

Market Power Test Guidance – Draft for Consultation

CAP 1354



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Chapter 1

Introduction

- 1.1 The Civil Aviation Act 2012 (CAA12) requires that we, the CAA, regulate certain airport operators directly by means of a licence if they meet the Market Power Test (MPT). This document sets out how we intend to approach applying the MPT and make Market Power Determinations (MPDs) under sections 6 and 7 of CAA12.
- 1.2 This guidance also outlines our powers under CAA12 to make determinations on which entity has overall responsibility for the management of an airport area (called “operator determinations”)¹.
- 1.3 We are providing this guidance to illustrate how we are likely to proceed in conducting MPDs. From time to time, given the specific circumstances of a particular case, we may need to deviate from this guidance. We will explain the rationale for deviating from the guidance in any report we publish.
- 1.4 This guidance is based on the practical understanding that we have gained from the MPDs we made in 2014², and applicable Competition and Market Authority (CMA) and European Commission (EC) competition law notices and guidance. As such, from time to time, we will amend and update this guidance to reflect learning and changes in best practice.
- 1.5 This guidance is not a definitive statement of the law, nor is it a substitute for individual parties seeking their own legal advice on the application of CAA12.

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

² We published four MPDs in January and March 2014. The MPDs we have undertaken are available from: <http://www.caa.co.uk/default.aspx?catid=78&pagetype=90&pageid=12275>.

We now regulate Heathrow and Gatwick airports through licences. These licences came into effect on 1 April 2014. The licences are available from:

<http://www.caa.co.uk/default.aspx?catid=78&pagetype=90&pageid=67>.

Consultation

- 1.6 Earlier guidance that we published in 2011, on assessing market power of airports³, prior to the enactment of CAA12 has been withdrawn⁴, along with other earlier papers on market power.
- 1.7 We are consulting on this draft guidance to gain stakeholders' views on how we propose to apply the MPT in future. Stakeholders' comments will allow us to ensure that this guidance is useful to them in explaining how we will apply our powers.
- 1.8 We welcome views on this draft guidance no later than 12 February 2016. We cannot commit to taking into account representations received after this date. Please send any representations to economicregulation@caa.co.uk
- 1.9 We will publish responses to this consultation on our website shortly after the close of the consultation period. If there are parts of your response that you consider commercially confidential, please mark them clearly as such.
- 1.10 If you would like to discuss any aspect of this guidance, please email economicregulation@caa.co.uk or telephone 020 7453 6217.

Structure of this guidance

- 1.11 This document is structured as follows:
- Chapter 2 sets out the high level test and the appeal rights of parties involved;
 - Chapter 3 outlines the process we intend to apply to undertaking an MPD;
 - Chapter 4 sets out particular issues relating to Test A of the MPT;
 - Chapter 5 sets out particular issues relating to Test B of the MPT;
 - Chapter 6 sets out particular issues relating to Test C of the MPT; and
 - Chapter 7 explains what happens after an MPD has been made.

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

⁴ See paragraph 2,6 of the CAA's 'CAP 1235 Guidance on the Application of the CAA's Competition Powers', published in May 2015, which is available from:
<http://www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=14523>

Chapter 2

Legal framework

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

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

Relevant definitions

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

Airport operation services

2.3 "Airport operation services" (AOS) refers to a group of services provided at an airport for the purposes⁵:

- the landing and taking off of aircraft;
- the manoeuvring, parking or servicing of aircraft;
- the arrival or departure of passengers and their baggage;
- the arrival or departure of cargo;
- the processing of passengers, baggage or cargo between their arrival and departure;

⁵ Sections 1(3) and (4) CAA12.

⁵ Section 68(1) CAA12 and 68(5) CAA12.

- the arrival or departure of persons who work at the airport; or
- permitting a person to access or use land that forms part of an airport or facilities at an airport for any of the above.

2.4 In particular, AOS includes⁶:

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

2.5 AOS does not include⁷:

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

Airport area

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

Core area

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

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

⁶ Section 68(3) CAA12.

⁷ Section 68(4) CAA12.

⁸ Section 6(7) CAA12.

Dominant airport

- 2.8 A "dominant airport" means an airport where the CAA has made a determination that all or part of its core area is considered to be dominant⁹.

Operator determination

- 2.9 The operator of an airport area is the entity with overall responsibility for the management of all of the area.
- 2.10 Section 10 of CAA12 set out how we may make an OD to determine whether, in a particular case, a person has overall responsibility for the management of an airport area. We will only undertake such a determination where we consider the situation as presented is not clear.
- 2.11 In making an OD, we must have regard to:
- any regulations made about ODs; and
 - the extent of control the entity has over the types of services that are or may be provided in the area, the prices that are or may be charged for services provided in the area, the quality of services provided in the area, access to the area, and the development of the area.
- 2.12 We must make an OD if we are asked to do so by that entity that has control over the area.¹⁰ The exceptions to this requirement are:
- if we have previously made an OD to the effect that the entity requesting the determination does or does not have overall responsibility for the management of the airport area;
 - we have not published a notice withdrawing that determination; and
 - we consider that there has not been a material change of circumstances since that determination; or
 - if we consider that it is possible to ascertain whether the entity has overall responsibility for the management of the area from:
 - information that is in the public domain; and
 - information that is in the entity's custody or under the entity's control.
- 2.13 We may treat a request for an OD as if it were:

⁹ Section 5(1) and 5(2) CAA12.

¹⁰ Section 10(5) CAA12.

- a number of requests in respect of a number of airport areas that consist of or include different parts of area; or
- a request in respect of an area that includes all of that area.

2.14 As soon as practicable after making an OD, we must:

- publish a notice of the determination; and
- send a copy of the notice to the entity in respect of whom the determination was made, and to such bodies representing airport operators or providers of air transport services as we consider appropriate.¹¹

The MPT

2.15 CAA12 prohibits the operator of a "dominant airport" from levying charges for the use of its facilities without an economic licence issued by us.¹² An airport operator is considered dominant if we make a determination that the MPT is met in relation to the airport or part of the airport ('the airport area') and publish a notice of that determination.¹³

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

Test A

2.17 Test A requires that we establish whether the relevant operator, either alone, or taken with such other persons as we consider appropriate, has, or is likely to acquire, substantial market power (SMP) in a market for one or more types of AOS provided within all or part of the airport area.¹⁴

2.18 Test A can only be met only if¹⁵:

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

¹¹ Section 11 CAA12

¹² Section 3 CAA12

¹³ Section 5 CAA12

¹⁴ Section 6(3) read together with sections 6(6) and 6(7) of CAA12.

¹⁵ Section 6(6) CAA12.

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

Test B

- 2.20 Test B requires that we establish that competition law does not provide sufficient protection against the risk that the relevant operator may engage in conduct that amounts to an abuse of that SMP.¹⁶
- 2.21 For the purposes of Test B, conduct may, in particular, amount to an abuse of SMP if it is conduct described as an abuse of a dominant market position in section 18(2)(a) to (d) of the Competition Act 1998.¹⁷
- 2.22 In Test B, “competition law” means¹⁸:
- Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU);
 - Part 1 of the Competition Act 1998 (CA98); and
 - Part 4 of the Enterprise Act 2002 (EA02) (market investigations).
- 2.23 Although Test B is a separate test, it cannot be divorced from Test A, because, to apply it, we must have already determined that the relevant operator has or is likely to acquire SMP in the relevant market under Test A. If the operator does not have and is not likely to acquire SMP, there can be no risk that the operator will abuse it.

Test C

- 2.24 Test C requires that we establish that, for current and future users of air transport services, the benefits of regulating the relevant operator by means of a licence are likely to outweigh the adverse effects.¹⁹ For the purposes of this test:
- the relevant operator is *‘the person who is the operator of the airport area at the time the test is applied.’*; and
 - *‘users of air transport services’* (users) are passengers or those with a right in cargo and include future users of such services.

¹⁶ Section 6(4) read together with sections 6(8) and 6(9) of CAA12.

¹⁷ Section 6(4) and Section 6(8) CAA12

¹⁸ Section 6(9) CAA12.

¹⁹ Section 6(5) CAA12.

- 2.25 Test C requires that we assess whether the benefits of regulating the relevant operator, by means of a licence, are likely to outweigh the adverse effects. As with Test A, we will assume the prevailing regulatory regime is in place.
- 2.26 Test C does not expressly require that we apply this test by reference to a specific set of regulatory licence conditions. Such a requirement would reverse the logical structure of CAA12 and would require the determination of individual licence conditions before the decision on whether to grant a licence is made.

Application of the tests

- 2.27 In applying tests A to C, we must have regard to²⁰:
- relevant notices and guidance published by the European Commission about the application and enforcement of the prohibitions in Articles 101 and 102 of the TFEU;
 - relevant advice and information published under section 52 of the CA98 (advice and information about the application and enforcement of the prohibitions in Part 1 of CA98 and Articles 101 and 102 of the TFEU); and
 - relevant advice and information published under section 171 of the EA02 (advice and information about the operation of Part 4 of that Act).
- 2.28 The case law referred to in this guidance is that which existed at the time this guidance was prepared.
- 2.29 Each of these tests is discussed in the following chapters. However there are a few points in common that require clarification.

Our general duty

- 2.30 In carrying out our assessment, we will act under our general duty to carry out our functions in a manner which we consider will further the interests of users regarding the range, availability, continuity, cost and quality of AOS, including any guidance issued by the Secretary of State. We will also carry out this function in a manner that we consider will promote competition in the provision of AOS (and have regard to the matters that we are required to by section 1 of CAA12).

Regulatory principles

- 2.31 We must also have regard to the regulatory principles in section 1(4) of CAA12, namely that our regulatory activities should be transparent, accountable,

²⁰ Section 6(10) CAA12.

proportionate and consistent, and targeted only at cases where action is needed. In addition, it must also comply with our statutory duty under section 73 of the Regulatory Enforcement and Sanctions Act 2008 to avoid the imposition of regulatory burdens which we consider to be unnecessary on operators of dominant airports.

Competition law in Test B and Test C

2.32 Competition law is a key element in the assessment of Test B and Test C, although each Test has a different focus:

- Test B focuses on the effectiveness of competition law to address potential abuses of an airport operator's SMP, when we have found that an airport operator has SMP at an airport. It assesses the risk of addressing various forms of anti-competitive behaviour by referring to case law. Case law illustrates how competition law has been used and how effective it has been. By definition in CAA12, the test does not consider the effect of either the ACRs or the AGRs.²¹#
- Test C focuses on whether an economic operating licence has more benefits than our non-licence powers (competition law, the ACRs and the AGRs), for users of air transport services at a specific airport. It compares these non-licence powers with the effectiveness of the use of our licensing powers that specifies ex ante what an individual airport operator can or must do and what it must not or cannot do.

Standard of proof

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

2.34 The CAT has defined the relevant standard of proof as follows:

- *"the standard of proof is the civil standard, the balance of probabilities, taking into account the gravity of what is alleged ... The standard is not akin to the criminal standard but the evidence must be sufficient to convince the Tribunal in the circumstances of the particular case, and to overcome the presumption of innocence to which [the parties are] entitled."*^{22, 23}

²¹ Section 6(9) CAA12.

²² Makers UK Limited v Office of Fair Trading [2007] CAT 11, paragraph 46.

²³ In a more recent judgement by the CAT, the CAT considered how far the Competition and Markets Authority (CMA) ought to pursue any particular aspect of its two year market investigation into the supply of private medical healthcare. The CAT found that the weight to be given to an aspect of the investigation in a particular context was very much a matter for the CMA, as the expert investigating body. It stated that

- 2.35 Overall, the judgment reaffirms that a specialist investigative body has a broad discretion over the use of its internal resources and the handling of various aspects of its investigations.

Process for appeals

- 2.36 Schedule 1 of CAA12 sets out the process for appeals against MPDs and ODs. Appeals may be made to the Competition Appeal Tribunal (CAT) against an MPD in respect of an airport area by:
- a person who is the operator of the area at the time the determination is made; and
 - any other person whose interests are materially affected by the determination.
- 2.37 A person who is the subject of an OD may appeal against that determination.
- 2.38 An appeal against a determination²⁴ must be made by sending a notice of appeal to the Registrar of the CAT. The notice must be received by the Registrar within 60 days of the publication of the determination.
- 2.39 An appeal against a determination does not suspend the effect of the determination, unless the CAT orders otherwise.
- 2.40 The CAT may allow an appeal if it is satisfied that the MPD or OD appealed against was wrong on one or more of the following grounds:
- that the determination was based on an error of fact;
 - that the determination was wrong in law; or
 - that an error was made in the exercise of a discretion.
- 2.41 The CAT may:
- confirm or set aside all or part of the MPD or OD;
 - direct us to make a further determination; or

the CMA was lawfully entitled, in the exercise of its investigative discretion, to decide not to pursue a particular dimension of its market investigation any further. To have done so might have jeopardised its ability to comply with its legal duty to produce its report within the statutory timetable. The CMA was entitled to have regard, as it did to 'the constraints on time and resources available for investigation overall.' The CAT also considered the weighing of evidence, which may point in different directions. 1228/6/12/14 AXA PPP Healthcare Limited - Judgment [2015] CAT 5 13 March 2015.

²⁴ An MPD or an OD

- give us such other directions as it considers appropriate, including directions about the time within which we must act.
- 2.42 We must comply with directions from the CAT. If we fail to comply with a direction to make a further MPD in respect of an airport area within the time specified by the CAT, the CAT may make the determination. If the CAT makes such an MPD the determination has effect as if we made it.
- 2.43 If we fail to comply with a direction to make a further OD in respect of a person and an airport area within the time specified by the CAT, the CAT may itself make the determination. If the CAT makes such an OD, the determination has effect as if we made it.

Once an MPD has been made

- 2.44 If an MPD determines that the MPT is met by an airport operator in relation to an airport area, then that airport operator will require an economic licence in order to be able to levy charges.
- 2.45 In some cases, we may decide to begin the process of developing a licence alongside the MPD.

Chapter 3

Market power determination process

- 3.1 This chapter outlines our general process and approach to conduct an MPD. It is set out in four sections:
- initiating an MPD;
 - timetable and stages;
 - powers to gather information; and
 - confidentiality.

Initiating an MPD

- 3.2 We have discretion to conduct an MPD when we consider it appropriate to do so to discharge our duty under Section 1 of CAA12.²⁵ This means that we can initiate an MPD at any time.
- 3.3 We are, in addition, required to make an MPD and therefore apply the MPT²⁶ where the following factors are met:
- we are asked to do so either by the operator of the airport area or another person whose interests are likely to be materially affected by the determination;
 - the area is located at an airport that has over 5 million annual passengers²⁷ at the time the request is made; and
 - the area consists of or includes all or part of the core area of the airport.²⁸
- 3.4 However, we have some discretion not to apply the MPT and make an MPD, even if these factors are met, when we have previously made an MPD and do not consider that there has been a material change of circumstances since that MPD.²⁹

²⁵ Section 7(1) CAA12.

²⁶ Section 7(2) CAA12.

²⁷ Sections 7(4) CAA12 which states that an airport is a large airport during a calendar year if, in the previous calendar year, the number of passenger movements at the airport exceeded 5 million.

²⁸ Section 7(1)-(4) CAA12.

²⁹ Section 7(5) CAA12.

Material change of circumstances

- 3.5 Material change of circumstances is not defined in the legislation. We consider that a change of circumstances needs to be material in areas that are likely to be relevant to Tests A to C. However, circumstances could be considered in aggregate and several relevant changes could be considered together with pre-existing circumstances when determining whether or not a new MPD should be completed.³⁰
- 3.6 It is matter of regulatory judgement as to whether there has been a material change of circumstances. In making such a judgement, we will refer to decisions made by other UK competition authorities where they have assessed whether a material change of circumstances has occurred in other circumstances.

Requesting an MPD

- 3.7 As noted, interested parties have the ability to request an MPD. In requesting an MPD, we expect the parties to be able to provide a well reasoned request containing information relevant to the analysis. This is especially the case where a request is being made for an MPD on an airport area where we have previously made a determination. In these cases, we would expect, in particular, information to be provided that demonstrates why a material change of circumstances has taken place. To facilitate this, we welcome early contact from a party considering making such a request.
- 3.8 A well reasoned request should contain the following information:
- the name of the airport operator and airport in question;
 - the services provided that are relevant to the request;
 - the likely scope of the market, which, as a minimum, is the list of the assumed competitors and/or competing products;
 - where requesting a further determination, the nature and scope of the material change in circumstances and how this may have had an impact on the prior determination; and
- 3.9 Following the receipt of the request and a review of any further relevant information, where we have discretion³¹, we will within six months of the receipt of the final submission by the party concerned, issue our response. The response will set out the following points:

³⁰ In our 'Discussion paper on the regulatory treatment of issues associated with airport capacity expansion' CAP 1195 in June 2014, we considered some capacity expansion related events that could, at first glance, suggest a material change of circumstances may have occurred. This is available from: <http://www.caa.co.uk/default.aspx?catid=78&pagetype=90&pageid=16210>

³¹ On whether to undertake an MPD.

- how we intend to respond to the request - no action, undertaking an MPD immediately or at some future date or other action;
 - the reasoning behind our decision; and
 - next steps as appropriate.
- 3.10 Following the receipt of the request, where we are required to undertake an MPD, we will within six months of the receipt of the final submission by the party concerned, issue our response. The response will set out the following points:
- how we intend to respond to the request - undertaking an MPD immediately or at some future date or other action;
 - the reasoning behind our decision; and
 - next steps as appropriate.
- 3.11 We will apply our prioritisation framework to decide when to commence an MPD. The framework enables us to make the best use of resources to address issues in the interests of aviation consumers and to produce the greatest benefits for consumers. Details of our framework are explained in the 'CAA's prioritisation framework for consumer protection, competition and economic regulation issues'.³²
- 3.12 During our consideration of the request, we may contact the airport operator and other relevant parties to obtain information from them and their view, in particular, on whether a material change of circumstances has taken place.

Timetable and stages

Notice of commencement

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

Timetable

- 3.14 We aim to publish an MPD decision within 18 months of commencement of our assessment. While our aim is to complete this process within 18 months, there may be instances where we need to depart from this. For example, we may be

³² The 'CAA's prioritisation framework for consumer protection, competition and economic regulation issues', which is available from:
<http://www.caa.co.uk/cap1233>.

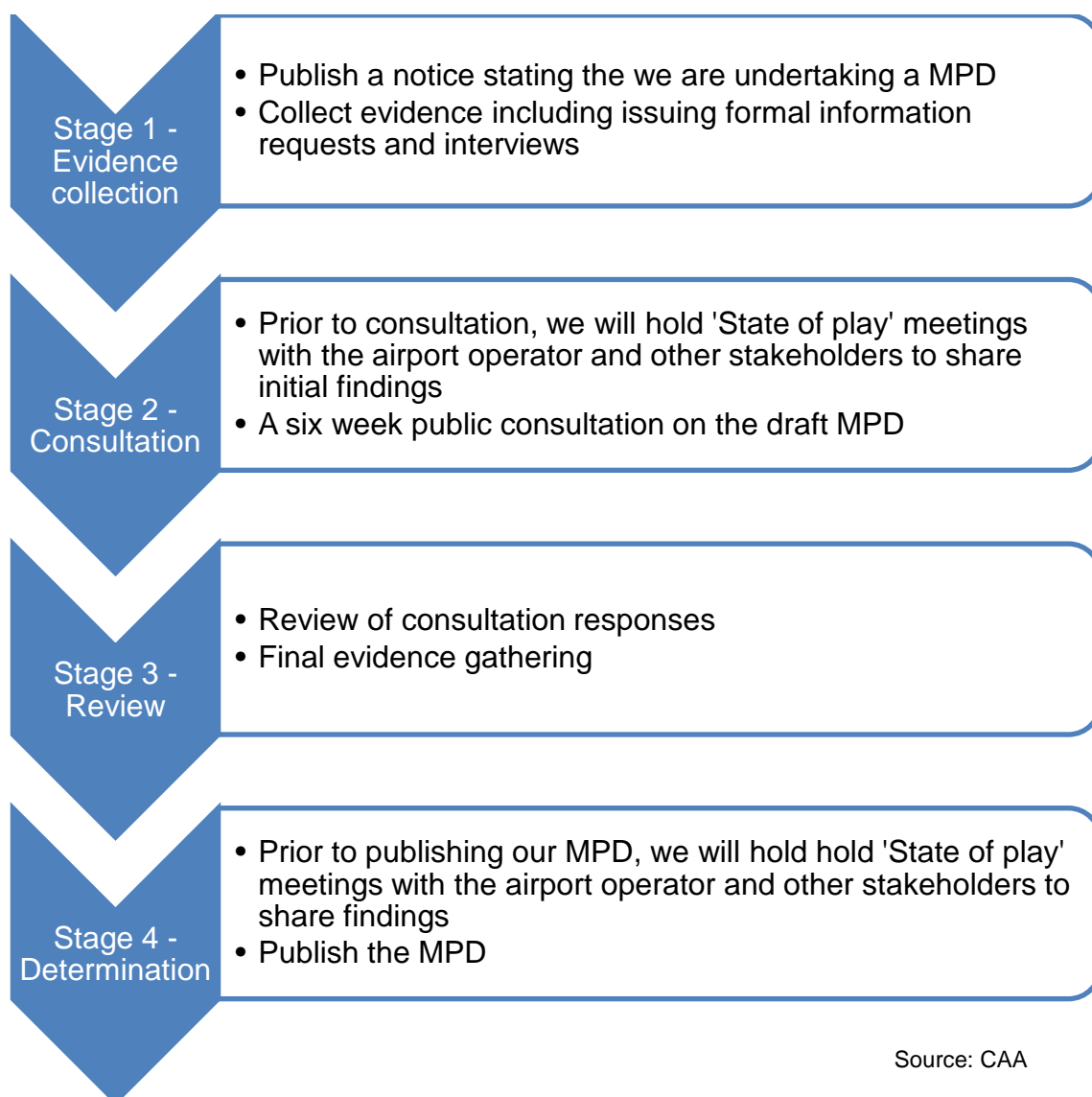
undertaking more than one MPD at the same time, although there may be synergies there will also be critical differences that may extend the timescale.

- 3.15 We will publish and send the airport operator that is the subject of the MPD and other key stakeholders a specific timetable for each MPD. Where we need to depart from it, we will publish that change and notify the stakeholders of this, together with the reasons why we are doing so.

Stages

- 3.16 In achieving this timetable, our aim is to follow clear stages, to assist in meeting the timetable and to reduce uncertainty for the industry.
- 3.17 This is set out in Figure 3.1.

Figure 3.1: Generic MPD stages



- 3.18 We intend to spend Stage 1 gathering evidence and performing initial analysis. To assist in minimising the time needed for this stage, we will issue data requests using our formal information gathering powers, which are outlined below (paragraph 3.25 and following).
- 3.19 Stage 2 and Stage 4 involve holding 'state of play' meetings with the airport operator and other key stakeholders. We intend to use these meetings to test our analysis with stakeholders and allow them a chance to comment on our work to date. It is likely that the state of play meeting at stage 2 will focus more on the assessment of Test A. The results of these meetings will feed into our further analysis.
- 3.20 Our aim is to minimise the need for extensive state of play meetings and consultation phases. We recognise, however, that particular circumstances (e.g. developments that occur while the assessment is underway that could materially affect the outcome of the MPD) may mean it is sensible to have additional engagement with key stakeholders.
- 3.21 In Stage 2, we will consult on a draft MPD. This will cover our initial assessment against all three tests. We intend to consult for a period of up to 6 weeks.
- 3.22 In Stage 3, we will review the consultation responses and collect any final evidence if it is needed. We intend to publish all non-confidential responses to the draft MPD on our website as soon as possible after the consultation has concluded. This allows all stakeholders to be kept informed about the information we have received.
- 3.23 Stage 4 will include final state of play meetings and publishing the MPD. Following the final state of play meetings, there will only be a limited opportunity for parties to submit new evidence and for us to take account of such evidence.
- 3.24 Given that our aim is to complete an MPD within 18 months, it is our expectation that stakeholders will support this process and meet the deadlines set for information requests and consultations. The stages are designed to separate the evidence gathering stages from the consultation on the draft MPD stage. We will endeavour to take account of all representations made. We will not, however, take account of commentary provided after consultation deadlines unless the parties can demonstrate that this is new evidence that could not reasonably have been submitted to us earlier.

Powers to gather information

- 3.25 We have powers to gather information under section 50 of CAA12.

- 3.26 Under section 50 of CAA12, we may require a person to provide information, or a document that we reasonably require to carry out our functions in relation to the regulation of operators of dominant airports.³³
- 3.27 To exercise this power, we must issue a notice which specifies the information or document(s) we require. The notice may not require a person to provide information or documents that the person could not be compelled to provide in evidence in civil proceedings.

Confidentiality

- 3.28 We acknowledge the importance parties attach to their confidential information. With that in mind, and to ensure compliance with the relevant legal provisions³⁴, we have developed internal processes to ensure that we handle confidential information with care.
- 3.29 Confidential material received from parties is accessed only by staff and external expert advisers to the CAA who are allocated to the MPD to which the information relates and is only shared more widely, where to do so would, in our view, be appropriate in the circumstances. We store electronic copies of confidential material on a secure CAA database. We also operate a clear desk policy so that printed confidential material is locked away at the end of each working day.

³³ Chapter 1 CAA12.

³⁴ For example, the Data Protection Act 1998 and the Freedom of Information Act 2000.

Chapter 4

Test A: Market definition and market power

- 4.1 This chapter sets out our approach to assessing Test A.
- 4.2 Test A is that the relevant operator has, or is likely to acquire, SMP in a market, either alone or taken with such other persons as we consider appropriate.³⁵
- 4.3 This chapter is set out as follows:
- our general approach;
 - how Test A is met;
 - our approach to market definition for MPDs;
 - defining the relevant market;
 - assessing market power; and
 - summary.

Our general approach

- 4.4 Test A is, in essence, an assessment of market power and therefore there is some interplay between Test A and our role as a competition authority.
- 4.5 We have published guidance on our approach to our concurrent competition powers, CAP 1235 'Guidance on the Application of the CAA's Competition Powers'.³⁶ In CAP1235, we noted that:

"Although there are some parallels between making MPDs and in investigating complaints under the competition prohibitions, there are also some important differences between them. For instance, when assessing market power at an airport as a whole, we will usually consider the overall bundle of AOS services and then determine the relevant market in which the airport offers those services. In comparison, when assessing complaints under the competition prohibitions, we need to start by determining a product market relevant to the complaint in question. This may be much narrower than the total range of services offered at an

³⁵ Section 6(3) CAA12

³⁶ CAP1235 'Guidance on the Application of the CAA's Competition Powers' is available from: <http://www.caa.co.uk/cap1235>

*airport e.g. it could relate to groundhandling or forecourt access at an airport or airports.*³⁷

- 4.6 However, as with our approach in applying competition law, in assessing market definition and market power for the purposes of Test A, we intend to have regard to applicable CMA³⁸ and European Commission (EC)³⁹ competition law notices and guidance.^{40/41}

How Test A is met

- 4.7 Test A is met only if⁴²:

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

- 4.8 As illustrated in Figure 4.1, we consider that Test A will be met in two distinct ways and that if either of these is met, then Test A is met:

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

³⁷ Paragraph 2.6, CAP1235 'Guidance on the Application of the CAA's Competition Powers' is available from: <http://www.caa.co.uk/cap1235>

³⁸ The CMA took over the duties of the Competition Commission (CC) and the Office of Fair Trading (OFT) from 1 April 2014. Further information on the CMA and its guidance is available from <https://www.gov.uk/cma>.

³⁹ Further information on the EC's notices and guidance is available from http://ec.europa.eu/competition/index_en.html.

⁴⁰ See for example:

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

⁴¹ We are required to have regard to those notices and guidance under section 6(10) of CAA12.

⁴² Section 6(6) CAA12

Figure 4.1: Illustration of how Test A is met

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

Source: CAA

- 4.9 However, where SMP is likely to diminish over time, such that we do not consider it is likely that the airport operator will have SMP in the future, this will also be considered in our assessment of the other tests.⁴³

Our approach to market definition for MPDs

- 4.10 When conducting our assessment, in defining the focal product in respect of which the airport area may have SMP, we will begin by looking across a bundle of goods and services and, where necessary, review differing subsets of products or services at the airport. We do not intend to start from a product-by-product inspection of the airport operator's position unless there is good reason to do so. This work would be both incredibly detailed and burdensome and may be of limited benefit, given the purpose of the analysis, as explained in paragraph 4.5. Instead, we propose to take a higher-level view of the airport operator's general market position.
- 4.11 As a starting point for the assessment, we will be guided by the parameters of the request to carry out the MPD and by how the airport operator actually charges for its services. We will also be guided by the legislation, in particular, whether the product or products in relation to which it may have substantial market power, are provided within the core area. Generally, we will start by looking at a broadly generic bundled product that is sold to airlines.
- 4.12 It may then be appropriate for us to consider focusing on non-aeronautical products to complement or further our analysis of aeronautical products. The extent to which we will look at non-aeronautical segments of AOS will depend on the terms of reference of the MPD and on the availability of evidence and concerns regarding the existence of SMP in non-aeronautical markets (i.e. in markets where airlines are not the airport operators' direct customers).

⁴³ In this case, it is possible that competition law may be able to provide sufficient protection against the risk of abuse of SMP or that the benefits of regulation are less likely to outweigh its adverse effects.

Defining the relevant market

General

- 4.13 Market definition is a key component of the MPT. We will assess whether:
- an airport operator has SMP in the relevant market for the purposes of Test A; and
 - there is a risk of abuse of that SMP under Test B.
- 4.14 In line with EC guidance, we consider market definition is a useful tool for identifying, in a systematic way, the competitive constraints which the relevant operator faces and whether those constraints prevent it from operating independently of effective competitive pressure.⁴⁴ Furthermore, market definition is a time-sensitive and context-specific exercise. It is based on an analysis of the structure of the market and competition prevailing at a particular point in time, therefore any assessment may change over time as market circumstances evolve.
- 4.15 Likewise, we also consider that, as in the EU guidance, market definition is not an end in itself. Rather, it is a key step in identifying the competitive constraints on a supplier of a given product or service. The market definition exercise consists, in essence, of identifying the effective alternative sources of supply for the customers of the relevant operator in terms of the products or services supplied and their geographical location.⁴⁵
- 4.16 However, there may be characteristics of the airport sector that make it difficult to define the market precisely. In Test A, we will therefore analyse all the competitive constraints faced by the airport operator, regardless of whether they arise from within or outside the relevant market or markets as we have defined them.⁴⁶

Product market

- 4.17 As defined in both EC⁴⁷ and CMA⁴⁸ guidance, a relevant product market comprises all those products and/or services that are regarded as interchangeable or substitutable for the focal product by the consumer by reason of the products' characteristics, their prices and their intended use.

⁴⁴ EC Market Definition Notice, paragraph 2.

⁴⁵ EC Market Definition Notice, paragraphs 7 to 9 and 13

⁴⁶ This is consistent with the approach adopted in the CC's report on the supply of airport services by BAA in the UK, 19 March 2009 (CC's 2009 BAA Report), paragraphs 2.48 to 2.49.

⁴⁷ EC Market Definition Notice, paragraph 7.

⁴⁸ CMA's Competition Law Guideline on Market Definition, December 2004 (OFT 403), paragraph 2.5.

- 4.18 We note that where a hypothetical monopolist (see below) would, or would be able and likely to, price discriminate significantly between groups of customers, each of these groups may form a separate market.⁴⁹

Geographic market

- 4.19 The geographic market 'comprises the area in which the undertakings concerned are involved in the supply of products or services and in which the conditions of competition are sufficiently homogeneous.'⁵⁰
- 4.20 The relevant geographic market area can be distinguished from neighbouring areas because the conditions of competition are appreciably different. In addition, it is important to recognise that, as airports serve a number of different users, there may be different relevant geographic markets for different groups of users, if they are considered a separate product market.⁵¹
- 4.21 The assessment of competitive constraints as part of the geographic market definition will include an analysis of the ability of airlines to switch away from an airport as well as the potential for passengers/owners of cargo to switch between airports, whether independently, or by following a particular airline.

Temporal Markets

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

The Hypothetical Monopolist Test

- 4.23 Wherever feasible, the hypothetical monopolist test will be adopted as a starting point for defining the relevant market.⁵² This test involves starting with the focal product or service and the smallest geographical area (normally that supplied by the operator in question) and assessing customers' switching reactions to a small but significant non-transitory increase in price (SSNIP) above the *competitive level*⁵³, generally considered as being 5 to 10 per cent. If the price increase is

⁴⁹ CMA's Competition Law Guideline on Market Definition, December 2004 (OFT 403), paragraph 3.9.

⁵⁰ EC Market Definition Notice, paragraph 8.

⁵¹ See section above on product market.

⁵² CMA's Competition Law Guideline on Market Definition, December 2004 (OFT 403), paragraphs 2.5 to 2.13 and EC Market Definition Notice, paragraphs 15 to 19.

⁵³ Where prices are likely to differ substantially from their competitive levels, caution must be exercised when dealing with the evidence on switching patterns as such evidence may not be a reliable guide to what would occur in normal competitive conditions. See CMA's Competition Law Guideline on Market Definition, December 2004 (OFT 403), paragraph 5.6.

unprofitable⁵⁴, due to marginal customers switching away to substitute products and areas (or other suppliers entering the presumed market), the test is repeated by widening the set of products and geographic area to include additional substitutes until the price increase is profitable. What is then left is the narrowest set of products and geographic area over which a hypothetical monopolist could profitably sustain prices 5 to 10 per cent above competitive levels.

- 4.24 Although the SSNIP test is a useful starting point, it is a framework for approaching market definition rather than a prescriptive methodology. It is intended to be carried out by reference to the competitive price level with the result that it is more difficult to apply where the prevailing price levels observed are not reasonably close to an assessment of the competitive price. As the CMA observes, the test assumes that the hypothetical monopolist is not subject to economic regulation that might affect its pricing behaviour. The test also assumes that prices outside the hypothetical monopolist's control are held at the competitive level. In addition, there may be other external considerations that might affect the uniformity and/or the profitability of the price increase.⁵⁵
- 4.25 As a result, it is therefore rarely possible to apply the SSNIP test in a precise manner due to its limitations as well as data and evidential restrictions.⁵⁶ That said, CMA guidelines⁵⁷ allow us to use this framework to define a plausible or most likely market where the competitive assessment is shown to be largely unaltered by which market definition is adopted:

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

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

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

⁵⁴ For this, we take into account all the revenue streams of the airport operator. For example, it may be that if passengers switch away in response to a SSNIP on aeronautical services, the airport operator can lose revenues and profits on related non-aeronautical services.

⁵⁵ CMA's Competition Law Guideline on Market Definition, December 2004 (OFT 403), paragraph 2.10 to 2.11 and 5.4 to 5.6.

⁵⁶ See the CC's 2009 BAA Report, paragraph 2.1.

⁵⁷ See CMA's Competition Law Guideline on Market Definition, December 2004 (OFT 403) paragraph 2.14.

of evidence on substitutability and interpret it, so far as possible and appropriate (using our regulatory judgement) within the hypothetical monopolist framework.

Assessing market power

- 4.27 Market power is the ability, profitably, to sustain prices above the competitive level or restrict output or quality below competitive levels. It is explained in case law as "an undertaking shall be deemed to have significant market power if, either individually or jointly with others, it enjoys a position equivalent to dominance, that is to say a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers."⁵⁸ As with market definition, the assessment of market power involves an analysis of the competitive constraints identified in the market definition process to see whether they are strong enough to prevent it from harming the process of competition, or alternatively whether there are barriers to these competitive constraints.⁵⁹
- 4.28 Market power is, therefore, not an absolute term but a matter of degree, which varies according to the individual circumstances of the case. As part of our assessment of market power, we need to identify the existence and the potential strength of the competitive constraints⁶⁰ from within and from outside the relevant market. We need to do this to determine whether the airport operator is subject to effective competition or not.
- 4.29 Evidence on market structure and market share is commonly used in competition assessments. Market power is more likely to exist if an operator has a persistently high market share over time compared to its nearest rivals.^{61 62}

⁵⁸ CMA's Competition Law Guidance on Assessment of Market Power, December 2004 (OFT 415), paragraph 2.8 and Case 27/76 United Brands v Commission [1978] ECR 207. This definition has been used in other cases.

⁵⁹ CMA's Competition Law Guidance on Assessment of Market Power, December 2004 (OFT 415), paragraphs 3.1 to 3.3.

⁶⁰ CMA's Competition Law Guidance on Assessment of Market Power, December 2004 (OFT 415) describes competitive constraints as 'market factors that prevent an undertaking from profitably sustaining prices above competitive levels': see OFT 415, paragraph 1.2 and DG COMP's Discussion Paper on the application of Article 82 to Exclusionary Abuses, paragraph 2.4.

⁶¹ CMA's Competition Law Guidance on Assessment of Market Power, December 2004 (OFT 415), paragraphs 4.2 to 4.3.

⁶² In line with case law, dominance can be presumed in the absence of evidence to the contrary if an undertaking has a market share persistently above 50 per cent. Furthermore, it is unlikely that an undertaking will be individually dominant if its share of the relevant market is below 40 per cent, although dominance could be established below that figure if other relevant factors (such as the weak position of competitors in that market and high entry barriers) provided strong evidence of dominance. See

- 4.30 However, we note that market shares are not sufficient, in isolation, to determine the intensity of competition in the relevant market as they are too static to shed light on the dynamics of the market. For example:
- the difficulties in defining the market precisely might limit the reliance that could be placed on any given measure of market shares as an indicator of market power;
 - the differentiated nature of airports, both in terms of their facilities and services, but also in terms of their location and the differing degrees of their interdependent demand, can reduce the reliability of market shares as an indicator of market power since alternatives, whether inside or outside the market definition, may be imperfect substitutes; and
 - capacity constraints at alternative airports will affect the extent to which those airports are able to provide competitive constraints to the airport operator.
- 4.31 Notwithstanding these concerns, we will calculate market shares by reference to the market definition adopted.
- 4.32 We will seek to identify the existence, and evaluate the strength, of all competitive constraints faced by the airport operator. These are market factors that prevent the airport operator from raising prices significantly above – and/or lowering quality significantly below – competitive levels, and can be factors both within and outside the relevant market.
- 4.33 In so doing, we may consider factors such as:
- the specific barriers to airline switching. For example, this can include the costs of moving a route away from the airport or the network benefits of airline co-location at an airport⁶³;
 - the extent to which passengers are prepared to use other airports' route networks or not travel in response to a price increase by the airport operator; and
 - any attempts by the airport operator to restrict output, increase prices above the competitive level and/or reduce quality at the airport below the levels that would be seen in a competitive market.
- 4.34 We will also have regard to market features, including:

paragraph 2.12 of CMA's Competition Law Guidance on Assessment of Market Power, December 2004 (OFT 415),

⁶³ Since that often passengers do not pay airport charges directly, as these are levied on airlines, this substitution mechanism is an indirect one.

- possible countervailing buyer power by airlines;
- prevailing capacity constraints at the airport and at neighbouring airports and barriers to entry; and
- the extent of potential competition being introduced through new entry and/or expansion or airport capacity.⁶⁴

4.35 We will look to supplement this with analysis on other available indicators of market power, including the airport operator's behaviour and performance, profitability measures, quality of service, efficiency and engagement with airlines⁶⁵ in order to assess whether the airport operator has, or is likely to acquire, SMP in the relevant market.

4.36 We note that, where the airport operator is already subject to economic regulation, this will need to be taken into account as regulation will be influencing the airport's behaviour and performance, as well the prices that it has charged in the past.

Summary

4.37 Test A is whether the relevant operator has, or is likely to acquire, SMP in a market for one or more types of AOS provided within all or part of the airport area, either alone or taken with such other persons as we consider appropriate.⁶⁶

4.38 We make our assessment having regard to all of the evidence obtained and our general duties under CAA12 and the relevant notices and guidance issued by the EC and the CMA regarding the competition law notices and guidance.

4.39 In conducting Test A, we will seek to define a relevant market and assess market share of the operator. In assessing market power we will assess the strength of the competitive constraints faced by the airport operator, which could arise from within and from outside the relevant market(s) identified. We will also consider other available indicators of the airport operator's behaviour and performance.

⁶⁴ CMA's Competition Law Guidance on Assessment of Market Power, December 2004 (OFT 415), chapter 5.

⁶⁵ CMA's Competition Law Guidance on Assessment of Market Power, December 2004 (OFT 415), paragraphs 6.5 to 6.7.

⁶⁶ Section 6(3) read together with sections 6(6) and 6(7) of CAA12.

Chapter 5

Test B: Adequacy of competition law

- 5.1 Test B is that competition law does not provide sufficient protection against the risk that the relevant operator may engage in conduct that amounts to an abuse of that SMP.
- 5.2 This chapter is set out as follows:
- our general approach;
 - competition law;
 - the concept of abuse; and
 - summary.

Our general approach

- 5.3 Where Test A is met, we are required under Test B to consider whether competition law provides sufficient protection against the risk of abuse of that SMP.⁶⁷
- 5.4 Although Test B is a separate test, its application is dependent on whether we have already determined that the relevant operator has SMP in a relevant market. Under Test B, we must consider the existence and extent of the risk of the relevant operator engaging in an abuse of that position in the relevant market and how best to prevent it. If Test A is not met, there is no market power in relation to which we can make an assessment under Test B.
- 5.5 Importantly, we are required to assess the adequacy of competition law from the perspective of "users" of an "air transport service", which is defined in section 69(1) of CAA12 as passengers carried by the air transport service or a person who has a right in property carried by the service (such as freight cargo).
- 5.6 Accordingly, when assessing the protection provided by competition law, we have to further the interests of passengers and cargo owners, and not the interests of commercial passenger airlines or cargo airlines or other intermediary service providers, such as groundhandling providers, car parking operators or retail concessionaires.

⁶⁷ Section 6 CAA12.

- 5.7 We will conduct our assessment in the light of our considerations under Test A. In assessing this, we will consider, but not be limited to considering, the potential and likelihood of:
- public enforcement action by us or other relevant authorities;
 - private enforcement action by relevant companies (i.e. airlines or groundhandlers); and
 - private enforcement action by private individuals or groups of private individuals.

Competition law

- 5.8 Test B focuses solely on the effectiveness of competition law.⁶⁸ These provisions include not just our concurrent competition law enforcement powers under sections 60 to 63 of CAA12⁶⁹ but also the ability of interested third parties to bring private actions before the courts to enforce directly Articles 101 and 102 and/or the CA98 prohibitions.
- 5.9 It also includes the market provisions in the EA02.⁷⁰ However, we consider that the market provisions are not designed to guard against the risk of an abuse of dominance, as the market provisions were developed to tackle structural rather than behavioural issues. In addition, market investigations under EA02 are based on an assessment of an adverse effect on competition, rather than a finding of an abuse of a dominant market position under CA98.
- 5.10 We consider that it is the Chapter II prohibition and/or Article 102 TFEU that are designed to and would be used to address an abuse of dominance and, therefore, are most relevant for the assessment under Test B.
- 5.11 The ACRs and the AGRs are applicable and may protect against some forms of abuse but these do not form part of 'competition law' as defined in Test B.⁷¹ Therefore, we will not take account of these powers in the assessment of Test B. However, we will give appropriate consideration to their role in the regulatory framework as part of Test C.

⁶⁸ Competition law is defined in section 6(9) of CAA12 to include Articles 101 and 102 TFEU, the Chapter I and II prohibitions in the CA98 as well as Part 4 of the EA02 (market investigations).

⁶⁹ CAP 1235 - 'Guidance on the Application of the CAA's Competition Powers', available from <http://www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=14523>

⁷⁰ Part 4 EA02.

⁷¹ Examples include the Groundhandling Directive (GHD) implemented in the UK as the Airports (Groundhandling) Regulations 1997 and the Airport Charges Directive (ACD) (implemented as the Airport Charges Regulations 2011).

The concept of abuse

- 5.12 In competition law, a dominant company has a special responsibility not to allow its conduct to impair undistorted competition in the relevant market.⁷² It is not the position of dominance or SMP itself that is prohibited, but the undertaking using that position to prevent or distort the effective competition in the market.
- 5.13 Section 6(8) of CAA12 clarifies that conduct may, in particular, amount to an abuse of SMP if it is conduct that is described in the Chapter II prohibition in section 18 of CA98. Section 18(2)(a) to (d) of CA98 contains an illustrative list of exploitative and/or exclusionary behaviour.⁷³
- 5.14 Likewise, the European Court of Justice has defined the term abuse in the following way:
- An objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on basis of the transaction of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition.*⁷⁴
- 5.15 As such, an abuse under competition law is broader than, and not limited to, the illustrative abuses set out under Section 18(2)(a) to (d) of CA98. Any particular observed behaviour should be assessed as to whether or not it is abusive on its own merits.⁷⁵

Types of abuse most relevant to the assessment of Test B

- 5.16 We will assess the relevant types of abuse on a case to basis. However, there are a number of high level points that we consider will be common to most assessments of Test B.

⁷² Case 322/81 *Michelin v Commission* [1983] ECR 3461, paragraph 57.

⁷³ The types of abuse listed include unfair or excessive pricing, unfair trading conditions, market limitation or production limitation, discrimination and making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of the contracts

⁷⁴ Case 85/76 *Hoffmann-La Roche* [1979] ECR 461.

⁷⁵ This reflects the position established in European case law that the categories of abuse set out in Article 102 are not exhaustive: see Case 6/72 *Continental Can v Commission* [1973] ECR 215.

Successful application of competition law

- 5.17 Over the years, there have been a number of competition law cases taken at both a domestic and European level against airports.⁷⁶ These indicate that an airport operator is an undertaking for the purposes of competition law and that they can be found to be dominant and to have abused that dominance.
- 5.18 Case law illustrates that competition law has been successfully applied in what could broadly be considered as vertical exclusion cases, where the airport is active in the upstream market for AOS but also has a presence or stake in the downstream market for air transport or other services. The defining feature of these cases is that they all involved the airport leveraging its market power to the advantage of either its own subsidiary in a downstream market, or a closely aligned party.⁷⁷
- 5.19 We consider, therefore, that for these vertical exclusionary behaviours, there are likely to be sufficient precedents available from other industries including those that are similarly regulated (such as telecoms or utilities) which could be relied on as relevant authorities in assisting us to challenge exclusionary behaviour by airports under CA98 or Article 101/102 TFEU. Competition law is, therefore, likely to be sufficient to deal effectively with the risk of such abuses.
- 5.20 Similarly, there are a number of cases relating to discriminatory abuses, including at airports. In addition, currently, all airports above 5 million annual passengers are subject to the requirements of the ACRs which prohibit discrimination in the way airports set their charges without the need for a finding of dominance. Given these existing safeguards and the range of precedents competition law is likely to be sufficient to deal effectively with the risk of such abuses.
- 5.21 However, we consider that it is in relation to exploitative abuses involving excessive prices and/or reduced service levels where there is the greatest likelihood of abuse occurring where competition law may not give sufficient protection. In particular, the case law that exists provides different approaches on how to identify excessive prices and service quality based abuse. These different approaches weaken the ability of competition law to be used as an effective tool to constrain the behaviour of airports. Additionally there is likely to be a range of price (or service quality degradation) between what we may seek to regulate (as proxy for the competitive price) and what may be defined as

⁷⁶ Commission decision 95/364/EC, Commission decision 1999/199/EC, Commission decision 1999/198/EC, Commission decision 98/513/EC; T-128/98, C-82/01 Commission decision 98/190/EC, Purple Parking & Anor v Heathrow Airport Limited [2011] EWHC 987 (Ch) and Arriva the Shires Ltd v London Luton Airport Operations Ltd [2014] EWHC 64 (Ch).

⁷⁷ The early European cases are typified by a strong single market imperative. These cases in the main consist of a state owned airport supporting state owned airlines.

"excessive" or "abusive" under competition law. This could result in a "creeping abuse" that is to the detriment of user of air transport services. We are, therefore, likely to focus our attention on these types of potential abuse in our assessment of Test B.

Competition law remedies

- 5.22 It is not only the ability to enforce competition law that needs to be considered under Test B but also the remedies available. In addition, there is the reputational impact of being found to have breached one of the competition law prohibitions.
- 5.23 The main remedy used is a financial penalty. Financial penalties are calculated in line with the CMA guidance on penalties. Financial penalties can be up to 10 per cent of the company's relevant global turnover.⁷⁸ Where an infringement is found, financial penalties can provide a strong incentive not to infringe the prohibitions, and to reinforce the considerations on exclusionary and discriminatory abuses.
- 5.24 Other remedies available are behavioural in nature, such as directions to bring an infringement to an end, accepting binding commitments to change behaviour; considering settlements offered to us and applying for directors' disqualification orders. Behavioural remedies usually need to be monitored and compliance assured on an ongoing basis. These remedies can take time to implement and to change behaviours. As such, they may not be as effective in addressing behaviours that are to the detriment of users of air transport services.

Action taken by the CAA/CMA against airports

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

Summary

- 5.26 Test B, is whether competition law does not provide sufficient protection against the risk that the relevant operator may engage in conduct that amounts to an abuse of that SMP.⁷⁹
- 5.27 Test B presupposes a finding of SMP against which to assess the sufficiency of competition law to protect against the risk of abuse of that SMP.

⁷⁸ The CMA's Competition Law Guideline on Appropriate CA98 penalty calculation, September 2012 (OFT423) is available from <https://www.gov.uk/cma>

⁷⁹ Section 6(3) read together with sections 6(8) and 6(9) of CAA12.

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

Chapter 6

Test C: Adverse effects/benefits of licence regulation

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

Our general approach

- 6.3 We view Test C as an analysis of the adverse effects and the benefits on the users of air transport services of imposing or maintaining regulation.

Balancing Exercise

- 6.4 Generally, Test C is a balancing exercise between the benefits of a licence imposed on the relevant airport operator and a situation where there is no licence. If there were no licence, the behaviour of the airport would be constrained only by existing market forces and general regulatory (non-licence) provisions.
- 6.5 CAA12 does not dictate a particular method of impact assessment and, as a result, such assessment may be qualitative or quantitative or a combination of both depending upon the availability of the relevant data. Where it is reasonably practicable to quantify the respective benefits and adverse effects, we will do so. We will then exercise our regulatory judgement in weighing those factors in order to apply Test C.
- 6.6 As part of the assessment, we must consider the extent to which any likely net benefits benefit end users rather than intermediate providers.
- 6.7 If we consider that there is a conflict between the interests of different classes of user, or between the interests of users in different markets, our duty is to carry

out the functions in a manner which we consider will further such of those interests as we think best.⁸⁰

Licence Conditions

- 6.8 CAA12 sets out the provisions for granting a licence and what a licence may contain.⁸¹ The licence may include:
- conditions that we consider are necessary or expedient having regard to the risk that the airport operator may engage in conduct that amounts to an abuse of SMP;
 - price control conditions we consider necessary;
 - payment to us on the grant of the licence and/or while it continues in force; and
 - other conditions that we consider are necessary or expedient having regard to our CAA12 duties.⁸²
- 6.9 Test C does not require that we apply the test by reference to a specific set of licence conditions (regulatory obligations). Such a requirement would reverse the logical structure of CAA12, and would require the determination of individual licence conditions before the decision of whether to impose a licence is made.
- 6.10 We intend to apply the MPT ahead of any considerations of the specific form of licence that may be applied in any specific case once an MPD has been made.
- 6.11 The generic licence conditions we will consider in the assessment of Test C are those mentioned in paragraph 6.8.
- 6.12 We will consider whether it would help the assessment to consider the specific issues that might be addressed by economic regulation. The extent to which we develop these in the assessment phase will depend on what is necessary and expedient. For example, we do not consider that it is necessary or expedient to develop draft licence conditions in undertaking an MPD. However it may be helpful to consider what price control or monitoring approach may be appropriate given our findings on Test A and B.
- 6.13 We will also have regard to the regulatory principles in CAA12⁸³ and the duty not to impose or maintain regulatory burdens which we consider to be unnecessary.⁸⁴ These provisions, taken together, in essence, build in a

⁸⁰ Section 1(5) CAA12

⁸¹ Chapter 1 sections 15 to 21 CAA12.

⁸² Section 18(1) CAA12.

⁸³ Section 1(4) CAA12

⁸⁴ Chapter 1 section 73(2A)(b) Regulatory Enforcement and Sanctions Act 2008 as amended by section

proportionality exercise to Test C to ensure that *ex-ante* regulation via a licence is only imposed where it is suitable, necessary and proportionate.

Making the comparison

- 6.14 In making a comparison we need to determine what the comparison will be between.

Airport operator that does not hold an economic licence

- 6.15 If we are making an MPD of an airport whose operator does not hold an economic licence, we would make a comparison between the status quo (an airport without economic licence regulation) and an airport regulated by means of a generic economic licence⁸⁵ (the counterfactual).
- 6.16 In developing this counterfactual we will consider the existing commercial behaviours of the airport operator. For example, where there are existing agreements in place between the airport operator and third parties, we will consider these as part of the counterfactual.

Airport operator that holds an economic licence

- 6.17 However, the situation would be different if we were making an MPD for an airport whose operator already holds an economic licence. In that situation we would make a comparison between the likely behaviour of the airport operator without an economic licence and a generic economic licence (the counterfactual). We consider that a generic licence is the appropriate counterfactual as Test C considers the imposition of regulation, not its intensity.
- 6.18 In assessing the airport operator absent an economic licence, we would take into account the behaviour that the airport operator had exhibited under its current economic licence regulation, for example where it has developed extant agreements with third parties that are not linked to regulation through its current or any potential future economic licence.
- 6.19 We note that assessing Test C against an unknown counterfactual may be challenging. Not least because the behaviour of the airport operator and all third parties could be different absent an economic licence. The exact nature of the non-licence counterfactual will depend on the particulars of the operation of the airport in question.

104 CAA12.

⁸⁵ We would not go into specifics of the precise form of licence regulation.

Areas considered under Test C

Benefits of economic regulation

6.20 The assessment of the benefits of economic regulation by an economic licence includes an assessment of the impact on prices, efficiency, service quality and investment, and other potential benefits of economic licence regulation. This includes the following points:

- **revenues** - licence regulation may have an effect on expected revenues through revenue caps or monitoring. Regulation can ensure that:
 - prices charged are cost-reflective;
 - the overall level of charges is capped;
 - the airport operators is limited in its ability to charge excessive prices; and
 - price changes can be predictable if they occur in line with a stable pricing mechanism depending upon changes in the underlying level of efficient costs.
- **efficiency** - licence regulation can be an effective way of promoting and incentivising operating and capital expenditure efficiency; if it mimics the market forces of effective competition by challenging the airport operator's reported operating and capital costs and efficiency assumptions putting downward pressure on them.
- **service quality** - licence regulation can address service quality through greater regulatory scrutiny, incentivising airport operators to take into account the views of stakeholders. It can promote service quality standards and as a result provide net benefits through the promotion of service quality standards and the protection of air transport users from service quality standards failure.
- **investment incentives** - licence regulation can provide incentives to invest, for example by providing a more certain mechanism by which investment can be remunerated. It can ensure that:
 - new capex is reviewed and agreed with the CAA as part of the regulatory process prior to its realisation;
 - investment is rewarded through a fair rate of return which is known *ex-ante*; and
 - new facilities are procured in the most efficient way to protect users against paying for the development of "gold plated" or inferior investments.

- **operational resilience** - licence regulation can be used to compel or incentivise the airport operator to ensure operational resilience, incentivising them to use the levers at their disposal to encourage and co-ordinate the relevant stakeholders to greater effect; and to protect users' interests in improved resilience.
- **financial resilience** - licence regulation can facilitate financial resilience, by the provision of financial undertakings, minimum financial standards (eg credit ratings), and limitations on financial and business activities. Adverse effects of economic regulation.

6.21 The assessment of the adverse effects of economic regulation through a licence includes considering the direct costs and other adverse effects of holding a licence.

6.22 Direct costs which will be incurred include the time and expenditure of management and regulation staff at the CAA, the regulated airport operator and airlines.

6.23 Other potential adverse effects from licence regulation include the following:

- **crowding out of a more commercial approach** such as commercial contracts, investment and development that would encourage commercial growth in aeronautical and non-aeronautical revenues.
- **management distraction**, which can distort incentives by distracting management to focus on maximising the value from a regulatory settlement rather than to focus on improved efficiency or service quality.
- **distortions to incentives**, such as investment incentives that encourage too much or too little investment, distortions in the trade-off between operating and capital expenditure, distortions of the service quality requirements and associated financial incentives so that they do not match passengers' priorities or there is a focus only (or primarily) on attributes that can be easily measured. Other potential distortions include the increased rigidity of a regulatory system, in particular in relation to consultation requirements and changes in charges and service quality and the requirement for capital plans to be set too far in advance.

***Ex-ante* licence versus *ex-post* powers**

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

Ex-ante licence regulation

- 6.25 Our *ex-ante* licence regulatory powers typically pursue different, albeit overlapping, policy objectives to the strict market considerations that apply under competition law and other sectoral powers. In particular, our general duty of furthering passengers' and cargo owners' interests, allow us to address a wider set of objectives and employ additional remedies than we could under our European and UK competition law powers. The flexibility as to what may be included in an economic licence allows us to pursue these wider aims. Both sets of powers are, however, ultimately directed at protecting the interests of end users.
- 6.26 For instance *ex-ante* licence regulatory powers can be utilised to reduce the level of market power in a market and thereby encourage effective competition to become established.⁸⁶ *Ex-ante* licence regulation may promote the development of effective competition in the relevant market by fostering market entry and creating incentives for innovation and efficiency. It may also seek to replicate the outcomes that are expected to be seen within an effectively competitive market, for example, by regulating prices. In this way, it can attempt to minimise the scope for conditions to develop in the market which are conducive to abusive conduct.

Ex-post powers

- 6.27 *Ex-post* powers, which are discussed below, include:
- competition law powers;
 - the ACRs;
 - the AGRs; and
 - monitoring.
- 6.28 *Ex-post* powers are designed to protect the degree of competition that already exists within a market (which may not be effective). Action under competition law and our sectoral powers may take time to reach a conclusion post-breach and the remedial powers may be more limited.

Competition law powers

- 6.29 We have concurrent powers with the CMA⁸⁷ to:

⁸⁶ For example, where in a market not yet operating in a state of effective competition, there is a risk of abusive conduct, regulation *ex-ante* via a licence can deliver detailed remedies for the benefit of all market participants over an appropriate time period.

⁸⁷ The CMA took over the duties of the Competition Commission (CC) and the Office of Fair Trading (OFT) from 1 April 2014.

- undertake investigations into whether an operator of airport services is breaching a prohibition under the CA98 or under the TFEU:
 - Article 101 TFEU and the Chapter I prohibition in CA98 both prohibit agreements between undertakings,⁸⁸ decisions by associations of undertakings and concerted practices that have the object or effect of preventing, restricting or distorting competition; and
 - Article 102 of TFEU and the Chapter II prohibition in CA98 both prohibit conduct by one or more undertakings which amounts to an abuse of a dominant position in a market.
- undertake market studies and make market investigation references to the CMA under the EA02 with respect to the provision of AOS:
 - Market studies, carried out under our competition law powers, assess whether a particular market is improving choice and value for aviation consumers, potentially leading to proposals as to how competition might be made to work more effectively; and
 - We can make a market investigation reference (MIR) to the CMA requesting that it conduct an in-depth market investigation. Alternatively, in lieu of us making an MIR, we can accept binding undertakings from market participants to address any competition harming features we have identified.

6.30 Further details on these powers are explained in our competition power guidance.⁸⁹

Airport Charges Regulations

6.31 The Airport Charges Regulations 2011 (ACRs)⁹⁰ came into effect in November 2011 and transposed into UK law Directive 2009/12/EC of the European Parliament and of the Council of 11 March 2009 on airport charges. The ACRs cover operators of all airports handling over 5 million passengers and provide

⁸⁸ The term 'undertaking' refers to any autonomous economic entity engaged in economic activity, regardless of its legal status and the way in which it is financed. It includes companies, firms, businesses, partnerships, individuals operating as sole traders, agricultural cooperatives, associations of undertakings, non-profit making organisations and (in some circumstances) public entities that offer goods or services on a given market. Companies in the same corporate group will generally be considered to constitute a single 'undertaking'.

⁸⁹ CAP 1235 - 'Guidance on the Application of the CAA's Competition Powers', available from <http://www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=14523>

⁹⁰ The airport charges directive can be found at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:070:0011:0016:EN:PDF>

The airport charges regulations can be found at:

http://www.legislation.gov.uk/ukxi/2011/2491/pdfs/ukxi_20112491_en.pdf

airlines with a number of protections. For example, it requires airport operators to provide information to and consult with airlines when changing airport charges, and to not discriminate between airlines without relevant, transparent and objective justification.

- 6.32 We must investigate complaints by an airline on which airport charges have been levied, or by another airport operator that considers its business has been harmed by the airport operator not complying with the ACRs. We may also investigate on our own initiative.
- 6.33 More information on the ACRs can be found on our website.⁹¹ We plan to update our guidance on how we implement the ACRs in 2015.

Airports (Groundhandling) Regulations

- 6.34 The Airports (Groundhandling) Regulations 1997 (AGRs) transpose the European Groundhandling Directive into UK law.⁹² Groundhandling covers a multitude of activities including check-in, handling baggage, cargo and mail, refuelling aircraft, and transporting passengers and crew to aircraft. The AGRs place some limitations on airport operators at airports with more than 2 million passengers annually, if they want to restrict the number of third-party groundhandlers that operate at the airport. The AGRs also constrain airports with more than 1 million passengers if they want to restrict the number of self-handling airport users. If an airport covered by these regulations wants to restrict the number of third-party groundhandlers or self-handling airport users that operate at the airport, it requires a determination from us to be able to do so.
- 6.35 There are currently no legal restrictions on the number of handlers at airports in the UK. Where handlers use aircraft facilities, such as check-in desks, baggage belts and fuel hydrant systems, the airport operator must set its charges according to relevant, objective, transparent and non-discriminatory criteria. We must investigate alleged breaches of the AGRs.
- 6.36 More information on the AGRs can be found on our website.⁹³

⁹¹ More information on the ACRs can be found at:

<http://www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=14467>

⁹² Airport Groundhandling Regulations – The airport groundhandling directive can be found at: [Http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:31996L0067](http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:31996L0067)

The airport groundhandling regulations can be found at:

<http://www.legislation.gov.uk/ukxi/1997/2389/made>

⁹³ More information on the AGRs can be found at:

<http://www.caa.co.uk/default.aspx?catid=78&pagetype=90&pageid=69>

Monitoring

- 6.37 We have a duty under section 64 of CAA12, so far as it appears practicable to do so, to keep under review the provision of AOS and to collect information about those services. Further details on this power are explained in our competition guidance.⁹⁴
- 6.38 Section 50 of CAA12 allows us to require the provision of information or documentation that we reasonably require for the purpose of carrying out our functions related to the regulation of operators of dominant airports under Chapter 1 of CAA12.

Assessing *ex-post* powers or *ex-ante* regulation

- 6.39 We will, therefore, need to consider carefully the potential risks involved on a forward looking basis and whether they are better managed in the interests of users through *ex-post* powers or *ex-ante* licence regulation. In doing so we would take into account:
- whether the likely issue is forward or backward looking:
 - *ex-ante* is forward-looking - it can prescribe or control types of market behaviour regardless of particular circumstances, based on public policy priorities or market failures that are found to exist in the market and need to be remedied; whereas
 - *ex-post* is backward-looking and relies on historical evidence of abuse that has occurred in an otherwise commercially competitive market.
 - Whether the market definition is narrow or broad:
 - *ex-ante* market assessments may be defined in broader terms with supply side substitution and demand side substitution⁹⁵; whereas
 - *ex-post* (usually under competition law) would have a relatively narrow view of product markets and may be driven primarily by demand side substitutability.
 - the specific or general nature of the likely issue:
 - *ex-ante* issues could be focused on addressing market failures arising from a certain industry structure or history; whereas

⁹⁴ CAP 1235 - 'Guidance on the Application of the CAA's Competition Powers' can be found at: <http://www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=14523>

⁹⁵ However, in the context of airports we note that supply side substitution is likely to be limited in the short-term.

- *ex-post* issues could be focused on redress for past actions and prohibiting future actions of a similar nature.
- the nature of the available remedies:
 - *ex-ante* remedies are usually narrow in scope, essentially declaratory in nature and neutral in terms of broader implications for industry of the remedies sought in a specific piece of competition litigation; whereas
 - *ex-post* remedies are generally very specific in nature but general in scope affecting the majority of customers. They are generally cost based assuming an efficient operator, they are defined in focus by the legislative context.
- the time taken to deal with potential issues:
 - *ex-ante* issues are generally enforced through independent sector-specific regulators such as ourselves. Where the regulator has the power to act, this can be taken quickly - in weeks or months and sometimes immediately; whereas
 - *ex-post* issues are usually dealt with through the Courts, the European Commission (EC), the CMA or ourselves, where case law tells us this can take months to years to reach a conclusion.

6.40 We will assess the comparative merits of *ex-post* regulation (through competition law, and other sectoral powers) as a sufficiently effective alternative to *ex-ante* regulation under an economic licence.

Summary

- 6.41 Test C is whether, for current and future users of air transport services, the benefits of regulating the relevant operator by means of a licence are likely to outweigh the adverse effects.⁹⁶
- 6.42 We intend to apply the MPT ahead of considerations of the form of licence that may be applied in any specific case once an MPD has been made.
- 6.43 Generally, Test C is a balancing exercise between the benefits of a licence imposed on the relevant airport operator and a situation where there is no licence. This means that the risk of the operator abusing its market power is constrained only by existing market forces and general regulatory (non-licence) provisions.

⁹⁶ Section 6(5) of CAA12.

- 6.44 The assessment may be qualitative or quantitative, or a combination of both, depending upon the availability of the relevant data. Where it is reasonably practicable to quantify the respective benefits and adverse effects, we will do so.
- 6.45 As part of Test C, we will assess the suitability of an *ex-ante* or *ex-post* approach against the nature of the likely issues which we consider to create the greatest risks for users of air traffic services.
- 6.46 We will then exercise our regulatory judgement in weighing those factors to apply Test C.

Chapter 7

Once an MPD has been made

Introduction

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

Once an MPD has been made

If the MPD concludes that the MPT is met

- 7.2 If an MPD concludes that the market power test is met by an airport operator in relation to an airport area, then that airport operator will require an economic licence in order to be able to levy charges. In some cases, we may decide to begin the process of developing a licence alongside the MPD.
- 7.3 The detailed process of granting a licence may vary from time to time but is likely to include the following steps:
1. We will normally treat the airport operator as making an application for a licence in accordance with section 14(4) of CAA12 and will begin the process of developing a licence. In some cases, we may require the airport operator to make and publish an application for a licence accompanied by the specified information under section 14(1) of CAA12;
 2. We will consult with interested stakeholders to explore areas of concern including the appropriate form of regulation and the potential scope of licence conditions;
 3. We will publish our initial proposals on the regulation of the airport operator;
 4. Written representations from stakeholders may be submitted in response to our initial proposals under timescales which we will specify;
 5. We will issue our final proposals, including the proposed licence conditions for the airport operator and our reasons for the proposed conditions. That document may constitute the notice of a proposal to grant a licence under section 15(1) of CAA12, or we may decide it is more appropriate to issue that notice separately, following representations on the final proposals;
 6. Written representations may be submitted in response to our final proposals;

7. If required, we may include additional consultation stages prior to issuing final proposals;
8. We will publish a copy of the licence under section 15(5) of CAA12. The notice will specify, among other things, the date on which the licence will come into force, our reasons for the conditions included in the licence, a summary of our response to representations received and the reasons for any differences between the conditions included in the licence and those set out in the final proposals; and
9. The airport operator and any other person with a qualifying interest (e.g. airlines) will have up to six weeks from the date of publication of the licence and notice to decide whether or not to seek permission to appeal to the CMA.

If the MPD concludes that the MPT is not met

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

Sectoral regulation and subsequent MPDs

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

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