



Stansted Market Power Assessment:  
consultation on relevant market  
developments



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## Executive Summary

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1. In January 2013, the CAA issued a 'minded to' market power assessment (MPA), pursuant to its duties under the Civil Aviation Act 2012 (the Act). That consultation stated that the CAA was 'minded to' find that the market power test (MPT) as set out in the Act was met in relation to Stansted Airport Limited (STAL) as the relevant operator of Stansted Airport (Stansted).
2. The 'minded to' MPA noted that likely future developments in the market, including the imminent divestment of Stansted, and their potential implications would form a key part of this MPA. The CAA acknowledged that one potential implication would be if the new owners of Stansted established different behaviours and relationships with the airlines.
3. Since the CAA published its 'minded to' MPA there have been a number of significant developments, which include:
  - with the approval of the Competition Commission (CC), Manchester Airports Group plc (MAG) acquired STAL in February 2013; and
  - MAG has reached long term bilateral agreements with some of its passenger airlines including easyJet and Ryanair for their use of Stansted.
4. The purpose of this consultation is for the CAA to consult stakeholders on how it should evaluate these recent developments in reaching its final market power determination (MPD) on the passenger market for STAL. In particular, the CAA is keen to examine whether the net effect of these recent developments is significant enough to cause it to change its mind on whether, and how, STAL passes or fails the MPT in relation to the passenger market.
5. In relation to the Stansted cargo market, the CAA is not aware of any significant analogous recent developments such as new bilateral agreements between MAG and the cargo users. However, the CAA needs to examine whether the recent developments in the passenger market have indirect implications for its evaluation of whether, and how, STAL passes or fails the MPT in relation to the cargo market.

6. In summary, in relation to the Stansted passenger market the CAA sees several potential implications of these recent developments for the three tests that comprise the MPT.
- Test A – whether STAL has substantial market power (SMP). The CAA's provisional view is that Test A for the Stansted passenger market would not be met because the bilateral agreements with easyJet and Ryanair could imply that there is a sufficient level of buyer power to constrain STAL's behaviour.
  - Test B – whether an economic licence is a better remedy than competition law. The CAA's provisional view is that Test B for the passenger market would not be met because the bilateral agreements between STAL and over 90% of its passenger traffic might be viewed as substantially reducing the risk of excessive pricing, the principal concern of the airlines previously.
  - Test C – whether the benefits of regulation through an economic licence outweigh the adverse effects. The CAA's provisional view is that Test C for the passenger market would not be met because the agreements cover the overwhelming majority of passenger traffic and are long-term in nature. The CAA has seen no evidence to suggest that the agreements will operate against the interests of passengers and hence there is not a compelling case for a licence.
7. In relation to the Stansted cargo market, the CAA's 'minded to' MPA found that Test A was passed for the passenger and cargo market, and as a result Tests B and C for the passenger and cargo market were considered together. If the CAA's MPD reaches different conclusions for Test A for the passenger and cargo markets, then Tests B and C would be considered separately for each market.
8. If Test C were considered separately for the Stansted cargo market, it is possible that the costs of regulation may mean the benefits of regulating the cargo market would not outweigh the adverse effects. In assessing this, the CAA would want to consider what, if anything, could replace the pricing principles adopted by the CC and the CAA in past reviews in regard to the pricing of cargo services. The CAA has not reached a provisional view on this but would welcome in particular any specific proposals from MAG or cargo stakeholders on how this might be addressed, and stakeholders' views on the balance of benefits and adverse effects of the CAA regulating the Stansted cargo

market without any licence regulation of the Stansted passenger market.

9. Before reaching a decision on the MPD for both the Stansted passenger market and Stansted cargo market, the CAA will take into account the response to this consultation. The CAA would especially like to hear stakeholders' views on:
  - whether recent developments in the form of bilateral agreements between MAG and some airlines covering a significant majority of passenger traffic should be seen by the CAA as evidence that STAL does not meet Test A of the MPT and/or does meet Test C of the MPT; and
  - the benefits and adverse effects of introducing licence based regulation for the Stansted cargo market in the light of the developments in the Stansted passenger market and taking into account the principles for pricing of cargo services which were adopted by the CC and the CAA in previous regulatory reviews.
10. The deadline for representations is 11 November 2013. This period for consultation responses reflects the extensive consultation that has already taken place on the MPT, and the relatively limited nature of the issues raised in this further consultation.
11. The CAA will carefully consider any further evidence and representations put forward during the consultation period along with the responses to the 'minded to' MPA before reaching a final view.
12. Between now and the implementation of the Q6 price control on 1 April 2014, the CAA expects the following major steps:
  - 11 November 2013: receive responses to this consultation.
  - Early in 2014: the CAA intends to publish its formal determination under the Act on the MPD for STAL. Stakeholders, including STAL and the airlines, will then have 60 days to decide whether or not to lodge an appeal with the Competition Appeals Tribunal (CAT).
13. When the CAA has published its MPD for STAL, the next steps depend on whether or not the MPD finds STAL passes the MPT.



- If the CAA finds that STAL passes the MPT then the CAA will issue a consultation, on its updated proposals for the economic regulation of STAL in Q6. Based on its conclusions following the consultation, the CAA will issue a formal notice that it proposes to grant a licence followed by a reasonable period for further representations. Following that period the licence and the Q6 economic regulation conditions within it will come into force.
  - If the CAA finds that STAL does not pass the MPT then STAL will not be subject to regulation under the Act from the date of the MPD. STAL will however remain subject to other regulation of its pricing conduct under various legislation such as the Airport Charges Regulations, the Ground Handling Regulations, and general competition law, in particular the Competition Act 1998.
14. Regardless of whether the CAA makes an MPD that STAL does or does not pass the MPT at this current time, the CAA appreciates (and the Act recognises) that circumstances may change in the future. Such change may necessitate a fresh look at the question of whether STAL passes or does not pass the MPT. Under section 7 of the Act:
- whenever the CAA considers it appropriate to do so; and
  - if there has been a material change in circumstances since the CAA last made an MPD, then STAL or another person whose interests are likely to be materially affected, may request that the CAA makes a new MPD.
15. The results of any subsequent MPD could lead the CAA to consider the need for economic regulation for STAL.

## Chapter 1

# Introduction

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## Purpose

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- 1.1 In January 2013, the CAA issued a 'minded to' market power assessment (MPA), pursuant to its duties under the Civil Aviation Act 2012 (the Act). That consultation stated that the CAA was 'minded to' find that the market power test (MPT) as set out in the Act<sup>1</sup> was met in relation to Stansted Airport Limited (STAL) as the relevant operator of Stansted Airport (Stansted). The CAA's consultation closed for responses at the end of May 2013. The CAA planned to consider representations and reach a final determination in 2013 on whether the test is met in relation to STAL.
- 1.2 In the 'minded to' MPA, the CAA stated that it welcomed new evidence from stakeholders and also stakeholders' views on how the CAA should allocate weight to particular items of evidence. The CAA noted in its 'minded to' MPA that likely future developments in the market and their potential implications would form a key part of this assessment. Those anticipated developments included the imminent divestment of Stansted which was expected but had not been concluded by January 2013.<sup>2</sup> The CAA acknowledged that one uncertainty that could alter its views would be if the new owners of Stansted established different behaviours and relationships with the airlines.
- 1.3 Since that date there have been further developments at Stansted, including recent developments in respect of the commercial behaviour of the new owners of Stansted. These developments include the

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<sup>1</sup> Section 6 of the Act.

<sup>2</sup> The change in ownership was required by the Competition Commission (CC) as a remedy to its investigation of the joint ownership of Heathrow Airport Limited (HAL), Gatwick Airport Limited (GAL) and STAL, which the CC found to have an adverse effect on competition. See CC Press Release: 'BAA ordered to sell three airports', 19 March 2009, available at: [http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/press\\_rel/2009/mar/pdf/11-09.pdf](http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/press_rel/2009/mar/pdf/11-09.pdf) (accessed 26 November 2012). GAL had already been divested in 2009 prior to the CC's report.

following.

- With the approval of the CC, Manchester Airports Group plc (MAG) acquired STAL in February 2013. The majority of MAG shares are held by Manchester City Council and other Greater Manchester Councils. MAG's shareholders<sup>3</sup> are Industry Funds Management (IFM) – 35.5%, Manchester City Council – 35.5%, and the other nine Greater Manchester Councils – 29%.
- MAG has agreed heads of terms for long term agreements with some of its passenger airlines including easyJet<sup>4</sup> and Ryanair<sup>5</sup> for their use of Stansted. Ryanair and easyJet accounted for 91% of passenger traffic at STAL during 2012.<sup>6</sup> The terms of these agreements include reductions to the current prices in return for passenger commitments and growth in passenger numbers and offer charges that are below the current regulated price cap.

1.4 MAG<sup>7</sup> has commenced negotiations to secure long term agreements with cargo airlines at Stansted.

1.5 As conditions in the passenger market appear to have changed in a way that is potentially material since the consultation closed and could, potentially, make a difference to the outcome of the CAA's evaluation of the evidence, the CAA is concerned to ensure that stakeholders should have an opportunity to make representations. Stakeholders may wish to state their views as to the implications of these changes, or have new evidence relating to those changes that it would not have been possible for them to present previously. In the light of that, the CAA has decided to set up a second, more targeted and limited, phase of consultation in relation to the specific matters raised.

1.6 This consultation paper does not comment on the responses received to the 'minded to' MPA and it does not provide an update on our developing thinking on all aspects regarding the MPA for STAL.

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<sup>3</sup> MAG website <http://www.manchesterairport.co.uk/manweb.nsf/Content/AboutUsAndOurGroup>

<sup>4</sup> <http://www.stanstedairport.com/about-us/media-centre/press-releases/easyjet-sign-long-term-deal-to-double-traffic-at-stansted>

<sup>5</sup> <http://www.ryanair.com/en/news/ryanair-agrees-10-year-growth-deal-at-stansted>

<sup>6</sup> CAA Airport Statistics

<sup>7</sup> Letter from MAG to CAA dated 20 September 2013

Instead it focuses on particular aspects where the market conditions that appear to have changed in a way that is potentially material to the CAA's evaluation of evidence since the 'minded to' MPA consultation closed and it is seeking further views and relevant evidence on these developments.

- 1.7 The CAA is therefore consulting on the potential impact of these market developments in reaching its final determination on whether Tests A, B and C are met in relation to Stansted's passenger market. In relation to the passenger market, the CAA has reached provisional views in certain respects as to the ways in which these developments may impact upon the MPT.
- 1.8 In relation to the cargo market, the CAA is not aware of any significant market developments that impact on the 'minded to' MPA. However it has considered whether the provisional views on Tests A, B and C for the passenger market might have an impact on the assessment of Tests A, B and C for the cargo market.
- 1.9 The CAA has set out in Chapter 3 below an indication of the ways in which these developments may impact upon the MPT.
- 1.10 The CAA invites stakeholders' representations on the alternative options open to it. Stakeholders' representations are also sought on any other evidence that the CAA should consider that is relevant to the assessment of the MPT, and on whether stakeholders would like to make changes to the representations they made to the January 2013 'minded to' MPA in the light of these market developments.
- 1.11 In the 'minded to' MPA, separate markets were identified for the passenger<sup>8</sup> and the cargo airlines at Stansted. As a result separate assessments were made on whether STAL had substantial market power (SMP) in each of the passenger and the cargo markets. As these assessments concluded that STAL had SMP in both the passenger and the cargo markets, the other elements of the MPT

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<sup>8</sup> The 'minded to' MPA identified two passenger markets: one for services to Full Service Carriers (FSCs) and associated feeder airlines; and one for services to Low Cost Carriers (LCC) and Charter airlines. For the purpose of this document the passenger market refers to the LCC and Charter market. No discussion is provided on the FSC and associated feeder airlines market as the CAA did not consider STAL to hold any market power over these airlines or their passengers.

were considered for STAL in total rather than for each market. If the recent market developments result in the CAA determining different conclusions for the passenger and the cargo markets, then the other elements of the MPT will need to be considered separately for each market.

- 1.12 This is a redacted version of the CAA's consultation on the developments since the 'minded to' MPA for STAL was published in January 2013. Some information has been removed on the basis that it is commercially confidential, following consideration by the CAA of requests by MAG and the airlines. Redactions are clearly marked with a [X]. In accepting redactions for the purposes of this document, the CAA reserves the right to revisit its position for subsequent publications.

## Context

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- 1.13 The Act only permits economic regulation of an airport operator through the granting of a licence by the CAA if the three tests set out in section 6 of the Act are met. Further detail on these three tests is set out in Chapter 3.
- 1.14 In this document, the term 'Stansted' refers to Stansted airport (the physical airport area) and STAL refers to Stansted Airport Limited (the company that owns and operates Stansted airport). Under section 6(1) of the Act, the MPT is met in relation to an airport area if the three tests (A to C) are met by or in relation to the operator of that area.
- 1.15 The practical consequence of the MPT being met is that the airport operator would be unable to charge for airport operation services<sup>9</sup> unless it has a licence granted by the CAA.<sup>10</sup> The Act sets out the primary duty of the CAA as being to further users' (which is to say, passengers' and cargo owners') interests in the provision of airport operation services; and, where appropriate, to do this by promoting competition.<sup>11</sup> It also sets out the provisions for the granting of a licence and what a licence may contain.<sup>12</sup> A licence may include such

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<sup>9</sup> Section 68 of the Act.

<sup>10</sup> Section 3 of the Act.

<sup>11</sup> Section 1 of the Act.

<sup>12</sup> Chapter 1 of the Act.

conditions as the CAA considers necessary or expedient in relation to risks of abuse of market power and any other condition that the CAA considers necessary or expedient having regard to its duties. This may include price control conditions. Any regulatory intervention must be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed.<sup>13</sup>

- 1.16 In this document, the term ‘airport charges’ means charges levied on operators of aircraft in connection with the landing, parking or taking off of aircraft at the airport (including charges that are determined by the number of passengers on board the aircraft), including any separate charges for aerodrome navigation services. It also includes charges levied on aircraft passengers in connection with their arrival at, or departure from, the airport by air.

## The CAA invites responses to this document

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- 1.17 The CAA welcomes representations on the implications of the developments, set out in this consultation, for its assessment on whether the MPT as set out in the Act is met in relation to STAL.
- 1.18 The deadline for representations is 11 November 2013. This period for consultation responses reflects the extensive consultation that has already taken place on the MPT, and the relatively limited nature of the issues raised in this further consultation. It also reflects the statutory timetable under the new Act and the need to have licences in place by 1 April 2014 or as soon as practicable thereafter.
- 1.19 The CAA cannot commit to take into account representations made after the deadline. The CAA reserves the right not to take into account information, or place less weight on information that is provided after 11 November 2013 that could have been provided by stakeholders at an earlier stage.
- 1.20 Please email your response to [airportregulation@caa.co.uk](mailto:airportregulation@caa.co.uk). If you would like to discuss with the CAA any aspect of this document informally please contact Beryl Brown on [beryl.brown@caa.co.uk](mailto:beryl.brown@caa.co.uk).
- 1.21 The CAA will publish responses to this consultation on its website shortly after the close of the consultation period. If there are parts of your response that you consider commercially confidential, please

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<sup>13</sup> Sections 1(3) and (4) of the Act.

mark them clearly as such. Please note that the CAA has powers and duties with respect to information disclosure established under various legislation such as section 59 and Schedule 6 of the Act, the Civil Aviation Act 1982, and the Freedom of Information Act 2000.

## Next steps

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- 1.22 Between now and the implementation of the Q6<sup>14</sup> price control on 1 April 2014, the CAA expects the following major steps:
- 11 November 2013: receive responses to this consultation.
  - Early in 2014: the CAA intends to publish its formal determination under the Act on the MPD for STAL. Stakeholders, including STAL and the airlines, will then have 60 days to decide whether or not to lodge an appeal with the Competition Appeals Tribunal (CAT).
- 1.23 When the CAA has published its MPD for STAL, the next steps depend on whether or not the MPD finds STAL passes the MPT.

## If the CAA finds that STAL passes the MPT

- 1.24 If the CAA finds that STAL passes the MPT then the CAA expects the following major steps:
- As soon as practicable in 2014: the CAA will issue a consultation on its updated proposals for the economic regulation of STAL in Q6.
  - Based on its conclusions following the consultation process described above, the CAA will issue a formal notice under section 15 of the Act that it proposes to grant a licence and the proposed conditions of the licence followed by a reasonable period for further representations. If the CAA decides to grant a licence once that period has expired, it will publish a notice of grant (which will include the date the licence will come into force) and a copy of the final licence.

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<sup>14</sup> The present regulatory arrangements cover the financial years 2009/10 to 2013/14 and are known as the fifth quinquennium (Q5). The arrangements to apply beyond this date are commonly known as the sixth quinquennium (Q6) although the length of the regulatory period can be more or less than five years.

- Stakeholders, including STAL and airlines, will then have six weeks to decide whether to lodge an appeal with the Competition and Markets Authority (CMA).<sup>15</sup>
- The CMA has ten weeks from the date of the CAA's notice of grant to decide whether to give stakeholders leave to present an appeal. The CMA has 24 weeks (again, running from the date of the notice of grant) to determine the appeal. The CMA may decide to apply an eight-week extension to its deadline if it is satisfied that there are good reasons for doing so.
- Subject to any appeal that might be made to the CMA, the Q6 economic regulation conditions in the licence will come into force.

### If the CAA finds that STAL does not pass the MPT

1.25 If the CAA finds that STAL does not pass the MPT then:

- STAL will not be subject to regulation through a licence under the Act from the date of the Market Power Determination (MPD).
- STAL will remain subject to other regulation of its pricing conduct under various legislation such as the Airport Charges Regulations, the Ground Handling Regulations, and general competition law, in particular the Competition Act 1998.

### What happens if there is a future change in circumstances?

1.26 Regardless of whether the CAA makes an MPD that STAL does/does not pass the MPT at this current time, the CAA appreciates (and the Act recognises) that circumstances may change in the future. Such change may necessitate a fresh look at the question of whether STAL passes or does not pass the MPT.

1.27 Under section 7 of the Act:

- the CAA may make an MPD whenever it considers it appropriate to do so; and

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<sup>15</sup> The CMA takes over the duties of the Competition Commission and the Office of Fair Trading from 1 April 2014.



- if there has been a material change in circumstances since the CAA last made an MPD, then STAL or another person whose interests are likely to be materially affected may request that the CAA makes a new MPD.
- 1.28 The results of any subsequent MPD could lead the CAA to consider the need for economic regulation for STAL.
- 1.29 In considering whether a further MPD should be undertaken, the CAA's principal consideration would be whether there had been any material change in circumstance since the previous MPD had been made. STAL or an affected party can make a request to the CAA at any time if they consider that there has been such a material change.

## Chapter 2

## Developments and new evidence

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- 2.1 This chapter sets out the key developments and new evidence, of which the CAA is aware, that may influence the CAA's MPA for STAL.

### CAA's 'minded to' MPA

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- 2.2 In the 'minded to' MPA, the CAA noted<sup>16</sup> the unique circumstances within which STAL and its airlines have been conducting business in the past three years: a deep recession; uncertainty linked to the forced sale of STAL; and potential distortions of STAL's behaviour owing to its joint ownership with Heathrow Airport Limited (HAL) and previously Gatwick Airport Limited (GAL). These may have artificially distorted the incentives and behaviours of both the airport operator and the airlines.
- 2.3 The CAA noted<sup>17</sup> that likely future developments in the market and their potential implications form a key part of this assessment, although evidence about the degree of market power currently held and previously held would also be taken into account.

### Change of ownership

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#### MAG acquires STAL

- 2.4 On 28 February 2013<sup>18</sup>, MAG acquired STAL from BAA. Charlie Cornish, Chief Executive of MAG, said:

*"We're delighted to have added Stansted to our strong portfolio of UK airports. We aim to help fulfil its potential in the London market and bring more choice to its passengers in the years ahead. Today represents the achievement of a major strategic ambition for MAG and we look forward to working alongside staff, partners and stakeholders*

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<sup>16</sup> Paragraph 14 Stansted 'minded to' Market Power Assessment January 2013  
<http://www.caa.co.uk/default.aspx?catid=1350&pagetype=90&pageid=14395>

<sup>17</sup> Paragraph 2.20 Stansted 'minded to' Market Power Assessment January 2013

<sup>18</sup> [MAG](http://www.manchesterairport.co.uk/manweb.nsf/content/MAGCOMPLETESITSACQUISITIONOFStanstedAIRPORT) completes its acquisition of London Stansted Airport  
<http://www.manchesterairport.co.uk/manweb.nsf/content/MAGCOMPLETESITSACQUISITIONOFStanstedAIRPORT>

*in ensuring the Group's success."*

2.5 MAG, in response<sup>19</sup> to the CAA's 'minded to' MPA, said:

*"As the new owner of Stansted, MAG believes that real competition between London's airports under separate ownership will emerge quickly and as part of a new approach, we would encourage the CAA to allow new management to compete freely for passengers and airlines. In the 12 weeks since MAG completed the acquisition of Stansted, excellent progress has been made in implementing a positive and dynamic new strategy to improve customer service and deliver value to airlines, including plans for a £40 million transformation of the terminal building to dramatically improve the passenger experience. These initiatives represent just the beginning of MAG's plans for Stansted. Building on Stansted's core strengths, significant opportunities exist to deliver growth and build connectivity, reduce operating costs and drive commercial revenues. MAG is confident that its new approach to operating and developing Stansted will succeed in a market where airports across the UK and Europe are competing to attract new business. This competition will protect and promote the interests of consumers, and bring significant additional benefits."*

2.6 MAG's Chief Executive, said<sup>20</sup>:

*"Under MAG's ownership, we are already competing hard for new passengers and airlines and Stansted provides the CAA with the perfect opportunity to adopt a forward looking approach and promote competition in the interests of passengers."*

2.7 This change in commercial approach is evidenced by the views expressed by easyJet and Ryanair in the announcements they separately made before and after MAG's acquisition of STAL.

### **easyJet statements**

2.8 On 20 December 2012<sup>21</sup> easyJet made a public statement that:

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<sup>19</sup> MAG response to 'minded to' MPA, 28 May 2013

<http://www.stanstedairport.com/about-us/media-centre/press-releases/stansted-responds-to-cao-market-power-assessment-consultation>

<sup>20</sup> <http://www.stanstedairport.com/about-us/media-centre/press-releases/stansted-responds-to-cao-market-power-assessment-consultation>

*"easyJet welcomes the CAA's announcement that it views Stansted as a monopoly airport. Continued regulation of Stansted will protect the interests of all passengers who use the airport."*

2.9 On 13 June 2013<sup>22</sup>, MAG announced that:

*"easyJet and the new owners of London Stansted, MAG, have today announced a new long-term growth framework deal to enable the airline to more than double its passenger numbers at Stansted from a current 2.8 million passengers to six million passengers a year over the next five years. The conclusion of the growth framework agreement comes just three months after MAG completed its acquisition of London Stansted in late February 2013."*

2.10 Paul Simmons, UK director for easyJet, said:

*"We are pleased to have reached a new deal with the new owners of Stansted which gives us the ability to grow at the London airport. We look forward to working with MAG over the coming months and years."*

2.11 The Stansted Airport Consultative Committee (SACC) in a letter dated 25 June 2013 to the CAA<sup>23</sup>, said that easyJet considered:

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

## Ryanair statements

2.12 On 28 February 2013<sup>24</sup> Ryanair announced that:

*"it will cut its London Stansted traffic by 9% over the coming year (from 12.5m to 11.4m) after the Ferrovial/BAA Stansted monopoly announced a further unjustified increase of Stansted's already high charges of 6% from April 2013, despite the fact that Ferrovial/BAA has sold Stansted to Manchester Airport Group who will take over the*

<sup>21</sup> [http://corporate.easyjet.com/media/latest-news/news-year-2012/20-12-2012-en.aspx?sc\\_lang=en](http://corporate.easyjet.com/media/latest-news/news-year-2012/20-12-2012-en.aspx?sc_lang=en)

<sup>22</sup> <http://www.stanstedairport.com/about-us/media-centre/press-releases/easyjet-sign-long-term-deal-to-double-traffic-at-stansted>

<sup>23</sup> Letter from SACC to CAA <http://www.caa.co.uk/docs/78/SACCApr13.pdf>

<sup>24</sup> <http://www.ryanair.com/en/news/ferrovial-baa-hikes-stansted-fees-by-6-percent-from-april-2013-in-a-parting-gift-to-manchester-airport-group-and-a-parting-slap-to-stansted-s-airlines-and-passengers>

*airport sometime before the end of March."*

2.13 On 30 April 2013<sup>25</sup> Ryanair called on the CAA to do more at STAL:

*"Ryanair called on the CAA to do more to tackle excessive airport charges and falling passenger numbers at Stansted. Following the doubling of charges at Stansted in the last 5 years, which has led to a dramatic 25% traffic collapse, the CAA's proposal to "monitor" charges at Stansted over the next 5 years does nothing to constrain Stansted's absolute pricing power over its airline users and passengers."*

*"The CAA's proposal that airport charges at Stansted can increase by half the rate of inflation over the next 5 years sanctions further charge increases at the airport which has already suffered the greatest ever traffic decline of any London airport. This proposal falls lamentably short of what is required to restore traffic growth and consumer choice at Stansted."*

2.14 On 20 May 2013<sup>26</sup> Ryanair said:

*"We are in active discussions with the new owners of Stansted Airport and the new management at Dublin Airport and while no agreements have yet been reached, if a competitive cost base emerges, then we could restart growth at one or other airports as early as September 2013."*

2.15 On 31 July 2013<sup>27</sup>, Ryanair said in relation to a potential agreement with STAL that:

*"We'll look to add 5 million passengers over five years taking us from 12.2 million to 17.2 million by 2018."*

2.16 On 16 September 2013<sup>28</sup>, Ryanair announced:

*"a new 10 year growth deal at London Stansted with MAG. This deal will see our Stansted traffic grow by over 50%, from 13.2m in 2012 to over 20m p.a. in return for lower costs and more efficient facilities at Stansted. This agreement, which will create over 7,000 new jobs in*

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<sup>25</sup> <http://www.ryanair.com/en/news/ryanair-calls-on-the-caa-to-do-more-at-stansted>

<sup>26</sup> <http://www.ryanair.com/en/news/20-may-full-year-results-2013>

<sup>27</sup> <http://www.anna.aero/2013/07/31/ryanairs-michael-oleary-no-departure-from-continuous-revolution/>

<sup>28</sup> <http://www.ryanair.com/en/news/ryanair-agrees-10-year-growth-deal-at-stansted>

*Stansted, proves how UK airports can flourish when released from the dead hand of the BAA monopoly and is the first dramatic initiative by MAG to reverse 7 years of decline, during which Stansted's traffic fell from 23.8m to 17.5m."*

## Developments related to the passenger airlines

### Passenger flights

- 2.17 Passenger flights accounted for 92.4% of all air transport movements (ATMs) at STAL during 2012.<sup>29</sup> (In 2012, cargo flights accounted for 7.6% of all ATMs at STAL.<sup>30</sup>)

### Bilateral agreements with passenger airlines

- 2.18 Since MAG acquired ownership of STAL in February 2013, it has developed bilateral agreements with some of the passenger airlines that use Stansted. These deals offer reduced charges that are below the current price cap in return for commitments from airlines to grow passenger numbers.
- 2.19 The CAA is still considering the responses that it received to the 'minded to' MPA in making the MPD on the passenger market. However, the prices in the deals with easyJet and Ryanair are within the range that the CAA considers to be a competitive level based on the analysis included in the 'minded to' MPA.<sup>31</sup> The 'minded to' MPA included the Leigh Fisher<sup>32</sup> analysis on prices at other comparable airports, the Long Run Incremental Cost analysis conducted by Europe Economics<sup>33</sup>, and the information provided by Ryanair and easyJet on prices at other airports that they each use.<sup>34</sup>
- 2.20 Figure 2.1 shows the share of passenger flights by airline for the last

<sup>29</sup> CAA Airport Statistics

<sup>30</sup> CAA Airport Statistics

<sup>31</sup> Paragraphs 6.38 to 6.69 Stansted 'minded to' Market Power Assessment January 2013

<sup>32</sup> Leigh Fisher – Comparing and capping airport charges at regulated airports  
<http://www.caa.co.uk/docs/1350/Leigh%20Fisher,%20Comparing%20and%20capping%20airport%20charges%20at%20regulated%20airports.pdf>

<sup>33</sup> Europe Economics - Advice on the application of long run incremental cost estimates  
<http://www.caa.co.uk/docs/1350/Europe%20Economics,%20Advice%20on%20the%20application%20of%20long%20run%20incremental%20cost%20estimates%20for%20Gatwick%20and%20Stansted%20-%20nonconfidential%20version.pdf>

<sup>34</sup> Paragraphs 6.64 to 6.65 Stansted 'minded to' Market Power Assessment January 2013

eight years.

**Figure 2.1: Percentage of passengers by airline at Stansted**

|                | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|----------------|------|------|------|------|------|------|------|------|
| Ryanair        | 63%  | 63%  | 63%  | 67%  | 69%  | 68%  | 68%  | 72%  |
| easyJet        | 21%  | 19%  | 20%  | 19%  | 19%  | 21%  | 22%  | 19%  |
| Air Berlin     | 3%   | 5%   | 5%   | 3%   | 2%   | 3%   | 1%   | 1%   |
| Other airlines | 12%  | 12%  | 12%  | 10%  | 10%  | 9%   | 9%   | 8%   |

Source: CAA Airport Statistics

2.21 STAL noted in September 2013<sup>35</sup> that it had reached agreement with airlines representing 95 out of every 100 passengers passing through STAL. STAL stated that:

*"This has all been achieved within a few months of MAG acquiring STAL, and having achieved its initial objective of securing long term deals with STAL's largest airline partners, it will continue to work to secure deals with other passenger and cargo airlines consistent with this new approach."*

2.22 At the time of this consultation, the CAA has been advised that:

- legally binding agreements have been reached with Ryanair, Thomas Cook, [redacted] and [redacted]; and
- heads of terms have been agreed with easyJet, [redacted] and a long-haul route with [redacted].

2.23 The rest of this section discusses the easyJet and Ryanair deals. The CAA understands that terms have been agreed with other airlines which comprise about 4% of STAL's passenger traffic.

### **easyJet**

2.24 In 2012 easyJet accounted for 19% of STAL's passenger traffic.<sup>36</sup>

2.25 easyJet agreed heads of terms with MAG on 3 June 2013.<sup>37</sup> The agreement with easyJet covers five years from 1 April 2013 [redacted]. This includes a doubling of passenger traffic from 2.8 million passengers to

<sup>35</sup> Letter from MAG to CAA dated 20 September 2013

<sup>36</sup> CAA Airport Statistics

<sup>37</sup> Letter from MAG to easyJet dated 3 June 2013

6 million passengers a year over the next five years.<sup>38</sup>

2.26 The easyJet deal incentivises the airline to grow with STAL. [redacted] The terms allow, for example, airport purchases to be permitted, without charge, to be carried on board in addition to cabin baggage. These terms appear to be designed to increase MAG's non-aeronautical income.

2.27 [redacted]

### Ryanair

2.28 In 2012, Ryanair accounted for about 72% of STAL's passenger traffic.<sup>39</sup>

2.29 Ryanair [redacted] expects to achieve 13.2 million departing passengers at Stansted in the year ending 31 March 2014.

2.30 Ryanair agreed heads of terms with MAG on 3 September 2013<sup>40</sup> [redacted] The deal<sup>41</sup> will see Ryanair grow its traffic at Stansted by over 50%, from 13.2 million passengers in 2012 to over 20 million per year in return for a package of lower costs and more efficient facilities at Stansted. The agreement will account for up to 25% of Ryanair's five year growth plans to 2019. Ryanair expects its Stansted traffic in year 1 of this 10-year deal to grow from 13.2 million to over 14.5 million.

2.31 [redacted]

### Summary

2.32 The easyJet and Ryanair bilateral agreements include charges in their respective first years of operation that are below the current regulated charges for STAL. The CAA considers that both agreements offer the potential for significantly lower charges than the base levels if growth targets are met. These lower charges are within the range of what the CAA considers to be a competitive level based on the analysis

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<sup>38</sup> [http://www.stanstedairport.com/about-us/media-centre/press-releases/easyjet-sign-long\\_term-deal-to-double-traffic-at-stansted](http://www.stanstedairport.com/about-us/media-centre/press-releases/easyjet-sign-long_term-deal-to-double-traffic-at-stansted)

<sup>39</sup> CAA Airport Statistics

<sup>40</sup> Letter from Ryanair to MAG dated 3 September 2013

<sup>41</sup> <http://www.ryanair.com/en/news/ryanair-agrees-10-year-growth-deal-at-stansted>



included in the 'minded to' MPA.<sup>42</sup>

- 2.33 The other deals, of which the CAA is aware, offer reduced charges for passenger commitments.
- 2.34 In addition to the developments noted above, the CAA understands that STAL is negotiating with other passenger airlines at STAL.

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<sup>42</sup> Paragraphs 6.38 to 6.69 Stansted 'minded to' Market Power Assessment January 2013

## Chapter 3

## The potential implications of these developments

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- 3.1 The 'minded to' MPA identified separate markets for cargo and passengers<sup>43</sup> at Stansted. Passenger flights account for 92.4%, and cargo flights account for 7.6% of flights at Stansted.<sup>44</sup>
- 3.2 This chapter discusses how to assess the three tests A to C and considers how the recent market developments might impact on the application of those tests to STAL as airport operator. At this stage, the CAA is unable to express definitive views on how these developments affect the MPA, but sets out their potential implications for the MPT and asks for stakeholders' views on the outcomes available.

### How to assess the three MPD tests

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#### How to assess Test A

- 3.3 The 'minded to' MPA<sup>45</sup> noted that the CAA's guidance on the assessment of airport market power (the Guidelines)<sup>46</sup> stated that the objective of a competition assessment is to establish the existence and strength of the competitive constraints facing an airport operator, and consequently to understand the nature and extent of its market power. Market power can be thought of as the ability profitably to sustain prices above competitive levels or restrict output or quality below competitive levels. This involves assessing two main issues:

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<sup>43</sup> The 'minded to' MPA identified two passenger markets: one for services to Full Service Carriers (FSCs) and associated feeder airlines; and one for services to Low Cost Carriers (LCC) and Charter airlines. For the purpose of this document the passenger market refers to the LCC and Charter market. No discussion is provided on the FSC and associated feeder airlines market as the CAA did not consider STAL to hold any market power over these airlines or their passengers.

<sup>44</sup> CAA Airport Statistics

<sup>45</sup> Paragraphs 2.15 to 2.17 Stansted 'minded to' Market Power Assessment January 2013

<sup>46</sup> CAA Guidance on the assessment of airport market power April 2012  
<http://www.caa.co.uk/docs/5/Final%20Competition%20Assessment%20Guidelines%20-%20FINAL.pdf>

- the degree to which users can respond to a failure to provide a reasonable price or inadequate-service offering and discipline the airport operator's behaviour through their ability to reduce their use of the airport, and
- the impact that these responses might have on the behaviour of the airport operator, and whether they sufficiently discipline the airport operator's pricing, investment and service quality.

3.4 The Guidelines further advise that the assessment should include a consideration of buyer power and potential competition.

### How to assess Test B

3.5 The 'minded to' MPA<sup>47</sup> explained that the application of Test B includes considering whether there is a risk of abusive conduct that competition law may not suitably address. The CAA noted that it was important to be aware of the risk of over-intervention, which might arise in particular because of temporary market power.

### How to assess Test C

3.6 The scheme of section 6 of the Act would seem to suggest that:

- Test C should be applied on the assumption that if Test A is passed then a licence of some kind may be needed to regulate that SMP.
- However, if Test B was failed, Test C could be academic. If competition law is sufficient to guard against the risk of abuse of the SMP found under Test A, it might be very hard to make a finding under Test C that the benefits of regulation outweighed the adverse effects. Much would depend on the nature of the harm to end users that would be likely to flow from the SMP identified under Test A.

3.7 The 'minded to' MPA<sup>48</sup> assessment of Test C considered the incremental benefits and costs of regulation by way of a licence which seeks, via appropriate conditions, to mitigate the risk of the abuse of SMP. In general the abuse of SMP can arise in many areas, but for the purposes of Test C, this assessment focuses on the areas most commonly addressed by economic regulation in assessing the likely

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<sup>47</sup> Paragraph 8.19 and 8.20 Stansted 'minded to' Market Power Assessment January 2013

<sup>48</sup> Paragraph 9.7 Stansted 'minded to' Market Power Assessment January 2013

impact of such regulation at STAL:

- price;
- efficiency (which impacts on future prices);
- service quality, in terms of the range and level of services; and
- investment, which in capital intensive industries such as aviation, can impact on future levels of service quality.

3.8 The 'minded to' MPA<sup>49</sup> also considered whether users may benefit from other additional licence requirements that are not directly related to market power but that may be necessary to fulfil the CAA's duties under Section 1 of the Act, for example on operational resilience.

3.9 The 'minded to' MPA<sup>50</sup> considered the adverse effects of licence regulation in terms of:

- the direct costs to the CAA, regulated companies and their users for example in manpower and expenditure, and
- the indirect costs/effects such as: management distraction, distortions to incentives, crowding out of a more commercial approach, distortions to competition more widely, for example on other airports, and other potential adverse effects such as those on consumers.

## Potential implications on the passenger market

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### 'minded to' MPA

#### Test A for the passenger market

3.10 The 'minded to' MPA<sup>51</sup> finding was that, in relation to the Stansted passenger market, STAL holds a degree of market power which may currently be substantial, and is likely to become substantial over the period 2014/2019 and that Test A was met.

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<sup>49</sup> Paragraph 9.8 Stansted 'minded to' Market Power Assessment January 2013

<sup>50</sup> Paragraph 9.9 Stansted 'minded to' Market Power Assessment January 2013

<sup>51</sup> Paragraph 14 Stansted 'minded to' Market Power Assessment January 2013

- 3.11 The 'minded to' MPA<sup>52</sup> noted that the analysis of SMP is often subject to some uncertainty and debate. This is compounded in this case by the change of ownership with consequent differences in commercial strategy during the period when the assessment is being made.

#### **Test B for the passenger market**

- 3.12 The 'minded to' MPA assessed Test B together for the passenger and cargo markets because the CAA found that Test A was met for the passenger market and the cargo market.
- 3.13 The 'minded to' MPA<sup>53</sup> found that Test B was met. The CAA considered that it was likely that some form of regulation under the Act would provide a more effective safeguard than competition law alone against the risk of exploitative abuse.

#### **Test C for the passenger market**

- 3.14 The 'minded to' MPA assessed Test C together for the passenger and cargo markets because the CAA found that Test A was met for the passenger market and the cargo market.
- 3.15 The 'minded to' MPA<sup>54</sup> found that Test C was met and that some form of licence regulation should apply to STAL. The CAA<sup>55</sup> did not consider that, given the level of market power identified in relation to STAL, that the Airport Charges Regulations (ACRs) or Airport Groundhandling Regulations would necessarily provide sufficient protection for users.
- 3.16 The CAA<sup>56</sup> noted that it was not necessary, in assessing whether Test C is met, to define precisely the type of regulation that would apply; only whether the benefits of some form of licence-based regulation were likely to outweigh the adverse effects.

#### **Analysis of market developments for the passenger market**

- 3.17 The recent developments of bilateral agreements between MAG and the airlines lead the CAA to consider the following key questions in assessing the impact of the market developments on the MPA for the

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<sup>52</sup> Paragraph 16 Stansted 'minded to' Market Power Assessment January 2013

<sup>53</sup> Paragraph 24 Stansted 'minded to' Market Power Assessment January 2013

<sup>54</sup> Paragraph 30 Stansted 'minded to' Market Power Assessment January 2013

<sup>55</sup> Paragraph 9.22 Stansted 'minded to' Market Power Assessment January 2013

<sup>56</sup> Paragraph 30 Stansted 'minded to' Market Power Assessment January 2013

passenger market.

### Test A

1. What do the change in ownership of STAL and the resulting observed behaviour imply for STAL's market power?
2. Do the long-term agreements negotiated between STAL and its airlines represent the exercise of buyer power by the airlines? If not, what do they demonstrate?

### Test B

3. Does STAL's willingness to enter into long-term agreements at discounted rates have any bearing on the effectiveness of competition law to prevent an abuse on SMP?
4. Would the airlines have a realistic ability to defend themselves under contractual provisions and/or competition law?

### Test C

5. Do the existence and terms of the long term agreements affect the assessment of whether the benefits of regulation by means of a licence outweigh the adverse effects?

3.18 MAG concluded the purchase of STAL from BAA on 28 February 2013.<sup>57</sup> On initial consideration a change in ownership on its own would not necessarily give rise to a change in the MPA. However the purchase of STAL by MAG is a structural change in the market as it ended the historical joint ownership of STAL and HAL. This may have wider effects as the incentives of STAL in separate ownership will be different. In terms of airline switching, separation of HAL and STAL does not add directly to the competitive constraint on STAL in the short-run. As regards the constraint from passenger switching, there is a catchment overlap between Stansted and Heathrow but the CAA considers that passengers are unlikely to be very sensitive to changes in airport charges because they form a small proportion of the total ticket price.

3.19 The CAA considers that the change in ownership, despite being

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<sup>57</sup> MAG completes its acquisition of London Stansted Airport  
<http://www.manchesterairport.co.uk/manweb.nsf/content/MAGCOMPLETESITSACQUISITIONOFSTANSTEDAIRPORT>

structural in nature, is unlikely to have altered the short to medium term constraints on STAL on its own. However, as evidenced in Chapter 2, since MAG acquired ownership of STAL, STAL has adopted a different more commercial approach than under the previous ownership. A clearer strategy for the future of the airport has also been presented in terms of a more cohesive commercial relationship with the incumbent airlines.

- 3.20 In response to the Airports Commission's call for evidence on options for meeting the need for additional airport capacity in the South East, the Chief Executive of MAG, said<sup>58</sup>:

*"Our short-term priority is to make Stansted better for passengers than ever before, and we've made major progress in our first four months of ownership, including starting work on an £80 million terminal transformation."*

*"Stansted is uniquely placed to meet the UK's aviation capacity needs now and over the next 15 years. Almost overnight, Stansted could double the number of flights it handles without any need for significant investment in new infrastructure."*

*"Looking to the long-term, the interests of passengers will be best served by a pragmatic approach, focused on delivering new capacity that is cost-effective and flexible, and capable of driving competition across the aviation industry."*

- 3.21 In MAG's response<sup>59</sup> to the CAA's initial proposal on the form of regulation for STAL, it said:

*"Under our ownership, we are confident that we can build on this strength by improving service levels and attracting new airlines and passengers to Stansted. By doing this, we will quickly reverse the long decline in Stansted's traffic that started back in 2007."*

- 3.22 This contrasts with BAA's behaviour which may have been more short-term in approach given the high risk of divestment and its historical relationships with its airlines.

<sup>58</sup> <http://www.stanstedairport.com/about-us/media-centre/press-releases/capacity-for-growth-%E2%80%93stansted%E2%80%99s-potential-to-meet-air-capacity-needs>

<sup>59</sup> Paragraph 2.5 of MAG's response to the CAA's initial proposals on the form of regulation for STAL <http://www.caa.co.uk/docs/78/MAGApr13.pdf>

- 3.23 Additionally, despite a short time since taking over, MAG<sup>60</sup> are at an advanced stage of consultation and planning on a substantial increase in the size of Stansted's international departure lounge with an aim to increase its commercial revenues and improve the passenger experience outside of the capital plan of the Q5 settlement. The bilateral agreements with the passenger airlines appear to complement this investment and indicate the MAG is looking to achieve a return on its investment in Stansted over the longer term. By contrast BAA's planning horizon may have been substantially shorter given the risk of and eventual requirement for divestment, which was imposed by the CC.
- 3.24 Therefore, although STAL has not been in MAG's ownership very long, pricing behaviour and the relationship with airlines under MAG's ownership appears to be different to when the airport was owned by BAA. This is evidenced by easyJet's assessment that it no longer sees a need for economic regulation at STAL to protect its interests. The CAA understands that BAA did not agree growth deals with Ryanair and easyJet after 2007.<sup>61</sup> Under BAA's ownership, STAL priced to its regulated price cap from 2009/10 until its sale, except for the correction factor<sup>62</sup> in 2011/12 and 2013/14.

### **Test A for the passenger market**

- 3.25 The CAA is still considering the responses that it received to the 'minded to' MPA in making the MPD on the passenger market. However, as noted above the CAA considers that the change in ownership together with the bilateral agreements represent potentially material changes to the market since our 'minded to' MPA. Although a change in ownership was envisaged in the 'minded to' MPA, the behaviour of the new owners (who were unknown at that time) could not be predicted. The recent bilateral agreements with the airlines would appear to be a material difference between January 2013 and now in relation to Test A and the strength of competitive constraints in the market.

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<sup>60</sup> <http://www.stanstedairport.com/about-us/media-centre/press-releases/transport-secretary-launches-£80-million-terminal-redevelopment>

<sup>61</sup> Ryanair and easyJet's operations at Stansted were supported by a number of long term deals the airport signed with these carriers in 2001, which resulted in passenger growth up to 2007. These deals expired in 2007 and were not renewed.

<sup>62</sup> The correction factor relates to an adjustment for previous under or over recovery.



- 3.26 The contracts could indicate that the airlines enjoy some measure of buyer power. This arises through the airlines' ability to allocate new growth away from Stansted. This strategy might be particularly effective because of the amount of current spare capacity at Stansted and STAL's commercial desire to utilise that capacity in a manner that would see it reward its initial investment in purchasing the airport. The ability of the incumbent airlines to allocate their new growth traffic away from Stansted, given its present significant spare capacity may be an effective competitive constraint preventing STAL from having SMP at present circumstances.
- 3.27 The CAA noted in the 'minded to' MPA<sup>63</sup> that easyJet may have had a degree of buyer power in that it sponsored Southend's entry, switching three based aircraft there. In its new contract, it has succeeded in negotiating reduced airport charges from 2014 [X].
- 3.28 In contrast, the CAA noted in its 'minded to' MPA<sup>64</sup> that Ryanair had less buyer power than its share of Stansted's passenger traffic would suggest, due to its more limited options to switch current aircraft across other London airports. In the 'minded to' MPA, Ryanair's ability to allocate growth across its network did not appear to the CAA to have been an effective constraint on the airport operator, as it had not been effective in leading to a reduction of charges or a long-term agreement on charges. This may have been because BAA was less sensitive to the allocation of growth given the likelihood that it would have to divest the airport. However, Ryanair has since reached agreement with MAG to [X] offer [X] reductions in its charges [X] in exchange for commitments on growth.
- 3.29 Buyer power is not usually found in relation to the allocation of growth. However, Ryanair and easyJet each account for a large proportion of STAL's business. The CAA notes that, while Ryanair and easyJet may be constrained in switching current traffic to other airports in their network, they have the ability to allocate new capacity across their respective networks, based on the relative profitability of the various options. Therefore, they may have the ability to impose substantial harm on STAL, which they may have been able to make use of in negotiations leading to the recent deals.

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<sup>63</sup> Paragraph 5.115 Stansted 'minded to' Market Power Assessment January 2013

<sup>64</sup> Paragraph 5.112 Stansted 'minded to' Market Power Assessment January 2013

- 3.30 The CAA will consider the evidence in relation to the guidance on assessing buyer power. The guidance issued by the Office of Fair Trading on the assessment of market power explains that buyer power exists<sup>65</sup> where buyers have a strong negotiating position with their suppliers, which weakens the potential market power of a seller. Buyer power is most commonly found in industries where buyers and suppliers negotiate, in which case buyer power can be thought of as the degree of bargaining strength in negotiations. A buyer's bargaining strength might be enhanced if the following conditions hold:
- the buyer is well informed about alternative sources of supply and could readily, and at little cost to itself, switch substantial purchases from one supplier to another while continuing to meet its needs.
  - the buyer could commence production of the item itself or 'sponsor' new entry by another supplier (e.g. through a long-term contract) relatively quickly and without incurring substantial sunk costs.
  - the buyer is<sup>66</sup> an important outlet for the seller (i.e. the seller would be willing to cede better terms to the buyer in order to retain the opportunity to sell to that buyer).
- 3.31 The European Commission's Merger Guidelines explain that one source of countervailing buyer power (CBP) would be:
- "if a customer could credibly threaten to resort, within a reasonable timeframe, to alternative sources of supply should the supplier decide to increase prices."*
- 3.32 The CAT noted in *Hutchinson 3G v Ofcom* [2005] CAT 39:
- "Various factors are relevant in determining whether there is SMP, and one of those is CBP."*
- 3.33 The CAT considered that the degree of buyer power was important in any assessment of SMP:

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<sup>65</sup> [http://www.offt.gov.uk/shared\\_offt/business\\_leaflets/ca98\\_guidelines/oft415.pdf](http://www.offt.gov.uk/shared_offt/business_leaflets/ca98_guidelines/oft415.pdf)

<sup>66</sup> Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings' (2004/C 31/03)

*"CBP is the power of counterparties to offset the powers of the party whose allegedly superior powers are under consideration, and the important question is what degree of CBP is there, and (bearing in mind all the circumstances) does it operate to a sufficient extent so as to mean that there is no SMP?"*

### Factors pointing towards Test A being failed

- 3.34 The CAA notes that the level of buyer power held by Ryanair might be higher than its initial assessment in the 'minded to' MPA. For example, since the publication of the 'minded to' MPA and before the sale to MAG, STAL increased prices by 6% effective from April 2013.<sup>67</sup> In response, Ryanair, (28 February 2013) announced<sup>68</sup> that it would cut its Stansted traffic by 170 flights or (9)% over the coming year (from 12.5 million to 11.4 million). Ryanair subsequently reinstated traffic of 13.2 million passengers for the year ended 31 March 2014 [3<].
- 3.35 The CAA considers that Ryanair's threat to switch traffic away from Stansted and STAL's reaction in reversing the price increase appears to be consistent with Ryanair having sufficient buyer power to constrain any SMP that STAL might have. As noted previously, Ryanair did not appear to have been able to achieve similar outcomes in negotiation with the previous owners.
- 3.36 Therefore, it could be argued that the easyJet and Ryanair bilateral agreements on the allocation of their growth indicate that the airlines enjoy some degree of buyer power that has allowed them to negotiate prices that are within the range of what the CAA considers to be a competitive level.
- 3.37 The bilateral agreements would therefore imply that the airlines have buyer power and as such STAL would not be likely to acquire SMP over the duration of Q6 for the passenger market (the bilateral contracts covering Ryanair and easyJet extend over Q6). This could immunise the airlines, and most importantly, passengers against the

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<sup>67</sup> <http://www.ryanair.com/en/news/ferrovial-baa-hikes-stansted-fees-by-6-percent-from-april-2013-in-a-parting-gift-to-manchester-airport-group-and-a-parting-slap-to-stansted-s-airlines-and-passengers>

<sup>68</sup> <http://www.ryanair.com/en/news/ferrovial-baa-hikes-stansted-fees-by-6-percent-from-april-2013-in-a-parting-gift-to-manchester-airport-group-and-a-parting-slap-to-stansted-s-airlines-and-passengers>

effects of tightening capacity constraints as the prices in both contracts are within the range of what the CAA considers to be a competitive level. The CAA also notes that STAL has agreed or already has bilateral contracts with a number of other smaller airlines and so in total 95% of passengers are covered by bilateral contracts. Given the apparent change in behaviour of STAL, the CAA has not seen robust evidence that similar bilateral contracts would not be available to other airlines if they wished to agree contracts. The CAA's general duty is also to passengers rather than airlines and passengers would have the ability to switch between airlines. Test A would therefore be failed for the passenger market.

### Factors pointing towards Test A being passed

- 3.38 An alternative view is that, in the light of STAL's strategy and the CAA's initial proposals for regulating Stansted, MAG is acting in a way to minimise the risk of regulatory intervention, essentially trading off the ability to exercise any SMP for the benefit of greater freedom in pursuing its commercial strategy. This outcome involves long-term agreements which have provided the airlines with price transparency and stability over the medium term and is the best outcome for them. For STAL, the deals more formally secure airline growth for the airport in line with its owner's strategy.
- 3.39 It could be that the bilateral contracts were signed as the best outcome for the airlines and for STAL, given the CAA's 'minded to' MPA for the passenger market and the initial proposals for regulating STAL in Q6. This suggests that the constraints on STAL are no less than those considered in the 'minded to' MPA. However, by concluding the long term deals, STAL would have voluntarily constrained its ability to exercise its SMP but might not have the same incentives to do so in future once those long-term deals are in operation. Test A therefore would be passed for the passenger market. This would have additional implications for Tests B and C.
- 3.40 ***For reasons set out above the CAA's provisional view for the passenger market is that Test A would be failed because there is a sufficient level of buyer power to constrain STAL's SMP. The CAA will carefully consider any further evidence and representations put forward during the consultation period along with the responses to the 'minded to' MPA before reaching a final view.***

**Test B for the passenger market**

- 3.41 The CAA is still considering the responses that it received to the 'minded to' MPA in making the MPD on the passenger market. However, bilateral agreements between STAL and a large proportion of the airlines might be viewed as substantially reducing the risk of price based abuse of dominance. It may also amount to evidence that STAL is willing to self-regulate by keeping prices within the range that the CAA considers to be a competitive level in the light of the deterrence of competition law and/or regulatory intervention. Test B therefore would be failed for the passenger market.
- 3.42 Alternatively, STAL may have SMP and there is a continuing risk of abuse as the agreements only represent a proportion of its total available capacity. The question is, in the absence of regulation, whether STAL could adopt a different pricing strategy with the airlines that may use the remainder of its capacity that is still not under long-term agreements. This turns on whether the airlines could use a combination of competition law, contractual negotiations and the ACRs to restrain any unjustified differences in charges.
- 3.43 ***In the light of the reasons set out above, the CAA's provisional view for the passenger market is that Test B would be failed. The CAA will carefully consider any further evidence and representations put forward during the consultation period along with the responses to the 'minded to' MPA before reaching a final view.***

**Test C for the passenger market**

- 3.44 The CAA is still considering the responses that it received to the 'minded to' MPA in making the MPD on the passenger market. However, the existence of long-term bilateral agreements that cover over 90% of the existing passenger traffic, and have prices that are within the range of what the CAA considers to be a competitive level, are likely to lead to Test C being failed. Furthermore in total 95% of passengers are covered by bilateral contracts, which constrain STAL's ability to increase prices. When introducing licence regulation the CAA would need to be mindful to try to avoid cutting across agreed commercial arrangements. Any remaining airlines would have protections from the non-discrimination provisions under competition law and the ACRs. The CAA also has not seen robust evidence to

suggest that, given STAL's change in behaviour, bilateral agreements would not be agreed with other airlines. Consequently there would be insufficient benefits of regulation by means of a licence to outweigh the adverse effects. Test C therefore would be failed for the passenger market.

- 3.45 ***For that reason, the CAA's provisional view for the passenger market is that Test C would be failed as the benefits of regulation by means of a licence would not outweigh the adverse effects. The CAA will carefully consider any further evidence and representations put forward during the consultation period along with the responses to the 'minded to' MPA before reaching a final view.***

#### **If the MPT for the passenger market were passed**

- 3.46 If the MPT for the passenger market was passed, STAL would be subject to a licence in relation to the passenger market.

#### **If the MPT for the passenger market were failed**

- 3.47 If the MPT for the passenger market was failed, STAL would **not** be subject to a licence in relation to the passenger market.
- 3.48 However, the CAA could continue to monitor prices and performance. In addition, the CAA may make a subsequent MPD whenever it considers it appropriate to do so.
- 3.49 ***The CAA would welcome stakeholders' representations on how it should monitor prices and performance for STAL's passenger market if it concluded that this was appropriate.***
- 3.50 If STAL was not licensed because it failed the MPT, and subsequently the bilateral agreements broke down or the airlines had concerns about STAL's behaviour, then STAL or another person whose interests are likely to be materially affected by the determination, may request that the CAA makes a new MPD.
- 3.51 The results of any subsequent MPD could lead to the CAA considering an appropriate form of economic regulation for STAL.

## Potential implications on the cargo market

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### 'minded to' MPA

#### Test A for cargo

3.52 The 'minded to' MPA<sup>69</sup> found that in relation to cargo services, the CAA had received consistent and credible evidence from STAL's cargo customers that access to London was essential to their operations and that they have no ability to switch to other airports. The CAA was therefore 'minded to' conclude that STAL currently has SMP in the STAL cargo market and that Test A was met.

#### Test B for cargo

3.53 The 'minded to' MPA did not set out a separate assessment for Test B for the cargo market. Instead because the CAA found that Test A was met for the passenger market and the cargo market, Test B was assessed together for both markets.

3.54 The 'minded to' MPA<sup>70</sup> found that Test B was met.

#### Test C for cargo

3.55 The 'minded to' MPA did not set out a separate assessment for Test C for the cargo market. Instead because the CAA found that Test A was met for the passenger market and the cargo market, Test C was assessed together for both markets.

3.56 The 'minded to' MPA<sup>71</sup> found that Test C was met and that some form of licence regulation should apply to STAL.

### Analysis of market developments on MPA for the cargo market

3.57 The 'minded to' MPA<sup>72</sup> noted that evidence of negotiations regarding price between the airport operator and its cargo-only carriers could be informative as to how important the airport considers their business to be to its profits. Overall, evidence suggested that STAL is not facing significant pricing pressure with regard to cargo-only carriers and users. In general, the evidence suggested that cargo carriers at

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<sup>69</sup> Paragraph 18 Stansted 'minded to' Market Power Assessment January 2013

<sup>70</sup> Paragraph 24 Stansted 'minded to' Market Power Assessment January 2013

<sup>71</sup> Paragraph 30 Stansted 'minded to' Market Power Assessment January 2013

<sup>72</sup> Paragraphs 5.174 to 5.175 Stansted 'minded to' Market Power Assessment January 2013

Stansted consider the airport operator has a significant position in the market, principally due to the cargo carriers' inability to move to another London airport, or indeed another airport in the UK to provide their existing services.

- 3.58 The evidence<sup>73</sup> suggested that STAL was not facing considerable pricing pressure from other airports, although the current price cap regulation was likely to be restricting the airport operator's scope for exerting any SMP through higher pricing. However, STAL was likely to have an incentive to maintain infrastructure of a sufficient quality in order to retain their business. Given the trend towards tightening night flight restrictions and London Air Traffic Distribution Rules (TDR)<sup>74</sup>, and low likelihood of significant new airport capacity until at least 2019, it seemed unlikely that STAL's position of SMP towards cargo-only carriers would lessen over the medium term.
- 3.59 As noted in chapter 1, there are no significant developments to take into account in the MPA for the cargo market.
- 3.60 However the 'minded to' MPA considered Tests B and C for the passenger and cargo market together, because Test A was passed for the passenger and cargo market. If the MPD reaches different conclusions for Test A for the passenger and cargo markets, then Tests B and C would need to be considered separately for each market.
- 3.61 The CAA is still considering the responses that it received to the 'minded to' MPA in making the MPD on the cargo market. However it is appropriate to note that if Test C were considered separately for cargo, then the CAA would have to consider the benefits of regulating the cargo market by means of a licence and any adverse effects in isolation.

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<sup>73</sup> Paragraph 5.179 Stansted 'minded to' Market Power Assessment January 2013

<sup>74</sup> The London Air Traffic Distribution Rules (TDR) came into effect in 1991. Under the Airports Act, the Secretary of State for Transport has the power to make such rules, which distribute traffic between airports in a 'system'. Article 19 of Regulation (EC) 1008/2008 gives member states the power to put in place TDRs, provided they do not discriminate on grounds of nationality. The TDRs essentially prevent cargo and general aviation operations from Heathrow and Gatwick at peak times (extending to a considerable period of the day), subject to exemptions granted by the airport operator.



- 3.62 The CC's finding<sup>75</sup> for the Q5 price control was that the current structure of landing charges at STAL, which failed to give off-peak discounts to aircraft in excess of 250 metric tonnes, had no objective basis and had been operating against the public interest.
- 3.63 This finding was incorporated into the CAA's Q5 price control decision for STAL<sup>76</sup> and into the initial proposals<sup>77</sup> for the regulation of STAL in Q6. The CAA proposed that STAL fix its airport charges for the landing of aircraft so that the charge levied for landing an aircraft in excess of 50 metric tonnes but below 250 metric tonnes during a peak period is higher than the charge levied for landing at other times. Where this condition continues to apply, the charges levied for landing aircraft in excess of 250 metric tonnes shall, at all times, bear the same relationship to the equivalent charges levied on aircraft in excess of 50 metric tonnes but below 250 metric tonnes.
- 3.64 The 'minded to' MPA<sup>78</sup> noted that the airport and airline direct costs of management and regulation staff at the airport and airlines as well as the direct costs of compliance with regulatory measures (such as the introduction of automated security queue measurement) if STAL were to be licensed (for both the passenger and cargo market), could be £2 million to £4 million per year, and possibly significantly greater. The CAA considers that the direct costs of a cargo-only licence would be less than a licence for all of STAL's services, although relatively speaking it would be higher because of the smaller size of the cargo market that is being regulated.
- 3.65 If Test C were considered separately for cargo, it is possible that the costs of regulating cargo on its own would mean the benefits of regulating the cargo market would not outweigh the adverse effects.

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<sup>75</sup> Paragraphs 13.46 to 13.53 Competition Commission Stansted Airport Ltd Q5 price control review report [http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep\\_pub/reports/2008/fulltext/539.pdf](http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2008/fulltext/539.pdf)

<sup>76</sup> Chapter 8 Airport Regulation – Economic Regulation of Stansted Airport 2009-2014 – CAA Decision <http://www.caa.co.uk/docs/5/ergdocs/20090313StanstedPriceControl.pdf>

<sup>77</sup> Paragraph 4.59 to 4.61 CAP 1030 Economic Regulation at Stansted from April 2014: Initial Proposals <http://www.caa.co.uk/docs/33/CAP%201030%20Economic%20Regulation%20at%20Stansted%20from%20April%202014%20initial%20proposal.pdf>

<sup>78</sup> Paragraph 9.98 Stansted 'minded to' Market Power Assessment January 2013

3.66 In reaching a conclusion on this particular aspect, the CAA would expect to take into account the extent to which the concerns of cargo customers around future pricing levels would be addressed in the absence of regulation. In particular, it would want to consider what, if anything, would replace the pricing principles adopted by the CC and the CAA in past reviews.

**3.67 *The CAA has not reached a provisional view on Test C for the cargo market but would welcome in particular any specific proposals from MAG or cargo stakeholders on how this might be addressed, and stakeholders' views on the benefits and the adverse effects of regulating the cargo market on its own. The CAA will carefully consider any further evidence and representations put forward during the consultation period along with the responses to the 'minded to' MPA before reaching a final view.***

## Chapter 4

## Impact on Final Proposals on Form of Regulation

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- 4.1 The CAA consulted in April 2013<sup>79</sup> about options for the form of future regulation for STAL. The CAA has not issued any final proposal about the precise form of any licence that might be issued to STAL should one be required, nor whether a licence should contain a price control condition. Stakeholders should not draw conclusions about how these questions will be answered from the content of this consultation.
- 4.2 The CAA has deferred publishing its final proposals for the economic regulation of STAL from 1 April 2014 (Q6) in order to take account of stakeholders' representations on the recent developments.
- 4.3 The CAA has considered the implications of delaying the development of a potential licence, should the CAA ultimately make an MPD early in 2014 that STAL has passed the MPT. There is a risk that, at that time, it may not be possible to carry out the necessary consultation on a full licence, including any price control or price monitoring condition, in time for it to take effect on 1 April 2014.
- 4.4 This deferral, means that the CAA has two options:
1. If by 31 March 2014, the CAA makes an MPD that STAL does not pass the MPT, then STAL does not need to be licensed.
  2. If by 31 March 2014, the CAA makes an MPD that STAL passes the MPT, the CAA will need to grant STAL a licence.

The CAA would prefer to have a licence in place by 1 April 2014 and would endeavour to issue its MPD in time to allow for consultation on the conditions of any licence. However, the licence does not necessarily need to be in place on 1 April 2014.

Under the Act, if the CAA has made an MPD that STAL passes the MPT, it will be treated as having a licence for the preliminary period whilst the CAA develops and grants the licence. Although

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<sup>79</sup> CAP 1030 Economic Regulation at Stansted from April 2014: Initial Proposals  
<http://www.caa.co.uk/application.aspx?catid=33&pagetype=65&appid=11&mode=detail&id=523>

there is no time-limit on this preliminary period, and for the purposes of section 3 of the Act, STAL would be allowed to charge for the airport operation services provided at Stansted, the CAA is conscious of the need to finalise the terms of licence as soon as practicable after 1 April 2014.

## Chapter 5

## Stakeholder representation

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- 5.1 The CAA is not aware of any other significant developments that relate to the CAA's 'minded to' MPA for the passenger and cargo markets.
- 5.2 The CAA welcomes stakeholder representations on:
- the CAA's provisional views on the passenger market which are set-out in Chapter 3;
  - the benefits and the adverse effects of regulating the cargo market on its own which is discussed in Chapter 3;
  - how to take these developments into account in assessing the MPT for the passenger and cargo markets;
  - how to monitor STAL's prices and performance if the CAA does not licence STAL in respect of the cargo and/or passenger markets and what information (if any) the CAA should publish; and
  - any evidence or analysis that would support your representations.
- 5.3 The CAA welcomes representations on any other developments related to MPA for the cargo and passenger market, and any changes stakeholders' would like to make to the representations they made to the January 2013 'minded to' MPA in the light of these developments.

**APPENDIX A****List of abbreviations**

| Abbreviation | Full form of phrase                     |
|--------------|---|
| the Act      | the Civil Aviation Act 2012             |
| ACRs         | Airport Charges Regulations 2011        |
| ATMs         | air transport movements                 |
| CAT          | Competition Appeals Tribunal            |
| CBP          | countervailing buyer power              |
| CC           | Competition Commission                  |
| CMA          | Competition and Markets Authority       |
| FSCs         | Full Service Carriers                   |
| GAL          | Gatwick Airport Limited                 |
| HAL          | Heathrow Airport Limited                |
| IFM          | Industry Funds Management               |
| LCCs         | Low Cost Carriers                       |
| MAG          | Manchester Airports Group plc           |
| MPA          | market power assessment                 |
| MPD          | market power determination              |
| MPT          | market power test                       |
| SACC         | Stansted Airport Consultative Committee |
| SMP          | Substantial Market Power                |
| STAL         | Stansted Airport Limited                |
| Stansted     | Stansted Airport                        |

|     |                                       |
|-----|---------------------------------------|
| TDR | London Air Traffic Distribution Rules |
|-----|---------------------------------------|