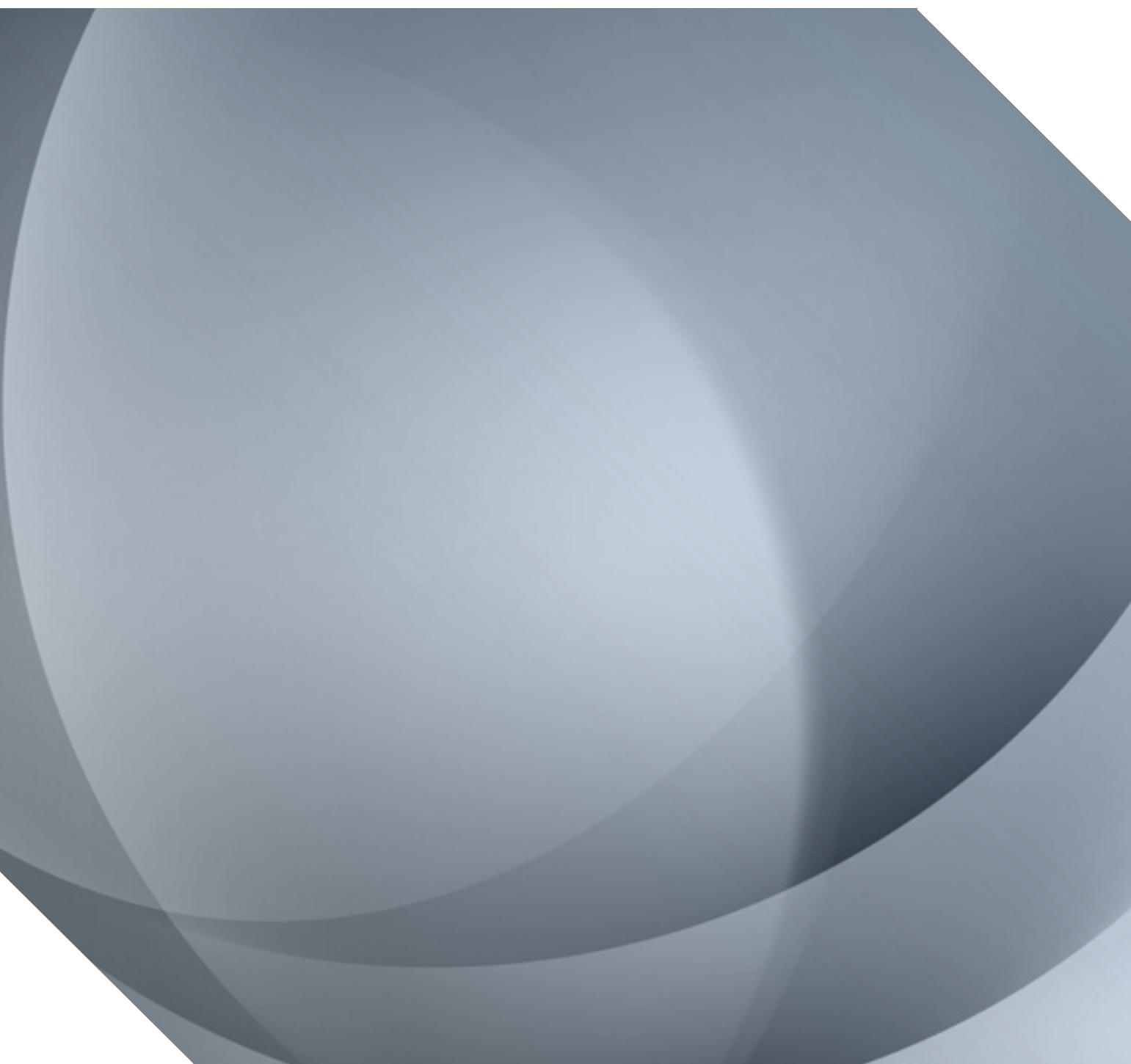


Investigation under Section 41 of the Airports Act 1986 of the structure of airport charges levied by Heathrow Airport Limited - CAA decision

CAP 1174



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CHAPTER 1**Background and preliminary matters**

- 1.1 This document sets out the CAA's investigation and decision, under section 41 of the Airports Act 1986 (the Act), into whether Heathrow Airport Limited (HAL) unreasonably discriminated against any particular user or class of user of the airport in restructuring its landing charges and per passenger charges from 1 April 2011. This document also sets out the CAA's decision whether to exercise its discretion to impose a condition on HAL to remedy or prevent the adverse effects of any unreasonable discrimination.
- 1.2 This document constitutes a report by the CAA under Regulation 11(3) of the Civil Aviation Authority (Economic Regulation of Airports) Regulations 1986. Under regulation 11(4) of regulations a decision as to the form and content of the report shall be taken only by a member of the CAA. The decision on the form and content of this report was taken by Iain Osborne (Group Director Regulatory Policy) a member of the CAA.

Structure of document

- 1.3 The document is structured as follows:
- Chapter 1 sets out the background to the complaint received, the CAA's investigation and some preliminary matters. It includes a history of the case, sets out which parts of the original complaint are no longer being pursued, the statutory framework in the Act under which the CAA has powers to investigate HAL's conduct, statements by the CAA as to how it performs its functions, and a summary of the remaining parts of the complaint that are being pursued.
 - Chapter 2 considers the application of the statutory tests. Whether the CAA has the right to investigate the matter, whether HAL's pricing policy was discriminatory, who is suffering the discrimination, and whether the discrimination is unreasonable.
 - Chapter 3 considers whether HAL's pricing policy has had any adverse effects on a class of user or on a particular user.
 - Chapter 4 considers whether the CAA should exercise its statutory discretion to impose a remedy.
 - Chapter 5 summarises the CAA's conclusions.

- The Appendices are:
 - Appendix A: July 2011 investigation/consultation
 - Appendix B: July 2012 notice
 - Appendix C: August 2012 notice
 - Appendix D: May 2013 notice
 - Appendix E: October 2013 investigation/consultation
 - Appendix F: List of evidence considered
 - Appendix G: Transfer Passenger Charge
 - Appendix H: Use of competition law in section 41 cases
 - Appendix I: HAL's cost modelling for passenger charges
 - Appendix J: The direct financial impact on Aer Lingus
 - Appendix K: Approach to competition analysis

History of this matter

HAL's new structure of charges

1.4 In 2010 and 2011, HAL consulted airlines on re-structuring its airport charges. The steps in its consultation process are set out below:

- January–June 2010 – informal meetings with airline community.
- 2 August 2010 – HAL consultation document proposing changes in the structure of charges.
- 29 October 2010 – HAL decision document¹ revising its structure of landing and per passenger charges from 1 April 2011. HAL had proposed amending the structure of its aircraft parking and air navigation service charges as well, but did not amend them in its final decision. Instead, HAL decided to consult further with airlines on these charges. (On 18 March 2011, HAL published a consultation document proposing changes in the structure of aircraft parking charges.)
- 12 November 2010 – HAL consultation document² proposing its airport charges for 2011/12. The proposals reflected HAL's revised structure of charges and increases allowed under the price cap set out in the CAA's March 2008 decision.

1 Available at <http://www.caa.co.uk/docs/5/HALStructureChargesOct10.pdf>

2 Available at <http://www.caa.co.uk/docs/5/rpg2011/halchargesconsult.pdf>

- 7 January 2011 – HAL decision on charges for 2011/12³.
- 1 April 2011 – new charges came into force.

1.5 The main changes brought about by the new structure were:

- Passenger charges were structured so that there is a charge for all passengers on European routes, and a charge for all other passengers. Previously, there were separate charges for domestic, Republic of Ireland (ROI) and international passengers.
- A 25% discount to the passenger charge was introduced for transfer passengers.
- For landing charges the Chapter 3 minus noise category was abolished and the Chapter 4 noise category divided into three sub-categories.

bmi's complaint and Aer Lingus' support for it

1.6 On 28 January 2011, bmi complained to the CAA that the effects of certain parts of HAL's re-structuring of charges from 1 April 2011 would have a particularly damaging effect on bmi's business at Heathrow. The changes would result in bmi incurring significant losses and force bmi to withdraw certain routes in circumstances where it was unable to mitigate substantially the significant financial impact of doing so. bmi complained that:

- The decision to equalise domestic passenger charges with those for EU passengers unreasonably discriminated against bmi and passengers on domestic routes.
- The decision to base landing charges solely on movements and noise values, ignoring the higher infrastructure costs generated by the operation of larger aircraft, unreasonably discriminated against short-haul carriers.
- The decision by HAL to implement these charges decisions in 2011/12, rather than introducing them gradually over time, unreasonably discriminated against bmi.

1.7 bmi said that the impact of the increase in charges for domestic passengers from £13.43 to £20.25⁴ was a significant change. HAL had failed to demonstrate that the increase was justified by reference to cost. The previous charges recognised that domestic passengers used fewer facilities and infrastructure than international passengers. HAL had ignored the impact of the change on

³ Available at www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=12293.

⁴ In its October 2010 decision document on airport charges, HAL said that £20.25 would be the European passenger charge if the structure had been applied to the level of airport charges allowed under the price cap for 2010/11. The actual European passenger charge from 1 April 2011 was £21.80 taking into account the higher price cap for 2011/12.

bmi, which was unique in its reliance on the domestic market. Noting that HAL had argued that the transfer passenger discount would offset the increase in domestic charges, bmi said as only 30% of its domestic passengers were transfer passengers, whereas 60% of Heathrow's domestic passengers overall were transfer passengers HAL had overestimated the effect of the transfer passenger charge offset.

- 1.8 bmi considered that HAL's passenger charges unreasonably discriminated against passengers as the effect of the increase for domestic passengers would be a loss of routes, and there were no suitable alternatives either by surface transport or routes switching to another London airport.
- 1.9 In its written representations, Aer Lingus supported bmi's complaint. It said that HAL had substantial market power and it would not be commercially viable for Aer Lingus to switch its services to other London airports. Aer Lingus considered that:
- HAL's costs of handling domestic and ROI passengers were materially different from HAL's costs of handling international passengers. HAL relied on the transfer passenger discount to mitigate the discriminatory effects of its passenger charges. However, Aer Lingus thought the discount provided no assistance to airlines such as itself which carried below average numbers of transfer passengers;
 - HAL's landing charges unfairly penalised airlines such as itself and bmi that used smaller aircraft and had to spread the fixed landing charge over a smaller number of passengers; and
 - HAL's failure to introduce the change gradually was a clear breach of ICAO principles.
- 1.10 Aer Lingus claimed that it would be forced to pass on the higher charges to passengers. Consequently, this risked that its network would be severely diminished thereby adversely impacting both origin and destination and connecting services to the detriment of passengers.

CAA investigation

- 1.11 Following a preliminary investigation, the CAA considered that HAL's justifications for its revised charging structure needed to be transparently and objectively substantiated. The CAA launched its formal investigation on 6 July 2011 by consulting interested parties on the matter⁵.
- 1.12 The CAA received responses to its consultation from HAL, bmi, Aer Lingus, Virgin, a joint response from US airlines (American, Delta, United and US

⁵ 'Investigation under Section 41 of the Airports Act 1986 of a complaint made by bmi against Heathrow Airport Limited – a consultation' (July 2011 is at Appendix A) available on the CAA website.

Airways), Gatwick Airport Limited, Belfast City Airport, the Consumer Council for Northern Ireland, and Oliver Hogan/David Starkie⁶.

- 1.13 bmi, HAL and Aer Lingus asked to take part in an oral hearing before the CAA's Group Director of Regulatory Policy and CAA staff. Subsequently, bmi decided not to attend the hearing and has not pursued the matter since⁷. The CAA received evidence from HAL and Aer Lingus at an oral hearing on 27 January 2012.
- 1.14 Following completion of its investigation, on 12 March 2012, the CAA published its decision. The CAA found that there was not a sufficient basis to conclude that HAL's conduct amounted to unreasonable discrimination.
- 1.15 On 26 April 2012, Aer Lingus informed the CAA that it was considering applying to the High Court for a judicial review of the CAA's decision. On 10 May 2012, Aer Lingus sent the CAA a draft of its Statement of Grounds for judicial review.
- 1.16 On 20 July 2012, the CAA published an investigation notice to the effect that it would consider the points raised by Aer Lingus and that the CAA's decision of 12 March should be treated as a provisional decision. The CAA requested comments on its provisional decision by 10 August 2012.
- 1.17 Aer Lingus and HAL responded to the CAA's notice. On 30 August 2012, the CAA sent Aer Lingus' response to HAL, and a redacted version of HAL's response to Aer Lingus.
- 1.18 On 13 September 2012, Aer Lingus and HAL sent the CAA their respective comments on each other's responses.
- 1.19 On 17 December 2012 the CAA published its decision. The CAA found that HAL's passenger charges were unreasonably discriminatory against the class of user that paid the combined ROI/domestic passenger charge. However, the CAA did not consider there were sufficient grounds on which it should exercise its discretion to impose a condition on HAL to remedy any adverse effects of that discrimination.
- 1.20 On 21 May, following an application for judicial review by Aer Lingus dated 13 February 2013, the CAA withdrew its December 2012 decision. On 29 October 2013, the CAA consulted on the issues raised by Aer Lingus in its application for judicial review. The CAA in particular invited further representations on the financial impact on Aer Lingus of HAL's revised passenger charges and the methods by which the CAA should assess whether there had been any effect on competition.

⁶ The responses are on the CAA website at <http://www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=12293>.

⁷ In April 2012 bmi was acquired by International Airlines Group.

- 1.21 The CAA received representations from Aer Lingus, Gatwick Airport Limited, HAL, Ryanair and Virgin. The CAA also invited, and received, representations on these representations from Aer Lingus and HAL.
- 1.22 Appendices A to E to this decision contain the following CAA documents:
- The July 2011 investigation/consultation;
 - The July 2012 notice;
 - The August 2012 notice;
 - The May 2013 notice; and
 - The October 2013 investigation/consultation.
- 1.23 Overall the CAA has received submissions from ten parties throughout the period since it received bmi's original complaint. This includes the evidence at the oral hearing. For the purpose of making this decision the CAA has carefully reconsidered all the evidence that has been submitted to it since receiving bmi's complaint on 28 January 2011. A full list of the evidence reconsidered in this matter is at Appendix F.
- 1.24 Aer Lingus has been critical of the CAA's investigation into this complaint. It has complained that the CAA has introduced new issues that have not been considered by the parties (see paragraphs 1.2.4 - 1.2.5 of Aer Lingus' November 2013 representation). However, throughout this decision process the CAA has drawn attention to where its approach or view of the correct analysis to undertake has changed. The CAA does not accept that the parties interested in the complaint have not had a chance to comment on the CAA's approach. The CAA has consulted with parties at every stage and has taken all the responses received into account.

Parts of the complaint no longer pursued

- 1.25 Although bmi complained about HAL's passenger charges (including the transfer passenger discount), landing charges and the lack of gradualism in introducing the revised structure of charges, Aer Lingus said at the hearing that it was no longer pursuing a challenge to HAL's landing charges or the lack of gradualism in HAL's re-structuring. As these are no longer being pursued by any party, and in accordance with CAA policy set out in paragraph 3.17 of its 2006 document on its policy and processes for handling section 41 complaints⁸ (that its process would normally be complaint driven) the CAA will not be dealing with these aspects of the complaint further in this decision.

⁸ The CAA's use of section 41 of the Airports Act 1986 – the CAA's policy and processes (December 2006), available at <http://www.caa.co.uk/docs/5/ergdocs/section41policy.pdf>

- 1.26 The transfer passenger charge was part of bmi's complaint. That complaint was supported by Aer Lingus. Aer Lingus has not informed the CAA that it is no longer pursuing this aspect of its complaint but it has not mentioned it since the hearing. The CAA's decision in respect of the complaint regarding the transfer passenger charge remains the same as the decision it reached on this issue in March 2012 and December 2012 (as set out in the provisional and withdrawn decisions respectively) and for the same reasons. These reasons are summarised in Appendix G. In summary as the transfer passenger charge is cost-based the CAA has concluded it is not discriminatory. As a consequence it is not necessary for the CAA to consider whether there are adverse effects of the charge and, if so, whether to impose a condition in respect of the transfer passenger charge.

The statutory framework

- 1.27 The economic regulation of airports in Great Britain designated for price control is governed by the Act⁹. Under the Act, an airport operator with an annual turnover exceeding £1m must obtain a permission to levy airport charges.
- 1.28 Heathrow Airport was designated for price control by the Secretary of State in 1986 who also issued the permission to levy airport charges in respect of Heathrow. Consequently, since 1987 HAL has been subject to a price cap on its airport charges. The price cap controls the totality of airport charges and not individual charges paid by individual airlines. When he designated Heathrow the Secretary of State indicated that he expected the airport to consult airlines on the detailed structure of its charges but with airlines having recourse to section 41 of the Act.
- 1.29 Under section 41 of the Act¹⁰ the CAA may, if it thinks fit and where there is a permission to levy airport charges in force, impose a condition on an airport operator where it appears that it is carrying out a course of conduct specified in section 41(3). One of the courses of conduct is:
- (a) the adoption by the airport operator, in relation to any relevant activities carried on by him at the airport, of any trade practice, or any pricing policy, which unreasonably discriminates against any class of users of the airport or any particular user or which unfairly exploits his bargaining position relative to users of the airport generally.

9 The designated airports are currently Gatwick, Heathrow and Stansted. From 1 April 2014, economic regulation of designated airports under the Act will cease. Instead the economic regulation of airports will be governed by the Civil Aviation Act 2012.

10 There is no direct equivalent to section 41 in the Civil Aviation Act 2012. However, under the 2012 Act the CAA has concurrent powers with the Competition and Markets Authority to enforce the prohibitions on anti-competitive conduct (including the abuse of a dominant position in a market) in the Competition Act 1998.

- 1.30 Users of the airport are defined in section 82 of the Act as:
- a person for whom any services or facilities falling within the definition of “relevant activities” are provided at the airport; or
 - a person using any of the air transport services operating from the airport.
- 1.31 This definition includes both airlines operating at the airport and passengers flying to or from the airport.
- 1.32 Relevant activities are defined in section 36(1) of the Act as the provision at the airport of any services or facilities for the purposes of:
- the landing, parking or taking off of aircraft;
 - the servicing of aircraft (including the supply of fuel); or
 - the handling of passengers or their baggage or of cargo at all stages while on airport premises (including the transfer of passengers, their baggage or cargo to and from aircraft).
- 1.33 In carrying out its regulatory functions, including assessing whether it appears that an airport operator has engaged in conduct described in section 41 of the Act, section 39 of the Act requires that the CAA does so in the manner it considers is best calculated:
- to further the reasonable interests of users of airports within the United Kingdom;
 - to promote the efficient, economic and profitable operation of such airports;
 - to encourage investment in new facilities at airports in time to satisfy anticipated demands by the users of such airports; and
 - to impose the minimum restrictions that are consistent with the performance by the CAA of its functions.
- 1.34 Under section 42(3) of the Act where the CAA receives a representation from a non-UK airline that an airport operator may be carrying out one of the courses of conduct in section 41 of the Act, the CAA has to notify the Secretary of State of the representation. In its decision, the CAA has to take into any account any advice given to it by the Secretary of State on practices at airports outside the UK. In this case, the CAA notified the Department for Transport of Aer Lingus’ representation on 12 January 2012. The CAA received no advice from the Department.

Statements made by CAA as to the performance of its functions

- 1.35 In its December 2006 policy and process document the CAA said it would handle cases in a way that was consistent with its statutory powers and duties in the Act. The CAA stated that to avoid the danger of arbitrary or

distortionary regulatory interventions, it would expect to adopt an approach that was consistent with the application of competition law, except where the circumstances of a particular case suggested it should follow a different approach. The rationale for this is that the exercise of its functions under section 41 is sufficiently akin to the power of the Office of Fair Trading (OFT)¹¹ when it applies competition law for the CAA to have regard to the analytical framework that would be adopted by the OFT when handling comparable cases under the Competition Act 1998. The CAA observed that, in practice, this is likely to result in decisions which would be consistent under both section 41 and national (and EU) competition law. The CAA made clear that it would, however, remain open to arguments that in any particular case its powers and duties may lead it to a different conclusion than would result from applying the Competition Act. The CAA reconsidered this approach when preparing the withdrawn December 2012 decision. That analysis and the CAA's conclusions are set out in Appendix H.

Summary of the complaint

- 1.36 Aer Lingus' complaint was originally set out in its April 2011 submission to the CAA, and has been further particularised in subsequent representations including its application for judicial review. (The CAA's understanding of Aer Lingus' complaint is summarised in paragraph 1.9 above). Aer Lingus supported each aspect of bmi's complaint: the departing passenger charge (including the transfer passenger discount), landing charges and a breach of the ICAO principle of gradualism. As mentioned in paragraph 1.25, Aer Lingus is no longer pursuing its complaint about landing charges and gradualism. The complaint regarding the transfer passenger discount is dealt with above, see paragraph 1.26 and Appendix G. Aer Lingus' remaining complaint is that the departing passenger charge unreasonably discriminates against Aer Lingus both as to domestic routes served by Heathrow and routes between the ROI and Heathrow.
- 1.37 At the oral hearing Aer Lingus set out six points on the remedies it was seeking from the CAA, these were:
- It was not trying to unpick HAL's cost figures, and was content for its modelling figures (with the errors corrected) to be reflected in the passenger charge.
 - It was not asking for any further analysis from HAL, and was asking the CAA to impose a separate domestic/ROI charge set at a level below the other European charges that reflected the 18% differential between those groups of passengers.

¹¹ On 1 April 2014 the functions of the OFT are being assumed by the Competition and Markets Authority.

- It wanted a pragmatic solution rather than a further time-consuming exercise to set charges.
- To avoid further delay the change in the charging structure should be implemented as soon as feasible.
- The CAA should order a repayment of the overcharge to Aer Lingus since April 2011.
- If the CAA considers that HAL should base its cost analysis, not only on asset costs, but also on operating costs and commercial revenues, there should be a future consultation with an immediate change based on HAL's current figures.

1.38 Notwithstanding the extensive exchanges that have taken place between Aer Lingus and CAA on the subject of Aer Lingus' complaint since the oral hearing on 12 January 2012, including the application for judicial review dated 13 February 2013, Aer Lingus has not altered the remedies that it considers the CAA should exercise its discretion to impose.

CHAPTER 2**Application of statutory tests**

Has the CAA the right to investigate the matter?

- 2.1 Under section 41 (and the definition of relevant activities in section 36), in order to consider whether to impose any conditions on HAL the CAA must first determine whether:
- Heathrow is an airport with a permission to levy airport charges;
 - The conduct by HAL is in respect of a relevant activity.
 - HAL has adopted a pricing policy.
 - HAL's passenger charges discriminate.
 - Any discrimination is against a class of user or a particular user.
 - Whether any discrimination is unreasonable.
- 2.2 As to the first of these questions, on 26 November 1986, the Secretary of State for Transport granted a permission to levy airport charges in respect of Heathrow Airport. Heathrow Airport was designated for the purposes of section 40 of the Act by the Economic Regulation of Airports (Designation) Order 1986.
- 2.3 As to the second question in paragraph 2.1, the current complaint is about HAL's airport charges. These are levied in relation to 'the landing, parking or taking off of aircraft' which are relevant activities under section 36 of the Act.
- 2.4 As to the third question in paragraph 2.1 HAL adopted a pricing policy when it announced its final charges for 2011/12.
- 2.5 The remaining questions are considered below.

Is HAL's pricing policy discriminatory?

What do we mean by discrimination?

2.6 There is no statutory definition of discrimination in the Act. However it is settled case law that discrimination can arise where equivalent terms are set for dissimilar transactions or dissimilar terms are set for equivalent transactions¹²¹³. Discrimination thus defined can be directed at or experienced by a particular user or class of user. Furthermore, it is the CAA's view that there is a question of materiality in the assessment of whether two transactions are dissimilar, and therefore whether treating them the same amounts to discrimination. This is particularly the case where the relevant difference is a difference in cost demonstrated by a cost model which is subject to a margin of error.¹⁴

Evidence relevant to whether the passenger charge is discriminatory

2.7 In its written submissions to the CAA and in its consultation with airlines, HAL said that it had a number of objectives in restructuring its charges and had used its (2005) cost modelling to analyse the effects of those proposals. As regards the passenger charge, HAL had based its modelling on an analysis of the asset costs of handling three categories of passengers: domestic/ROI, other European and non-European. HAL's cost modelling assumed a direct relationship between space required and asset cost. The CAA understands that passengers on longer flights are likely to impose higher costs on HAL as they tend to dwell longer at the airport (and therefore need more space) and carry more baggage than passengers on shorter flights. The CAA notes that this is a very basic form of model. Furthermore, in its modelling HAL largely used the results of an exercise it had undertaken in 2005 to determine the terminal usage by different categories of passengers.

12 Codorniu SA v Council of the European Union (Case C-309/89), SCAC v Associazione dei Produttori Ortofruticoli (case C-56/94) and National Farmers' Union and Others (Case C-354/95).

13 In paragraph 3.5 of its July 2011 investigation notice the CAA defined "unfair discrimination" as "applying dissimilar terms for equivalent transactions or similar terms for dissimilar transactions without an objective justification". It said these words reflected its understanding and therefore its approach to whether discriminatory behaviour is unreasonable. However, the CAA now considers that in terms of section 41 discrimination occurs whether it is objectively justified or not, and that the matter of objective justification is only taken into consideration in determining whether the discrimination was unreasonable.

14 It appears to the CAA that this view is shared by all the parties to this complaint. HAL does not consider that the transfer passenger discount of 25% is discriminatory even though the modelling reflects a 77.7% differential between transfer and non-transfer passengers. Aer Lingus appears not to be challenging this view.

- 2.8 HAL's modelling, shared with parties in the course of the CAA's investigation, showed that the cost of handling domestic/ROI passengers was 11 % lower than the cost of handling other Europe passengers. However, Aer Lingus discovered an error in HAL's modelling which, when corrected, increased the differential to 16%. At the hearing (before the CAA in January 2012), HAL accepted it had made this error.
- 2.9 Aer Lingus further contended that HAL's allocation of indexation of HAL's regulatory asset base (RAB) was incorrect, which in Aer Lingus' view further increased the differential to 18%. HAL disagreed with Aer Lingus about RAB indexation. After consultation on the issue and consideration of the representation on the point put forward by HAL and Aer Lingus the CAA has concluded that Aer Lingus' approach is more consistent with HAL's overall approach to its modelling. Whilst the modelling is very simplistic and therefore provides only an approximation of costs actually incurred by passengers or particular groups of passengers, the CAA notes that both HAL and Aer Lingus based their arguments on the differential shown by HAL's model. The CAA, therefore, has used the figure of 18% as a measure of the cost differential between serving domestic/ROI passengers and Europe passengers, in considering whether the charges are discriminatory. It does so, however, very conscious of the limitations of the modelling. HAL's modelling, and the reasons for the CAA's considerations in respect of this point, are considered in greater detail in Appendix I.

CAA analysis on whether it should conclude the passenger charge is discriminatory

- 2.10 The question is whether this cost differential gives rise to discrimination. This issue was discussed in the CAA's Investigation dated October 2013 at paragraphs 2.10-2.15 and the CAA invited response on the level of differential that the CAA should consider not material and therefore not discriminatory. Aer Lingus said that it accepts that airport charges issued by HAL cannot always be fully cost reflective but that in its view the 5% or 10% illustrative examples put forward by the CAA in the consultation were "without justification". HAL made no further comment on the level of discrimination that the CAA should find as not material and therefore not discriminatory. However, HAL initially considered that the cost differential was 11%, and that such a differential was not material but within an acceptable margin (and therefore not unreasonable discrimination). Gatwick Airport considered that a differential between the charge and underlying costs can be acceptable and that the consideration of discrimination need not start from an assumption of a zero differential.

- 2.11 The CAA has concluded that charges need not match costs exactly to avoid being treated as discriminatory. The CAA therefore considers that a differential between the charge and cost would be acceptable, given the range of acceptable bases for pricing, the absence of an obligation to price on a cost oriented basis and the limitations of the available modelling. Furthermore each different route could impose different costs on an airport and it would be impractical to implement a charging structure that reflected these cost differences exactly on a “per airline” basis.
- 2.12 The CAA notes that there is no single ‘right’ way to allocate sunk and common costs and there are a number of legitimate approaches that HAL could adopt.
- 2.13 The CAA considers that HAL’s modelling was relatively unsophisticated and that the margin for error is therefore high. The reasons for this view are further explained in Appendix I.

CAA conclusion on discrimination

- 2.14 As the available cost modelling is only approximate its results should be treated with caution. However, even if the CAA could be confident about the accuracy of the modelling in question, the CAA would regard some level of differential as acceptable and as not necessarily constituting discrimination. The available information indicates a material difference in the cost of HAL handling passengers on domestic and ROI routes compared with the cost of handling passengers on other European routes. This differential is somewhat greater than HAL had assumed when setting the charge because of errors in its modelling. In the circumstances, and notwithstanding its concerns about the weight that can be placed on the modelling, on the basis of the available information the CAA considers that HAL’s per passenger charges discriminate against carriers that pay the combined European passenger charge when operating domestic and ROI routes.

Who is experiencing this discrimination?

- 2.15 The discrimination is against airlines operating domestic and ROI routes at Heathrow. When HAL’s new structure of charges came into force on 1 April 2011 there were three airlines which operated domestic and/or ROI routes at Heathrow: bmi, Aer Lingus and British Airways. bmi was bought by British Airways in 2012 and thus no longer operates in its own right. As a condition of the acquisition British Airways had to divest slots at the airport to operate routes on which it previously competed with bmi (including Manchester, Aberdeen and Glasgow). These slots were awarded to Virgin which operates routes to these three domestic destinations using its Virgin Little Red brand.

- 2.16 HAL differentiates its charges for classes of users and not for individual users. The CAA has not found that there is discrimination against any particular user. However a particular user in that class may be affected more than another user in that class. If that were the case it would be relevant at the stage of assessing the impacts of the discrimination (assuming that the CAA has concluded that the discrimination identified is unreasonable). Out of the three airlines that are in the class of users that have been discriminated against, the CAA notes that Aer Lingus is the only one that operates exclusively domestic and/or ROI routes at Heathrow. The effect of this is considered in this decision in the section on the financial effects of the pricing policy on Aer Lingus.

Is the discrimination unreasonable?

- 2.17 In the CAA's view there are two ways of looking at whether identified discrimination is reasonable or not. The first is whether the differential is sufficiently small or of a size that it cannot be considered to be unreasonable. The second is whether the differential treatment, whatever the size of the differential can be objectively justified.

Size of the differential

- 2.18 In the light of the issues concerning the approximate nature of the modelling noted above, the issue is not straightforward. However, as noted above, in the absence of other material the CAA has treated the information provided as indicating that there is a material difference between the costs domestic/ROI passengers impose on HAL and the charges being imposed. In the circumstances, the CAA does not treat the differential as simply too small as to give rise to unreasonable discrimination. However, given the CAA's view that the cost differential need not be zero, it follows that not all of the cost differential necessarily has the potential to be regarded as unreasonable.

Is the discrimination identified objectively justified?

- 2.19 As to the second question in paragraph 2.17 above, the CAA considers that objective justification means the pursuit of a reasonable objective by the use of reasonable means.
- 2.20 At the hearing HAL put forward four reasons why it thought a separate charge for domestic/ROI passengers was not warranted. These partly focused on presenting an objective justification of its new structure in order to explain why its effects were not unreasonably discriminatory. In terms of arguments aimed at objective justification, HAL said:

- There was a presumption in the Airport Charges Directive (ACD) for a standard EU charge, which HAL said was the starting point for its consideration of passenger charges. In particular, the Directive could be taken to mean that HAL was not permitted to discriminate between passengers from different Member States.
- There was a need to have a charging structure that was practicable. Therefore the airport had discretion to choose the granularity of its pricing structure. If HAL attempted to base all passenger charges on the cost of handling passengers according to their destination the charging structure would be too complex and unwieldy. Indeed, separating out domestic and ROI services could also lead to marked differentials.

2.21 HAL also mentioned that in terms of the effects of its charging structure:

- The structural changes to airport charges only resulted in an increase of about 7% in the total amount that Aer Lingus paid in airport charges at Heathrow, according to HAL's modelling. This is considered in Appendix J.
- The cost modelling could only approximate the passenger experience which was similar for domestic, ROI and other European passengers, so the model could not be absolutely determinative.

2.22 HAL noted that within its price control any restructuring of charges would be revenue neutral for it. In addition, it was inevitable that with over 90 airlines operating at Heathrow, there would be winners and losers and the fact that some airlines had complained ought not to be taken as evidence of unreasonable conduct in and of itself.

2.23 The CAA agrees that any restructuring of charges by HAL will be revenue neutral under the price control and that there will be winners and losers when an airport alters its charging structure. It remains however necessary to consider the issue of objective justification. It has the following observations on HAL's arguments.

a) Compliance with the ACD

2.24 The CAA recognises HAL's concern that its charging structure needs to be consistent with the ACD's requirement for non-discrimination. Article 3 of the Directive states that Member States should ensure that airport charges do not discriminate among airport users in accordance with community law. The CAA acknowledges the force of this argument by HAL and agrees that in order to comply with community law consideration should be given by HAL to the reasonableness of imposing a standard European charge. However, the CAA does not consider the ACD prevents HAL levying a separate domestic/ROI charge if otherwise justified by analysis of differences in costs and consideration of revenues.

2.25 The CAA, therefore, does not regard concerns about ACD compliance, by itself, as a justification for discrimination against airlines on domestic and ROI routes.

b) Striking a balance between reflecting actual costs and avoiding an overly complex charging structure

2.26 HAL's view is that its charging structure cannot exactly match the costs imposed on the airport by every individual passenger or airline and it is legitimate to avoid a pricing policy that is overly complex. In setting its charges HAL therefore has to exercise judgement as to how to structure its passenger charges, and that may result in winners and losers relative to a cost-oriented charge.

2.27 In its response to the October 2013 investigation Virgin commented that HAL's revised pricing policy in respect of passenger charges was in line with the policy of Manchester, Birmingham, Glasgow, Edinburgh, and Stansted. Furthermore after extensive analysis Gatwick has decided to move to a flat passenger charge for all passengers phased over 3 years¹⁵. Whilst the CAA has not carried out further analysis of these charging schemes for the purpose of this decision, it will be the case that different passengers and categories of passengers at these other airports will impose different costs on each airport. As such it is at least instructive that a number of airports approach matters on the basis of a simple charging structure.

2.28 Aer Lingus' and bmi's representations did not dispute the fact that charging schemes should not be overly complex but concentrated on the equalisation of domestic, ROI and other European charges. However, they suggested there could be other alternatives acceptable such as the retention of a separate domestic charge and a separate ROI charge, or charges set by the distance of the destination from Heathrow.

2.29 In response to Aer Lingus' views, HAL said that if it was required to set airport charges according to Aer Lingus' methodology it could potentially need to have as many as 183 separate charges, one for each destination served from Heathrow. HAL added that the cost differential was sensitive to the particular destination or group of destinations modelled. HAL considered that having so many different charges would be completely impractical, overly complex and unmanageable. This seems to the CAA to amount to an argument that its charging structure was in part justified by a need to strike a balance between cost reflectivity and complexity.

¹⁵ The CAA notes that, as mentioned at the oral hearing, Dublin's passenger charges are the same on domestic and other routes.

- 2.30 Aer Lingus considered that the fact that there may be a number of acceptable structures within HAL's margin of discretion was irrelevant. In any event, as far as Aer Lingus was aware, there was no discussion during HAL's consultation on charges about a more granular charge apart from a separate charge for domestic and ROI passengers. Furthermore, Aer Lingus contended that as a result of the Common Travel Area between ROI and the UK and the absence of immigration facilities, flights to domestic and ROI destinations were a unique category.
- 2.31 Reference to other possible approaches may illustrate the limitations of the approach being proposed by Aer Lingus. For example, flights to Europe may take around the same time as flights to destinations in the Rest of the World and, within each category, flights can hugely vary in length¹⁶. In its view, it is appropriate for the CAA to evaluate the reasonableness of HAL's charging structure with this wider perspective in mind.
- 2.32 HAL also said in its August 2011 note on its cost model that "it is equally legitimate to consider Domestic only and ROI only categories. In this case, using Rest of Europe as a base of 100%, the same model produces a relative cost of 91% for Domestic only and 95% for ROI only. These cost differentials are lower than the combined Domestic and ROI scenario due to a number of different space requirements for the particular passenger and aircraft characteristics applying to Domestic and ROI only terminals". In the CAA's view these results highlight the caution with which any modelling results should be approached.
- 2.33 Further, while the CAA has assessed whether the charge is discriminatory principally on the basis of cost reflectivity, the question of whether any discrimination is justified (that is unreasonable or not) is a broader consideration that must take account of the CAA's statutory objectives. These include furthering the reasonable interests of all airport users and the efficient and economic use of the airport.
- 2.34 Given the theoretical nature of cost models, it is the CAA's view that HAL should be able to adopt a practical and workable approach as long as it has a reasonable basis on which to do so.
- 2.35 The CAA accepts HAL's overall point that a simpler charging structure may be easier to administer than a more complex structure. The fact that some other UK airports, and Dublin airport, have either already introduced uniform flat charges, or are in the process of doing so, gives some support to HAL's argument for the reasonableness of a uniform charge for all EU destinations. It also suggests that other airports have not tended to rely on the results of imprecise cost modelling to determine individual charges.

¹⁶ As noted above, the CAA understands that passengers on longer flights are likely to impose higher costs on HAL as they tend to dwell longer at the airport (and therefore need more space) and carry more baggage than passengers on shorter flights.

- 2.36 The CAA does not agree with Aer Lingus that the reasonableness of HAL's judgement as to how to set its charges cannot be considered in the context of the other approaches which it might have taken. While the CAA agrees that the cost of providing a service is a relevant consideration in determining whether a pricing policy is discriminatory and if so if it is unreasonably so, the CAA agrees with HAL that there are limits to the extent to which charges can precisely reflect HAL's costs.
- 2.37 However, the CAA is not convinced that the cost savings from moving from the three passenger destination structure (domestic, ROI and international) to a two destination structure (European and other) are likely to be large. There were previously separate charges for domestic and ROI passengers, so the CAA does not consider that introducing a joint domestic/ROI charge would be impracticable or overly burdensome for HAL nor cause unnecessary confusion for airlines. HAL has not provided evidence of particular problems caused by the previous structure, which would suggest that Aer Lingus' proposed structure would be equally workable.
- 2.38 In conclusion, whilst the need for simplicity and to avoid over complexity in the setting of charges can provide a justification for pricing not being unduly precisely cost orientated (even where cost considerations are used in setting charges) on balance the CAA is not satisfied that treating all European passengers in the same way, rather than subjecting domestic and ROI passengers to a distinct charge as Aer Lingus has argued has been justified in this case.

c) Additional factors HAL took into account

- 2.39 In its August 2010 consultation with airlines HAL also set out a number of additional factors it took into account in its overall pricing strategy some of which, such as encouraging efficient use of scarce assets, could provide an objective justification for its decision. These additional factors were to:
- support Heathrow's hub status by introducing a discount for transfer passengers;
 - encourage efficient use of scarce resources by increasing the minimum departure charge and charging for transit passengers;
 - simplify the charging structure, for example in parking charges;
 - promote environmentally responsible behaviour by encouraging airlines to use aircraft with lower noise and air quality impacts; and
 - safeguard legal and regulatory compliance.

- 2.40 In its Statement of Grounds for judicial review Aer Lingus thought there was no coherent link between equalising domestic, ROI and other European per passenger charges and encouraging the efficient use of assets. On the contrary, Aer Lingus considered that charging users so as to reflect the resource usage of their passengers would seem more likely to promote efficient use. Aer Lingus also said that at the hearing HAL had accepted that factors such as the use of scarce resources were not ultimately relevant to determining per passenger charges.
- 2.41 The CAA notes that at the hearing HAL did not argue firmly that any one of these factors, taken individually, would necessarily justify the structure of its passenger charges¹⁷. The CAA does accept that they do show that HAL was trying to achieve a number of reasonable goals by re-structuring its charges including the passenger charge. Nonetheless, the CAA does not consider it has sufficient evidence from HAL on these factors to enable the CAA to conclude any of them individually or collectively justify the discrimination identified such that the CAA can conclude the discrimination is reasonable.

Conclusion on whether HAL's pricing policy unreasonably discriminated against a particular user or class of users

- 2.42 As set out above, the CAA has found that on the basis of the available modelling the extent of the difference between HAL's costs of handling domestic/ROI versus other European passengers is material such that the equalisation of the per passenger charge on domestic, ROI and other European passengers may be regarded as discriminatory. Although HAL did not intend its charges to be solely based on cost-orientation, it adopted its charging structure on the basis of an understanding, derived from its cost model, that the differential was 11%. That modelling contained errors. Correcting those errors, HAL's model indicates a differential of 18%.
- 2.43 The CAA notes that HAL's model is unsophisticated, and in the CAA's view, is subject to a margin of error. Nevertheless, HAL used the model in adopting the charges, so that the results of the model (subject to significant caution relating to the margin for error) are therefore relevant to the CAA's assessment of whether the charges are discriminatory.

¹⁷ At the hearing, the CAA asked HAL whether if having separate domestic/ROI and other European passenger charges would go against any of the additional factors that HAL took account of in setting its charges. HAL said "in terms of encouraging efficient use of resources, it may or may not do so depending on the impact of the departing passenger charge".

- 2.44 HAL argued that the ACD required it to levy a common European passenger charge. Whilst the CAA acknowledges it was right for HAL to take the ACD into account the CAA is not persuaded that the ACD requires a common European charge, for the reasons set out above
- 2.45 HAL has also argued that the need to strike a balance between cost reflectivity and complexity is a justification for the new charges. Although the CAA has accepted that this is a relevant factor in principle, the CAA has not found that it provides a justification in this case.
- 2.46 Finally the CAA has concluded that although HAL asserted at the hearing in January 2012 its pricing policy was also aimed at achieving other objectives, which the CAA agrees are reasonable (see paragraph 2.39 above), HAL has not provided sufficient explanation on how those aims will be achieved by the pricing policy for the CAA to be able to place significant weight on those arguments.
- 2.47 On balance therefore, the CAA has concluded, on the basis of the information provided that, HAL's new passenger charges is discriminatory as against airlines on domestic and ROI routes at Heathrow and that HAL has not provided sufficient reason why that discrimination is reasonable.
- 2.48 The discretion given to the CAA in section 41 is therefore engaged. The CAA must therefore consider whether it is appropriate for it to impose any remedy in respect of the discrimination it has found. Under section 41 the CAA may, if it thinks fit, impose in relation to Heathrow, such conditions as it considers appropriate for the purpose of remedying or preventing what it considers are the adverse effects of that course of conduct. Whether the passenger charge caused adverse effects is considered in Chapter 3.

CHAPTER 3**Has the pricing policy had any adverse effects?**

- 3.1 The CAA's decision on whether the pricing policy has had an identifiable effect, whether it is adverse and if so whether to impose a condition must in the CAA's view be evidence based. The CAA considers it must be able to conclude that it is more likely than not that an unreasonably discriminatory pricing policy has caused an identified effect before the CAA can consider intervening by imposing a condition on HAL.

Has there been an adverse effect on a class of user?

- 3.2 Aer Lingus only commented on the effects of the charges on it rather than the effects on the class of users in respect of whom the CAA has found unreasonable discrimination. Aer Lingus said it was paying £3.9 million more per year to HAL in passenger charges compared to what it would be paying if charges reflected the modelled 18% differential in the costs to the airport of handling a domestic/ROI passenger and a passenger to other European destinations.
- 3.3 Nevertheless, as all the airlines in the class pay the same passenger charge, the CAA, in its October 2013 investigation, was able to calculate the additional amount that all airlines in the class were paying in passenger charges for domestic and ROI services.
- 3.4 On the assumption that all airlines on domestic/ROI routes had the same proportion of transfer passengers as Aer Lingus and using Aer Lingus' method of calculation, the CAA estimated that the class of users could be paying up to £13.3 million per year in additional passenger charges on domestic/ROI flights.
- 3.5 In the same document, the CAA used an alternative approach to estimate that all users in the class may have paid up to £10 million per year extra. In its response to the October 2013 investigation, Aer Lingus argued that the CAA's alternative approach was flawed. The CAA accepts that there is no single correct method of calculation and Aer Lingus' method of calculation is a reasonable one to use. The methods of calculation are discussed in further detail in Appendix J.
- 3.6 These calculations indicate a financial impact on the class of users that previously paid lower domestic and ROI charges but are now paying the equalised domestic and ROI passenger charge. However, for those airlines which also fly on other European routes, that financial impact will be offset by the reduced amounts which they pay in passenger charges for their flights on these routes.

- 3.7 The CAA considers it significant that the only member of the class that has complained is Aer Lingus. Neither British Airways nor Virgin have contested HAL's decision to abolish lower passenger charges for domestic and ROI passengers, nor have they suggested that the decision had had adverse effects on them. The CAA notes that under paragraph 3.17 of its 2006 section 41 policy and processes document, it is CAA policy that its process in respect of imposing conditions under section 41 shall be complaint driven.
- 3.8 Further, the CAA notes that British Airways opened a new route from Heathrow to Leeds Bradford in 2012 and that Virgin was willing to operate the domestic routes that British Airways had to give up slots for as a condition of the approval of its acquisition of bmi (both after the new structure of charges was introduced). These developments do not suggest that HAL's charges have reduced the attractiveness to Virgin and BA of operating domestic/ROI services from Heathrow. Virgin commented that "the changes in the departing charges structure by HAL in 2011 has not reduced or damaged the benefits of operating at [Heathrow] and short haul operators are looking to increase, rather than decrease the extent of [their] operations at the airport".
- 3.9 In all the circumstances, the CAA does not find that the changes to passenger charges at Heathrow have had adverse effects overall on the whole class of users paying the charge, of which Aer Lingus forms part.

Has there been an adverse effect on a particular user?

- 3.10 As set out above Aer Lingus is a member of a class that pays a charge that the CAA has concluded is unreasonably discriminatory. There is therefore necessarily unreasonable discrimination against Aer Lingus as a member of that class of user.
- 3.11 Aer Lingus considers it has suffered adverse effects, and in particular financial adverse effects, caused as a consequence of the passenger charge in respect of which it has brought this complaint.
- 3.12 In its investigation document dated October 2013 the CAA set out how it was minded to assess those effects, and its preliminary conclusions. CAA has taken into account the submissions received in response to that investigation document. As a result, the CAA has considered whether there has been:
- an adverse financial impact on Aer Lingus;
 - an adverse effect in the overall wider context of Aer Lingus' business;
 - an adverse effect on the number of passengers carried; and
 - an adverse effect on Aer Lingus' ability to compete.
- caused by HAL's revised pricing policy.

Has there been a direct financial impact on Aer Lingus?

- 3.13 Since it first made its complaint to the CAA in 2011, Aer Lingus has produced various updated estimates of the additional amount it has paid as a result of HAL not setting cost-reflective passenger charges for domestic and ROI routes. In paragraph 39 of its Statement of Grounds for judicial review (dated February 2013), Aer Lingus said “if the charging structure had been constructed to ensure that the departing passenger charge levels properly reflected the 18% cost differential [to HAL] between domestic/Republic of Ireland (ROI) and other European passengers, Aer Lingus would be paying around £4 million less per year than it pays under the current disputed charging structure. By April 2013 this will have amounted to an aggregate overcharge in excess of £8 million”. In its response to the CAA’s October 2013 investigation dated November 2013 Aer Lingus increased this aggregate to £11.5 million over the period April 2011 to November 2013.
- 3.14 In its October 2013 investigation, the CAA consulted on the methodology by which this sum asserted by Aer Lingus was calculated and whether it was a reasonable assessment of the financial impact on Aer Lingus. The CAA said it had been unable directly to replicate Aer Lingus figures and so had used an alternative approach. Under this approach the charges for domestic/ROI and Europe passengers were calculated with an 18% differential while maintaining the revenue from the two charges at the level forecast by HAL for 2011/12. This approach suggested that Aer Lingus was paying about £3.1 million per year extra to HAL as a result of the equalisation of domestic, ROI and European passenger charges. This approach took no account of the level of the non-Europe passenger charge about which no complaint had been made.
- 3.15 In its response to the consultation Aer Lingus explained that it had calculated what HAL’s passenger charges would have been if they had fully followed HAL’s cost model. Its calculations were therefore based not only on an 18% differential between domestic/ROI and other European passenger charges but also allowed for a 41% differential between the charge for European and non-European passengers, while keeping HAL’s total revenue from all of its passenger charges at the same level as the airport had forecast for 2011/12. On this basis, Aer Lingus derived per passenger charges of £18.10 (domestic/ROI), £22.07 (Europe) and £31.12 (non-Europe). On this strict cost-based assessment Aer Lingus calculated that it was paying £3.9 million more per annum under HAL’s current charges than it should have been.

- 3.16 There is no absolutely correct way to calculate what the charges would have been under different circumstances and the results will vary with the assumptions made. On the assumptions Aer Lingus' has made the CAA accepts that £3.9 million per annum might be the starting point to estimate the additional charges that Aer Lingus pays HAL as a result of HAL not setting its charges in a way that reflected an 18% cost difference between handling domestic/ROI and other European passengers. The calculations are addressed in more detail in Appendix J.
- 3.17 However, in the CAA's view, Aer Lingus' calculation cannot be regarded as definitive. The CAA notes first that it is based on the cost modelling on which HAL used in support of its charges, which is considered above and in Appendix I. There the CAA has noted that cost modelling can only approximate the different costs that different passengers impose on the airport, and has noted the limitations of HAL's cost modelling.
- 3.18 The CAA considers that Aer Lingus' use of the modelling to calculate the extent of the financial effects of the disputed charges on Aer Lingus involves relying on HAL's model to a significantly greater degree of granularity than the CAA's broad analysis of the charges which led to the conclusions in Chapter 2. It also relies on the model to a greater level of detail than did HAL itself.
- 3.19 This lack of precision in the modelling means that the CAA is cautious about placing significant reliance on the precise figures on which Aer Lingus relies, and in approaching its discretion to impose a remedy under section 41 predominantly with reference to the financial adverse effects demonstrated by that model. Aer Lingus stated in its response dated November 2013 that the CAA should not be cautious in doing so. Its reasons for this view are that "the CAA should limit itself to ensuring that HAL has correctly applied the cost model on which its charging structure was based". In its view once the CAA had done so it "should not draw any adverse conclusions from the limitations which are inherent in any cost-based model ... or ... attach any lesser weight to the results of that model".
- 3.20 However, the CAA remains of the view that there is a difference between referring to an imperfect model for determining broadly how cost reflective or otherwise a charge may be and relying on it in order to make precise calculations of the financial consequences. The CAA notes that Aer Lingus itself is aware of and has pointed out to the CAA during the course of this investigation, the limitations of HAL's model, although it is prepared to rely on the results of that model as a basis to argue for the CAA to impose a condition on HAL.

- 3.21 Although the CAA recognises that the model prepared by HAL was the only cost information available to it when it set the revised charges and remains the only basis that can be used by the parties to quantify the financial effects on Aer Lingus of the passenger charge, it does not follow that the results shown by that model are reliable or that significant weight should be placed upon the exact figures on which Aer Lingus relies.
- 3.22 Furthermore, as explored in the CAA's October 2013 Investigation and concluded above, the CAA's findings above based on a modelled cost differential of 18% does not mean that the only acceptable cost differential is zero. As the CAA has concluded that some percentage of differential between the charge and cost would be acceptable, the consideration or quantification of adverse effects, need not therefore start from the assumption of a zero differential.
- 3.23 The CAA consulted on this approach in its Investigation dated October 2013. HAL agreed with this analysis stating that "some level of differential would have applied which did not constitute unreasonable discrimination". Aer Lingus did not agree with the CAA's analysis. In its view "once pricing behaviour is discriminatory it is the totality of such pricing against which any adverse effects must be considered."
- 3.24 Aer Lingus relies on an analogy with the de minimis threshold in cases under Article 101 of the EU Treaty, arguing that the de minimis threshold should not in effect be deducted, otherwise a 40% market share would be treated as a 25% share when considering a vertical agreement. In making this argument Aer Lingus says that it defies all reasonable logic to state that the impact of discriminatory behaviour should only be assessed above a permitted level of discrimination.
- 3.25 The CAA considers that this comparison is flawed.
- 3.26 The CAA has concluded that the fact that Aer Lingus could have incurred some of the additional charges under a passenger charge which would not have been regarded as unreasonably discriminatory is relevant to its assessment of the measure of the adverse effects caused by the discriminatory pricing policy and therefore ultimately to the question of whether it should exercise its discretion to impose a remedy. Given the limitations of cost modelling, and that the relationship between costs and prices is likely to be approximate, a proportion of the 18% differential which forms the basis for Aer Lingus' complaint could represent an acceptable margin of appreciation or tolerance. Aer Lingus could therefore incur a significant proportion of the financial losses of which it complains; and yet have had no basis for seeking a remedy. This is consistent with the fact that section 41 does not establish an obligation that charges should be cost oriented.

- 3.27 Thus there are significant factors which suggest that the amount that Aer Lingus has paid (and will continue to pay) when compared with a regime which could not be said to be unreasonable discriminatory is significantly overstated.
- 3.28 In addition, the CAA notes that the effects of the higher passenger charges on Aer Lingus itself depend on the extent to which it can pass them on to its passengers as higher fares.
- 3.29 In April 2011, Aer Lingus said that “it will be forced, given the prevailing economic climate, to pass on these changes directly to customers” and that the economic climate would “force airlines to pass on any additional costs to passengers or absorb these increases with the inevitable impact on route profitability”; it also mentioned that its traffic was “extremely price elastic” so “the inevitable increase in fares...will therefore have a disproportionate impact on passenger numbers on those routes.”
- 3.30 In its statement of grounds for judicial review it said “requiring...Aer Lingus (and consequently their passengers) to pay charges that are millions of pounds a year higher than they should be” and “while Aer Lingus may have offset some of this increase by reducing other elements of its fares, given the price elasticity of air travel, it is without doubt that the overall amount payable by passengers has increased as a result of the new charging structure”. Further in its response to the CAA’s October 2013 consultation, Aer Lingus said “To the extent that Aer Lingus has been able to pass on the cost increase to its passengers, the revised charging structure has had an adverse impact on passengers who would have been required to pay higher fares than would otherwise have been the case.”¹⁸
- 3.31 While Aer Lingus has not provided evidence about the specific amounts passed on to its passengers, it has said that some proportion has been passed on. This would reduce any direct financial effect of the charge on Aer Lingus, and would give rise to further questions as to whether Aer Lingus has experienced a reduction in passenger numbers (as a result of charging higher fares) or whether adverse effects have felt by passengers. Both of these issues are considered below.
- 3.32 Aer Lingus emphasised that it was the only airline operating from Heathrow to operate exclusively domestic and ROI flights. As a result, in contrast to other airlines, all of its flights suffer from the impact of the revised passenger charge.

¹⁸ In the oral hearing when faced with statistics relating to passenger number increases Aer Lingus said “it is not surprising to us that there is an increase in passenger numbers. I have to say that ought to be a credit to Aer Lingus in a time when HAL says overall passenger numbers are depressing. But... I think it is easy to point towards our determination to bring extra passengers and to absorb and directly hit our bottom line.” However, the CAA did not consider this statement to undermine the point repeatedly made by Aer Lingus that some if not all charge increases would be passed on to customers.

- 3.33 The effect of this point made by Aer Lingus is that it does not pay “reduced” passenger charges on other routes which might offset the financial impact on Aer Lingus’ domestic and ROI operations. In other words, it is a factor which goes to the level of the financial impact of the new charge on Aer Lingus. That is reflected in the CAA’s analysis above. The CAA does not consider that the point demonstrates any further or separate adverse effect on Aer Lingus.

CAA’s conclusion in respect of the financial effects on Aer Lingus of the revised passenger charge.

- 3.34 In conclusion, the CAA considers it likely that Aer Lingus is paying a material additional sum each year as a result of the revised charge for domestic/ROI passengers at Heathrow.
- 3.35 The CAA does not however find that Aer Lingus is incurring financial losses in the amount claimed, in part because HAL’s model is not sufficiently reliable to support such a precise calculation, and in part because Aer Lingus says it has passed an unspecified amount of that sum on to passengers. In addition Aer Lingus might well have paid material additional sums (over and above a strictly cost reflective charge) under a charge which is not unreasonably discriminatory. It is in any event a separate question whether the amount is significant in the context of Aer Lingus’ business as a whole, and whether it has affected its business decisions or operations (as to which see paragraphs 3.37 to 3.41 below).

Evidence on total charges paid referred to in CAA’s Investigation dated October 2013

- 3.36 In Appendix B of its October 2013 investigation the CAA published updated redacted figures provided by HAL showing the amount paid in total airport charges to HAL by the top 40 airlines. The CAA notes that those figures show that in terms of the absolute amount paid per passenger in airport charges in 2012/13 Aer Lingus paid less than any of the other top 40 airlines. The CAA acknowledges that this is only one factor indicating effect and does not place any reliance on it other than to acknowledge there will always be different ways of analysing effect and not all factors will lead to the same conclusion.

Effect on Aer Lingus in the overall wider context of its business

- 3.37 Across its network Aer Lingus pays nearly €300 million (around £230 million) annually in airport charges. Its estimate of the additional amount it paid of €3.9 million at Heathrow, represents 1.7% of this total. In terms of total network operating costs of €1324 million (£1030 million at an exchange rate of 1.29) per annum £3.9m is 0.4% of its operating costs¹⁹.

¹⁹ The figures in this paragraph are taken from Aer Lingus’ accounts for 2012

3.38 The CAA has no information on the profitability of Aer Lingus' routes from Heathrow despite making clear in its Investigation dated October 2013 this was a factor the CAA was minded to take into account when considering whether there had been adverse effects on Aer Lingus caused by the HAL's pricing policy. In its response to the CAA's October Investigation, Aer Lingus criticised the CAA for not looking in detail at the profitability of its routes from Heathrow. However, Aer Lingus provided no data or analysis of its profitability itself. In the absence of such data from Aer Lingus the CAA has to rely on published sources of Aer Lingus' profitability. Aer Lingus' annual reports publish profits for the airline as a whole. These show the following operating results over the past five years:

- 2008 €20 million loss
- 2009 €81 million loss
- 2010 €52.5 million profit
- 2011 €49.1 million profit
- 2012 €69.1 million profit
- 2013 €61.1 million profit (unaudited preliminary results)

3.39 While Dublin – London is, in Aer Lingus' submission, its most important route²⁰, it operates three other routes from Heathrow to/from Ireland and overall the airline serves nearly 100 routes mainly within Europe but with some long haul routes as well. Consequently, while additional amounts that Aer Lingus pay at Heathrow might be thought likely to reduce the airline's global profitability all other things being equal, the rest of the network is so large that Aer Lingus' global business does not appear to be significantly affected by the new passenger charge. Nor is there evidence that the charges in question affect the route network or product offering as a whole.

²⁰ In its April 2011 submission to the CAA Aer Lingus said "Dublin Heathrow is the single most important route ✂". In its May 2012 draft statement of grounds for judicial review Aer Lingus said "the Dublin-Heathrow route, in particular, is the most important route in Aer Lingus' entire network ✂".
✂ confidential information redacted.

- 3.40 Indeed, it is notable that Aer Lingus has maintained its presence at Heathrow despite having the possibility of diverting services to other airports serving London. The statement of its Chief Executive in its 2012 accounts that Aer Lingus is interested in purchasing or leasing slots in Heathrow indicates that Aer Lingus is seeking to increase its presence at Heathrow²¹. This may reflect the fact that there is substantial demand for slots and flights at Heathrow, which is severely capacity constrained. The CAA notes that, in these circumstances, the price control at Heathrow is likely to maintain airport charges below the level that would be payable in a competitive market, notwithstanding the significant demand from passengers.
- 3.41 These factors support the view that any adverse effects on Aer Lingus of the revised passenger charge are mitigated by excess demand at Heathrow that is reflected in the fares that airlines can charge passengers on their routes and/or are of limited significance in the context of Aer Lingus' business as a whole, including the scale and success of its operations at Heathrow

Effect on number of passengers carried by AL on domestic/ROI routes

- 3.42 In its October 2013 investigation the CAA published numbers showing the number of passengers that Aer Lingus carried on each of its Heathrow routes for 2010/11, 2011/12 and 2012/13. The figures are shown in Table 3.1 below. In 2011/12 Aer Lingus' Heathrow passenger numbers increased. This was reversed in 2012/13 with Aer Lingus passenger numbers declining on all routes. Over the two years together Aer Lingus passenger numbers fell by 2.9%. However, passenger numbers grew on its Heathrow-Dublin route \times ²² by 0.7%. The overall decline in Aer Lingus' passengers resulted from a sharp fall in numbers for Aer Lingus on one route, its Belfast route, in 2012/13. The CAA notes that in July 2012 British Airways re-launched a Heathrow-Belfast service replacing the route formerly operated by bmi. Overall, the CAA considers that the change in Aer Lingus' passenger numbers at Heathrow since the revised charges came in has been small, and there is nothing to suggest that the change is due to HAL's new structure of charges and not to other exogenous factors.

21 In Aer Lingus' 2012 Annual Report its Chief Executive Officer said "Aer Lingus has considerable experience and strength at London Heathrow. In 2014, we will move to Terminal 2 at Heathrow and this modern facility will provide us with a considerable opportunity to provide short haul feed from Ireland to our partner airlines operating long haul services at both this terminal and other terminals in Heathrow. London Heathrow remains a focal point of our strategy. Despite not obtaining any slots from the remedy package related to the IAG acquisition of bmi, Aer Lingus remains interested in the outright purchase or lease of slots in order to enhance our feeder capabilities in London Heathrow".

22 Confidential information redacted.

Table 3.1: Aer Lingus passenger numbers on routes operated at Heathrow 2010/11, 2011/12 and 2012/13 (% change from previous year). [Numbers in 000's]

| | 2010/11 | 2011/12 | 2012/13 | % change 2012/13 compared to 2010/11 |
|---------|---------|-----------------|-----------------|--------------------------------------|
| Belfast | 281.3 | 285.6 (+1.4%) | 219.9 (-22.9%) | (-21.8%) |
| Cork | 384.0 | 393.7 (+2.5%) | 382.7 (-2.8%) | (-0.3%) |
| Dublin | 1,155.6 | 1,239.8 (+7.3%) | 1,163.8 (-6.1%) | (+0.7%) |
| Shannon | 270.1 | 269.7 (-0.2%) | 264.1 (-2.0%) | (-2.2%) |
| Total | 2,091.0 | 2,188.4 (+4.7%) | 2,030.5 (-7.2%) | (-2.9%) |

Source: CAA statistics

3.43 In Aer Lingus' response to the CAA's October 2013 investigation document it said its passenger numbers at Heathrow had been increasing in years prior to 2011 and steadily falling since 2011. Aer Lingus included passenger numbers for the calendar years 2009 to 2013, with the last two months of 2013 forecast rather than actual figures. The figures are in Table 3.2.

Table 3.2: Aer Lingus departing passengers from Heathrow²³

| | Actual | Actual | Actual | Actual | Actual/forecast (10/2) |
|---------|-----------|-----------|-----------|-----------|------------------------|
| | 2009 | 2010 | 2011 | 2012 | A2013 |
| Dublin | 584,586 | 571,270 | 614,601 | 591,814 | 557,760 |
| Cork | 243,058 | 195,737 | 196,881 | 190,838 | 194,784 |
| Shannon | 64,885 | 132,579 | 135,808 | 131,360 | 124,181 |
| Belfast | 132,727 | 141,096 | 143,681 | 114,190 | 99,249 |
| Total | 1,025,216 | 1,040,681 | 1,090,970 | 1,028,202 | 975,974 |

Source Aer Lingus

²³ Tables 3.1 and 3.2 show passenger numbers on a different basis. In Table 3.1 the CAA used total passengers (both departing and arriving). In Table 3.2 Aer Lingus just used departing passengers. The CAA considers that either basis would be valid and that both bases would yield very similar results.

- 3.44 The CAA does not consider that Aer Lingus' figures show evidence of a fall in passenger numbers due to HAL's pricing policy. While the CAA uses figures for HAL's charging year (that is 1 April to 31 March), HAL uses figures for calendar years. This means that 2011 which is the high point overall and for three of the four routes individually, covers eight months of the new charges and only four of the old charges. There is accordingly no correlation between these results and the introduction of the new passenger charge as Aer Lingus suggests. There are also variations by route, which do not suggest a uniform effect, and some instances of passenger numbers falling before the new charges were introduced (see Dublin and Cork).
- 3.45 In conclusion it is the CAA's view that the available evidence does not show that HAL's pricing policy has had an adverse effect on Aer Lingus' passenger numbers at Heathrow.

Effect on ability of Aer Lingus to compete

- 3.46 The CAA has investigated and received representations on whether there has been an adverse effect on Aer Lingus' ability to compete as a result of the restructured charges and in particular as a result of the unreasonably discriminatory passenger charge.
- 3.47 The standard approach to considering issues of airline competition is to consider competition on a route by route (origin and destination) basis²⁴. The CAA notes that HAL levies identical per passenger charges on all airlines on the same route²⁵ so there is no concern that Aer Lingus will be disadvantaged against other airlines operating domestic and ROI routes from Heathrow. However, Aer Lingus could in principle be disadvantaged against airlines operating the same routes from other London airports (that is on city pairs).
- 3.48 In its March 2012 provisional decision the CAA looked at competition between airlines operating routes from Heathrow. In its October 2013 investigation, the CAA carried out a broader analysis as it was persuaded that a city pair assessment was the correct approach. This issue is considered in Appendix K.

²⁴ This approach has been taken by the Office of Fair Trading and the European Commission in many cases, including the Commission's approval of IAG's acquisition of bmi, in which the routes considered were short haul routes from Heathrow. In particular, the CAA notes that a large majority of respondents (IAG's competitors, travel agents and corporate customers) to the Commission's market investigation questionnaires agreed with the use of the origin and destination approach.

²⁵ Apart from cost-related discounts for transfer and transit passengers.

- 3.49 Aer Lingus disagrees with the CAA's emphasis on considering competition on a city pairs basis. At the hearing Aer Lingus said that it also competes for passengers against airlines flying from London on other European routes. For example, a leisure passenger to/from Dublin could decide to fly to another European destination (e.g. Paris or Frankfurt) instead. Aer Lingus said that competition for leisure passengers on short-haul routes had been affected, although it also noted that there is a tendency towards business travel at Heathrow²⁶.
- 3.50 The CAA recognises that an airline's costs of operating to Dublin have risen compared to the costs of operating to, for example, Paris. However, for the reasons set out in Appendix K, the CAA does not consider that this is the proper basis for an assessment of the effect of HAL's charging structure on competition between airlines. The impact on competition, and Aer Lingus' ability to compete, should be assessed in the markets on which it competes.
- 3.51 In considering whether Aer Lingus' ability to compete with other airlines has been affected the CAA primarily compared how its passenger numbers on its Heathrow routes compared to passenger numbers on these routes carried by all airlines at all London airports. This is shown in the Tables 3.3 and 3.4 below. The CAA recognises that these passenger numbers are only one guide to the impact of the charges on competition, and that passenger numbers may be affected by a variety of factors. However, in the CAA's view, this data provides the best available insight into whether competition between Aer Lingus, operating from Heathrow, is prejudiced in its ability to compete with other airlines operating in the same market following HAL's changes to the level of the passenger charge.

Table 3.3 - Aer Lingus passenger numbers on routes operated at Heathrow 2010/11, 2011/12, 2012/13 (% change from previous year). [Numbers in 000's]

| | 2010/11 | 2011/12 | 2012/13 | % change 2012/13 compared to 2010/11 |
|---------|---------|-----------------|-----------------|--------------------------------------|
| Belfast | 281.3 | 285.6 (+1.4%) | 219.9 (-22.9%) | (-21.8%) |
| Cork | 384.0 | 393.7 (+2.5%) | 382.7 (-2.8%) | (-0.3%) |
| Dublin | 1,155.6 | 1,239.8 (+7.3%) | 1,163.8 (-6.1%) | (+0.7%) |
| Shannon | 270.1 | 269.7 (-0.2%) | 264.1 (-2.0%) | (-2.2%) |
| Total | 2,091.0 | 2,188.4 (+4.7%) | 2,030.5 (-7.2%) | (-2.9%) |

Source: CAA statistics

²⁶ However, the CAA's passenger survey showed that about 69% of Heathrow's passengers were leisure travellers in 2011 (CAA passenger survey report 2011).

Table 3.4 - Passengers numbers carried by all airlines to the city pair destinations that Aer Lingus operates at Heathrow 2010/11, 2011/12, 2012/13²⁷ (% change from previous year). [Numbers in 000's]

| | 2010/11 | 2011/12 | 2012/13 | % change 2012/13 compared to 2010/11 |
|---------|---------|-----------------|-----------------|--------------------------------------|
| Belfast | 2,001.3 | 1,975.0 (-1.3%) | 2,017.1 (+2.1%) | (+0.8%) |
| Cork | 790.7 | 798.8 (+1.0%) | 769.2 (-3.7%) | (-2.7%) |
| Dublin | 3,502.3 | 3,698.0 (+5.6%) | 3,690.2 (-0.2%) | (+5.4%) |
| Shannon | 547.8 | 562.1 (+2.6%) | 556.4 (-1.0%) | (+1.6%) |
| Total | 6,842.1 | 7,033.8 (+2.8%) | 7,032.9 (0.0%) | (+2.8%) |

Source: CAA statistics

- 3.52 Tables 3.3 and 3.4 show Aer Lingus passenger numbers at Heathrow and passenger numbers on the same city pair routes operated by all airlines. The numbers do not appear to show that Aer Lingus has suffered a competitive disadvantage. In 2011/12 Aer Lingus' Heathrow passenger numbers increased more quickly than those of all airlines on the city pair. This was reversed in 2012/13 with Aer Lingus passenger numbers declining on all routes. However, in that second year, Aer Lingus performed better than all airlines on the Cork route and at a very similar level to all airlines than the Shannon route.
- 3.53 Over the two years together Aer Lingus passenger numbers fell by 2.9% whilst total traffic on the city pairs grew by 2.8%. This difference is small with the overall decline in Aer Lingus' passengers resulting from a sharp fall in numbers for Aer Lingus on one route, its Belfast route, in 2012/13. The CAA notes that in July 2012 British Airways re-launched a Heathrow-Belfast service replacing the route formerly operated by bmi. Since this competing route also operates from Heathrow, there cannot be any impact on competition from airport charges at HAL.
- 3.54 Overall the CAA does not consider that these figures show a significant difference between Aer Lingus' passenger numbers at Heathrow and its competitors on a city-pair basis and thus they do not support the view that Aer Lingus has suffered a competitive disadvantage as a result of the new passenger charge.

²⁷ The figures show the number of passengers carried by all airlines (including Aer Lingus) on routes from the six London airports to the destinations that Aer Lingus serves from Heathrow.

- 3.55 Aer Lingus argued that the CAA's analysis does not identify the counterfactual. The purpose of a counterfactual is to enable a comparison to be drawn with the position in the absence of the disputed charge. In the CAA's view, the analysis of passenger numbers at other London airports is intended to serve this purpose, because that data shows the overall trend in passenger numbers, in contrast to Aer Lingus data which reflects payment of the new charge on all its operations.
- 3.56 Aer Lingus also relies on a comparison with Gatwick, which Aer Lingus argues is the only airport with a separate domestic/ROI charge. Aer Lingus argues that the gap between domestic and ROI passenger numbers at Gatwick and HAL is 4%, resulting from a 2% increase at Gatwick and a 2% reduction at Heathrow. In the CAA's view, this difference is too small to suggest that the charge has had a material impact.
- 3.57 Aer Lingus said that the analysis would need to account for other factors such as differences in absolute passenger charge levels between airports. However, the CAA does not think that such refinements to its analysis are either necessary to consider the effect which the change in the charge has had on competition, or practicable.
- 3.58 Aer Lingus argued that the relevant legal test under EU competition law is whether the revised charges tend to distort competition, not whether there is evidence of an actual deterioration in competition. The CAA agrees that this is the test under EU competition law. However, in the present case, the CAA has the benefit of being able to consider information and evidence concerning the way in which competition in the market has developed since the new charging structure was introduced. The CAA does not consider that the test under EU competition law would prevent the CAA from looking at that evidence to inform its assessment of the effect which the new passenger charge has on Aer Lingus' ability to compete, and whether the charges tend to distort competition. In fact the CAA considers it would be perverse to disregard the evidence of actual effects.
- 3.59 Aer Lingus has not provided any information or analysis to indicate any material deterioration in its competitive position (or a tendency to harm competition). Its argument that the revised charge tends to distort competition rests essentially on an assertion that it must do so. The CAA does not agree. Whether the charges of which Aer Lingus complains tend to distort competition does not follow from the CAA's finding of unreasonable discrimination - as Aer Lingus itself observes, this is a separate limb of the test under EU law. On the basis of the evidence considered in this section, there is nothing to indicate that the passenger charge will necessarily undermine (or tend to undermine) the attractiveness of Aer Lingus' offering to its customers, or its ability to offer attractive and competitive services.

- 3.60 The CAA further notes that as the price control on Heathrow holds down HAL's charges to airlines, those airlines that operate at Heathrow pay airport charges that are lower than they would be in an unregulated competitive market and do not fully relate to the value that airlines can earn through passengers' willingness to pay higher fares to use Heathrow. Gatwick's and Stansted's airport charges are also price controlled but they are closer to the level that would prevail if they were not regulated. This is reflected in the relative slot values at the airports, with Heathrow slots being much more expensive than slots at Gatwick and Stansted. This is a further factor mitigating the extent to which the new passenger charges may prejudice Aer Lingus' ability to compete with airlines that operate from other London airports.
- 3.61 In conclusion the CAA considers it has no basis to conclude that the passenger charge has had an adverse effect on Aer Lingus' ability to compete or, more generally, has actually or has a tendency to distort competition.

Effect on Aer Lingus' passengers

- 3.62 One of the CAA's statutory duties in section 39(2) of the Act is to "further the reasonable interests of users of airports within the United Kingdom". As mentioned in paragraph 1.30, users include both airlines and passengers. Potential adverse impacts on passengers may manifest themselves in terms of higher fares or in terms of unfulfilled journeys.
- 3.63 In terms of passenger numbers, an analysis of UK/ROI routes suggests that numbers continued to increase to 2011/12 but then some reduction was evident. However these numbers did not show any clear result or pattern such as to suggest that they are related to the change in the passenger charges. The CAA finds no basis on which to conclude that the new passenger charges have caused passenger numbers on domestic/ROI routes to decline.
- 3.64 Aer Lingus has said it passed on some proportion of the additional charges it paid to passengers through higher fares. It has not quantified this amount.

- 3.65 However, even if passengers have paid higher fares the extent of the adverse effect on them need not reflect the entire amount by which fares are higher. Most passengers are likely to be able to use alternative providers (either a different airline, or a different London airport, or both), so they would still be able to make their journeys. For these passengers the adverse impact will only be realised, therefore, to the extent that substitutes are not available or insufficient. Some other passengers may put a high value in flying to/from Heathrow, in which case they may be willing to pay a higher fare for that benefit. The CAA does not regard the customer's willingness to pay the higher fare as an adverse effect of the new charge, as the passenger chooses to pay the higher fare because of the value they place on flying from Heathrow. The CAA, therefore, considers it likely to be the case that only a small proportion of the amount arising from unreasonable discrimination, if any, will manifest itself as an adverse effect on passengers.
- 3.66 In conclusion, the CAA has not found any material adverse effect on passengers that fly with the airlines on the routes that pay the discriminatory passenger charge.

CHAPTER 4

Should the CAA use its discretion to remedy the adverse effects?

CAA's approach

- 4.1 Under section 41(2) of the Act if it appears to the CAA that an airport operator is pursuing one of the courses of conduct specified in 41(3) the CAA may, if it thinks fit, impose in relation to the airport operator "such conditions as it considers appropriate for the purpose of remedying or preventing what it considers are the adverse effects of that course of conduct". In this case and in the light of the material considered, the CAA has found, on balance that HAL is pursuing one of the courses of conduct, namely (unreasonably discriminating against a class of users of the airport and a particular user) and the conduct has had financial adverse effects on Aer Lingus. The CAA has not however found that those financial adverse effects are in the amount of £3.9 million per annum which is claimed by Aer Lingus (or near to that amount).
- 4.2 In deciding whether it should (by means of imposing a condition on HAL) exercise its discretion to remedy those adverse effects, the CAA takes account of its statutory duties in section 39 of the Act (see paragraph 1.33 above). In its 2006 policy and process document the CAA also said it would, when considering the application of a remedy, adopt an approach that is consistent with the OFT's guidelines on the application of competition law except where the circumstances of the case suggest that it should follow a different approach. The CAA commented on this approach in paragraphs 2.1-2.7 of the CAA's withdrawn decision dated 17 December 2012 (which are repeated in Appendix H to this decision).
- 4.3 Aer Lingus has consistently maintained that section 41 of the Act does not require any competition test. It mentioned this at the oral hearing and in its response to the CAA's October 2013 investigation. In the latter response Aer Lingus considered it unreasonable that the CAA required a level of overcharge so great as to cause Aer Lingus to reduce the quality and/or scale of its operations at Heathrow before it would exercise its discretion to apply a condition to remedy the adverse effects of unreasonable discrimination.
- 4.4 At the hearing HAL thought that the most natural way in which the CAA may take account of competition is, if it established there is unreasonable discrimination, in the exercise of its discretion to take remedial action.

- 4.5 Taking into account the representations received on its proposed approach, the CAA has concluded that the approach set out above reflects and is consistent with its statutory duties.

CAA's analysis

- 4.6 As noted above, the CAA has found that the conduct of which Aer Lingus complains is likely to have resulted in Aer Lingus paying a material additional sum each year as a result of the passenger charge which the CAA has found to be unreasonably discriminatory.
- 4.7 The CAA has also found, however, that HAL's model is not an adequate basis upon which to calculate with precision the financial impact of the new passenger charges.
- 4.8 The CAA recognises the model prepared by HAL was the only cost information available to it when it revised its charges for the reasons set out in its consultation document and referred to in this decision. However, in the CAA's view, it does not follow that the model should be regarded as precisely or definitively establishing the financial consequences of the discriminatory charge.
- 4.9 The extent of the financial impact on Aer Lingus also depends on the extent to which the charges are being passed on to passengers. Aer Lingus states that passengers have paid higher fares than they would have done as a result of the new charges. To that extent, Aer Lingus itself has not borne the direct financial impact of the new charge.
- 4.10 Therefore, whilst the CAA accepts that the financial impact on Aer Lingus merits careful consideration in the context of the CAA's remedial powers, it has not been able precisely to quantify the financial impact on Aer Lingus of the new passenger charge.
- 4.11 The CAA is in any event not persuaded that the sums are material in the context of Aer Lingus' business as a whole. The CAA has not found evidence that there is any material impact on Aer Lingus' global business or that the charges in question will affect the route network or product offering as a whole. Indeed Aer Lingus has a stated strategy that its business model is based on maintaining or increasing the scale of its operations at Heathrow and the continued use of its slots at Heathrow to serve the Ireland-London market. Instead, Aer Lingus intends to maintain and even increase the scale of its operations at Heathrow. The CAA notes that other operators either have operated additional domestic or ROI routes from Heathrow notwithstanding the passenger charge that is the subject of this complaint.

- 4.12 The CAA has also noted that HAL is not required to impose cost oriented charges. The effect of that point is twofold. First, that any charging structure adopted by HAL will result in “winners and losers,” relative to a position in which charges are strictly cost oriented and that overall winners and losers are determined in part by the destinations airlines choose to serve from Heathrow. Secondly, that Aer Lingus might have incurred a material proportion of the financial losses of which it complains under a passenger charge which would not be regarded as discriminatory under section 41.
- 4.13 Although the precise scale of the adverse effects on Aer Lingus is uncertain, the CAA notes that its analysis points to the scale of the adverse effects being lower than the £3.9 million figure relied on by Aer Lingus.
- 4.14 Having regard to these factors, the CAA considers that it should be cautious before imposing a remedy under section 41 solely or predominantly on the basis of the adverse financial impact of which Aer Lingus complains.
- 4.15 The CAA also notes that the conditions sought by Aer Lingus by way of remedy are as follows:
- a condition on HAL that it impose a separate domestic/ROI charge set at a level below the other European charges to reflect the 18% cost differential between those groups of passengers;
 - a condition on HAL that it makes to Aer Lingus a payment representing the overcharge Aer Lingus considers it has incurred; and
 - if the CAA considers that HAL should base its cost analysis, not only on asset costs, but also on operating costs and commercial revenues, a condition on HAL that it undertake a future consultation with an immediate charge based on HAL’s current figures.
- 4.16 The CAA notes that the first two of these conditions would rely very directly on the accuracy of HAL’s model as a precise basis for establishing the exact amount of the passenger charge and the resultant loss to Aer Lingus. In the CAA’s view, each of these conditions would rely on the model to a much greater level of granularity than was intended when the model was developed. For the reasons set out in more detail above the CAA is very cautious before using the model in this way. The third suggested condition depends on criticisms of the model which the CAA has not upheld (see Appendix I).
- 4.17 Against this background, the CAA remains of the view that it is important and relevant to consider whether the passenger charge has had an impact on Aer Lingus’ ability to compete. The CAA has not found evidence that it has done so, or that the charge has affected or tends to affect competition.

- 4.18 The CAA has also concluded it has no evidence of the charge having had any material impact on passengers, either in terms of unfulfilled journeys or in terms of an adverse effect from prices paid for air travel.
- 4.19 The CAA is mindful of its statutory duties which include a duty to impose the minimum restrictions that are consistent with the performance by the CAA of its functions. In those circumstances, the CAA considers that a clear and objective basis is required before imposing further regulatory conditions on HAL (i.e. see paragraphs 4.1 et seq above). The CAA notes that HAL is already subject to price regulation, and that the remedies claimed by Aer Lingus would give rise to still further intervention in the market.
- 4.20 The CAA does not therefore consider that it should necessarily impose a remedy in respect of any adverse effects of HAL's unreasonably discriminatory conduct. Indeed section 41 gives the CAA a discretion in this regard.
- 4.21 In the CAA's view, the minimum restrictions duty supports the need to consider not simply whether the disputed charge has had some financial impact on Aer Lingus, but also whether it had affected its ability to compete in the market (or detrimentally affected competition more generally) and/or has affected passengers. In the CAA's view, evidence of these latter effects would provide a clearer and more objective basis, in line with its statutory duties, for intervention and the imposition of a condition on HAL.
- 4.22 Conversely, in the CAA's view, the absence of any demonstrable effect on Aer Lingus' ability to compete or on competition more generally, or any material adverse effect on passengers, are factors which militate strongly against imposing any condition on HAL, in all the circumstances.
- 4.23 The CAA has therefore given full consideration to the impact of the passenger charges on Aer Lingus, including the financial effects on which it relies. However, for the reasons given above, the CAA concludes that in this case, it would not be appropriate to impose any condition on HAL. In the CAA's view, the adverse effects of which Aer Lingus complains are not sufficient when weighed against other factors for the CAA to exercise its statutory discretion. This conclusion is consistent with the CAA's statutory duties, and is in line with its published policy.

CHAPTER 5**Conclusion**

5.1 In conclusion:

- the CAA finds that on balance on the information available HAL's passenger charge unreasonably discriminates against airlines operating on domestic and ROI routes from Heathrow;
- the CAA does not however consider it appropriate, in the exercise of its discretion, to impose any condition for the purposes of remedying or preventing any adverse effects of the passenger charge.

28 March 2014

APPENDIX A

July 2011 investigation/consultation

**Investigation under Section 41
of the Airports Act 1986
of a complaint made by bmi
against
Heathrow Airport Limited**

A Consultation

July 2011

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SUMMARY

- 1 bmi has complained to the CAA that Heathrow Airport Limited (HAL) has unreasonably discriminated by: equalising domestic and EU passenger charges, basing landing charges solely on noise values, and not phasing in changes to its structure of charges over time. HAL contended that its passenger charges were cost-related, its landing charges were based on the same criteria for all its airlines and incentivised the best use of its scarce runway capacity, and it would not have been possible to phase in the changes as they affected airlines in different ways.
2. Following its preliminary investigation, the CAA considers that HAL's justifications need to be transparently and objectively substantiated. The CAA is now formally investigating HAL's structure of charges, and invites representations to be sent no later than 6 September.

1 INTRODUCTION

- 1.1 bmi made a complaint to the CAA on 28 January 2011 against HAL. bmi expressed concern that in deciding on its structure of airport charges from 1 April 2011, HAL had breached the provisions of Section 41 (S41) of the Airports Act 1986 (the Act) in the following respects:
 - a. HAL unreasonably discriminated against bmi and passengers on domestic routes by equalising domestic and EU passenger charges;
 - b. HAL unreasonably discriminated against short-haul carriers (including bmi) by basing landing charges solely on noise values; and
 - c. HAL unfairly discriminated against bmi by implementing the charging regime from 1 April 2011 instead of phasing it in gradually.
- 1.2 This document starts the CAA's formal investigation following its preliminary assessment of representations made by bmi, HAL and certain third parties. Non-confidential copies of these representations have been placed on the CAA's website.¹ The CAA sets out its initial views following its preliminary assessment on the key issues in section 3 and invites comments on these from any interested party.

¹ Available at www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=12293

For the interests of the parties and market certainty, the CAA is keen to resolve this matter as soon as possible. Its current intention is to conclude its investigation by end October 2011. To help it do this it requires any representations to be sent by no later than **Tuesday 6 September 2011** preferably by e-mail to airportsregulation@caa.co.uk².

- 1.3 If you would like to discuss any aspect of this investigation please contact Rod Gander on 0207 453 6225 or rod.gander@caa.co.uk.

² Or alternatively representations can be sent by post to: Susie Talbot, Regulatory Policy Group, CAA House, 45-59 Kingsway, London, WC2B 6TE.

2 BACKGROUND

HAL's changes to its structure of charges

- 2.1 Heathrow Airport is designated by the Secretary of State under section 40(10) of the Act for price control. In March 2008, the CAA set a price control that limits the maximum per passenger revenue that HAL can receive from airport charges at the airport for each of the five years from 1 April 2008 to 31 March 2013³.
- 2.2 The current price control does not prescribe the structure of airport charges at Heathrow and the airport can therefore structure its charges within the constraint of the overall price cap. In its decision of March 2008 that set the current price controls the CAA said that the structure of charges was first and foremost the responsibility of each airport operator following consultation with its airline users. The CAA did not therefore propose to involve itself in the determination of the structure of airport charges although it would consider under its S41 powers, and in line with its guidelines on the operation of these powers, any case brought by an airline which alleged undue discrimination which might have been effected through changes in the structure of charges.⁴ HAL's airport charges consist of the following separate charges on airlines: landing charge, air navigation services (ANS) charge, per passenger charge and parking charge. bmi's complaint relates to the landing and per passenger charges.
- 2.3 HAL held a number of informal meetings with the airline community between January and June 2010 to discuss possible changes to its structure of charges. On 2 August 2010, HAL issued a consultation document⁵ proposing changes in the structure of charges. HAL said the proposals were designed to:

- support Heathrow's hub status by introducing a discount for transfer passengers;

³ In April 2011, the CAA extended the price control for an additional year so it now expires on 31 March 2014.

⁴ Economic Regulation of Heathrow and Gatwick Airports 2008-2013 – CAA decision (March 2008) paragraphs 3.28 and 3.29. Available at http://www.caa.co.uk/docs/5/ergdocs/heathrowgatwickdecision_mar08.pdf

⁵ Available at http://www.heathrowairport.com/assets/Internet/Heathrow/Heathrow%20downloads/Static%20files/Consultation_Document.pdf

- encourage efficient use of scarce resources by increasing the minimum departure charge and charging for transit passengers;
- simplify the charging structure, for example in parking charges;
- promote environmentally responsible behaviour by encouraging airlines to use aircraft with lower noise and air quality impacts; and
- safeguard legal and regulatory compliance.

2.4 On 29 October 2010, HAL issued its decision document⁶ revising its structure of landing and per passenger charges from 1 April 2011. HAL had proposed amending the structure of its aircraft parking and ANS charges as well, but did not amend them in its final decision. Instead, HAL decided to consult further with airlines on these charges. On 18 March 2011, HAL published a consultation document⁷ proposing changes in the structure of aircraft parking charges.

2.5 On 12 November 2010, HAL issued a consultation document⁸ proposing its airport charges for 2011/12. The proposed charges reflected HAL's revised structure of charges and increases allowed under the price cap set out in the CAA's March 2008 decision. On 7 January 2011, HAL announced its decision on charges for 2011/12.⁹ The revised charges came into force on 1 April 2011.

2.6 A summary of HAL's previous structure of passenger and landing charges, the structure of charges proposed in HAL's consultation and the revised structure is shown in Table 1.

⁶ Available at
http://www.heathrowairport.com/assets/Internet/Heathrow/Heathrow%20downloads/Static%20files/airport_charges_final_decision_291010.pdf

⁷ Available at
http://www.heathrowairport.com/assets/Internet/Heathrow/Heathrow%20downloads/Static%20files/AircraftParkingChargesConsultationPaper_LHR.pdf

⁸ Available at www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=12293

⁹ Available at www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=12293

Table 1: Summary of the changes in HAL's structure of passenger and landing charges

| | Previous structure (pre April 2011) | Proposed structure (HAL's August 2010 Consultation) | Current structure (from 1 April 2011) |
|--|--|--|---|
| Passenger charge by destination | Domestic Republic of Ireland International | European (i.e. combined domestic and rest of EU) Other | European (i.e. combined domestic and rest of EU) Other |
| Transfer passenger charge | Not differentiated from origin and destination charge | 25% transfer passenger discount | 25% transfer passenger discount |
| Transit passenger charge | No charge | Charged as per transfer passengers | Charged as per transfer passengers |
| Basis of landing charge | Movement | Movement (no change) | Movement (no change) |
| Noise charge(1) | Undifferentiated chapter 4 | Differentiated Chapter 4 | Differentiated Chapter 4 |
| Emissions charge(2) | Per kg of NOx | Per kg of NOx (no change) | Per kg of NOx (no change) |

Notes: (1) The noise charge is based on ICAO and ACI noise categories for aircraft. Chapter 4 is the quietest category. From 1 April 2011, HAL divided Chapter 4 into three sub-categories.

(2) The emissions charge is based on emissions of Oxides of Nitrogen from the engine type of the aircraft.

2.7 HAL's passenger and landing charges for 2010/11 and 2011/12 are shown in Table 2

Table 2: HAL's passenger and landing charges 2010/11 and 2011/12

| | 2010/11 charges (£) | 2011/12 charges (£) |
|------------------------------------|---------------------|---------------------|
| Landing charges | | |
| Chapter 2 | £2,328.00 | £4,912.05 |
| Chapter 3 high | £1,164.00 | £4,912.05 |
| Chapter 3 base | £776.00 | £1,637.35 |
| Chapter 3 minus | £698.40 | n/a |
| Chapter 4 or equivalent | £659.60 | n/a |
| Chapter 4 high | n/a | £982.41 |
| Chapter 4 base | n/a | £818.68 |
| Chapter 4 minus | n/a | £491.21 |
| Emissions charge (per kg of NOx) | £2.73 | £6.09 |
| Departing passenger charges | | |
| Domestic | £13.43 | n/a |
| Republic of Ireland | £17.38 | n/a |
| Europe | n/a | £21.80 |
| International | £22.97 | n/a |
| Rest of World | n/a | £30.63 |
| Europe – transfer | n/a | £16.35 |
| Rest of World – transfer | n/a | £22.97 |

Section 41 of the Airports Act 1986 and the CAA's policy and process

- 2.8 Under S41 the CAA may, if it thinks fit, impose a condition on an airport operator where it appears that it is carrying out a course of conduct specified in section 41(3). One of the courses of conduct is:
- the adoption by the airport operator, in relation to any relevant activities carried on by him at the airport, of any trade practice, or any pricing policy, which unreasonably discriminates against any class of users of the airport or any particular user or which unfairly exploits his bargaining position relative to users of the airport generally.
- 2.9 Relevant activities are defined in section 36(1) of the Act as the provision at the airport of any services or facilities for the purposes of:
- (a) the landing, parking or taking off of aircraft;
 - (b) the servicing of aircraft (including the supply of fuel); or
 - (c) the handling of passengers or their baggage or of cargo at all stages while on airport premises (including the transfer of passengers, their baggage or cargo to and from aircraft).
- 2.10 bmi mentioned in its complaint section 41(3)(b) of the Act which is concerned with the granting of rights by virtue of which relevant activities may be carried on at the airport. However, as the complaint is concerned with charges levied by HAL on airlines and no rights have been granted in this respect, the CAA is not investigating HAL's conduct with respect to this part of S41.
- 2.11 Under Regulation 11(1) of the Civil Aviation Authority (Economic Regulation of Airports) Regulations 1986 (the Regulations), if it appears to the CAA that an airport operator *may* be pursuing one of the courses of conduct specified in section 41(3) of the Act, it *shall* investigate the matter (italics added). In assessing the merits of the complaint, the CAA must take into account its statutory duties under section 39 of the Act. These are:
- to further the reasonable interests of users of airports within the United Kingdom;
 - to promote the efficient, economic and profitable operation of such airports;

- to encourage investment in new facilities at airports in time to satisfy anticipated demands by the users of such airports; and
- to impose the minimum restrictions that are consistent with the performance by the CAA of its functions.

2.12 In December 2006, the CAA published its policy and processes for handling S41 cases¹⁰. It said it would handle cases consistent with its statutory powers and duties in the Act and, would expect to adopt an approach that is consistent with the application of competition law, except where the circumstances of a particular case suggest it should follow a different approach.

2.13 The CAA set out a three-stage process for handling complaints:

- Stage one: an initial consideration of a complaint – to determine whether it fell within the scope of S41, was not trivial, frivolous or vexatious, and whether there was a more effective alternative way to address the complainant's concerns;
- Stage two: preliminary investigation by the CAA – to determine whether the available evidence raised any concerns that the airport might be carrying out a course of conduct specified in S41(3); and
- Stage three: a formal investigation, in which the CAA would invite representations from interested parties into the matter.

2.14. This document opens the CAA's stage 3 formal investigation.

2.15 At stage 2 the CAA invited comments from HAL on bmi's complaint. In addition, the CAA was aware that other airlines had concerns over HAL's revised structure of charges, and it had also received correspondence from regional interests expressing their concerns. The CAA therefore decided to request comments from Heathrow airlines (via the AOC and ACC¹¹) and the regional interests concerned. The CAA received comments from: Heathrow AOC, ACC Heathrow, Virgin, Aer Lingus, the Northern Ireland Department for Regional Development, and the Scottish Minister for

¹⁰ The CAA's use of section 41 of the Airports Act 1986 – the CAA's policy and processes (December 2006), available at <http://www.caa.co.uk/docs/5/ergdocs/section41policy.pdf>

¹¹ The Airline Operators' Committee and Airline Consultative Committee are airline representative bodies at Heathrow.

Transport and Infrastructure. The CAA also received correspondence from the Consumer Council for Northern Ireland and Newcastle Airport.

- 2.16 Should the CAA conclude at the end of its formal investigation that it appears that HAL has undertaken a course of conduct described in S41 it can, if it thinks fit, impose conditions on HAL to remedy or prevent what it considers to be the adverse effects of that conduct. Under S41(6) the CAA would have to notify HAL of any conditions it proposed to impose and if, within one month, HAL objected the CAA could not proceed with the implementation of its proposed conditions but could instead make a reference to the Competition Commission under S43(3).
- 2.17 The CAA's policy sets out that we shall inform stakeholders of the timetable for completing our stage three investigation. Our current intention is to try and conclude this investigation by the end of October 2011. This is subject to change. The precise timetable will depend on a number of factors, including whether the parties request an oral hearing before a CAA panel.

3 THE CAA'S INITIAL VIEWS

3.1 The CAA considers that it should broadly adopt the approach used in European and domestic competition cases in its investigation. Accordingly, the CAA considers that the principal points it would expect to be relevant in this case are:

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

3.2 The CAA's initial views on these issues are set out below. As part of its stage two assessment, the CAA prioritised its consideration by seeking views from the parties of objective justification in particular.

Is Heathrow in a position of significant market power?

3.3 The CAA has undertaken its stage one and stage two assessment on the presumption that Heathrow has market power in the absence of any compelling contrary evidence. Although the CAA is currently gathering evidence for its latest competition assessments at the designated airports, due to report in December 2011, it does not consider it is proportionate to delay consideration of this complaint until this time when:

- (a) Heathrow remains a designated airport; and
- (b) a significant body of relevant evidence on this issue was discussed and evaluated in the course of the recent Competition Commission market inquiry into BAA. Amongst other things, this inquiry concluded that Heathrow's position as the only significant hub airport in the UK was a feature that restricted competition.

3.4 The CAA's initial view is that it should continue to assume that Heathrow has market power for the purposes of this investigation unless compelling evidence is submitted to the contrary by interested parties.

Is there an objective justification for the pricing structure that HAL has adopted and the timetable for its introduction?

- 3.5 Unfair discrimination can be thought of as applying dissimilar terms for equivalent transactions or similar terms for dissimilar transactions without an objective justification. The weight of evidence received to date seems to the CAA to bear principally on whether HAL has an objective justification for its conduct. Given HAL has advanced a cost relatedness objective justification the CAA is keen for HAL to further substantiate this and do so in a transparent manner.
- 3.6 The CAA also has an interest in HAL's justification for its transfer passenger discount given concerns raised by Aer Lingus and Virgin.
- 3.7 It is important to recognise that charges need not match costs exactly. The CAA accepts that there is not one 'right' way to allocate sunk and common costs and there are a number of legitimate approaches HAL could adopt. It has a margin of discretion about how it recovers the sunk and common costs associated with providing airport infrastructure.¹² Furthermore each different route, or aircraft type, could impose different costs on the airports, and a charging structure that attempted to reflect these cost differences exactly would be extremely complex. The CAA considers that there can be merit in adopting a simpler charging structure. With this in mind, should HAL's claimed cost justification be substantiated by this investigation, the CAA's initial view is that the equalisation of charges would not in itself be in contravention of S41. It is also important to note that it may be necessary to consider relevant non-cost related objective justifications that can be legitimate and demonstrable such as encouraging efficient use of a scarce asset or improving the passenger experience. In such circumstances, the CAA would expect the airport to ensure its reasoning can be transparently and objectively justified rather than simply asserted.

¹² See the CAA's recent decision in relation to the Ryanair v Gatwick Airport Limited Appeal under the 1997 Ground Handling Regulations for a discussion on the principles that support objective justification in relation to pricing conduct. Available at <http://www.caa.co.uk/docs/5/GH111GALRyanair.pdf>.

Passenger charges – views of parties

- 3.8 bmi said that the equalisation of domestic and other EU passenger charges had led to a 50% increase in the charge in respect of passengers on domestic routes. It thought that any such increase in the charge should be objectionable *per se*, but in any event if that increase was cost-related there should be clear evidence to demonstrate that.
- 3.9 bmi thought that HAL had failed to provide the required cost evidence and that its cost modelling was founded on wrong assumptions. HAL had failed to take account of the lower cost of domestic operations and had incorrectly assumed similar usage of landside facilities and baggage systems by domestic and international passengers, ignoring the reduced dwell time of domestic passengers at the airport.
- 3.10 bmi said that HAL had failed to take into account the impact of the changes in domestic passenger prices on bmi, which was unique in its reliance on the domestic market, with 53% of all its Heathrow passengers travelling on domestic routes. HAL had argued that the newly introduced transfer passenger discount would offset the increase in domestic charges, but bmi said this ignored the characteristics of its passengers. Only 30% of bmi's domestic passengers were transfer passengers, compared to 60% of Heathrow's traffic on all domestic routes.
- 3.11 Aer Lingus thought that HAL had also discriminated against passengers on routes to the Republic of Ireland (ROI). HAL's cost analysis had been flawed as it had not identified categories of cost where the handling of different passenger types was materially different, such as immigration and passport control. Aer Lingus would not benefit from the transfer passenger discount as it carried below average numbers of transfer passengers, and the discount had resulted in higher costs to non-transfer passengers. HAL had failed to provide evidence showing how the transfer discount would increase passenger numbers.
- 3.12 Virgin thought that HAL's decision to differentiate passenger charges was flawed as all Heathrow's facilities are common use. The introduction of a transfer passenger discount was based on an incomplete analytical model and created harmful competitive effects against non-hub carriers.
- 3.13 HAL said it consulted with airlines about changes to its pricing structure, and that the revised structure took into account responses to its consultation and was aligned with

the airport's objectives. HAL mentioned that the task of structuring airport charges was complex and difficult given the need to balance the varied and conflicting interests of many airport users

- 3.14 HAL said it had reviewed the cost of providing airport facilities to domestic and EU passengers and found no material difference between them. Passengers departing to domestic and EU destinations used equivalent facilities at the airport and there was no objective justification for charging them different prices¹³.
- 3.15 HAL said it had taken account of the impact its charges would have on airport users, but HAL could not modify its charges to take account of the characteristics of individual airlines, as all airlines operating at Heathrow were unique, and it would not be possible to have different charges for different airlines. HAL had reviewed the impact of the restructure would have on airlines and that had shown that bmi was not more acutely affected by the new charging structure relative to other airlines.

Passenger charges – CAA's initial view

- 3.16 CAA notes HAL's argument that its conduct is objectively justified on the grounds of cost relatedness. Cost-relatedness would be an example of an objective justification that could support HAL's conduct if it could be substantiated. HAL has modelled the costs of handling different categories of passengers: domestic and ROI, EU, and the rest of the world. Overall this analysis shows that the cost of handling a domestic or ROI passenger is about 88% of the cost of handling a European passenger.
- 3.17 The CAA is not in a position to confirm this assessment without undertaking a formal investigation and undertaking due diligence on the HAL model to test various assumptions. Following concerns raised by bmi and others, the CAA is keen to understand:
- a. why HAL only looked at asset costs and not at other, potentially significant, factors such as operational costs and commercial revenues?
 - b. why HAL chose to base its analysis on theoretical new build terminals for either domestic/ROI only, EU only, or non-EU passengers only?

¹³ A note by HAL on its cost model for determining the passenger charge differential by destination is on the CAA website at: www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=12293.

- c. how HAL's costs relate to its cost drivers, such as passenger dwell times and passenger characteristics?
- d. what is included in "other passenger assets" and why HAL chose to spread these costs equally between all except transfer passengers?

Landing charges – views of parties

3.18 bmi said that by continuing to use a basis for calculating landing charges that was not based on aircraft weight, HAL had ignored the higher infrastructure costs generated by larger aircraft, such as:

- larger aircraft exert more pressure on the runways;
- larger aircraft require larger and wider runways; and
- the greater wake vortex created by larger aircraft requires greater separation between aircraft thus reducing the number of movements that can be accommodated on a runway.

3.19 bmi said that most airports, even those that suffer from congestion, use weight as the differentiator in their charges. The financial impact of HAL's approach on bmi and other short-haul carriers is that they contribute an unreasonable proportion of the costs associated with landing charges, and as a result unreasonably subsidise other aircraft types.

3.20 Aer Lingus agreed with bmi's arguments. It was unaware of any of Heathrow's peer airports that used a similar pricing methodology. Aer Lingus recognised that ICAO policies indicate that allowance might be made in certain circumstances for movement based charges, or a combination of a fixed charge and a weight based element, such as at congested airports and at peak periods. However, it submitted that HAL should have regard to the overall effect of changes in charges on individual airlines.

3.21 HAL said that its landing charges were based solely on environmental factors, aircraft noise and NOx emissions. The charges were objectively justified as the level of charge varies according to the environmental effect produced by each aircraft landing at the airport. Landing charges could not be discriminatory as they applied equally to all aircraft using the airport. HAL considered that this aspect of the complaint did not

concern discrimination but instead was an objection to the noise element of the charging structure, and was therefore outside the scope of S41.

- 3.22 In its consultation with airlines, HAL highlighted the importance of encouraging airlines to use runway slots efficiently so they made the most effective use of scarce capacity.

Landing charges – CAA's initial view

- 3.23 HAL has not argued that its landing charges are justified by cost-relatedness, but that it set these charges to incentivise more efficient use of its runways and to incentivise quieter and cleaner flights. The CAA recognises that Heathrow's runways are very highly utilised and that the demand for aircraft slots exceeds supply. The CAA considers that incentivising a more efficient use of its runways could be an objective and justifiable reason for a charging structure that tends to discriminate between different classes of users. Such an approach would be in line with the CAA's statutory duties, in particular its duty to promote the efficient, economic and profitable operation of airports. The CAA is therefore seeking to substantiate whether HAL's chosen charging structure does, in fact, fulfil this objective.
- 3.24 The CAA supports HAL's objective to promote environmentally responsible behaviour and does not consider that setting charges to incentivise the use of quieter and cleaner aircraft is inappropriate. Indeed, the Civil Aviation Act 2006 makes it clear that an aerodrome authority may charge aircraft operators for use of the aerodrome by reference to the emissions from an aircraft as well as the noise produced. The Government's intention was to enable aerodrome operators to set their charges to reflect the impact of aircraft on local air quality in the vicinity of an airport.
- 3.25 The CAA does not consider that HAL is necessarily obliged to adopt the most commonly used charging system worldwide.

Implementation of charges – views of parties

- 3.26 bmi said that the time allowed for implementation of the charges was unreasonably discriminatory to bmi, as it denied the airline the proper opportunity to undertake the necessary restructuring in the available time. bmi said it would suffer a significant financial detriment as a result. In particular, it would need to re-structure its route network and fundamentally change its fleet profile.

- 3.27 bmi said that HAL had ignored the ICAO principle of gradualism in all the important areas of its price re-structuring. Other airports had revised proposed fundamental changes to their charging structure or agreed to introduce changes over a period of time. bmi had the opportunity to comment on HAL's original pricing proposals, but these were significantly amended in HAL's decision and bmi had no opportunity to comment on the final structure¹⁴.
- 3.28 bmi mentioned, in particular, that the immediate introduction of new Chapter 4 noise categories would not have the desired effect of incentivising quieter aircraft. It was not immediately clear to bmi into which Chapter 4 category its aircraft would fit. It suggested that phasing in the new categories, with the phasing known from the outset, would allow airlines to re-consider the composition of their fleets in response to the charges.
- 3.29 Aer Lingus agreed with bmi's arguments on gradualism.
- 3.30 HAL disagreed with bmi, saying that all airlines using Heathrow were subject to the same implementation schedule. It would not have been possible to have different implementation dates for different airlines, as they affected airlines in different ways. The lack of gradualism, therefore, could not be discriminatory, and was outside the scope of S41.

Implementation of charges – CAA's initial view

- 3.31 Gradualism is an ICAO principle, but it is not mandatory, and has not been notified to the CAA as an international obligation to which it must have regard. Furthermore the ICAO guidelines themselves recognise that there may be circumstances where a departure from the principle may be necessary. The CAA would not therefore consider a lack of gradualism to be objectionable *per se*. The CAA notes that bmi would not have enough time to adjust its fleet in response to HAL's changes to its structure of charges, but considering the time taken to adjust aircraft fleets (bmi mentioned that it takes a minimum of two years for the delivery of new aircraft) the CAA does not consider that changes to pricing structures must be phased to fit in

¹⁴ HAL withdrew both its parking and navigation charge proposals after closing the August 2010 consultation. Had HAL not withdrawn significant elements of its initial proposals, the increased charges for bmi would have been offset to some extent by decreases in other charges.

with this timetable. For the CAA to insist on such timing of implementation would be unnecessarily prescriptive.

- 3.32 The European Airport Charges Directive (Directive 2009/12/EC) requires airports to consult on new charges at least four months before they come in force, and normally publish revised charges at least two months before they come into force. HAL met these deadlines.
- 3.33 The CAA is not persuaded that bmi, nor any other respondent, has made the case so far that the speed of the implementation of the revised charges has been unreasonably discriminatory. It does not intend, therefore, to consider this aspect of bmi's complaint further unless a respondent can present further evidence that the lack of gradualism has been unreasonably discriminatory.
- 3.34 Consistent with the findings of its recent Ground Handling Appeal (Ryanair v Gatwick Airport)¹⁵ the CAA does not consider that a large price increase in and of itself is discriminatory if it is based on a cost related justification and therefore entails revising a pricing structure that is itself unreasonably discriminatory or has become so over time.

Does HAL's revised pricing structure cause harm or have the potential to cause harm to passengers and/or the competitive process?

- 3.35 The revised structure of HAL's charges is revenue neutral within the price control and thus the amount charged to airlines in total has not changed. At one level it could therefore be argued that the overall effect on passengers might not be significant. Nevertheless, if HAL did not have an objective justification for its conduct it could be argued that such pricing behaviour for an airport with market power would lead to distortions to the competitive process in terms of the prices airlines could then charge passengers.
- 3.36 This could impact different users, or classes of users, in different ways with increases in fares for some or reduction in route choice. Some parties who contacted the CAA

¹⁵ Appeal to the Civil Aviation Authority under Regulation 20 of the Airports (Groundhandling) The Regulations 1997 made by Ryanair Limited against Gatwick Airport Limited and BAA Airports Limited: The CAA's Decision (May 2011). Available at <http://www.caa.co.uk/docs/5/GH1111GALRyanair.pdf>

following bmi's submission to the CAA of its complaint drew attention to adverse effects on passengers on domestic and Irish services.

- 3.37 Against this background, the CAA notes that in 2005 and 2007 it published reports into UK Regional Air Services¹⁶. These reports recognised that access to Heathrow was an important issue for regional economic development, and in particular for passengers wishing to connect to other services. There had been some reductions in services between UK regional airports and Heathrow over the decade preceding the report, but services to other London airports more than offset the loss of Heathrow services, and links to other European hubs provided an alternative means of making connections. Overall the CAA found there had had been improvements in the connectivity of UK regions, delivering benefits to passengers and, potentially wider economic benefits to UK regions through the aviation industry responding to incentives created through liberalisation. The reports recognised that there could be alternative policy interventions open to the government, for example by public funding via Regional Development Funds, or through Public Service Obligations¹⁷.
- 3.38 The CAA's initial view is that harm can be presumed should HAL be considered to have market power and have no objective justification for its pricing conduct that has a significant impact on a class or classes of user. However, the CAA ought not to use S41 to pursue wider policy goals of regional connectivity given that the CAA has to apply S41 against its statutory duties in the Airports Act alone. The regulatory regime of Part IV of the Act is not designed for wider purposes that could risk importing distortions and where such wider purposes are more properly addressed by alternative mechanisms open to the government.

Views invited

- 3.39 This document sets out the matters that the CAA will be investigating and its initial views based on its preliminary assessment. Before reaching a decision on its formal

¹⁶ CAP 754 UK Regional Air Services – a study by the UK Civil Aviation Authority (2005), available on the CAA website at: <http://www.caa.co.uk/docs/33/CAP754.PDF>.

CAP 775 Air Services at UK Regional Airports – An update on Developments (2007), available on the CAA website at <http://www.caa.co.uk/docs/33/CAP775.pdf>.

¹⁷ Under European law Public Service Obligations would be permitted where there is no access from a region to a city, e.g. London. However, it is less certain whether they could be used to protect a route to Heathrow if there are routes to other London airports.

investigation the CAA would welcome representations from the main parties and any other interested parties on its initial views set out in this section.

3.40 In particular, the CAA welcome views on:

- the basis of HAL's objective justification for its passenger charges (including its transfer passenger discount); and
- whether HAL's landing charges fulfill its objective to incentivise more efficient use of its runways and cleaner and quieter flights.

3.41 The CAA would also be open to:

- views relating to CAA's presumption that HAL has significant market power;
- compelling evidence that the speed of the implementation of the revised charges has been unreasonably discriminatory; and
- views on any other matters parties consider to be relevant.

3.42 To enable a timely resolution of this complaint, the CAA seeks views by no later than **Tuesday 6 September 2011**.

APPENDIX B**July 2012 notice**

CAA Notice 20 July 2012

On 12 March 2012 the CAA published a decision concerning the structure of airport charges levied by Heathrow Airport Limited ("the March Decision").

Since then the CAA has received correspondence from an interested party, Aer Lingus, raising a number of grounds of criticism of the March Decision which Aer Lingus considers would give rise to grounds for judicial review.

The issues raised include criticisms of the reasoning in the March Decision, and complaints that the interested party concerned was not given the opportunity to comment on certain material which is referred to in the Decision (specifically in relation to the effect of the revised charging structure on competition).

The CAA considers it is important that interested parties should have the opportunity to make representations in relation to the evidence referred to in the March Decision whether or not the CAA is under any legal obligation to seek those views. The CAA further considers that it is desirable that its reasoning in relation to the matters under investigation is clearly expressed and understood by all stakeholders concerned.

Aer Lingus has emphasised the need for a timely resolution of the CAA's investigation into the revised structure of HAL's charges. The CAA considers that resolution of these issues as quickly as possible is in the interests of the industry as a whole. Judicial review proceedings in relation to the March Decision would likely take some months to resolve even on a relatively expedited timetable. If the outcome of such proceedings were to be that the CAA was required to give further consideration to the March Decision, that would further delay the timely resolution of the CAA's investigation.

In the circumstances, the CAA has decided that it should give further consideration to the March Decision in the light of points raised by Aer Lingus. The March Decision should therefore be regarded by interested parties as a provisional view.

The CAA has published with this Notice non-confidential versions of

(1) the points made by Aer Lingus in connection with the March Decision together with a report referred to in those points and

(2) evidence referred to in the March Decision (in addition to that set out in the March Decision) which has not been made available to interested parties. This information was provided by Heathrow Airport Limited ("HAL"). Some data has been redacted to ensure that HAL remains compliant with the confidentiality obligations it has entered into with the airlines concerned. CAA however has seen the non-redacted version of this data.

If, as an interested party, you are minded to make further comments/representations please do so within 21 days of this notice (or let us know if you need extra time to respond and why). Whilst the CAA does not limit the nature and scope of comments that could be made it is expected that comments would focus upon Aer Lingus's criticisms of the March Decision and the additional material provided.

The CAA will give further consideration to the matters addressed in the decision having regard both to the points made by Aer Lingus and representations received from any other interested party. CAA request you do not repeat points which have been made to the CAA previously during the course of the investigative process.

Please send all comments and any queries to Rod Gander at rod.gander@caa.co.uk.

APPENDIX C**August 2012 notice**

CAA Notice 1 August 2012

On 20 July 2012, the CAA published a Notice relating to its decision of 12 March 2012 on the structure of airport charges levied by Heathrow Airport Limited (HAL).

With the Notice the CAA published a non-confidential version of evidence referred to in the CAA's March decision which had not been made available to interested parties. This information had been provided by HAL. Some data had been redacted to ensure that HAL remained compliant with the confidentiality obligations it had entered into with the airlines concerned. Following further discussion with HAL, the CAA is publishing another version of this evidence which includes some information on airport charges per passenger which was fully redacted in the version published on 20 July.

The period for interested parties to make further comments or representations on the matters addressed in the CAA's March decision remains at 21 days from the Notice published on 20 July (ie by Friday 10 August 2012)

APPENDIX D**May 2013 notice**

NOTICE FROM THE CAA 21 MAY 2013**IN THE MATTER OF THE COMPLAINT FURTHERED BY AER LINGUS PLC IN RESPECT OF HEATHROW AIRPORT LIMITED'S STRUCTURE OF AIRPORT CHARGES****SECTION 41 AIRPORTS ACT 1986**

The CAA's decision dated 17 December 2012 has been withdrawn. This is because the CAA has received further representations, in the context of a judicial review of the decision, which the CAA considers it right to take into account. Those representations in particular concerned the possible adverse effects of the disputed charges on Aer Lingus and the possible impact of those charges on competition and passengers. The CAA will accordingly reconsider its Decision.

The CAA wishes to minimise any uncertainty or delay caused by this step. Therefore the process the CAA will follow before making and publishing its Decision is set out below and the time frame is intentionally short so as to expedite reaching that Decision.

Process

1. The CAA will publish any data and/or analysis it considers relevant and necessary to address the further representations it has received.
2. Any representations on that data and/or analysis on which it is based must be received within 10 working days of CAA publication.
3. Any representations received will be published on the working day following the closing day for representations. Representations should not contain information in a form which cannot be published as received by the CAA.
4. Any comments on those representations must be received by the CAA within 10 working days of publication of those representations by the CAA.
5. The CAA will then complete its further consideration of the complaint and publish its Decision.

APPENDIX E

October 2013 investigation/consultation

Investigation under section 41 of the Airports Act 1986 of the structure of charges levied by Heathrow Airport Limited - October 2013 data and analysis

CAP 1121



CHAPTER 1

Introduction

Introduction and purpose of this document

- 1.1 On 13 February 2013 Aer Lingus issued a claim for permission to judicially review the CAA's decision in this matter dated 17 December 2012. On 21 May 2013 the CAA withdrew the decision dated 17 December 2013 ("the withdrawn decision"¹). On 18 July 2013 Aer Lingus applied to the Court to withdraw its claim. This is a consultation document published by the CAA to solicit the views of interested parties on issues raised by Aer Lingus in its application for judicial review. The document is part of the process by which the CAA will reach its decision in this complaint. The issues considered are:
- the financial effects of the Heathrow Airport Limited's (HAL's) revised passenger charges on Aer Lingus; and
 - the methods by which the CAA should assess whether there has been any effect on competition.

Consultation and next steps

- 1.2 Any representations on this document must be sent to the CAA at the following e-mail address (rod.gander@caa.co.uk) by 28 November 2013.
- 1.3 Any representations received will be published on the working day following the closing day for representations. Representations should not contain information in a form which cannot be published as received by the CAA.
- 1.4 Any comments on those representations must be received by the CAA within 10 working days of publication of those representations by the CAA.
- 1.5 The CAA will then complete its further consideration of the complaint and publish its decision.

1 The withdrawn decision is on the CAA website at http://www.caa.co.uk/docs/78/HeathrowS41Decision2012_withdrawn.pdf.

Structure of this document

- 1.6 This document is structured as follows:
- Chapter 2 looks at the effects of the revised passenger charges on Aer Lingus.
 - Chapter 3 considers the methods by which the CAA should assess whether there has been any effect on competition.
 - Appendix A is the CAA analysis referred to in chapter 2.
 - Appendix B is data provided by HAL on total airport charges and total airport charges per passenger for the top 40 airlines at Heathrow.
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CHAPTER 2

The effects of the revised passenger charges on Aer Lingus

Introduction

- 2.1 Aer Lingus said in paragraph 39 of its Statement of Grounds for judicial review “that if the charging structure had been constructed to ensure that the departing passenger charge levels properly reflected the 18% cost differential [to HAL] between domestic/Republic of Ireland (ROI) and other European passengers, Aer Lingus would be paying around £4 million less per year than it pays under the current disputed charging structure. ... By April 2013 this will have amounted to an aggregate overcharge in excess of £8 million”.
- 2.2 The CAA wishes to understand interested parties’ views on this analysis proposed by Aer Lingus. In particular, it wishes to understand the robustness of the figures which Aer Lingus relies upon and their relevance to the exercise in which the CAA is engaged.
- 2.3 This chapter considers the methodology by which the sum asserted by Aer Lingus is calculated and whether this sum is a reasonable assessment of the financial impact on Aer Lingus.

Aer Lingus conclusions and the HAL modelling

- 2.4 Aer Lingus’ calculation of the impact on it of HAL’s charges, HAL’s justification for its charges and the CAA’s analysis in the withdrawn decision of whether HAL’s charges are unreasonable are all based on an analysis of HAL’s modelling.
- 2.5 The CAA’s view is that modelling of this nature can never be wholly accurate as it is inevitably based on a number of assumptions. In particular, the allocation of costs of passengers involves a range of simplifications about the time passengers spend in an airport which are a very broad approximation. The CAA recognises that an allocation of costs between passengers on European routes and other passengers is, therefore, only a broad approximation of the levels of costs that such customers impose on HAL. Similarly, the CAA is concerned that the

previous arrangements which allocated costs between domestic, ROI and international passengers were also only a very broad approximation.

- 2.6 Whilst the CAA considers that the modelling put forward by HAL does show a material difference in the cost of handling passengers on domestic and ROI routes compared to handling passengers on other European routes the accuracy of the differential would appear to the CAA to be debatable.
- 2.7 Aer Lingus' use of the modelling to calculate the extent of the financial effects of the disputed charges on Aer Lingus involves relying on the model to a significantly greater degree of granularity than the CAA's broad analysis of the charges which lead to the conclusion that HAL had not provided a proper justification of its charge differentiation and that its charges could therefore be treated as unreasonably discriminatory.
- 2.8 It is the CAA's provisional view that the limitations of the modelling mean the CAA cannot rely on the modelling to calculate the precise financial impact of HAL's charges, and that the CAA should therefore be cautious about deciding whether a remedy is warranted predominantly on the basis of calculations derived from the cost model. Indeed, to the extent that any party wishes to make representations as to whether the limitations of the modelling mean that CAA should not make any finding of unreasonable discrimination, such representations should be made in response to this consultation.
- 2.9 Given that the CAA is minded to come to this conclusion, the CAA seeks representations on the points made above and in particular on:
- the robustness of HAL's modelling;
 - its adequacy for the calculation of specific financial adverse effects; and
 - the weight the CAA should attach to any conclusions or analysis drawn from the results of that modelling.

What divergence from cost reflective pricing is acceptable?

- 2.10 HAL's position has been that, whilst its starting point for setting the per passenger charge has been the cost to it of handling that passenger, it should not be required to levy purely cost reflective charges, partly because the resulting charging structure would be too complex. (The

evidence given was this would result in approximately 180 different passenger charges.)

- 2.11 In the withdrawn decision, the CAA accepted this point in principle. Although non-complexity is not necessarily a goal in itself a charging scheme should be easily understood, capable of being managed with reasonable resources and allow errors to be readily identified. The CAA found that against these tests it would not be overly burdensome for HAL to maintain a separate domestic/ROI charge and issues about complexity did not provide an objective justification for HAL applying a common charge for all passengers on European routes. The CAA concluded that HAL's charges were unreasonably discriminatory not because they were not cost orientated, but because HAL justified them on the basis of cost orientation when in fact they were not so justified.
- 2.12 Furthermore, the CAA's finding of unreasonable discrimination based on a cost differential of 16/18% does not mean that the only acceptable cost differential is zero. For instance, HAL initially believed that the cost differential was 11%, and that such a differential was not material but within an acceptable margin (and therefore not unreasonable discrimination).
- 2.13 HAL's argument raises the question, to what extent should charges be cost oriented. Cost orientation would be a normal starting point (to avoid undue discrimination) but it does not follow that any lawful charge needs to be precisely cost reflective. This in turn gives rise to the question of how far any remedy should bring about cost oriented charging when that is not otherwise required.
- 2.14 This issue may be of particular concern where the basis of the cost allocation methodology may be seen as "broad brush" rather than very specific or accurate.
- 2.15 The CAA considers that some percentage of differential between the charge and cost may have been acceptable, given the range of acceptable bases for pricing, the absence of an obligation to price on a cost oriented basis, the limitations of the available modelling and the impracticability of a "per airline" charge. The consideration of adverse effects, therefore need not start from the assumption of a zero differential as some level of differential would have been acceptable and may not therefore have constituted unreasonable discrimination.
- The CAA would welcome representations on these issues.

Aer Lingus' calculations of the actual effect on it of the revised charges

- 2.16 As set out in paragraph 2.1 above Aer Lingus has submitted that the increased cost to it of the revised passenger charges is £4 million per annum. In its stage 3 submissions of September 2011 Aer Lingus calculated the impact on it of HAL's new charging structure based on an 11% cost differential between the cost of handling domestic/ROI passengers and the cost of handling other European passengers. At the time HAL said its modelling showed such an 11% differential. However, after Aer Lingus discovered flaws in the modelling, HAL accepted there was a 16% differential. Aer Lingus contends that the differential is 18%.
- 2.17 It appears to the CAA that Aer Lingus' initial calculations compared the consequences of being charged the actual revised charge and a charge 11% lower than the revised charge.
- 2.18 The CAA considers that Aer Lingus used the same approach to calculate the increased cost to it of the revised passenger charge in its application for judicial review, albeit now using a charge 18% lower than the revised charge. The methodology by which Aer Lingus may have reached its estimate of £4 million can be tested by comparing the HAL passenger charge of £21.80 applied to Aer Lingus' departing passengers at Heathrow in 2011 (1.098m passengers) producing £23.9 million against a charge 18% lower (£17.88) producing £19.6 million, a difference of £4.3 million.
- 2.19 In its pre-hearing submissions in January 2012, Aer Lingus calculated that if its per passenger charge for domestic/ROI passengers had been 18% lower its total airport charges payable to HAL in 2011 would have been £28.4 million, that is £4.1 million less than the £32.5 million it actually paid in 2011.
- The CAA would welcome views, in particular from Aer Lingus, on whether its assessment of how the £4 million figure was reached is correct.

What is the effect of the revised charges on Aer Lingus

- 2.20 While the CAA is unable to replicate Aer Lingus' figures above its preliminary view is that, the methodology used by Aer Lingus tends to overstate the financial effect of the revised per passenger charges on Aer Lingus (even ignoring issues concerning HAL's cost allocation

methodology raised above). The CAA's reasons for its preliminary view on this matter are set out below.

- 2.21 It seems to the CAA that Aer Lingus has reduced HAL's per passenger charge for domestic/ROI departing passengers by 18% and concluded that this results in the charge that it would be paying if HAL's per passenger charge were cost related. However, if Aer Lingus (and other airlines operating on domestic/ROI routes) paid a charge 18% lower this would have reduced HAL's overall revenue from airport charges. In that situation, HAL would presumably have adjusted its charges to generate the same amount of revenue to which it was entitled under the CAA price cap on airport charges at Heathrow. In its consultation on 2011/12 charges HAL said that it expected to generate revenue of £218 million from the Europe passenger charge. To maintain this overall revenue while decreasing revenue from domestic/ROI departing passengers HAL would have to increase passenger charges, pro rata, for passengers travelling on other European routes.
- The CAA would welcome representations on its view that Aer Lingus' assumption its charges would decrease by 18% is an oversimplification.
- 2.22 An alternative approach might be to re-calculate what passenger charges would generate the same amount of revenue for HAL if they reflected an 18% differential between the domestic/ROI charge and the rest of Europe charge and a 40% differential between the rest of Europe charge and the Rest of the World passenger charge². Using this alternative approach the CAA calculates that the European charge would have been £22.99 rather than £21.80 and the domestic/ROI charge £18.85 rather than the £17.88 under the assumed Aer Lingus methodology.
- 2.23 If the CAA decided it was appropriate to base the comparisons on the alternative approach set out in paragraph 2.22 above, the CAA calculates the 'overcharge' would be £2.6 million (see Table B1 in Appendix A). This figure is not directly comparable with Aer Lingus' figure of £4.1m as the latter includes all the airport charges the airline pays at Heathrow but it does suggest that the financial impact is likely to be less than that asserted by Aer Lingus even on the basis of Aer Lingus' approach to modelling. As Table B1 in Appendix A also shows the CAA calculates

2 HAL's modelling stated that HAL's costs in handling passengers on non-European routes were 40% higher than its costs of handling passengers on European routes.

that on a comparable basis the 'overcharge' to Aer Lingus, using Aer Lingus' methodology, would be £3.5 million.

2.24 The CAA also notes that if the difference between the amount domestic/ROI departing passengers and other European passengers cost HAL is 16% rather than 18%, the 'overcharge' would, using the approach in the previous paragraph, be £2.3 million.(see Table B1 in Appendix A).

- The CAA would welcome representations on this calculation and analysis.

2.25 The CAA's calculations above are based on the charges levied on point to point passengers and make no allowance for the lower charges paid in respect of transfer passengers. Under HAL's revised charging structure in 2011/12, transfer passengers were charged at a lower rate (£16.35 rather than £21.80 on European routes). Aer Lingus' evidence says that 19% of its passengers on domestic/ROI routes are transfer passengers. Taking transfer passengers into account the CAA estimates that Aer Lingus would have paid £3.1 million less at an 18% differential or £2.7 million less at a 16% differential compared to HAL's actual charges (see Table B2 in Appendix A). The CAA considers that these figures would be a more accurate indication of the impact of the revised charges on Aer Lingus (where Aer Lingus' methodology was otherwise being applied), as they recognise that some of Aer Lingus' passengers are transfer passengers.

- The CAA would welcome representations on this analysis including whether or to what extent and on what basis a finding of unreasonable discrimination would be appropriate.

What is the effect of the revised charges overall on all airlines in the class affected by the revised charges that are the subject of this complaint?

2.26 The CAA has also assessed the financial impact on all airlines operating on domestic/ROI routes using the same methodologies as described above. On the assumptions first that 19% of all domestic/ROI passengers are transferring at Heathrow (as for Aer Lingus) and second that the transfer charge is set at 75% of the point to point charge, otherwise using the Aer Lingus model the CAA estimates that, in aggregate, airlines serving domestic/ROI routes would have paid £10 million less at an 18% differential and £8.8 million less at a 16%

differential compared to HAL's actual charges in 2011/12. (see Table C2 in Appendix A).

- 2.27 The following table summarises the results of the CAA's preliminary assessment. The raw data on which the CAA based its assessment and its more detailed calculations are at Appendix A.

Table 1 CAA preliminary assessment of increased cost to Aer Lingus and all airlines on domestic/ROI routes of HAL's non-cost oriented passenger charges

| | HAL actual charges in 2011/12 | Assumed Aer Lingus methodology with 18% differential | Alternative approach with 18% differential | Alternative approach with 16% differential |
|--|-------------------------------|--|--|--|
| Europe charge | £21.80 | £21.80 | £22.99 | £22.85 |
| Domestic/ROI charge | £21.80 | £17.88 | £18.85 | £19.19 |
| Transfer charge (75%) | £16.35 | £13.41 | £14.14 | £14.39 |
| Passenger charges paid by Aer Lingus (£000) | 22,799 | 18,700 | 19,715 | 20,069 |
| Difference (£000) | | 4,100 | 3,084 | 2,730 |
| Passenger charges paid by airlines on all domestic/ROI routes (£000) | 73,880 | 60,595 | 63,884 | 65,033 |
| Difference (£000) | | 13,285 | 9,996 | 8,847 |

Note: Assumes 19% transfer passengers on all routes.

Summary of the CAA's preliminary analysis on the impact of the revised charges

2.28 The effect on Aer Lingus of HAL's decision to charge the same per passenger charge for domestic/ROI departing passengers and the rest of Europe passengers in 2011 is more likely to have been in the region of £2.7 - £3.1 million even using Aer Lingus' basic methodology. The CAA is minded to use these figures as a starting point in its assessment of the impact of the revised charges on Aer Lingus. However, as also highlighted, the CAA is concerned that the underlying basis for these figures is not such as to give substantial confidence in the extent of

actual cost differences imposed on HAL by different categories of passenger.

- The CAA would welcome any views on this analysis.

2.29 The calculations in the preceding paragraphs compare a zero price differential between Europe and domestic/ROI passengers with a cost differential to HAL of 16% or 18%. However, if the CAA was to conclude that, for example, a 5% cost differential would not be considered sufficiently material to require different levels of charge the calculation of any 'overcharge' on Aer Lingus would then amount to £1.6-£1.9 million (on the basis of Aer Lingus' figures as corrected). This would fall to £0.9-£1.2 million if a 10% differential was regarded as acceptable. Fuller details are in Table B3 in Appendix A.

- The CAA would welcome views on this further analysis and issues of materiality of such figures along with any representations on the nature and scope of the CAA's regulatory discretion in relation to such matters.
- Overall, the CAA would welcome comments as to whether it should conclude:
 - that the revised charges unreasonably discriminate against carriers on domestic and ROI routes as a class of user at Heathrow; and, if so,
 - what are the adverse effects of the unreasonable discrimination; and, whether,
 - the implications for the need for - or nature of - any remedy relation to any finding of unreasonable discrimination against carriers on domestic and ROI routes in respect of passenger charges.

Information the CAA has available to it to consider the impact of the revised charges on Aer Lingus in the context of Aer Lingus' particular circumstances

2.30 The analysis above considers the impact on Aer Lingus' in relation to its Heathrow routes alone. However, if the CAA concluded that the actual effects on Aer Lingus should be considered in the wider context of the airline's business, the CAA provisionally considers it should take the following data into account.

- 2.31 Across its network Aer Lingus pays nearly €300 million (around £230 million) in airport charges. Its estimate of its 'overcharge' of £4.1 million at Heathrow, represents 1.8% of this total. In terms of total network operating costs of €1324 million (£1030 million at an exchange rate of 1.29) Aer Lingus' view of its 'overcharge' at Heathrow is 0.4% of its operating costs. If the 'overcharge' was £3.1m or £2.7m in line with the CAA's calculations the proportion of Aer Lingus' operating costs would be lower.
- 2.32 The CAA has no information on the profitability of Aer Lingus' routes from Heathrow³. Aer Lingus' annual reports publish profits for the airline as a whole. These show the following operating results over the past five years:
- 2008 €20 million loss
 - 2009 €81 million loss
 - 2010 €52.5 million profit
 - 2011 €49.1 million profit
 - 2012 €69.1 million profit
- 2.33 While Dublin – London is, in Aer Lingus' submission, its most important route, it operates three other routes from Heathrow and overall the airline serves nearly 100 routes mainly within Europe but with some long haul routes as well. Consequently, in the CAA's preliminary view, whilst Aer Lingus' own estimate of a £4.1 million 'overcharge' on its domestic/ROI routes at Heathrow might in itself be considered a significant sum, and might be thought likely to reduce the airline's global profitability all other things being equal, the rest of the network is so large that no reliable conclusion can be drawn about how Aer Lingus' global business is affected, or how the charges in question will affect the route network or product offering as a whole.
- 2.34 Despite the increase in its airport charges at Heathrow, Aer Lingus continues to regard Heathrow as an important operating base. In the airline's 2012 report the Chief Executive Officer said: *"Aer Lingus has considerable experience and strength at London Heathrow. In 2014, we will move to Terminal 2 at Heathrow and this modern facility will provide us with a considerable opportunity to provide short haul feed from Ireland to our partner airlines operating long haul services at both this*

3 Aer Lingus operates to Belfast City, Dublin, Shannon and Cork from Heathrow.

terminal and other terminals in Heathrow. London Heathrow remains a focal point of our strategy. Despite not obtaining any slots from the remedy package related to the IAG acquisition of bmi, Aer Lingus remains interested in the outright purchase or lease of slots in order to enhance our feeder capabilities in London Heathrow”.

- 2.35 In the oral hearing of this complaint in January 2012 Aer Lingus’ evidence was that it had chosen not to pass all the increase in charges to its passengers.
- 2.36 In the CAA’s preliminary view, these two statements support a conclusion that Aer Lingus considers that the benefits to it of operating at Heathrow will continue to outweigh the costs to it of doing so. It is clear that Aer Lingus still regards Heathrow as an important part of its operations and that it is looking to increase, rather than decrease, the extent of its operations at the airport. The CAA does not therefore consider it likely that the revised passenger charges at Heathrow would of themselves cause Aer Lingus to reduce the quality and/or scale of its operations at the airport.
- The CAA would welcome representations on the preliminary views set out above.

CHAPTER 3

The methods by which the CAA should assess whether there has been any effect on competition

Introduction

- 3.1 In the CAA's withdrawn decision (paragraphs 2.2-2.16), the CAA explained that it proposed to consider whether HAL's revised charging structure either had affected, or had a tendency to affect, or harm competition between airlines. The CAA is minded to continue to take that approach for the reasons set out in the withdrawn decision.
- 3.2 Aer Lingus has argued that the CAA's analysis of the effect on airline competition was incorrect in two respects:
1. in paragraph 71 of its Statement of Grounds Aer Lingus argued that the CAA should not look at whether there have been any actual effects on competition but whether there has been any tendency to distort competition⁴; and
 2. in paragraph 74 of its Statement of Grounds Aer Lingus said that the CAA should consider a broader test of competition than airlines flying on domestic and ROI routes as Aer Lingus also competes against airlines flying to other European destinations.
- 3.3 As set out in the CAA's Notice dated 21 May 2013, the CAA has re-examined its consideration of this aspect of the case in light of Aer Lingus' representations. The CAA's provisional conclusions are set out below.

Theoretical or actual effect?

- 3.4 The CAA is minded to continue to consider that it should not only look at whether there has been a tendency to distort competition, but, where relevant evidence is available, it should consider the actual effects on airline competition on the routes affected by the charges it had found to be unreasonably discriminatory. The CAA considers that to disregard

4 Aer Lingus said that "A test of tendency to distort competition does not involve looking at actual effects in terms of an identifiable deterioration in relevant market positions. Quite the opposite..."

actual effects and rely instead on a purely theoretical approach would be perverse.

The relevant market in which to consider the effect on competition

- 3.5 With respect to Aer Lingus' contention that the CAA should look at airlines flying to other European destinations, the CAA notes that there have been a number of European Union airline competition cases that can guide an analysis of airline competition. The CAA's preliminary view is that the most relevant are the European Commission's consideration of IAG's acquisition of bmi⁵ and also its consideration of Ryanair's proposed acquisition of Aer Lingus⁶. The IAG/bmi case appears to be particularly pertinent as it relates to competition on short haul routes from Heathrow. In both cases the Commission concluded that the most appropriate approach was to look at competition on a route by route (city pairs) basis, rather than considering competition between different destinations.
- 3.6 In IAG/bmi, the Commission said it *"has traditionally defined the relevant market for scheduled passenger air transport services on the basis of the 'point of origin/point of destination' ('O&D') city pair approach⁷. Such a market definition reflects the demand-side perspective whereby passengers consider all possible alternatives of*

⁵ Regulation (EC) No 139/2004 Merger Procedure - Case No COMP/M.6447-IAG/BMI (30 December 2012).

⁶ Regulation (EC) No 139/2004 Merger Procedure - Case No COMP/M.4439-Ryanair/Aer Lingus (27 June 2007).

⁷ *"Commission's decision of 26 January 2011 in Case No COMP/M.5830 - Olympic/Aegean Airlines; Commission's decision of 27 July 2010 in Case No COMP.M5889 - United Air Lines/Continental Airlines; Commission's decision of 14 July 2010 in Case No COMP.M5747 - Iberia/British Airways, Commission's decision of 28 August 2009 in Case No COMP.M5440 - Lufthansa/Austrian Airways, Commission's decision of 14 May 2009 in Case No COMP.M5403 - Lufthansa/bmi, Commission's decision of 9 January 2009 in Case No COMP.M5364 - Iberia/Vueling/Clickair, Commission's decision of 22 June 2009 in Case No COMP.M5181 - Lufthansa/SN Airholding; Commission's decision of 6 August 2009 in Case No COMP.M5181 - Delta Air Lines/Northwest Airlines; Commission's decision of 4 July 2005 in Case No COMP.M3770 - Lufthansa/Swiss; Commission's decision of 11 February 2004 in Case No COMP.M3280 - Air France/KLM. The O&D approach was confirmed by the General Court, most recently in Case T-342/07 Ryanair Holdings plc v European Commission [2010] ECR, paragraph 53."*

travelling from a city of origin to a city of destination, which they do not consider substitutable to a different city-pair. As a result, every combination of a point of origin and a point of destination is considered a separate market.

- 3.7 *In the past, the Commission has also taken into consideration supply-side elements such as network competition between airlines based on the hub and spoke structure of traditional carriers. However, the Commission considered that the degree of supply-side substitutability between different O&Ds remains limited. It considered in this respect that, although from a supply-side perspective a network carrier could in theory fly from any point of origin to any point of destination, in practice network carriers build their network and decide to fly almost exclusively on routes connecting to their hubs⁸.*
- 3.8 *In line with the Commission's notice on market definition⁹, the Commission has given pre-eminence to demand-side substitution, whereby it considered that customers still need the transportation from one point to another and that competition still takes place on an O&D city-pair basis (even though some customers, in particular corporate customers, may have concluded corporate agreements for a range of routes and the commercial advantages stemming from such agreements may lead them to prefer one airline among the different airlines that operate on the route). It has thus traditionally upheld the O&D approach".¹⁰*
- 3.9 *The Commission went on to say "during the market investigation, some competitors indicated that the O&D approach fails to capture the nature and extent of network competition and the issues of slot*

8 *"On the network approach, see: Commission's decision of 27 July 2010 in Case No COMP/M.5889 - United Air Lines/Continental Airlines, recital 9 and following; Commission's decision of 28 August 2009 in Case No COMP/M.5440 - Lufthansa/Austrian Airlines, recital 11 and following; Commission's decision of 14 May 2009 in Case No COMP/M.5403 - Lufthansa/bmi, recital 8 and following, Commission's decision of 22 June 2009 in Case No COMP/M.5335 - Lufthansa/SN Airholding, recital 12 and following; Commission's decision of 6 August 2008 in COMP/M.5181 - Delta Air Lines/Northwest Airlines, recital 8 and following; Commission's decision of 4 July 2005 in Case No COMP/M.3770 - Lufthansa/Swiss, recital 12 and following; Lufthansa/Swiss, recital 12 and following, Commission's decision of 11 February in Case No COMP/M.3280 - Air France/KLM, recital 9 and following; Commission's decision of 11 February 2004 in Case No COMP/M.3280 - Air France/KLM, recital 9 and following."*

9 *"Commission Notice on the definition of the relevant market, paragraph 13 (OJ C 372, 1997. p5)."*

10 *IAG/bmi, paragraph 31*

availability and market dominance of carriers in slot restricted airports. It was also mentioned that while the O&D approach is appropriate for customers that have a particular destination in mind, it would not be appropriate for customers that do not. Some respondents also indicated that the Commission should pay particular attention as to which airports to include in the relevant O&D market, since not all airports at a given city are necessarily substitutable. Nevertheless, a large majority of respondents to the market investigation questionnaires (competitors, travel agents and corporate customers) agree with the O&D approach.”¹¹.

3.10 On the question of London airport substitutability the Commission said *“the parties, without distinguishing between time sensitive and non-time sensitive customers, consider that all London airports (Heathrow, Gatwick, City, Stansted and Luton and the new London Southend airport) and arguably also further airports in the South East of England are substitutable regardless of the city pair served”¹² “¹³.*

3.11 The Commission reached a similar conclusion in Ryanair/Aer Lingus saying: *“defining a market for a ‘bundle’ of all flights from or to Ireland is not the most appropriate way to define the market in the present case. From the demand side, passengers are in principle flying a given route to a given destination rather than from any route to anywhere”¹⁴.¹⁴ Also “the vast majority of airline customers book their flights according to plans to get from a specific city or region to another specific city or region. Following a small but significant and non-transitory price increase, these customers would not change their travel plans and choose another destination from Ireland”¹⁵ “¹⁶ “Furthermore, in the case of business passengers or passengers visiting friends and relatives, any substitutability of different destinations is unlikely as the purpose of their journey is itself connected to with a specific destination (place of a business meeting or place of residence of friends and relatives). For the vast majority of passengers, therefore, a flight from Ireland*

¹¹ IAG/bmi, paragraph 33

¹² *“The parties argue that there is no basis for concluding that customer preferences vary depending on which city they are flying to; the individual city-pair assessments indicate that the parties’ services are constrained by third-party services from any London airport.”*

¹³ IAG/bmi, paragraph 47

¹⁴ IAG/bmi, paragraph 62

¹⁵ See e.g. case M.770 - Lufthansa/Swiss paragraph 12,.

¹⁶ IAG/bmi, paragraph 63

*to one destination is not simply substitutable with a flight to another destination.*¹⁷

- 3.12 On London airport substitutability the Commission observed *“that all of Ryanair’s direct competitors on the Dublin to London route (Aer Lingus, British Airways, bmi and Cityjet) take the view that London airports are substitutable for a majority of the point-to-point customers. This has been confirmed by many other carriers and by the affected airports”*.¹⁸
- 3.13 The Commission’s analysis in the preceding paragraphs leads the CAA to provisionally conclude that the most appropriate way of assessing whether HAL’s amended structure of passenger charges has adversely affected the competitive position of carriers on domestic/ ROI routes from Heathrow is to look at those routes on a city pair basis as these are the markets on which Aer Lingus and other airlines on Heathrow domestic/ROI routes compete¹⁹. In assessing competition between airlines the CAA is not minded to consider that it should look at charges levied on an airline operating to one destination (e.g. Dublin) to those levied on an airline operating to a different destination (e.g. Frankfurt)²⁰. The CAA is minded to agree with the Commission that passengers do not regard a flight to Frankfurt as an acceptable alternative to a flight to Dublin.
- 3.14 In its application for judicial review Aer Lingus argued that any analysis of competition should go beyond considering individual air routes. Aer Lingus quoted a number of cases where it said the Commission had

17 IAG/bmi, paragraph 63

18 IAG/bmi, paragraph 117

19 The CAA does not consider that this preliminary conclusion affects the views on competition between airports it has expressed in its market power assessments of Heathrow, Gatwick and Stansted. In assessing airport competition the CAA does not primarily have to consider whether passengers view the airports as substitutes, but whether airlines consider the airports as substitutes. In considering whether to move services from one airport to another an airline also has to consider the effects on the airline’s network of routes at the airports on passenger demand (i.e. transfer passengers) and the effects on the airline’s cost base of moving to a different airport. An airline, therefore, may not consider two airports to be substitutes in terms of the “airport to airline” services they supply even if passengers consider the airports to be substitutes in terms of flight options they see as comparable. The lack of availability capacity in the London area is also an important matter to be considered in analysing airport competition as airlines may not be able to obtain enough slots at another London airport to make moving its services worthwhile.

20 In looking at destinations where more than one airport serves a city the CAA will consider city pair data rather than data for just one airport. That is for London it will consider data for Heathrow, Gatwick, Stansted, Luton, London City and Southend combined, rather than just data for Heathrow.

applied a broader test of competition in cases of discrimination against transport operators. These cases were: *Aéroports de Paris*²¹, *Corsica Ferries*²² and *Portuguese airports*²³.

- 3.15 The CAA's current view is that the cases cited by Aer Lingus are not instructive for present purposes. The CAA considers it should attach greater weight to the IAG/bmi and Ryanair/Aer Lingus cases which involved similar routes to those in the current case (short haul routes from London and Irish airports) and similar airlines (including Aer Lingus, British Airways (IAG) and bmi). The CAA considers these are the markets on which Aer Lingus competes and hence its preliminary view that these are the right markets to assess to understand whether the revised passenger charges have affected Aer Lingus' ability to compete with other airlines. In contrast, the CAA is currently minded to attach less weight to cases that involved French airports, Portuguese Airports and an Italian seaport, which are cases where the Commission and the European Court were concerned with the effective establishment of the single European market in the face of apparent discrimination aimed at protecting domestic undertakings at the expense of those from other member states. The cases are also significantly less recent than the bmi/Ryanair cases.
- 3.16 In its Statement of Grounds, Aer Lingus said that as the IAG/bmi and Ryanair/Aer Lingus cases are merger cases they did not represent the standard approach to airline competition issues. The CAA is minded to disagree with Aer Lingus as these cases identify the European Commission's view on the proper approach to analysing competition between airlines, which is the issue the CAA is concerned with here.
- 3.17 In its application for judicial review Aer Lingus also referred to the Commission's decision that the Irish authorities' levying of an excise duty on air passenger transport that varied according to the distance flown constituted illegal state aid to Aer Lingus and other Irish airlines. The CAA notes that this case was concerned with state aid in respect of which there were doubts about its compatibility with the single market. Although the case concerns Aer Lingus and Irish routes, the CAA is minded not to consider it to be as relevant as the IAG/bmi and Ryanair/

21 Case T-128/98 *Aéroports de Paris v Commission* [2000] ECR II-3929.

22 case C-18/93 *Corsica Ferries* [1993] ECR, I-1783.

23 Case C-163/99 *Portugal v Commission* ECR I-2613.

Aer Lingus cases which are directly concerned with airline competition on domestic and Irish routes from London. Furthermore, as this case is unpublished, the CAA is unable to review it and properly consider its implications for this complaint.

- The CAA would welcome representations on its analysis and preliminary conclusion that the appropriate market on which to assess the effect on airline competition is an analysis of city-pair data, and that it should accordingly use data relating to city pairs for the purposes of its analysis.

Evidence to inform the CAA's analysis of the effect, if any, on competition

3.18 The CAA has considered what evidence of city pair data it has available to assist it in assessing the effects on airline competition. Table 2 below looks at the domestic and ROI destinations that were served from Heathrow in 2010/11 showing for each the number of passengers in 2010/11, 2011/12 and 2012/13. It also looked at flight and passenger numbers for services from any of the six London airports to these destinations in the same period²⁴. (The table does not include services to Leeds Bradford which was not served from Heathrow in 2010/11 but was in 2012/13.) Table 3 looks at passenger numbers on the same routes for the same years at the six London airports combined.

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The London airports are Heathrow, Gatwick, Stansted, Luton, London City and Southend. Belfast includes both Belfast City and Belfast International airports. Glasgow includes Glasgow International and Prestwick airports.

Table 2 - Passengers numbers on domestic and ROI routes from Heathrow 2010/11, 2011/12, 2012/13 (% change from previous year). [Numbers in 000's]

| | 2010/11 | 2011/12 | 2012/13 | % change 2012/13 compared to 2010/11 |
|------------|---------|--------------------|--------------------|---|
| Aberdeen | 631.4 | 649.6 (2.9%) | 661.2 (1.8%) | (4.7%) |
| Belfast | 745.1 | 708.6 (-4.9%) | 681.6 (-3.8%) | (-8.5%) |
| Cork | 384.0 | 393.7 (2.5%) | 382.7 (-2.7%) | (-0.3%) |
| Dublin | 1,476.5 | 1,563.4 (5.9%) | 1,581.4 (1.1%) | (7.1%) |
| Edinburgh | 1,267.7 | 1,264.1 (-0.3%) | 1,222.9 (-3.3%) | (-3.5%) |
| Glasgow | 1,020.4 | 776.9 (-23.9%) | 848.7 (9.2%) | (-16.8%) |
| Manchester | 796.3 | 766.4 (-3.8%) | 766.4 (0.0%) | (-3.8%) |
| Newcastle | 442.6 | 486.0 (9.8%) | 480.8 (-1.1%) | (8.6%) |
| Shannon | 269.8 | 269.7 (0.0%) | 264.1 (-2.1%) | (-2.1%) |
| Total | 7,033.8 | 6,878.4 (-2.2%) | 6,889.8 (0.2%) | (-2.0%) |

Source: CAA statistics

Table 3 - Passengers numbers on domestic and ROI routes from all London airports combined 2010/11, 2011/12, 2012/13 (% change from previous year). [Numbers in 000's]

| | 2010/11 | 2011/12 | 2012/13 | % change 2012/13 compared to 2010/11 |
|------------|----------|--------------------|---------------------|--------------------------------------|
| Aberdeen | 892.6 | 1,002.5 (12.3%) | 1,023.8 (2.1%) | (14.7%) |
| Belfast | 2,001.3 | 1,975.0 (-1.3%) | 2,017.1 (2.1%) | (0.8%) |
| Cork | 790.7 | 798.8 (1.0%) | 769.2 (-3.7%) | (-2.7%) |
| Dublin | 3,502.3 | 3,698.0 (5.6%) | 3,690.2 (-0.2%) | (5.4%) |
| Edinburgh | 2,805.9 | 2,915.8 (3.9%) | 2,861.7 (-1.9%) | (2.0%) |
| Glasgow | 2,394.4 | 2,192.8 (-8.4%) | 2,206.6 (0.6%) | (-7.8%) |
| Manchester | 1,040.5 | 996.9 (-4.2%) | 953.0 (-4.4%) | (-8.4%) |
| Newcastle | 652.7 | 581.8 (-10.9%) | 564.4 (-3.0%) | (-13.5%) |
| Shannon | 547.8 | 562.1 (2.6%) | 556.4 (-1.0%) | (1.6%) |
| Total | 14,628.2 | 14,723.5 (0.7%) | 14,642.4 (-0.6%) | (0.1%) |

Source: CAA statistics

Inferences and conclusions the CAA is minded to make from the available evidence

(a) effect on all carriers

3.19 Tables 2 and 3 do not appear to show any evidence that carriers on domestic and ROI routes from Heathrow have been disadvantaged compared to carriers at other London airports. In 2011/12 passenger numbers at the six airports combined grew slightly whilst numbers at Heathrow declined by a small amount. In 2012/13 the situation reversed with some small growth at Heathrow and a slight decline at the six airports combined. Over the two years in total, there has been a slight decline at Heathrow whilst passenger numbers at the six airports combined are almost exactly the same. There has been no significant change on the routes combined over the years. In looking at individual

routes it is noticeable that the decline at Heathrow over the two years is entirely accounted for by falling passenger numbers on the Glasgow route in 2010/11. This reflected bmi's withdrawal from the route in March 2011. There have been various factors that may have affected passenger numbers in this period which has been one of weakness in both the UK and Irish economies. It has also been a time of change for airlines with the takeover of bmi by British Airways and the subsequent divestment of slots that led to the entrance of Virgin Little Red on Heathrow domestic routes²⁵. Overall the evidence does not suggest that HAL's charges have had a material effect on domestic and ROI carriers at Heathrow. This is re-inforced by the evidence of new entry on Heathrow domestic routes, by Virgin Little Red and by British Airways opening a new route to Leeds Bradford²⁶.

(b) effect on Aer Lingus

3.20 In its withdrawn decision, the CAA was not minded to consider the effect on Aer Lingus in isolation from the other carriers on domestic and ROI routes as all carriers on these routes had faced the same increase in passenger charges. The CAA has now looked at Aer Lingus passenger numbers in Tables 4 and 5, which show Aer Lingus passenger numbers at Heathrow and passenger numbers on the same city pair routes operated by all carriers for 2010/11, 2011/12 and 2012/13. The numbers do not appear to show that Aer Lingus has suffered a competitive disadvantage. In 2011/12 Aer Lingus' Heathrow passenger numbers increased more quickly than those of all airlines on the city pair. This was reversed in 2012/13 with Aer Lingus passenger numbers declining on all routes. However, in that second year, Aer Lingus performed better than all airlines on the Cork route and at a very similar level to all airlines than the Shannon route. Over the two years together Aer Lingus passenger numbers fell by 2.9% whilst total traffic on the city pairs grew by 2.8%. Although Aer Lingus did worse than other carriers in terms of passenger numbers the overall difference was small with the overall decline in Aer Lingus' passengers resulting from a sharp fall in numbers for Aer Lingus

25 Virgin Little Red has services to Manchester, Edinburgh and Aberdeen that are operated by Aer Lingus on a wet lease basis.

26 The CAA's duties to users in section 39 encompass passengers as well as airlines. The CAA looked at effects on passengers in its withdrawn decision and found no evidence that HAL's changes to its structure of charges had materially affected passengers on domestic and ROI routes from Heathrow. Tables 2 and 3 update the data shown in the withdrawn decision. In the CAA's views, the new information continues to show no evidence that passengers have been adversely affected by HAL's charges.

on one route, its Belfast route, in 2012/13. The CAA notes that in July 2012 British Airways re-launched a Heathrow-Belfast service replacing the route formerly operated by bmi. The CAA's preliminary views are that these results do not suggest that Aer Lingus has suffered a competitive disadvantage and that any apparent difference is likely to be due to factors other than HAL's charges.

Table 4 - Aer Lingus passenger numbers on routes operated at Heathrow 2010/11, 2011/12, 2012/13 (% change from previous year). [Numbers in 000's]

| | 2010/11 | 2011/12 | 2012/13 | % change 2012/13 compared to 2010/11 |
|---------|---------|----------------|-----------------|---|
| Belfast | 281.3 | 285.6 (1.4%) | 219.9 (-22.9%) | (-21.8%) |
| Cork | 384.0 | 393.7 (2.5%) | 382.7 (-2.8%) | (-0.3%) |
| Dublin | 1,155.6 | 1,239.8 (7.3%) | 1,163.8 (-6.1%) | (0.7%) |
| Shannon | 270.1 | 269.7 (-0.2%) | 264.1 (-2.0%) | (-2.2%) |
| Total | 2,091.0 | 2,188.4 (4.7%) | 2,030.5 (-7.2%) | (-2.9%) |

Source: CAA statistics

Table 5 - Passengers numbers carried by all airlines to the city pair destinations that Aer Lingus operates at Heathrow 2010/11, 2011/12, 2012/13²⁷ (% change from previous year). [Numbers in 000's]

| | 2010/11 | 2011/12 | 2012/13 | % change 2012/13 compared to 2010/11 |
|---------|---------|-----------------|-----------------|--------------------------------------|
| Belfast | 2,001.3 | 1,975.0 (-1.3%) | 2,017.1 (2.1%) | (0.8%) |
| Cork | 790.7 | 798.8 (1.0%) | 769.2 (-3.7%) | (-2.7%) |
| Dublin | 3,502.3 | 3,698.0 (5.6%) | 3,690.2 (-0.2%) | (5.4%) |
| Shannon | 547.8 | 562.1 (2.6%) | 556.4 (-1.0%) | (1.6%) |
| Total | 6,842.1 | 7,033.8 (2.8%) | 7,032.9 (0.0%) | (2.8%) |

Source: CAA statistics

Evidence of effects on competition between different European destinations

3.21 As stated above in paragraph 3.13 the CAA considers that airlines compete with airlines operating to the same destination on a city pairs basis and not with airlines operating to different destinations. However, Aer Lingus considers that it would be informative to compare passenger numbers on domestic and ROI routes with those on other European routes. The CAA has therefore done so in Table 6 below.

²⁷ The figures show the number of passengers carried by all airlines (including Aer Lingus) on routes from the six London airports to the destinations that Aer Lingus serves from Heathrow.

Table 6 - Passengers numbers on domestic and ROI routes, and other European routes²⁸ from Heathrow 2010/11, 2011/12, 2012/13 (% change from previous year). [Numbers in 000's]

| | 2010/11 | 2011/12 | 2012/13 | % change 2012/13 compared to 2010/11 |
|-----------------------------|----------|-----------------|-----------------|---|
| Domestic and ROI routes | 7,033.8 | 6,878.4 (-2.2%) | 6,889.8 (0.2%) | (-2.0%) |
| Other European routes | 22,630.9 | 24,398.1 (7.8%) | 24,506.3 (0.4%) | (8.3%) |

Source: CAA statistics

²⁸ Other European routes are to the following countries: Austria, Belgium, Bulgaria, Cyprus, Czech, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and Switzerland.

Table 7 - Passengers numbers on domestic and ROI routes, and other European routes²⁹ from London airports 2010/11, 2011/12, 2012/13 (% change from previous year). [Numbers in 000's]

| | 2010/11 | 2011/12 | 2012/13 | % change 2012/13 compared to 2010/11 |
|------------------------------------|----------|-----------------|------------------|--------------------------------------|
| Other London airports ¹ | | | | |
| Domestic and ROI routes | 7,594.4 | 7,845.1 (3.3%) | 7,752.6 (-1.2%) | (2.1%) |
| Other European routes | 41,300.0 | 43,915.0 (6.3%) | 44,905.7 (2.3%) | (8.7%) |
| All London airports ² | | | | |
| Domestic and ROI routes | 14,628.2 | 14,723.5 (0.7%) | 14,642.4 (-0.6%) | (0.1%) |
| Other European routes | 63,930.8 | 68,313.1 (6.9%) | 69,412.0 (1.6%) | (8.6%) |

¹ Other London airports are: Gatwick, Stansted, Luton, London City and Southend.

² All London airports are other London airports plus Heathrow.

Source: CAA statistics

3.22 The figures in Table 6 show that at Heathrow passenger numbers on other European routes have grown over the two years by 8.3% compared to a fall in passengers on domestic and ROI routes of 2%. If Aer Lingus' contention that its Heathrow services (which are all to domestic or ROI destinations) compete with airlines operating from Heathrow to other European countries is correct, this could be evidence that airlines operating domestic and ROI routes from Heathrow (including Aer Lingus) have seen their competitive position weaken if the differential growth rates are due to HAL's revised charging structure. However, the figures for the other five London airports are similar to those at Heathrow. Passenger numbers on other European routes have risen by 8.7% over the two years, whilst passengers on domestic and ROI routes have only grown by 2.1%. Whilst the difference between the

²⁹ See footnote 27.

growth rates is larger at Heathrow than at the other London airports, it is not markedly so and the pattern of results is similar. It is informative to note that some of the other London airports have also changed their charging structures in ways that have raised charges on domestic/ROI services relative to other European services. London City abolished lower passenger charges on domestic routes in 2010/11, while Stansted abolished lower passenger charges on domestic and ROI routes in 2012/13, and Gatwick has in recent years increased the relative share of landing charges in total airport charges (which had a greater effect on operators of smaller aircraft that generally operate domestic routes)³⁰. This suggests that the larger difference between the growth rates at Heathrow may not be due to changes in HAL's charging structure. The CAA's provisional conclusion is that comparing passenger numbers on domestic and ROI routes with those on other European routes does not show that Aer Lingus' competitive position has been adversely affected.

- The CAA would welcome representation on the data it has analysed and the preliminary conclusions which it has drawn from that data.
- The CAA would also welcome representations on any other data which it is considered could inform the CAA's view when considering the effect of the revised charges on competition.

Has Aer Lingus been affected more than any other airline in the affected class?

- 3.23 In its Statement of Grounds Aer Lingus said that it was affected more than other airlines as it was the only airline that operates exclusively domestic and ROI flights at Heathrow and that the CAA had failed to take this into account when considering whether to exercise its discretion whether to impose conditions on HAL as a remedy. In its withdrawn decision the CAA did not consider that it could infer any impact on competition from this point, nor that in itself it justified the imposition of a remedy.
- 3.24 The CAA's conclusion in the withdrawn decision relied on evidence provided by HAL showing the changes in the 'total' and 'total per passenger' charges paid by the top 40 airlines at Heathrow³¹. In

30 Gatwick Airport is currently consulting with airlines on a phased withdrawal of separate domestic and ROI passenger charges.

31 The top 40 airlines are the airlines with the highest number of passengers using their Heathrow services in the 6 months to the end of September 2011.

the withdrawn decision the CAA gave consideration to Aer Lingus' submission on why the data could not be relied upon, and set out the CAA's conclusions drawn from its analysis of the data. (See paragraphs 4.14 – 4.21). In summary, the CAA concluded that "these figures ... did not show that any particular airline or class of airline was affected more significantly than other airlines". The CAA was not commenting on whether Aer Lingus was financially affected more than any other airline, rather whether there was any evidence to suggest that Aer Lingus' ability to compete was affected more than any other airline. The CAA has now set out above a preferred approach to the assessment of the effect of the revised charges on competition.

- 3.25 In its Statement of Grounds Aer Lingus criticised the CAA's analysis as it considered the CAA should only have considered the effects of changes in domestic, ROI and other European passenger charges rather than all airport charges. However, the analysis was directed at Aer Lingus' argument that it has suffered a competitive disadvantage compared to airlines flying to destinations outside the UK/ROI. Airlines on other routes will necessarily pay a different mix of airport charges, and hence the CAA considered whether having to pay the new passenger charges meant that Aer Lingus faced a greater increase in the airport charges it paid than other airlines flying to other destinations. In that context the CAA found that the data did not show that any particular airline was more significantly affected than other airlines. Furthermore, and for the reasons set out above the CAA's preliminary view is that the relevant market to consider the affect on competition is point to point (city pairs) and accordingly an assessment of the affect on competition across European destinations is not helpful or appropriate in the context of this complaint.
- 3.26 HAL has updated those figures (Appendix B). The updated figures continue to show that the amount paid in airport charges by individual airlines varies, but there is no one airline that is obviously an outlier and is paying considerable more on a per passenger basis than any other airline. Aer Lingus continues to be near the top of the table but is not at the top. In terms of the absolute amount paid per passenger in airport charges in 2012/13 Aer Lingus paid less than any of the other top 40 airlines. (In 2010/11 it also paid less than any other of the top 40 airlines, in 2011/12 two other airlines in the top 40 paid less.) The CAA is not minded to change the conclusions drawn from the earlier figures published in the withdrawn decision.

- The CAA would welcome representations on whether the conclusion referred to above is a valid conclusion to reach in light of the new information submitted to CAA by HAL.
- Furthermore, the CAA would welcome representations in the light of the analysis considered above (or any part of it) as to the implications for the need for - or nature of - any remedy in relation to any finding of unreasonable discrimination against carriers on domestic and ROI routes in respect of passenger charges.

APPENDIX A

CAA analysis referred to in chapter 2 of this document

Raw data used in CAA calculations

| | | | Source/assumption |
|---|---------|------------|---|
| TOTAL PASSENGERS | | | |
| Total domestic departing passengers | a | 2,519,159 | HAL forecast for 2010/11 |
| Irish departing passengers | b | 1,038,824 | HAL forecast for 2010/11 |
| Total domestic/Irish departing passengers | a+b | 3,557,983 | HAL forecast for 2010/11 |
| Aer Lingus departing passengers | c | 1,098,000 | HAL traffic data for 2011 |
| Total Europe passengers (including domestic/ROI) | d | 13,767,869 | HAL forecast for 2011/12 |
| Total Europe passengers (excluding domestic/ROI) | d-(a+b) | 10,209,886 | HAL forecast for 2011/12 minus HAL forecast for 2010/11 |
| TRANSFER PASSENGERS | | | |
| Domestic transfer passengers | e | 478,640 | 19% of total as for Aer Lingus |
| Irish transfer passengers | f | 197,376 | 19% of total as for Aer Lingus |
| Total domestic/Irish transfer passengers | e+f | 676,016 | |
| Aer Lingus transfer passengers | g | 208,620 | 19% of total - Aer Lingus evidence |
| Europe transfer passengers (including domestic/ROI) | h | 3,760,991 | HAL forecast for 2011/12 |
| Europe transfer passengers (excluding domestic/ROI) | h-(e+f) | 3,084,975 | |
| POINT TO POINT PASSENGERS | | | |

| | | | |
|--|-------------------------|--------------|---|
| Domestic departing passengers | a-e | 2,040,519 | |
| Irish departing passengers | b-f | 841,448 | |
| Total domestic/Irish departing passengers | (a-e) - (b-f) | 2,881,967 | |
| Aer Lingus departing passengers | c-g | 889,380 | |
| Total Europe passengers (including domestic/ROI) | d-h | 10,006,878 | |
| Total Europe passengers (excluding domestic/ROI) | [d-(a+b)] -[h-(e+f)] | 7,124,911 | |
| | | | |
| REVENUE AND CHARGES | | | |
| Revenue from Europe point to point passengers | | £218,148,940 | HAL forecast for 2011/12 |
| Average Europe charge | | £21.80 | Actual charge in 2011/12 |
| Revenue from Europe transfer passengers | | £61,492,203 | HAL forecast for 2011/12 |
| Average Europe transfer charge | | £16.35 | Actual charge in 2011/12 (25% discount) |
| Total revenue from Europe passengers | | £279,642,143 | HAL forecast for 2011/12 |

CAA calculations of financial impact of HAL charging structure

Table A: Revised charges in 2011/12

| | HAL actual charges | Charges with 18% differential | Charges with 16% differential | Charges with 10% differential | Charges with 5% differential |
|------------------------------|--------------------|-------------------------------|-------------------------------|-------------------------------|------------------------------|
| Revenue to be generated | £218,149,940 | £218,149,940 | £218,149,940 | £218,149,940 | £218,149,940 |
| Europe Passengers | | 7,124,912 | 7,124,912 | 7,124,912 | 7,124,912 |
| Domestic/ ROI passengers | | 2,881,966 | 2,881,966 | 2,881,966 | 2,881,966 |
| Total passengers | 10,006,878 | 10,006,878 | 10,006,878 | 10,006,878 | 10,006,878 |
| Average charge | £21.80 | | | | |
| Average Europe charge | | £22.99 | £22.85 | £22.45 | £22.12 |
| Average domestic/ ROI charge | | £18.85 | £19.19 | £20.21 | £21.01 |

Table B1: Impact on Aer Lingus (no allowance for margin of discretion)

| | Aer Lingus methodology with 18% differential | Alternative approach with 18% differential | Alternative approach with 16% differential |
|------------------------------------|--|--|--|
| Aer Lingus domestic/ROI passengers | 889,380 | 889,380 | 889,380 |
| Actual charge | £21.80 | £21.80 | £21.80 |
| Revised charge | £17.88 | £18.85 | £19.19 |
| Difference | £3.92 | £2.95 | £2.61 |
| Total revenue impact | £3,486,370 | £2,623,671 | £2,321,282 |

Table B2: Total passenger charges paid by Aer Lingus

| | At HAL charges | Aer Lingus methodology with 18% differential | Alternative approach with 18% differential | Alternative approach with 16% differential |
|-----------------------------------|----------------|--|--|--|
| Aer Lingus point-point passengers | 889,380 | 889,380 | 889,380 | 889,380 |
| Aer Lingus transfer passengers | 208,620 | 208,620 | 208,620 | 208,620 |
| Point to point charge | £21.80 | £17.88 | £18.85 | £19.19 |
| Transfer charge (75%) | £16.35 | £13.41 | £14.14 | £14.39 |
| Revenue from pt-pt charge | £19,388,484 | £15,902,114 | £16,764,813 | £17,067,202 |
| Revenue from transfer charge | £3,410,937 | £2,797,594 | £2,949,887 | £3,002,042 |
| Total revenue | £22,799,421 | £18,699,708 | £19,714,700 | £20,069,244 |
| Difference | | £4,099,713 | £3,084,721 | £2,730,177 |

Table B3: Impact on Aer Lingus (allowing for margin of discretion)

| | Charges with 18% differential | Charges with 16% differential |
|------------------------------------|-------------------------------|-------------------------------|
| Aer Lingus Domestic/ROI passengers | 889,380 | 889,380 |
| Charge at 5% margin of discretion | £21.01 | £21.01 |
| Revised charge | £18.85 | £19.19 |
| Difference | £2.16 | £1.82 |
| Total revenue impact (1) | £1,921,061 | £1,618,672 |
| Charge at 10% margin of discretion | £20.21 | £20.21 |
| Revised charge | £18.85 | £19.19 |
| Difference | £1.36 | £1.02 |
| Total revenue impact (2) | £1,209,557 | £907,168 |

Table C1: Impact on all airlines on domestic/ROI routes (no allowance for margin of discretion)

| | Aer Lingus methodology with 18% differential | Alternative approach with 18% differential | Alternative approach with 16% differential |
|-------------------------|--|--|--|
| Domestic/ROI passengers | 2,881,966 | 2,881,966 | 2,881,966 |
| Actual charge | £21.80 | £21.80 | £21.80 |
| Revised charge | £17.88 | £18.85 | £19.19 |
| Difference | £3.92 | £2.95 | £2.61 |
| Total revenue effect | £11,297,307 | £8,501,800 | £7,521,931 |

Table C2: Total passenger charges paid by all airlines on domestic/ROI routes

| | At HAL charges | Aer Lingus methodology with 18% differential | Alternative approach with 18% differential | Alternative approach with 16% differential |
|------------------------------|----------------|--|--|--|
| Point-point passengers | 2,881,966 | 2,881,966 | 2,881,966 | 2,881,966 |
| Transfer passengers | 676,016 | 676,016 | 676,016 | 676,016 |
| Point to point charge | £21.80 | £17.88 | £18.85 | £19.19 |
| Transfer charge (75%) | £16.35 | £13.41 | £14.14 | £14.39 |
| Revenue from pt-pt charge | £62,826,858 | £51,529,552 | £54,325,059 | £55,304,927 |
| Revenue from transfer charge | £11,052,874 | £9,065,374 | £9,558,866 | £9,727,870 |
| Total revenue | £73,879,732 | £60,594,926 | £63,883,925 | £65,032,797 |
| Difference | | £13,284,806 | £9,995,807 | £8,846,935 |

Table C3: impact on all airlines on domestic/ROI routes (allowing for margin of discretion)

| | Charges with 18% differential | Charges with 16% differential |
|------------------------------------|-------------------------------|-------------------------------|
| Domestic/ROI passengers | 2,881,966 | 2,881,966 |
| Charge at 5% margin of discretion | £21.01 | £21.01 |
| Revised charge | £18.85 | £19.19 |
| Difference | £2.16 | £1.82 |
| Total revenue impact (1) | £6,225,047 | £5,245,178 |
| Charge at 10% margin of discretion | £20.21 | £20.21 |
| Revised charge | £18.85 | £19.19 |
| Difference | £1.36 | £1.02 |
| Total revenue impact (2) | £3,919,474 | £2,939,605 |

APPENDIX B

Total airport charges and total airport charges per passenger for top 40 airlines³². Data provided by HAL on 5 June 2013

Table C1 Total airport charges (millions) - 12 months to 31 March

| | a | b | | c | |
|-------|---------|---------|------------------------|---------|------------------------|
| | 2010/11 | 2011/12 | Variance % (a vs b) | 2012/13 | Variance % (b vs c) |
| Short | 0-6m | 6-12m | 128.1% | 6-12m | -7.1% |
| Long | >12m | >12m | 90.5% | >12m | 6.1% |
| Long | 0-6m | 0-6m | 34.7% | 0-6m | 8.8% |
| Mid | 6-12m | 6-12m | 46.7% | 6-12m | 10.7% |
| Mid | 0-6m | 0-6m | 49.6% | 6-12m | 18.6% |
| Mid | 6-12m | 6-12m | 31.5% | 6-12m | 18.9% |
| Mid | 6-12m | >12m | 35.8% | >12m | 30.0% |
| Long | 0-6m | 0-6m | 26.8% | 0-6m | -1.3% |
| Short | >12m | >12m | 30.4% | >12m | 2.2% |
| Mid | >12m | >12m | 28.3% | >12m | 17.9% |
| Long | 6-12m | >12m | 23.4% | >12m | 25.8% |
| Long | 6-12m | 6-12m | 26.9% | 6-12m | 20.4% |
| Long | 6-12m | 6-12m | 28.7% | >12m | 17.0% |
| Mid | 0-6m | 0-6m | 27.7% | 6-12m | 16.8% |
| Long | 0-6m | 0-6m | 21.8% | 0-6m | -2.0% |
| Long | >12m | >12m | 21.4% | >12m | 8.1% |
| Long | >12m | >12m | 22.1% | >12m | 4.1% |
| Long | >12m | >12m | 20.4% | >12m | -2.2% |
| Long | 0-6m | 6-12m | 17.3% | 6-12m | 6.0% |
| Mid | >12m | >12m | 16.3% | 6-12m | -33.8% |
| | 2010/11 | 2011/12 | Variance % (a vs b) | 2012/13 | Variance % (b vs c) |
| Long | >12m | >12m | 18.8% | >12m | 19.5% |

32 See footnote 30

| | | | | | |
|-------|-------|---------|--------|---------|--------|
| Long | 6-12m | 6-12m | 9.3% | 6-12m | 1.6% |
| Long | >12m | >12m | 17.1% | >12m | 14.1% |
| Short | 0-6m | 0-6m | 15.4% | 6-12m | 19.7% |
| Long | 6-12m | 6-12m | 17.0% | 6-12m | -2.7% |
| Long | >12m | >12m | 13.8% | >12m | 10.2% |
| Short | >12m | >12m | 8.9% | >12m | -0.6% |
| Short | >12m | >12m | 13.1% | >12m | 13.6% |
| Short | 6-12m | 6-12m | 8.5% | 6-12m | 13.3% |
| Short | >12m | >12m | 4.6% | >12m | 7.7% |
| Short | 6-12m | 6-12m | 9.8% | >12m | 18.6% |
| Short | >12m | >12m | 4.2% | >12m | 1.2% |
| Long | >12m | >12m | 9.5% | >12m | 15.4% |
| Short | 0-6m | 0-6m | 2.9% | 0-6m | 1.9% |
| Short | >12m | >12m | 6.3% | >12m | -66.3% |
| Short | 0-6m | 0-6m | 1.2% | 6-12m | 49.3% |
| Short | 6-12m | >12m | 5.3% | >12m | 16.9% |
| Long | 6-12m | 6-12m | 0.9% | 6-12m | 5.6% |
| Long | 6-12m | 6-12m | 2.6% | 6-12m | 7.6% |
| Mid | 0-6m | 0-6m | -27.6% | 0-6m | -8.4% |
| Total | 922.9 | 1,090.8 | 18.2% | 1,197.9 | 9.8% |

Source HAL

Table C2: Airport charges per passenger - 12months to 31 March

| | a | b | | c | |
|-------|---------|---------|------------------------|---------|------------------------|
| | 2010/11 | 2011/12 | Variance % (a vs b) | 2012/13 | Variance % (b vs c) |
| Mid | <15 | >17 | 29.1% | >17 | 11.5% |
| Mid | <15 | >17 | 30.1% | >17 | 11.6% |
| Mid | <15 | >17 | 25.7% | >17 | 7.8% |
| Short | <15 | <15 | 24.5% | 15-17 | 10.1% |
| Long | 15-17 | >17 | 25.2% | >17 | 1.7% |
| Long | <15 | >17 | 24.8% | >17 | 10.5% |
| Long | 15-17 | >17 | 22.7% | >17 | 11.1% |
| Long | 15-17 | >17 | 23.0% | >17 | 8.0% |
| Long | <15 | >17 | 26.5% | >17 | 16.0% |
| Long | 15-17 | >17 | 18.0% | >17 | 12.6% |
| Long | 15-17 | >17 | 20.6% | >17 | 8.8% |
| Mid | 15-17 | >17 | 22.8% | >17 | 10.3% |
| Long | 15-17 | >17 | 17.1% | >17 | 13.8% |
| Long | 15-17 | >17 | 18.0% | >17 | 13.7% |
| Long | 15-17 | >17 | 19.1% | >17 | 11.7% |
| Short | <15 | 15-17 | 17.4% | >17 | 18.0% |
| Mid | <15 | >17 | 20.6% | >17 | 11.6% |
| Long | 15-17 | >17 | 18.1% | >17 | 12.5% |
| Long | 15-17 | >17 | 15.1% | >17 | 8.8% |
| Long | 15-17 | >17 | 15.5% | >17 | 11.3% |
| Long | 15-17 | >17 | 14.9% | >17 | 10.7% |
| Mid | 15-17 | >17 | 13.4% | >17 | 12.0% |
| Long | 15-17 | >17 | 11.6% | >17 | 8.6% |
| Long | 15-17 | >17 | 12.7% | >17 | 15.3% |
| Mid | >17 | >17 | 9.6% | >17 | 5.8% |
| Long | >17 | >17 | 15.9% | >17 | 6.6% |
| Long | <15 | 15-17 | 7.2% | >17 | 8.6% |
| | a | b | | c | |
| | 2010/11 | 2011/12 | Variance % (a vs b) | 2012/13 | Variance % (b vs c) |
| Short | 15-17 | 15-17 | 3.9% | >17 | 9.3% |
| Short | <15 | 15-17 | 6.1% | >17 | 12.3% |

| | | | | | |
|---------|-------|-------|-------|-------|-------|
| Short | 15-17 | 15-17 | 6.1% | >17 | 11.8% |
| Short | 15-17 | 15-17 | 4.0% | >17 | 10.4% |
| Short | 15-17 | 15-17 | 2.4% | >17 | 10.0% |
| Short | 15-17 | 15-17 | 2.8% | >17 | 10.3% |
| Short | <15 | 15-17 | 2.5% | 15-17 | 10.7% |
| Short | 15-17 | 15-17 | 1.5% | >17 | 15.6% |
| Short | 15-17 | 15-17 | 2.5% | >17 | 14.6% |
| Short | 15-17 | 15-17 | -1.1% | >17 | 12.0% |
| Long | 15-17 | 15-17 | -1.6% | >17 | 11.5% |
| Short | <15 | <15 | -1.9% | >17 | 20.1% |
| Mid | <15 | <15 | -3.0% | 15-17 | 18.7% |
| Average | 15.48 | 17.56 | 13.4% | 19.54 | 11.2% |

Source HAL

APPENDIX F**List of evidence considered**

F1 Below is a list of the evidence that the CAA took into account when making its decision.

*= includes confidential information of one or more parties (confidential information printed on pink paper).

| Item no. | Description | Date |
|----------|---|------------------|
| 1 | Heathrow Airport structure of aeronautical charges Decision document | 29 October 2010 |
| 2 | Heathrow Airport Charges for 2011/12 Consultation Document | 12 November 2010 |
| 3 | Letter from bmi to CAA (group Director) – HAL Structure of aeronautical Charges Decision | 22 November 2010 |
| 4 | HAL Decision | 7 January 2011 |
| 5 | Section 41 Complaint from bmi | 28 January 2011 |
| 6 | Letter from bmi to CAA – Complaint under section 41 of the Airports Act | 1 February 2011 |
| 7 | Note of meeting with BAA 10 February | 14 February 2011 |
| 8 | Letter from the Scottish Government to the Department for Transport | 24 February 2011 |
| 9 | Letter from BAA to CAA (Group Director) – bmi complaint against HAL | 4 March 2011 |
| 10 | Letter from the Scottish Government to the CAA (Group Director) – bmi complaint against HAL | 21 March 2011 |
| 11 | Letter from BAA to CAA (Group director) enclosing their response to bmi's complaint | 23 March 2011 |
| 12 | bmi supplementary submission | 23 March 2011 |
| 13 | Letter from Newcastle International to CAA (director of Economic Regulation) – Heathrow and Gatwick landing charges | 6 April 2011 |
| 14 | Letter from BAA to CAA (Group Director) – Review of structure of aeronautical charges | 11 April 2011 |
| 15 | Email (with attachment) from Emma Gilthorpe to Rod Gander – 23 March 2011 public version of HAL's initial response to bmi complaint | 11 April 2011 |
| 16 | Confidential HAL response to bmi's supplementary submission | 12 April 2011 |
| 17 | Letter from the Department for Regional Development to CAA (Group Director) | 12 April 2011 |
| 18 | Redacted version of HAL's response to the bmi s41 supplementary submission response | 14 April 2011 |
| 19 | Letter from AOC to CAA (regulatory Policy Adviser) – section 41 complaint about Heathrow airport's structure of charges | 14 April 2011 |
| 20 | *Email chain between Richard Senior to Rod Gander – Impact to bmi of Structure of Charges | 15 April 2011 |
| 21 | Letter from IATA to CAA (Regulatory Policy Adviser) – s41 bmi complaint | 18 April 2011 |
| 22 | Letter preceding Virgin Response to the s41 complaint | 19 April 2011 |
| 23 | Virgin response to the s41 complaint | 20 April 2011 |
| 24 | * Aer Lingus submissions on section 41 complaint | 26 April 2011 |
| 25 | Summary of Virgin's response to section 41 complaint | undated |
| 26 | Bmi's comments on HAL's submissions and other parties' submissions | 13 May 2011 |
| 27 | HAL's response to 3rd party submissions | 19 May 2011 |

| Item no. | Description | Date |
|----------|---|------------------|
| 28 | Bmi complaint for publication | 4 July 2011 |
| 29 | CAA's Consultation: Initial thoughts on the s41 complaint | 6 July 2011 |
| 30 | Email (with attachment) from Richard Senior to Rod Gander – HAL cost modelling | 22 July 2011 |
| 31 | Email from Emma Gilthorpe to Richard Moriarty, Paul Taylor and Rod Gander – Appendix 1 Passenger Charge Differential by Destination | 3 August 2011 |
| 32 | Note from HAL on cost basis for charging structure | 4 August 2011 |
| 33 | Consumer council's view on Heathrow's intention to increase charges | 30 August 2011 |
| 34 | Gatwick response to bmi s41 complaint | 2 September 2011 |
| 35 | Bmi section 41 complaint – response to bmi's supplementary submission | 5 September 2011 |
| 36 | Virgin response to consultation | 6 September 2011 |
| 37 | * HAL confidential response to s41 CAA consultation. N.B. Annex 3 (Asset Register) is over 10000 pages | 6 September 2011 |
| 38 | Belfast City Airport response to CAA consultation | 6 September 2011 |
| 39 | Newcastle International Airport's response to CAA consultation | 6 September 2011 |
| 40 | *Bmi submission to Stage 3 of the section 41 investigation | 6 September 2011 |
| 41 | Aer Lingus response to the CAA consultation document | 9 September 2011 |
| 42 | HAL's non-confidential response to s41 CAA consultation | 3 October 2011 |
| 43 | Non-confidential version of bmi's submission to Stage 3 of the section 41 investigation | 4 October 2011 |
| 44 | Joint submission of American, Delta, United and US Airways | 5 October 2011 |
| 45 | * Aer Lingus Submission – HAL confidential version | 5 October 2011 |
| 46 | * Aer Lingus Submission – BMI confidential version | 5 October 2011 |
| 47 | Revised HAL response to s41 CAA consultation | 6 October 2011 |
| 48 | Information request from bmi to HAL | 7 December 2011 |
| 49 | HAL response to information request | 21 December 2011 |
| 50 | * Supporting documentation for HAL's response to bmi's information request | 22 December 2011 |
| 51 | Non-confidential version of the info above | 17 January 2012 |
| 52 | CAA Statement of Issues for consideration at the Panel hearing | 18 January 2012 |
| 53 | Aer Lingus material submitted for oral hearing | 23 January 2012 |
| 54 | * HAL material submitted for oral hearing | 23 January 2012 |
| 55 | * Aer Lingus figures re-calculated for the oral hearing | 25 January 2012 |
| 56 | Chair's steering brief (internal not published) | 25 January 2012 |
| 57 | CAA Panel Hearing Transcript | 27 January 2012 |

| Item no. | Description | Date |
|----------|---|-------------------|
| 58 | *Email (with attachment) from Alex Haffner to Rod Gand60er – Explanation of the Aer Lingus figures provided on 25 January | 9 February 2012 |
| 59 | Email (with attachment) exchange between Manish Madhas and Rod Gander – Explanation of the HAL figures provided on 23 January | 10 February 2012 |
| 60 | * Aer Lingus comments on the hearing transcript (only amended pages printed) | 13 February 2012 |
| 61 | Email (with attachment) from Manish Madhas to Rod Gander – Section 41 CAA Panel Hearing | 14 February 2012 |
| 62 | CAA Provisional Decision | 12 March 2012 |
| 63 | * Aer Lingus submissions (statement of grounds for JR and expert report) | 30 May 2012 |
| 64 | Non-confidential versions of the Aer Lingus submissions | 7 June 2012 |
| 65 | Email from Catherine Ledger to Imogen Brooks attaching a redacted version of the HAL figures referred to in the CAA decision | 4 July 2012 |
| 66 | Email from Alex Haffner to Imogen Brooks - further request for information from HAL | 4 July 2012 |
| 67 | Email exchange between Catherine Ledger and Imogen Brooks , Alex Haffner and Sam Szlezinger | 6 July 2012 |
| 68 | CAA Notice re draft Judicial review claim form | 20 July 2012 |
| 69 | CAA notice and revised version of data on airport charges paid by airlines | 1 August 2012 |
| 70 | Aer Lingus' submissions regarding the CAA decision | 10 August 2012 |
| 71 | * HAL's response to the CAA's invitation for comments on the March decision | 10 August 2012 |
| 72 | Non-confidential version of HAL's response to the CAA's invitation for comments on the March decision | 17 August 2012 |
| 73 | Aer Lingus' response to HAL's comments of 10 August 2012 | 13 September 2012 |
| 74 | HAL's response to Aer Lingus' submission of 10 August 2012 | 14 September 2012 |
| 75 | CAA Withdrawn Decision | 17 December 2012 |
| 76 | Aer Lingus' Judicial Review application | 13 February 2013 |
| 77 | CAA Grounds of Resistance | 6 March 2013 |
| 78 | HAL (Interested party) Representations | 6 March 2013 |
| 79 | CAA Notice Decision has been withdrawn | 21 May 2013 |
| 80 | *Email from James Jamison (Heathrow) to Rebecca Staheli containing updated information (Appendices B and C Confidential) | 5 June 2013 |
| 81 | CAA Investigation – analysis and further data | 29 October 2013 |
| 82 | Ryanair's response to the CAA's consultation document | 25 November 2013 |
| 83 | HAL's response to the CAA's consultation document | 28 November 2013 |

| Item no. | Description | Date |
|-----------------|---|------------------|
| 84 | Virgin Atlantic Airways response to the CAA's consultation document | 28 November 2013 |
| 85 | Gatwick Airport response to the CAA's consultation document | 28 November 2013 |
| 86 | Aer Lingus response to the CAA's consultation document (non-confidential) | 28 November 2013 |
| 87 | HAL's response to Aer Lingus, Ryanair, Virgin and Gatwick's comments | 12 December 2013 |
| 88 | Aer Lingus responses to other parties' responses | 13 December 2013 |

APPENDIX G**Transfer passenger charge**

- G1 When HAL restructured its airport charges from 1 April 2011 it introduced a 25% discount to the passenger charge for transfer passengers. HAL argued that the transfer passenger discount was cost-based, as it was based on the value of assets used exclusively by originating passengers; assets used exclusively by transfer passengers and assets used by both originating and transfer passengers. The analysis concluded that a transfer passenger used 77.7% of the asset cost base of an originating passenger, because transfer passengers did not access or use landside assets. HAL had rounded the figures to produce a 25% discount for transfer passengers. HAL also said that the discount would offset the increase in domestic charges.
- G2 bmi thought there was a lack of transparency over the transfer passenger charge and intuitively considered a 25% discount to be too high. bmi and Aer Lingus both said it would not benefit them. bmi as only 30% of its domestic passengers were transfer passengers, whereas 60% of Heathrow's domestic passengers overall were transfer passengers. Aer Lingus as it carried below average numbers of transfer passengers.
- G3 Virgin thought the transfer passenger discount was based on an incomplete analytical model and created harmful competitive effects against non-hub carriers.
- G4 At the hearing, Aer Lingus did not dispute the discount which it thought was cost related.
- G5 In its March 2012 preliminary decision the CAA said in the absence of any contrary evidence, it considered that the proximity of the amount of the discount to the costs produced by HAL's modelling was enough to show that the transfer passenger charge was not discriminatory. As indicated elsewhere in this decision, there are limitations to the accuracy of cost modelling, and CAA considers that any disparity between cost and the level of the transfer charge are within an acceptable margin. The CAA has received no new evidence on the transfer discount so it is confirming its preliminary view that the charge is not discriminatory.

APPENDIX H

CAA analysis on the use of competition law when considering the use of its powers under section 41 of the Airports Act 1986

- H1 bmi's complaint, received on 28 January 2011, was that HAL had pursued one of the courses of conduct specified in section 41 of the Act, specifically because HAL's new charging structure represented unreasonable discrimination against bmi, and/or passengers on domestic services and/or short haul carriers at Heathrow. Aer Lingus added that the charging structure discriminated against Aer Lingus and operators of smaller aircraft. The complaint is therefore one of unreasonable discrimination. In this regard, the CAA notes that:
- discrimination, being the course of conduct of which bmi and Aer Lingus complain, is also one of the forms of conduct which may constitute an abuse of a dominant position under Article 102 of the Treaty on the Functioning of the European Union and/or the Chapter II prohibition in the Competition Act 1998, in particular where it involves the application of dissimilar conditions to equivalent transactions with other trading parties, thereby putting them at a competitive disadvantage²⁸; and
 - whether discrimination can be unreasonable under section 41 will turn, at least in part, on whether there is an objective justification for otherwise discriminatory conduct. Similarly, under competition law, discriminatory conduct which might otherwise constitute an abuse of a dominant position may be objectively justified and hence not infringe competition law²⁹.
- H2 bmi and Aer Lingus therefore raise issues which are comparable to issues which may arise under competition law in these respects, and the CAA will have regard to the framework of competition law where relevant³⁰.

28 Case law has also developed the proposition that discrimination can also involve the application of similar conditions to unequivalent transactions.

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

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

- H3 In considering whether conduct that is otherwise discriminatory has an objective justification, the CAA will have regard to the market power of the party alleged to have carried out a course of conduct and to the effect of the conduct on competition. In *United Brands*, it was held that even if the possibility of a counter-attack (in that case by a refusal to supply) is acceptable, that counter-attack must still be proportionate to the threat taking into account the economic strength of the undertakings confronting each other. Where the degree of market power is greater, the risk of harm must be greater and therefore the justification must be more clearly demonstrated to be proportionate³¹.
- H4 Similarly, conduct which has significant negative effects on competition will require stronger and more cogent justification. In *British Airways*³², the Court of Justice stated that the assessment of the economic justification for conduct (in that case, a system of discounts or bonuses) is to be made on the basis of the whole of the circumstances of the case, including whether the exclusionary effect arising from the conduct in question which is disadvantageous for competition may be counterbalanced, or outweighed, by advantages in terms of efficiency which also benefit the consumer. This decision indicates that the degree of harm must be balanced against the potential benefits from efficiency enhancements³³. It follows that the greater the negative effects of the conduct in question, the greater the strength of the justification required to outweigh those effects. A similar approach is set out in the European Commission's Guidance Communication on Article 102³⁴.
- H5 The CAA considers that this approach properly reflects its statutory duties, and in particular, its duty to further the reasonable interests of users, including both airlines and passengers. Harm to the competitive process between airlines will adversely affect not only the airline or airlines concerned, but also passengers, who are likely to benefit from competition between airlines, both in terms of price and service offering. In assessing the effect on competition, the CAA may have to take into account whether the airline in question is an efficient user of the airport's facilities.
- H6 If the CAA finds that HAL has pursued one of the courses of conduct alleged, the CAA can, if it thinks fit, impose conditions to remedy or prevent the adverse effects of that course of conduct. The CAA notes that it has a power, and not a duty, to impose a remedy in such circumstances.

31 *United Brands*, above paragraph 190.

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

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

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

- H7 In considering whether (and if so how) to exercise its power to impose a remedy, the CAAs will have regard to (1) whether the airport operator in question has substantial market power and (2) the effect of the course of conduct on competition and passengers. The CAA considers that this approach reflects and is consistent with its statutory duties, for reasons explained above. It is also consistent with the fact that any remedy must be directed at the adverse effects arising from any course of conduct. In addition, the CAA also notes that:
- The CAA's starting assumption is that to impose a condition on an airport operator without substantial market power would be likely to cut across its duty to impose minimum restrictions. Airport operators without such market power are less likely to act unreasonably against users, as the users are more likely to respond to such conduct by using an alternative airport. The CAA will therefore consider whether an operator has substantial market power before imposing any remedy. (As noted above, the degree of market power is also relevant to a finding that conduct is harmful and therefore likely to be found to be unreasonable within the terms of section 41 as it will affect the strength of objective justification needed to offset any harm as set out at paragraph H.5 above).
 - Whilst harm to competition may militate in favour of the imposition of a remedy, an absence of harm or potential harm to competition is a relevant consideration in the context of our duty only to impose minimum restrictions.
 - In addition to considering the effect on competition, the CAA will also consider whether any other aspect of its statutory duties has a bearing on the imposition of a remedy.
- H8 Aer Lingus contends³⁵ that the CAA should only look at whether any discriminatory conduct tends to distort competition, not whether it has had actual effects on competition, and that in the present case, the discriminatory impact of the changes made warrants the conclusion that this test is satisfied (given the increased financial impact on Aer Lingus). Aer Lingus cites cases such as *British Airways v Commission*³⁶, *Tomra*³⁷ and a state aid case concerning air travel tax in support of its position.³⁸

35 In its rebuttal submission to HAL's representation on the re-issued provisional decision.

36 *British Airways v Commission* [2007] ECR I-23331.

37 *Tomra Systems v Commission*, judgment of 19 April 2012.

38 The European Commission's decision concerning an air travel tax imposed on airlines by the Irish Government (Case SA. 29604). This decision is dated 25 July 2012 and as far as the CAA is aware is not published. Accordingly the CAA is unable to attach weight to this decision.

- H9 The CAA considers that it is entitled under section 41 to look at the actual effect of the changes in charging in reaching a view on whether there is unreasonable discrimination and in considering what, if any, remedy should be imposed. It does not consider that it is precluded from doing so by any aspect of the legal test.
- H10 As a starting point, it is clear that the element of distortion of competition cannot simply be inferred from the discriminatory impact of the charges, which is how Aer Lingus puts its position.
- H11 The CAA notes that the test established in EU law is one of tendency to distort competition. Under that test, an infringement may be established without it being shown that there are actual effects on competition. However, it does not follow that, under competition law, an authority is precluded from considering the position in fact, and from looking at whether conduct has actually affected competition. On the contrary, the CAA considers that if there is evidence of the actual effects which conduct has had on the market, that is evidence which the CAA should take into account in considering the matter.
- H12 The CAA notes that, in case law cited by Aer Lingus, a finding of tendency to distortion of competition was not reached solely on the basis of the discriminatory impact of the charges. For example, in *British Airways v Commission*, the Commission demonstrated that British Airways, a competitor in the market where the conduct ultimately took effect, had a dominant position and that the market was already distorted by that fact. It also established as fact that the commission structure had a noticeable effect at the margin, and could lead to exponential changes in the revenue of travel agents. The schemes were accordingly found to have a fidelity building effect. The Commission did therefore undertake some examination of the specific effects of the pricing practices being adopted by British Airways.
- H13 The CAA considers therefore that it is entitled to examine the overall circumstances of the case including evidence of how the pricing conduct complained of has or has not affected the market to date. It does not consider that it is precluded by the statutory test from doing so.

APPENDIX I**HAL's cost modelling for passenger charges**

- 11 In its written submissions to the CAA and in its consultations with airlines, HAL said that it had based its passenger charges on an analysis of the asset costs of handling three categories of passengers – domestic/ROI, other European and non-European. The complexity of the current four terminals had made it impossible, in practice, to analyse actual differences in passenger usage. HAL, therefore, based its analysis on theoretical terminals for different passenger types, the terminals having different space requirements for the different passenger groups.
- 12 HAL's cost modelling assumed a direct relationship between space required and asset cost. It saw the key drivers of asset costs as peaks in passenger flow, passenger characteristics (such as nationality, number of bags carried, regularity of travel and size of party and dwell time in terminal), and aircraft characteristics (such as maximum number of passengers on a flight and dwell time of aircraft between flights). In its modelling HAL largely used the results of an exercise it had undertaken in 2005 to determine the terminal usage by different categories of passengers³⁹⁴⁰.
- 13 In its modelling HAL divided its asset base (excluding rail) into assets used for passengers, aircraft landing/take off, and aircraft parking. Passenger assets were then divided into terminal buildings and 'other'. Assets in 'other' included: roads, car parks, campus wide services (such as gas and electricity), IT systems and campus wide baggage systems. HAL did not consider that these 'other' assets were used differently by passengers solely as a consequence of their flight's destination or origin, and, therefore, the value of the assets was allocated equally to all passengers. The difference between the asset register and the average RAB from the CAA's Q5 decision was allocated pro-rata across all passengers as part of other passenger assets.
- 14 HAL considered but did not take account of operational costs in its modelling. It said that it was largely a fixed cost business and that operational costs varied according to a passenger's use of assets, so it did not expect that taking such costs into account would materially alter its modelling results.

39 At the hearing, HAL said that it had made some adjustments to its 2005 modelling where the previous figures did not reflect current passenger experience. Specifically, it had added allocations for passenger usage of the international departure lounge and connections facilities by domestic and ROI passengers whereas no allocation of either had been made to these passengers in 2005.

40 A note provided by HAL on its cost model is on the CAA website at <http://www.caa.co.uk/docs/5/Appendix%201%20-%20Passenger%20Charge%20Differential%20by%20Destination.pdf>

- 15 HAL also did not take commercial revenues into account in its modelling. It said that the majority of commercial revenues, e.g. property, non-regulated charges and car parking, did not vary with passenger destination and would need to be allocated on some basis. It acknowledged that retail revenues from domestic and ROI passengers were lower than from long haul passengers, but said that the overall picture was complex and could vary from year to year. It also said that the ACD set out a cost-based approach to pricing, and that it had acted within its margin of discretion in pricing by not taking commercial revenues into account.
- 16 Airline respondents had different views on the reasonableness of HAL's cost modelling. Virgin and US carriers thought that HAL's decision to differentiate passenger charges was flawed as Heathrow's facilities were in common use. Virgin also said that HAL had not justified its decision not to take account of commercial revenues. bmi and Aer Lingus accepted that HAL had some discretion in how it carried out its modelling and did not consider the basis of the modelling itself as unreasonable.
- 17 Aer Lingus mentioned that when HAL had taken operational expenditure into account in its 2005 modelling it had made little difference to the results. However, both Aer Lingus and bmi thought that HAL had erred in its allocation of asset costs by spreading the increase in terminal asset values due to indexation across all passenger types equally, rather than allocating it in the same ratio as total terminal assets. bmi also thought that campus wide baggage systems should have been allocated to transfer passengers⁴¹.
- 18 The CAA considers that cost modelling can only approximate the different costs that different passengers impose on it. The CAA does not consider that HAL acted unreasonably by differentiating passenger charges. The costs that passengers impose on an airport vary with the amount of time that passengers spend at an airport and on the amount of baggage they carry. As there is information available on passenger dwell times and baggage requirements, the CAA considers that it is legitimate for HAL to take this information into account when setting passenger charges. However, the CAA considers that HAL's modelling was relatively unsophisticated and that large confidence limits should be put around its results. HAL did not take commercial revenues into account, albeit that this would not have been straightforward. Intuitively, the CAA would expect commercial revenues to be lower for passengers on domestic and ROI flights. The CAA notes further that HAL did not carry out new analysis of passenger behaviour but relied on data from 2005. It is possible that behaviour may have changed since then. HAL also had to allocate common and overhead costs, and there are a number of alternative reasonable ways of doing so.

41 HAL said that it could have allocated campus wide baggage systems differently between transfer and point-to-point passengers. This would have changed the cost differential between passengers slightly but not enough to have an impact on the 25% transfer passenger discount.

- 19 HAL's modelling, shared with parties in the course of the CAA's investigation, showed that the cost of handling domestic/ROI passengers was 11 % lower than the cost of handling other EU passengers. However, Aer Lingus discovered an error in HAL's modelling. HAL had inadvertently used a wrong set of figures from the 2005 results and using the correct figure increased the differential to 16%⁴². HAL accepted this point at the hearing.
- 110 Aer Lingus' contention that HAL's allocation of RAB indexation was incorrect further increased the differential to 18%⁴³. HAL disagreed with Aer Lingus' view over RAB indexation. The CAA recognises the logic of Aer Lingus' argument that the indexation of terminal assets should be allocated between domestic, ROI, European and non-European passengers in the same way as terminal assets have been allocated. Although there are several different reasonable approaches to cost allocation, HAL did not offer a clear justification for the approach it took. Although the difference between the two approaches is small (2%), in circumstances where the cost allocation is not highly precise and will contain an inevitable margin of error, the CAA considers that Aer Lingus' use of 18% was reasonable. The CAA, therefore, uses 18% as the cost differential from HAL's modelling.
- 111 HAL said that cost modelling could only approximate the passenger experience which was similar for domestic, ROI and other EU passengers, so the model could not be absolutely determinative of airport costs.
- 112 In response to the CAA's October investigation Aer Lingus said it would be inappropriate now for the CAA to question HAL's modelling. The CAA should subject it to critical scrutiny, as Aer Lingus has done for the purpose of its submissions to the CAA during the investigation, however, the CAA should now limit its analysis to ensuring that HAL has correctly applied its cost model when it revised its structure of charges from 1 April 2011. The CAA should not draw any adverse conclusions from the limitations which are inherent in any cost-based model of the type constructed by HAL, or otherwise attach any lesser weight to the results of that model. Aer Lingus went on to say that HAL's model:
- has been relied on and supported by all the parties in the process to date;
 - was subject to external expert approval; and
 - HAL itself continues in its most recent submission to consider to be sound in design.

42 The figure HAL had used for operational space required for 'other EU passengers' was the figure from the 2005 model for 'All EC flights *including* domestic' rather than the *appropriate* 2005 figure for 'EC & EEA excluding Ireland and domestic'. (*emphasis added*).

43 In June 2005, Aer Lingus sent the CAA an Expert Report by Dan Elliott which agreed with Aer Lingus' views on how HAL allocated the RAB indexation.

- 113 In its response to the October investigation, HAL said that as it was not possible to model actual use it had to use a theoretical model to approximate use. HAL took independent external expert advice on the use of the model which confirmed that the model was sound but was just one of many models that could be used to estimate passenger use of the airport. HAL was fully supportive of the CAA's view that it could not be used to calculate the financial impacts of airport charges on particular airport users.
- 114 The CAA does not consider that the responses to its October 2013 investigation provided any new information on the limitations of the model when assessing whether the charges are discriminatory or when calculating the financial impact of HAL's revised charges on Aer Lingus.

APPENDIX J**The direct financial impact on Aer Lingus**

- J1 In preparation for the hearing in January 2012 HAL and Aer Lingus produced different figures showing the effects of the increase in total airport charges on Aer Lingus. As the figures were produced using different methodologies and were based on different underlying data, they were not directly comparable.
- J2 HAL's figures compared what Aer Lingus would have paid in airport charges in 2010/11 had the revised structure been in place for that period, with an alternative scenario in which there was a differential tariff for domestic/ROI passengers, reflecting an 11% cost differential from HAL's modelling under the revised structure. HAL's figures showed Aer Lingus paying 7.2% more in overall airport charges under the revised structure than under the alternative scenario⁴⁴.
- J3 Aer Lingus' figures compared how much it would pay in airport charges in 2011/12 under the new structure, to what it would pay if there was an 11% or 18% differential in passenger charges. The 11% differential showed it paying 8.4% less overall, and the 18% differential 14.5% less. (Aer Lingus used 2011 traffic as a baseline)⁴⁵.
- J4 Shortly after the hearing Aer Lingus provided more detailed calculations which showed that the airline would be paying around £4 million per annum more in passenger charges than under a strict cost based charging structure with an 18% differential. In paragraph 39 of its Statement of Grounds for judicial review in February 2013, Aer Lingus said "if the charging structure had been constructed to ensure that the departing passenger charge levels properly reflected the 18% cost differential [to HAL] between domestic/Republic of Ireland (ROI) and other European passengers, Aer Lingus would be paying around £4 million less per year than it pays under the current disputed charging structure. ... By April 2013 this will have amounted to an aggregate overcharge in excess of £8 million".
- J5 In its October 2013 investigation, the CAA consulted on the methodology by which this sum asserted by Aer Lingus was calculated and whether it was a reasonable assessment of the financial impact on Aer Lingus. The CAA said it had been unable to precisely replicate Aer Lingus' figures and so had used an alternative approach to calculate the financial impact on Aer Lingus. The CAA assumed that HAL would adjust its charges to generate the same amount of

44 At the hearing Aer Lingus said it could not replicate HAL's figures as it did not know on what basis they had been prepared. After the hearing HAL clarified to the CAA how the figures had been prepared.

45 At the hearing, Aer Lingus wondered whether the difference between its figures and HAL's figures could have been due to HAL assuming that Aer Lingus carried a higher proportion of transfer passengers than it actually does. The CAA can confirm that although HAL and Aer Lingus did not use identical transfer passenger proportions in their calculations, the proportions they used were broadly similar.

revenue to which it was entitled under the CAA price cap on airport charges at Heathrow. In particular it assumed that HAL's revenue from the Europe and domestic/ROI charge (with an 18% difference between the two charges) would generate the same revenue (£218 million) as expected when HAL has set its charges. Under this approach the CAA calculated that Aer Lingus was paying about £3.1million extra to HAL as a result of the equalisation of domestic, ROI and European passenger charges after allowing for the different charges paid for point-to-point and transfer passengers.

- J6 In its response to the consultation Aer Lingus said that the CAA's approach was flawed as the correct assumption would have been that HAL's revenues from all passengers including non-Europe passengers would remain constant. Within this overall revenue, Aer Lingus re-calculated the levels of passenger charge necessary to achieve with an 18% differential between the Europe and domestic/ROI charge and a 40%⁴⁶ differential between the Europe and the Rest of the World charge⁴⁷. On this basis Aer Lingus calculated it was paying about £3.9 million more per annum under HAL's current charges than it should have been.
- J7 There is no absolutely correct way to calculate what the charges would have been under different circumstances. However, the CAA accepts that Aer Lingus' calculations are reasonable and, therefore, it has used £3.9 million per annum as the starting point of the additional charges that Aer Lingus pays HAL as a result of HAL not setting its charges that reflected an 18% cost difference between handling domestic/ROI and other European passengers.
- J8 Table J.1 taken from Aer Lingus' response to the CAA's October 2013 consultation shows how Aer Lingus calculated its figure of £3.9million for the additional charges it is paying each year.

⁴⁶ The modelling showed a 41% difference between the costs of handling European and Rest of World passengers due to additional space requirements for Rest of World passengers across all key terminal areas analysed. In the published prices tariff, this differential was rounded to 40%.

⁴⁷ Sources: HAL's modelling.

Table J.1: Aer Lingus calculation of the additional charges it pays per year resulting from HAL not setting its passengers charges to reflect an 18% cost difference between handling domestic/ROI and other European passengers and a 40% differential between European and non-European passengers

| | At HAL charges | Aer Lingus methodology with 18% differential | CAA alternative approach with 18% differential | Corrected alternative approach |
|-----------------------------------|-----------------------|---|---|---------------------------------------|
| Aer Lingus point-point passengers | 889,380 | 889,380 | 889,380 | 889,380 |
| Aer Lingus transfer passengers | 208,620 | 208,620 | 208,620 | 208,620 |
| Point-point charge | £21.80 | £17.88 | £18.85 | £18.10 |
| Transfer charge (75%) | £16.35 | £13.41 | £14.14 | £13.57 |
| Revenue from point-point charges | £19,388,484 | £15,902,114 | £16,764,813 | £16,096,835 |
| Revenue from transfer charges | £3,410,937 | £2,797,594 | £2,949,887 | £2,831,851 |
| Total revenue | £22,799,421 | £18,699,709 | £19,714,700 | £18,928,685 |
| Difference | | £4,099,712 | £3,084,721 | £3,870,736 |

APPENDIX K**Approach to competition analysis**

- K1 In cases of alleged discrimination by an undertaking in an upstream market against a player in a downstream market (such as by airport operators against an airline), it would be of particular concern to a regulator (whether applying ex ante sectoral powers or ex post competition law principles) if the company in the upstream market is trying to leverage its market power in that market into the downstream market so as to favour its own activities in the downstream market. HAL does not operate in the downstream airline market. HAL does have an interest in attracting large aircraft with more passengers as they provide higher profits for the airport where the additional revenue, derived from both aeronautical charges and commercial activities, exceeds the incremental costs of handling the additional passengers. However, this incentive would be reduced to some extent by HAL's need to attract passengers on short-haul routes for its hub operation. The additional profit would be limited to the current price control period given the existing single till revenue yield regulation. Overall, as HAL does not operate in the downstream market as a competitor it has no obvious pecuniary interest in favouring one particular airline over another with a similar operation, in terms of increasing profits it might make in that downstream market.
- K2 The standard approach to considering issues of airline competition is to consider competition on a route by route (origin and destination) basis⁴⁸. The CAA notes that HAL levies identical per passenger charges on all airlines on the same route⁴⁹.
- K3 Although all operators on domestic and ROI routes have faced the same price increases, at the hearing Aer Lingus said that competition had been affected to the extent that it competes for passengers against airlines flying from London on other European routes. For example, a leisure passenger to Dublin could decide to fly to another European destination (e.g. Paris or Frankfurt) instead. Aer Lingus said that competition for leisure passengers on short-haul routes had been affected, although it also noted that there is a tendency towards business travel at Heathrow⁵⁰.

48 This approach has been taken by the Office of Fair Trading and the European Commission in many cases, including the Commission's approval of IAG's acquisition of bmi, in which the routes considered were short haul routes from Heathrow. In particular, the CAA notes that a large majority of respondents (IAG's competitors, travel agents and corporate customers) to the Commission's market investigation questionnaires agreed with the use of the origin and destination approach.

49 Apart from cost-related discounts for transfer and transit passengers.

50 However, the CAA's passenger survey showed that about 69% of Heathrow's passengers were leisure travellers in 2011, (CAA passenger survey report 2011).

- K4 The CAA recognises that an airline's costs of operating to Dublin have risen compared to the costs of operating to, for example, Paris. However, the CAA does not consider that this is sufficient to demonstrate an effect on competition or a tendency to distort competition between airlines flying to different destinations.
- K5 With respect to Aer Lingus' contention that the CAA should look at airlines flying to other European destinations, the CAA notes that there have been a number of European Union airline competition cases that can guide an analysis of airline competition. In the CAA's view the most relevant are the European Commission's consideration of IAG's acquisition of bmi⁵¹ and also its consideration of Ryanair's proposed acquisition of Aer Lingus⁵². The IAG/bmi case appears to be particularly pertinent as it relates to competition on short haul routes from Heathrow. In both cases the Commission concluded that the most appropriate approach was to look at competition on a route by route (city pairs) basis, rather than considering competition between different destinations.
- K6 In IAG/bmi, the Commission said it *"has traditionally defined the relevant market for scheduled passenger air transport services on the basis of the 'point of origin/point of destination' ('O&D') city pair approach⁵³. Such a market definition reflects the demand-side perspective whereby passengers consider all possible alternatives of travelling from a city of origin to a city of destination, which they do not consider substitutable to a different city-pair. As a result, every combination of a point of origin and a point of destination is considered a separate market.*

51 Regulation (EC) No 139/2004 Merger Procedure - Case No COMP/M.6447-IAG/BMI (30 December 2012).

52 Regulation (EC) No 139/2004 Merger Procedure - Case No COMP/M.4439-Ryanair/Aer Lingus (27 June 2007).

53 "Commission's decision of 26 January 2011 in Case No COMP/M.5830 - Olympic/Aegean Airlines; Commission's decision of 27 July 2010 in Case No COMP.M5889 - United Air Lines/Continental Airlines; Commission's decision of 14 July 2010 in Case No COMP.M5747 - Iberia/British Airways, Commission's decision of 28 August 2009 in Case No COMP.M5440 - Lufthansa/Austrian Airways, Commission's decision of 14 May 2009 in Case No COMP.M5403 - Lufthansa/bmi, Commission's decision of 9 January 2009 in Case No COMP.M5364 - Iberia/Vueling/Clickair, Commission's decision of 22 June 2009 in Case No COMP.M5181 - Lufthansa/SN Airholding; Commission's decision of 6 August 2009 in Case No COMP.M5181 - Delta Air Lines/Northwest Airlines; Commission's decision of 4 July 2005 in Case No COMP.M3770 - Lufthansa/Swiss; Commission's decision of 11 February 2004 in Case No COMP.M3280 - Air France/KLM. The O&D approach was confirmed by the General Court, most recently in Case T-342/07 Ryanair Holdings plc v European Commission [2010] ECR, paragraph 53."

- K7 *In the past, the Commission has also taken into consideration supply-side elements such as network competition between airlines based on the hub and spoke structure of traditional carriers. However, the Commission considered that the degree of supply-side substitutability between different O&Ds remains limited. It considered in this respect that, although from a supply-side perspective a network carrier could in theory fly from any point of origin to any point of destination, in practice network carriers build their network and decide to fly almost exclusively on routes connecting to their hubs⁵⁴.*
- K8 *In line with the Commission's notice on market definition⁵⁵⁵⁶, the Commission has given pre-eminence to demand-side substitution, whereby it considered that customers still need the transportation from one point to another and that competition still takes place on an O&D city-pair basis (even though some customers, in particular corporate customers, may have concluded corporate agreements for a range of routes and the commercial advantages stemming from such agreements may lead them to prefer one airline among the different airlines that operate on the route). It has thus traditionally upheld the O&D approach".⁵⁷*
- K9 *The Commission went on to say "during the market investigation, some competitors indicated that the O&D approach fails to capture the nature and extent of network competition and the issues of slot availability and market dominance of carriers in slot restricted airports. It was also mentioned that while the O&D approach is appropriate for customers that have a particular destination in mind, it would not be appropriate for customers that do not. Some respondents also indicated that the Commission should pay particular attention as to which airports to include in the relevant O&D market, since not all airports at a given city are necessarily substitutable. Nevertheless, a large majority of respondents to the market investigation questionnaires (competitors, travel agents and corporate customers) agree with the O&D approach."⁵⁸.*

54 "On the network approach, see: Commission's decision of 27 July 2010 in Case No COMP/M.5889 - United Air Lines/Continental Airlines, recital 9 and following; Commission's decision of 28 August 2009 in Case No COMP/M.5440 - Lufthansa/Austrian Airlines, recital 11 and following; Commission's decision of 14 May 2009 in Case No COMP/M.5403 - Lufthansa/bmi, recital 8 and following, Commission's decision of 22 June 2009 in Case No COMP/M.5335 - Lufthansa/SN Airholding, recital 12 and following; Commission's decision of 6 August 2008 in COMP/M.5181 - Delta Air Lines/Northwest Airlines, recital 8 and following; Commission's decision of 4 July 2005 in Case No COMP/M.3770 - Lufthansa/Swiss, recital 12 and following; Lufthansa/Swiss, recital 12 and following, Commission's decision of 11 February in Case No COMP/M.3280 - Air France/KLM, recital 9 and following; Commission's decision of 11 February 2004 in Case No COMP/M.3280 - Air France/KLM, recital 9 and following."

55 "Commission Notice on the definition of the relevant market, paragraph 13 (OJ C 372, 1997. p5)."

56 "Commission Notice on the definition of the relevant market, paragraph 13 (OJ C 372, 1997. p5)."

57 IAG/bmi, paragraph 31

58 IAG/bmi, paragraph 33

- K10 On the question of London airport substitutability the Commission said *“the parties, without distinguishing between time sensitive and non-time sensitive customers, consider that all London airports (Heathrow, Gatwick, City, Stansted and Luton and the new London Southend airport) and arguably also further airports in the South East of England are substitutable regardless of the city pair served”*⁵⁹⁶⁰.
- K11 The Commission reached a similar conclusion in Ryanair/Aer Lingus saying: *“defining a market for a ‘bundle’ of all flights from or to Ireland is not the most appropriate way to define the market in the present case. From the demand side, passengers are in principle flying a given route to a given destination rather than from any route to anywhere”*.⁶¹ Also *“the vast majority of airline customers book their flights according to plans to get from a specific city or region to another specific city or region. Following a small but significant and non-transitory price increase, these customers would not change their travel plans and choose another destination from Ireland”*⁶².⁶³ *“Furthermore, in the case of business passengers or passengers visiting friends and relatives, any substitutability of different destinations is unlikely as the purpose of their journey is itself connected to with a specific destination (place of a business meeting or place of residence of friends and relatives). For the vast majority of passengers, therefore, a flight from Ireland to one destination is not simply substitutable with a flight to another destination”*.⁶⁴
- K12 On London airport substitutability the Commission observed *“that all of Ryanair’s direct competitors on the Dublin to London route (Aer Lingus, British Airways, bmi and Cityjet) take the view that London airports are substitutable for a majority of the point-to-point customers. This has been confirmed by many other carriers and by the affected airports”*.⁶⁵

59 “The parties argue that there is no basis for concluding that customer preferences vary depending on which city they are flying to; the individual city-pair assessments indicate that the parties’ services are constrained by third-party services from any London airport.”

60 IAG/bmi, paragraph 47

61 IAG/bmi, paragraph 62

62 See e.g. case M.770 - Lufthansa/Swiss paragraph 12.

63 IAG/bmi, paragraph 63

64 IAG/bmi, paragraph 63

65 IAG/bmi, paragraph 117

- K13 The Commission's analysis in the preceding paragraphs leads the CAA to conclude that the most appropriate way of assessing whether HAL's amended structure of passenger charges has adversely affected the competitive position of carriers on domestic/ ROI routes from Heathrow is to look at those routes on a city pair basis as these are the markets on which Aer Lingus and other airlines on Heathrow domestic/ROI routes compete⁶⁶. In assessing competition between airlines the CAA does not consider that it should look at charges levied on an airline operating to one destination (e.g. Dublin) compared to those levied on an airline operating to a different destination (e.g. Frankfurt)⁶⁷. The CAA agrees with the Commission that passengers do not regard a flight to Frankfurt as an acceptable alternative to a flight to Dublin.
- K14 In its application for judicial review Aer Lingus argued that any analysis of competition should go beyond considering individual air routes. Aer Lingus quoted a number of cases where it said the Commission had applied a broader test of competition in cases of discrimination against transport operators. These cases were: *Aéroports de Paris*⁶⁸, *Corsica Ferries*⁶⁹ and *Portuguese airports*⁷⁰.

66 The CAA does not consider that this conclusion affects the views on competition between airports it has expressed in its market power assessments of Heathrow, Gatwick and Stansted. In assessing airport competition the CAA does not primarily have to consider whether passengers view the airports as substitutes, but whether airlines consider the airports as substitutes. In considering whether to move services from one airport to another an airline also has to consider the effects on the airline's network of routes at the airports on passenger demand (i.e. transfer passengers) and the effects on the airline's cost base of moving to a different airport. An airline, therefore, may not consider two airports to be substitutes in terms of the "airport to airline" services they supply even if passengers consider the airports to be substitutes in terms of flight options they see as comparable. The lack of availability capacity in the London area is also an important matter to be considered in analysing airport competition as airlines may not be able to obtain enough slots at another London airport to make moving its services worthwhile.

67 In looking at destinations where more than one airport serves a city the CAA will consider city pair data rather than data for just one airport. That is for London it will consider data for Heathrow, Gatwick, Stansted, Luton, London City and Southend combined, rather than just data for Heathrow.

68 Case T-128/98 *Aéroports de Paris v Commission* [2000] ECR II-3929.

69 Case C-18/93 *Corsica Ferries* [1993] ECR, I-1783.

70 Case C-163/99 *Portugal v Commission* ECR I-2613.

- K15 The CAA considers that the cases cited by Aer Lingus are not instructive for present purposes. The CAA considers it should attach greater weight to the IAG/bmi and Ryanair/Aer Lingus cases which involved similar routes to those in the current case (short haul routes from London and Irish airports) and similar airlines (including Aer Lingus, British Airways (IAG) and bmi). The CAA considers these are the markets on which Aer Lingus competes and hence its view is that these are the right markets to assess to understand whether the revised passenger charges have affected Aer Lingus' ability to compete with other airlines. In contrast, the CAA attaches less weight to cases that involved French airports, Portuguese Airports and an Italian seaport, which are cases where the Commission and the European Court were concerned with the effective establishment of the single European market in the face of apparent discrimination aimed at protecting domestic undertakings at the expense of those from other member states. The cases are also significantly less recent than the bmi/Ryanair cases.
- K16 In its Statement of Grounds, Aer Lingus said that as the IAG/bmi and Ryanair/Aer Lingus cases are merger cases they did not represent the standard approach to airline competition issues. The CAA disagrees with Aer Lingus as these cases identify the European Commission's view on the proper approach to analysing competition between airlines, which is the issue the CAA is concerned with here.
- K17 In its application for judicial review Aer Lingus also referred to the Commission's decision that the Irish authorities' levying of an excise duty on air passenger transport that varied according to the distance flown constituted illegal state aid to Aer Lingus and other Irish airlines. The CAA notes that this case was concerned with state aid in respect of which there were doubts about its compatibility with the single market. Although the case concerns Aer Lingus and Irish routes, the CAA does not consider it to be as relevant as the IAG/bmi and Ryanair/Aer Lingus cases which are directly concerned with airline competition on domestic and Irish routes from London. Furthermore, as this case is unpublished, the CAA is unable to review it and properly consider its implications for this complaint

