research to aid our

assessment with the objective of quantifying the costs and benefits where we consider this to be appropriate in order to apply Test C.

- 6.6 As part of the assessment, we must consider the extent to which any likely net benefits benefit end users rather than intermediate providers.
- 6.7 If we consider that there is a conflict between the interests of different classes of user, or between the interests of users in different markets, our duty is to carry out the functions in a manner which we consider will further such of those interests as we think best.⁸⁸

***Ex-ante* licence regulation and *ex-post* powers**

- 6.8 This section explains in summary form what *ex-ante* licence regulation encompasses and the range of our *ex-post* powers.

***Ex-ante* licence regulation**

- 6.9 Our *ex-ante* licence regulatory powers typically pursue different, albeit overlapping, policy objectives to the strict market considerations that apply under competition law and other sectoral powers. In particular, our general duty of furthering passengers' and cargo owners' interests, allow us to address a wider set of objectives and employ additional remedies than we could under our European and UK competition law powers. The flexibility as to what may be included in an economic licence allows us to pursue these wider aims in addition to dealing with the risk of abuse of substantial market power. Both sets of powers are, however, ultimately directed at protecting the interests of end users.
- 6.10 For instance *ex-ante* licence regulatory powers can be utilised to reduce the level of market power in a market and thereby encourage effective competition to become established.⁸⁹ *Ex-ante* licence regulation may promote the development of effective competition in the relevant market

⁸⁸ Section 1(5) CAA12

⁸⁹ For example, where in a market not yet operating in a state of effective competition, there is a risk of abusive conduct, regulation *ex-ante* via a licence can deliver detailed remedies for the benefit of all market participants over an appropriate time period.

by fostering market entry and creating incentives for innovation and efficiency. It may also seek to replicate the outcomes that are expected to be seen within a competitive market, for example, by regulating prices. In this way, it can also attempt to minimise the scope for conditions to develop in the market which are conducive to abusive conduct.

- 6.11 Test C does not require that we apply the test by reference to a specific set of licence conditions (regulatory obligations). Such a requirement would reverse the logical structure of CAA12, and would require the determination of individual licence conditions before the decision of whether to impose a licence is made.
- 6.12 We intend to apply the MPT ahead of any considerations of the specific form of licence that may be applied in any specific case once an MPD has been made.
- 6.13 The generic licence conditions we will consider in assessing Test C are based on what a licence may contain.⁹⁰ CAA12 states that a licence may include:
- conditions that we consider are necessary or expedient having regard to the risk that the airport operator may engage in conduct that amounts to an abuse of SMP;
 - price control conditions we consider necessary;
 - payment to us on the grant of the licence and/or while it continues in force; and
 - other conditions that we consider are necessary or expedient having regard to our CAA12 duties.⁹¹
- 6.14 We will consider whether it would help the assessment to consider the specific issues that might be addressed by economic regulation. The extent to which we develop these in the assessment phase will depend on what is necessary and expedient. For example, we do not consider that it is appropriate (for the reasons set out above) to develop draft licence

⁹⁰ Chapter 1 sections 15 to 21 CAA12

⁹¹ Section 18(1) CAA12

conditions in undertaking an MPD. However it may be helpful to consider at a high level what price control or monitoring approach may be appropriate given our findings on Test A and B.

6.15 We will also have regard to the regulatory principles in CAA12⁹² and the duty not to impose or maintain regulatory burdens which we consider to be unnecessary.⁹³ These provisions, taken together, in essence, build in a proportionality exercise to Test C to ensure that *ex-ante* regulation via a licence is only imposed where it is suitable, necessary and proportionate.

Ex-post powers

6.16 *Ex-post* powers, which are discussed below, include:

- competition law powers;
- the ACRs;
- the AGRs; and
- monitoring.

6.17 *Ex-post* powers are designed to protect the degree of competition that already exists within a market (which may not be effective). Action under competition law and our sectoral powers may take time to reach a conclusion post-breach and the remedial powers may be more limited.

6.18 Unlike Test B, we would expect to give equal weight to all possible *ex-post* interventions in assessing the potential benefits from using an *ex-ante* licence. These are described below.

Competition law powers

6.19 We have concurrent powers with the CMA⁹⁴ to:

- undertake investigations into whether a prohibition under the CA98 or under the TFEU has been breached in relation to airport operation services:

⁹² Section 1(4) CAA12

⁹³ Chapter 1 section 73(2A)(b) Regulatory Enforcement and Sanctions Act 2008 as amended by section 104 CAA12

⁹⁴ The CMA took over the duties of the Competition Commission (CC) and the Office of Fair Trading (OFT) from 1 April 2014.

- Article 101 TFEU and the Chapter I prohibition in CA98 both prohibit agreements between undertakings,⁹⁵ decisions by associations of undertakings and concerted practices that have the object or effect of preventing, restricting or distorting competition; and
- Article 102 of TFEU and the Chapter II prohibition in CA98 both prohibit conduct by one or more undertakings which amounts to an abuse of a dominant position in a market.
- undertake market studies and make market investigation references to the CMA under the EA02 with respect to the provision of AOS:
 - market studies, carried out under our competition law powers, assess whether a particular market is improving choice and value for aviation consumers, potentially leading to proposals as to how competition might be made to work more effectively; and
 - we can make a market investigation reference (MIR) to the CMA requesting that it conduct an in-depth market investigation. Alternatively, in lieu of us making an MIR, we can accept binding undertakings from market participants to address any competition harming features we have identified.

6.20 Further details on these powers are explained in our competition power guidance.⁹⁶

Airport Charges Regulations

6.21 The Airport Charges Regulations 2011 (ACRs)⁹⁷ came into effect in November 2011 and transposed into UK law Directive 2009/12/EC of the

⁹⁵ The term 'undertaking' refers to any autonomous economic entity engaged in economic activity, regardless of its legal status and the way in which it is financed. It includes companies, firms, businesses, partnerships, individuals operating as sole traders, agricultural cooperatives, associations of undertakings, non-profit making organisations and (in some circumstances) public entities that offer goods or services on a given market. Companies in the same corporate group will generally be considered to constitute a single 'undertaking'.

⁹⁶ CAP 1235 - 'Guidance on the Application of the CAA's Competition Powers', is available from www.caa.co.uk/CAP1235

⁹⁷ The airport charges directive can be found at: eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32009L0012

European Parliament and of the Council of 11 March 2009 on airport charges. The ACRs cover operators of all airports handling over 5 million passengers and provide airlines with a number of protections. For example, it requires airport operators to provide information to and consult with airlines when changing airport charges, and to not discriminate between airlines without relevant, transparent and objective justification.

- 6.22 We must investigate complaints by an airline on which airport charges have been levied, or by another airport operator that considers its business has been harmed by the airport operator not complying with the ACRs. We may also investigate on our own initiative.
- 6.23 More information on the ACRs can be found on our website⁹⁸, along with our 'Guidance on the application of the CAA's powers under the Airports Charges Regulations 2011' (CAP1343).⁹⁹

Airports (Groundhandling) Regulations

- 6.24 Airports (Groundhandling) Regulations 1997 (AGRs) transpose the European Groundhandling Directive into UK law.¹⁰⁰ Groundhandling covers a multitude of activities including check-in, handling baggage, cargo and mail, re-fuelling aircraft, and transporting passengers and crew to aircraft. The AGRs place some limitations on airport operators at airports with more than 2 million passengers annually, if they want to restrict the number of third-party groundhandlers that operate at the airport. The AGRs also constrain airports with more than 1 million passengers if they want to restrict the number of self-handling airport users. If an airport covered by these regulations wants to restrict the number of third-party groundhandlers or self-handling airport users that

The airport charges regulations can be found at:

<http://www.legislation.gov.uk/ukxi/2011/2491/contents/made>

⁹⁸ More information on the ACRs can be found at: www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Competition-policy/Airport-charges-regulations/

⁹⁹ CAP1343 – 'Guidance on the application of the CAA's powers under the Airports Charges Regulations 2011', is available from www.caa.co.uk/CAP1343

¹⁰⁰ Airport Groundhandling Regulations – The airport groundhandling directive can be found at: eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:31996L0067

The airport groundhandling regulations can be found at:
www.legislation.gov.uk/ukxi/1997/2389/made

operate at the airport, it requires a determination from us to be able to do so.

6.25 There are currently no legal restrictions on the number of handlers at airports in the UK. Where handlers use aircraft facilities, such as check-in desks, baggage belts and fuel hydrant systems, the airport operator must set its charges according to relevant, objective, transparent and non-discriminatory criteria. We must investigate alleged breaches of the AGRs.

6.26 More information on the AGRs can be found on our website.¹⁰¹

Monitoring

6.27 We have a duty under section 64 of CAA12, so far as it appears practicable to do so, to keep under review the provision of AOS and to collect information about those services. Further details on this power are explained in our competition guidance.¹⁰²

6.28 Section 50 of CAA12 allows us to require the provision of information or documentation that we reasonably require for the purpose of carrying out our functions related to the regulation of operators of dominant airports under Chapter 1 of CAA12.

Making the comparison

6.29 In making a comparison to establish whether, 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, we need to determine what the comparison will be between.

¹⁰¹ More information on the AGRs can be found at: www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Competition-policy/Airports-Groundhandling-Regulations-1997/

¹⁰² CAP 1235 - 'Guidance on the Application of the CAA's Competition Powers' can be found at: www.caa.co.uk/CAP1235

Airport operator that does not hold an economic licence

- 6.30 If we are making an MPD of an airport whose operator does not hold an economic licence, we would make a comparison between the status quo (an airport without economic licence regulation) and an airport regulated by means of a generic economic licence¹⁰³ (the counterfactual).
- 6.31 In developing this counterfactual we will consider the existing commercial behaviours of the airport operator. For example, where there are existing agreements in place between the airport operator and third parties, we will consider these as part of the counterfactual.
- 6.32 If after assessing Tests A, B and C, we determine that the MPT is met, only then will the specific licence conditions for the airport operator be developed. This is covered in Chapter 7.

Airport operator that holds an economic licence

- 6.33 If we were making an MPD for an airport whose operator already holds an economic licence, we would make a comparison between the likely behaviour of the airport operator without an economic licence and a generic economic licence (the counterfactual). We consider that a generic licence is the appropriate counterfactual as Test C considers the imposition of regulation, not its intensity.
- 6.34 In assessing the airport operator absent its economic licence, we would take into account the behaviour that the airport operator had exhibited under the regulation currently applicable. For example we would take into account any agreements that the airport operator had developed with third parties independently of its regulation.
- 6.35 If after assessing Tests A, B and C, we determine that the MPT is met, then the specific licence that the operator holds would be reviewed. This is covered in Chapter 7.

¹⁰³ We would not go into specifics of the precise form of licence regulation.

Areas considered under Test C

Benefits of economic regulation

6.36 The assessment of the benefits of economic regulation by an economic licence includes an assessment of the impact on prices, efficiency, service quality and investment, and other potential benefits of economic licence regulation. These benefits will be assessed from the perspective of the current and future users of air transport services – namely passengers and those with a right in cargo.

6.37 Following are points that our assessment could include:

- **revenues** - licence regulation may have an effect on expected revenues through revenue caps or monitoring, which can benefit users of air transport services. For example, regulation may ensure one of more of the following:
 - prices charged are cost-reflective;
 - the overall level of charges is capped;
 - the airport operators is limited in its ability to charge excessive prices; and/or
 - price changes can be predictable if they occur in line with a stable pricing mechanism depending upon changes in the underlying level of efficient costs.
- **efficiency** - licence regulation can be an effective way of promoting and incentivising operating and capital expenditure efficiency, if it mimics the market forces of effective competition by challenging the airport operator's reported operating and capital costs and efficiency assumptions putting downward pressure on them. This can benefit users of air transport services by driving the provision of a more efficient service.
- **service quality** - licence regulation can address service quality through greater regulatory scrutiny, incentivising airport operators to take into account the views of stakeholders. It can promote service quality standards and as a result protect air transport users from service quality standard failures.

- **investment incentives** - licence regulation can provide incentives to invest, for example by providing a more certain mechanism by which investment can be remunerated. This can ensure investment decisions are made which benefit users of air transport services. For example, regulation can ensure one or more of the following:
 - airlines are engaged in the process for identifying and scoping new capital expenditure and that this is reviewed and agreed with us as part of the regulatory process prior to its realisation;
 - investment is rewarded through a fair rate of return which is known *ex-ante*; and
 - new facilities are procured in the most efficient way to protect users against paying for the development of “*gold plated*” or inferior investments.
- **operational resilience** - licence regulation can be used to compel or incentivise the airport operator to ensure operational resilience, incentivising them to use the levers at their disposal to encourage and co-ordinate the relevant stakeholders to greater effect; and to protect users' interests in improved resilience.
- **financial resilience** - licence regulation can facilitate financial resilience, by the provision of financial undertakings, minimum financial standards (e.g. credit ratings), and limitations on financial and business activities. This can benefit users of air transport services by encouraging the airport operator to be financially resilient and able to finance their activities.

Adverse effects of economic regulation

- 6.38 The assessment of the adverse effects of economic regulation through a licence includes considering the direct costs and other adverse effects of holding a licence.
- 6.39 Direct costs which will be incurred include the time and expenditure of management and regulation staff at the CAA, the regulated airport operator and airlines.

6.40 Other potential adverse effects from licence regulation may include the following:

- **crowding out of a more commercial approach**, such as commercial contracts, investment and development that would encourage commercial growth in aeronautical and non-aeronautical revenues. This could have an adverse effect on users of air transport services by the airport operator being focussed on the incentives in its licence rather than on a commercial approach such as growth in services offered.
- **management distraction**, which can distort incentives by distracting management to focus on maximising the value from a regulatory settlement rather than to focus on improved efficiency or service quality. This could have an adverse effect on users of air transport services by the airport operator being distracted from improving efficiency or service quality for the benefits of users.
- **distortions to incentives**, such as incentives that encourage too much or too little investment, distortions in the trade-off between operating and capital expenditure, distortions of the service quality requirements and associated financial incentives so that they do not match passengers' priorities or there is a focus only (or primarily) on attributes that can be easily measured. This could have an adverse effect on users of air transport services if the airport operator has incentives that do not match users' priorities or the incentives become misaligned with users' priorities over time.
- Other potential distortions include the **increased rigidity of a regulatory system**, in particular in relation to consultation requirements on changes in charges and service quality, and the requirement for capital plans to be set too far in advance. This could have an adverse effect on users of air transport services by the airport operator being focused more on meeting the regulators requirements than on services that are to the benefit of users.

6.41 Our assessment will take into account the examples above as a guide to assessing the benefits and adverse effects, to current and future users of

air transport services, of regulating the relevant operator by means of a licence.

Assessing *ex-ante* licence regulation and *ex-post* powers

6.42 The assessment of the benefits of introducing economic licence regulation includes assessing the application of the sectoral regulatory powers that are already in place. This directs us to weigh the comparative merits of *ex-post* powers (through competition law, and other sectoral powers) as a sufficiently effective alternative to *ex-ante* regulation under an economic licence.

6.43 We will need to consider carefully the potential risks involved between using *ex post* powers and *ex-ante* regulation on a forward looking basis to assess whether the benefits of regulating the relevant operator by means of a licence are likely to outweigh the adverse effects. In assessing *ex-post* powers or *ex-ante* licence regulation, we would take into account the following factors:

- whether the likely issue is forward or backward looking, for example:
 - *ex-ante* is forward-looking - it can prescribe or control types of market behaviour regardless of particular circumstances, based on public policy priorities or market failures that are found to exist in the market and need to be remedied; whereas
 - *ex-post* is backward-looking and relies on historical evidence of abuse that has occurred in an otherwise commercially competitive market.
- the specific or general nature of the likely issue, for example:
 - *ex-ante* issues could be focused on addressing market failures arising from a certain industry structure or history; whereas
 - *ex-post* issues could be focused on redress for past actions and prohibiting future actions of a similar nature.
- the nature of the available remedies, for example:
 - *ex-ante* remedies are usually narrow in scope, essentially declaratory in nature and neutral in terms of broader

implications for industry of the remedies sought in a specific piece of litigation; whereas

- *ex-post* remedies are generally very specific in nature, but general in scope, affecting the majority of customers. They are generally cost based assuming an efficient operator, and are defined in focus by the legislative context.
- the time taken to deal with potential issues, for example:
 - *ex-ante* issues are generally enforced through independent sector-specific regulators such as ourselves. Where the regulator has the power to act, this can be taken quickly - in weeks or months and sometimes immediately; whereas
 - *ex-post* issues are usually dealt with through the Courts, the EC, the CMA or ourselves, where case law tells us this can take months to years to reach a conclusion.

6.44 Our assessment of Test C will include the factors noted above to assess the comparative merits, for the specific circumstances of the airport operator being assessed, of *ex-post* powers (through competition law, and other sectoral powers) as a sufficiently effective alternative to *ex-ante* regulation under an economic licence.

Summary

6.45 Test C considers whether, 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.¹⁰⁴

6.46 We intend to apply the MPT ahead of considerations of the form of licence that may be applied in any specific case once an MPD has been made.

6.47 Generally, Test C is a balancing exercise between the benefits of a licence imposed on the relevant airport operator and a situation where there is no licence. This means that the risk of the operator abusing its

¹⁰⁴ Section 6(5) of CAA12

market power is constrained only by existing market forces and general regulatory (non-licence) provisions.

- 6.48 The assessment may be qualitative or quantitative, or a combination of both, depending upon the availability of the relevant data. Where it is reasonably practicable to quantify the respective benefits and adverse effects, we will do so.
- 6.49 As part of Test C, we will assess the suitability of an *ex-ante* or *ex-post* approach against the nature of the likely issues which we consider to create the greatest risks for users of air traffic services.

Chapter 7

Once an MPD has been made

Introduction

7.1 This chapter explains what happens after an MPD has been made and when a future MPD could be considered.

7.2 This chapter is set out as follows:

- once an MPD has been made; and
- sectoral regulation and subsequent MPDs.

Once an MPD has been made

If the MPT is met by an operator without a licence

7.3 If an MPD concludes that the market power test is met by an airport operator in relation to an airport area, then that airport operator will require an economic licence in order to be able to levy charges. In some cases, we may decide to begin the process of developing a licence alongside the MPD.

7.4 The detailed process of granting a licence may vary from time to time but is likely to include the following steps:

- 1) we will normally treat the airport operator as making an application for a licence in accordance with section 14(4) of CAA12 and will begin the process of developing a licence. In some cases, we may require the airport operator to make and publish an application for a licence accompanied by the specified information under section 14(1) of CAA12;
- 2) we will consult with interested stakeholders to explore areas of concern including the appropriate form of regulation and the potential scope of licence conditions;

- 3) will publish our initial proposals on the regulation of the airport operator;
- 4) written representations from stakeholders may be submitted in response to our initial proposals under timescales which we will specify;
- 5) we will issue our final proposals, including the proposed licence conditions for the airport operator and our reasons for the proposed conditions. That document may constitute the notice of a proposal to grant a licence under section 15(1) of CAA12, or we may decide it is more appropriate to issue that notice separately, following representations on the final proposals;
- 6) written representations may be submitted in response to our final proposals;
- 7) if required, we may include additional consultation stages prior to issuing final proposals;
- 8) we will publish a copy of the licence under section 15(5) of CAA12. The notice will specify, among other things, the date on which the licence will come into force, our reasons for the conditions included in the licence, a summary of our response to representations received and the reasons for any differences between the conditions included in the licence and those set out in the final proposals; and
- 9) the airport operator and any other person with a qualifying interest (e.g. airlines) will have up to six weeks from the date of publication of the licence and notice to decide whether or not to seek permission to appeal to the CMA.

If the MPT is met by an operator with a licence

7.5 If an MPD concludes that the MPT is met by an airport operator in relation to an airport area, then that airport operator will require an economic licence in order to be able to levy charges. Where that airport operator already has an economic licence, we will review that licence to determine if it needs to be modified in the light of the MPD.

- 7.6 The detailed process of reviewing and modifying a licence may vary from time to time but is likely to include the following steps:
- 1) we will normally talk to the airport operator to begin the process of reviewing the licence;
 - 2) we will consult with interested stakeholders to explore areas of concern including the appropriate form of regulation and the potential need and scope for changes to the existing licence conditions;
 - 3) we will publish our initial proposals on the regulation of the airport operator;
 - 4) written representations from stakeholders may be submitted in response to our initial proposals under timescales which we will specify;
 - 5) we will issue our final proposals, including the proposed licence conditions for the airport operator and our reasons for the proposed conditions. That document may constitute the notice of a proposal to modify the licence under section 22(2) of CAA12, or we may decide it is more appropriate to issue that notice separately, following representations on the final proposals;
 - 6) written representations may be submitted in response to our final proposals;
 - 7) if required, we may include additional consultation stages prior to issuing final proposals;
 - 8) we will publish a copy of the licence modifications under section 22(6) of CAA12. The notice will specify, among other things, the date on which the licence modifications will come into force, our reasons for the conditions included in the licence, a summary of our response to representations received and the reasons for any differences between the conditions included in the licence and those set out in the notice proposing the modifications; and
 - 9) the airport operator and any other person with a qualifying interest (e.g. airlines) will have up to six weeks from the date of publication of the licence modification notice to decide whether or not to seek permission to appeal to the CMA.

If the MPD concludes that the MPT is not met

- 7.7 If an MPD concludes that the market power test is not met by an airport operator in relation to an airport area, then that airport operator will not require an economic licence in order to be able to levy charges.
- 7.8 In this situation, we will continue to use our sectoral regulatory powers (summarised below).
- 7.9 In doing so, we will consider whether any developments of which we become aware constitute a material change of circumstances. If they do, we may consider undertaking a further MPD.

Sectoral regulation and subsequent MPDs

- 7.10 Regardless of whether we make an MPD that an airport operator does, or does not, meet the MPT for the relevant market at any point in time:
- we have sectoral regulatory powers (as outlined in chapter 6) that still apply and which we will consider using in appropriate circumstances; and
 - we recognise that circumstances may change in the future. Such change may necessitate a fresh look at the question of whether the three elements of the MPT are met in relation to an airport operator.
- 7.11 Under section 7 of CAA12:
- we may make an MPD whenever we consider it is appropriate to do so; and
 - if there has been a material change of circumstances since we last made an MPD, then an airport operator or another person whose interests are likely to be materially affected may request that we make a new MPD, and we must make an MPD.
- 7.12 The results of any subsequent MPD could lead us to consider the need for economic regulation of an airport operator.

- 7.13 In considering whether a further MPD should be undertaken, we are likely to consider whether there has been any material change of circumstances since the previous MPD. The airport operator or an affected party can make a request to us at any time if they consider that there has been such a material change.

Appendix A

Possible initial evidential requirements

1. The initial requests for information and analysis could include, as a starting point, for example, the following.
2. From the airport operator:
 - past airport accounts of revenues, costs and profitability by business activity;
 - data on the evolution of output volumes (such as passengers, flights and cargo tonnage);
 - airport charges received by airline and passenger;
 - detailed structure of charges;
 - terms of bilateral commercial agreements between airport and airlines;
 - behavioural evidence (service quality and consumer satisfaction; profitability, operational and financial efficiency, etc);
 - evidence of consultation/liaison with airlines on capital investment projects and traffic projections;
 - consumer and market research they may have to inform the evaluation of competitive constraints faced by the airport operator;
 - estimates of how costs vary with output volumes;
 - estimates of how non-aeronautical revenues vary with output;
 - evidence of whether and by how much airport demand by passengers; cargo and airlines responds to price/quality; and
 - financial business plans and details of forthcoming investment projects.
3. From airlines:
 - airport charges paid at the airport, neighbouring airports and at “*comparable*” airports elsewhere;

- past route revenue, profitability, number of flights and passengers by month at the airport as well as at neighbouring airports and at “comparable” airports elsewhere;
 - evidence on switching costs and investments made in airports by airlines and presence of other alliance members;
 - evidence on the level of airline competition across airports (own and cross-airport airfare elasticities);
 - qualitative evidence on level of commercial engagement with airport operator;
 - consumer and market research they may have to evaluate competitive constraints faced by airports; and
 - terms of bilateral commercial agreements with airport operators.
4. From various sources, any interested party, including CAA’s own information:
- existing passenger surveys and/or commission new surveys on passenger profile, determinants of airport choice, and views on airport substitutability;
 - traffic volumes by airline at the airport as well as neighbouring and comparable airports;
 - catchment areas and extent of overlap between airports;
 - route overlaps with substitutable airports;
 - proportion of passengers connecting between flights at the airport and their profile;
 - traffic demand forecasts including cargo;
 - capacity constraints at the airport and at neighbouring airports; and
 - commission (DfT’s forecasting model, for example) estimates of airport substitutability.
5. However, when we decide to undertake an MPD, we will determine at that time what evidence we need. This will include discussions with the key stakeholders about evidence and research that they have, and considering whether we may conduct or commission research to aid our assessment.