

Competition Guidelines: Issues paper

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Comments from Gatwick Airport on the CAA's Competition Guidelines Issues paper published in September 2010

Introduction

With the sale of Gatwick to GIP and the associated increase in competition and benefits for passengers that this brings, we welcome the work that the CAA has been progressing, both on developing competition guidelines and to assess alternative forms of regulation. In our view it is imperative that the CAA fully takes into account recent market developments and the potential for future enhancements in competition when it develops its proposals for the economic regulation of airports beyond the end of Q5, which is currently expected to end in March 2013. The development of competition guidelines, with effective stakeholder engagement, is critical to ensuring that there is a clear analytical framework set out in advance of the CAA conducting its competition analysis and that this framework is well understood by stakeholders.

This response provides our comments to the issues raised in the Issues paper. We have already provided both written and oral feedback on some of these issues and as such this response seeks to cover these previously discussed issues at a high level and provide more detailed comments on the areas that we have not yet provided feedback.

Before providing our comments on the issues in the Issues paper, we set out some other, more contextual observations on the Issues paper and the development of the competition guidelines more generally.

Contextual observations

Development of competition

As noted above, the recent development of competition in the provision of airport services, particularly in the south east, through the sale of Gatwick to GIP needs to be properly understood and appropriately factored into the CAA's future decisions on economic regulation. While the timescales are currently uncertain due to the potential extension of Q5 by one year, if this extension were to occur this provides an opportunity for the CAA to progress its competition analysis in advance of it having to develop detailed proposals for economic regulation. In the event that there is no extension of Q5, there will continue to be a need for the CAA to develop a detailed and comprehensive understanding of the competitive environment under which the currently designated airports operate before it can come to a well informed view of the appropriateness, or not, of different price control options, or indeed whether there should be any price control at all.

The designation status of Gatwick has not been considered since privatisation. The sale of Gatwick to GIP and the associated increase in competition that has resulted, means that Gatwick is much less likely to be found to have SMP in the future. The DfT recognised that common ownership of

YOUR LONDON AIRPORT

Gatwick

the airports by BAA was a factor in the decision not to de-designate Stansted. As such, the CAA cannot attribute any market power to Gatwick until it has undertaken full and robust analysis. Clearly, any finding that there was not SMP would point towards the de-regulation of Gatwick.

Dual role of the competition guidelines

The CAA has taken the view that it will produce one set of competition guidelines to cover both ex ante analysis (e.g. to assess competition on a forward-looking basis for the purposes of informing price control decisions) and ex post analysis (e.g. to assess competition on a backward-looking basis to inform decision under general competition law or section 41 of the Airports Act). While this is largely an issue of presentation, the CAA will need to be mindful of the potential need for different analytical approaches, depending on whether a backward-looking or forward-looking analysis is being conducted and that the guidelines make a clear distinction when this is warranted.

Application of competition analysis to airports

We are pleased to see and we support the CAA's general approach of seeking to identify those areas of competition analysis that might warrant 'special' treatment for airports and a divergence from the analysis that would be conducted in other sectors. This approach has illustrated that the competition analysis that may be required in the airport sector is to a large extent very similar to the analysis that would be required in other sectors. This means that the CAA will be able to rely on the precedents from general competition law and on the analytical approaches included in the competition guidelines produced by other competition authorities, most notably the OFT and the European Commission. Only where unique aspects of the airports sector have been identified should the CAA seek to depart from these more established analytical approaches.

We were also pleased to hear that the CAA has been and will continue to engage with the OFT on the production of its guidelines as this will help ensure consistency of approach where this is warranted and as such reduce regulatory risk across the industry.

Effective stakeholder consultation

At the stakeholder working group on 12 November there was a discussion of the effectiveness of the CAA's stakeholder engagement on the development of its competition guidelines. Our view on this issue is that there has been significant stakeholder engagement and potentially significantly more than would be undertaken by other regulators or competition authorities in developing guidelines such as the CAA is developing. While we welcome this stakeholder engagement and we consider it has provided benefits in terms of ensuring that we are well informed of how the CAA is thinking about key issues, this has come at a cost of delaying the production of draft guidelines. An alternative and better approach might have been for the CAA to have had effective, but more limited stakeholder engagement upfront and produced draft guidelines earlier. This would have enabled the CAA to conduct (or at least significantly progress) its competition analysis in advance of its consideration of the appropriateness of the different regulatory options for individual airports.

We also note that the CAA has indicated that there will be a delay in the publication of its draft guidelines, to January 2011. We urge the CAA to ensure that there is no further delay beyond this date and that it concludes publication of its final guidelines soon afterwards.

Comments on issues raised in the Issues document

In this section we set our comments on the issues raised by the CAA in its Issues document.

Competitive price level

As recognised by the CAA, the appropriate evaluation of the competitive price level will be critical to the conclusions of the CAA's competition analysis properly reflecting the constraints that exist in the markets that it is assessing. This issue is inherently linked to the consideration of capacity constraints and scarcity (see below). As we have previously noted and as recognised by the CAA, the appropriate definition of costs, when determining the competitive price level for the purposes of market definition and assessing competition is the forward-looking, full economic cost. This is in comparison to any prevailing regulated price level or to a measure of the efficient operator cost, either of which may or may not equate to the forward-looking full economic cost. This can be seen by reference to a number of other sectors where it is accepted that operators operate in competition with each other, but where the competitive price level is above the efficient operator cost. We have previously discussed the housing market, the mobile telephony market and the airline market as being examples of such sectors. In addition, the oil and gas production sector is a further example.

Capacity constraints and scarcity

We previously wrote to the CAA on 22 October on this issue and we do not repeat the detailed arguments we put forward there. We agree that capacity constraints are important and that there should be a proper and appropriate appreciation of them in the CAA's competition analysis. In particular, we welcome the CAA making the appropriate and important distinction between temporal, underlying and artificial scarcity. As noted above, there is a strong link between the treatment of scarcity in the analysis and the determination of the competitive price level. If the CAA does not treat this issue appropriately this will risk erroneous conclusions from its analysis.

Airports as multi-sided platforms

We have previously provided the CAA with our thoughts on this issue and we agree that airports are multi-sided platforms and that this should be the basis of the CAA's analysis of the airports market. That said, the key issue for the analysis is what additional constraints, if any, at a particular airport emanate from the fact that it is a multi-sided platform.

We would also like to re-iterate a point made previously that although an airport is a multi-sided platform, this does not mean that demand for airport services from airlines is not derived from demand for air travel from passengers. Multi-sided platforms and derived demand are not mutually exclusive, which appears to be implied by the CAA's Issues paper.

It is not clear to us from the Issues paper how the CAA will apply the hypothetical monopolist test (HMT) in the multi-sided platform framework, in particular it is not clear what the CAA will be using the HMT to assess substitution from and to. We consider that this issue would benefit from further explanation from the CAA.

Role of existing regulation

The CAA needs to ensure that it takes due account of existing economic regulation in place at an airport, particularly when it is conducting an ex ante analysis for the purpose of assessing whether

economic regulation continues to be required. This is particularly important to the extent that regulation keeps prices below the competitive level and full economic cost, which as discussed above is the appropriate benchmark for market definition and assessing SMP. Also, to the extent regulation keeps price below the competitive level, then it is possible that airports' market shares are different and the market structure is different from what would be the case if prices were at the competitive level.

We also consider it important that the CAA recognises that regulation at one airport can impose additional constraints at other airports, reducing any market power that the other airports may have.

Product market definition

We have a number of comments on the CAA's discussion of product market definition:

- Throughout the discussion of market definition, when discussing substitution, the CAA needs to be clear that substitution is assessed from the competitive price level, which is not necessarily the prevailing price level. This is left ambiguous in a number of areas. Moreover, it is not clear to us from the CAA's discussion of this issue how it will ensure that its substitution analysis is carried out appropriately (from the competitive price level). As such, this part of the CAA's methodology might warrant further explanation.
- We agree market definition is not an end in itself and it is important that CAA bears this in mind when conducting its analysis. However, despite this it is important that the CAA is clear what it considers the market boundaries to be and why, so that all relevant constraints are taken into account in its market power assessment.
- The CAA's discussion of product market definition needs to explicitly recognise that demand from airlines for airport services is a derived demand, derived from passenger demand for air travel. This links into the discussion of multi-sided markets, where we note above that the CAA seems to imply that derived demand and multi-sidedness are mutually exclusive, which they are not.
- We agree that passenger characteristics will be important to the product market definition exercise in the ways identified by the CAA. We also note that airports have limited ability to identify and segregate passengers on the basis of their characteristics, whereas airlines have much greater ability to do so.
- We also agree that airline characteristics are important for product market definition. This will be particularly important when the CAA comes to assessing whether Gatwick has SMP as there is a broad range of different types of airlines at Gatwick, servicing the full spectrum of passenger types. This puts Gatwick at greater exposure to the potential for airline switching.
- The CAA should be clear that if there is price discrimination present, this does not necessarily imply multiple different product markets.
- We agree that the opportunities for supply-side substitution are probably limited, but again these should be assessed from the competitive price level. However, it will be the case that existing airports have the ability to expand in response to relative price changes and act as a constraint. It is a bit of a moot point whether this is considered as supply-side substitution or

YOUR LONDON AIRPORT

Gatwick

entry. What is important is that these constraints are properly and fully assessed and taken into account in the analysis.

Geographic market definition

The definition of the product market definition is logically prior to the geographic market definition so the CAA needs to be clear on its product definition (what it is or what they are) before defining geographic market.

We also note that the CAA has recently published a working paper on geographic market definition and we will respond to this in due course. At a high level, the CAA seems to have captured the key areas for analysis: in particular passengers' willingness/ ability to travel to a particular airport, which will inform the extent to which different airports are constraints on each other and will be a key determinant of the geographic scope of the market. In addition, we agree that the geographic analysis has to be forward-looking so it would not be appropriate for the CAA to limit its analysis only to existing catchment areas.

The CAA's assessment of airline switching is also very important to the definition of the geographic market. However, we consider that the discussion of this issue would benefit from more detail on the types of information CAA will take into consideration of its analysis e.g.:

- Information on past switching and by what airlines and from where and to where
- Airline business plans
- Airline investor briefings and
- Information from airports on airline threats to switch.

We also note that some network airlines also operate point to point services so might well have a similar ability to switch these services as low cost airlines do.

A further important point when considering airline switching is that the CAA's assessment of 'next best' should be conducted at the competitive price level and not at prevailing prices, where these are found to be different. In such a scenario next best might in fact be first best.

Assessment of market power

We have a number of comments on the CAA's discussion of its assessment of market power

- The CAA appears to be under-playing the potential role of market share data in its analysis. While we agree that this should not have undue focus in the competition assessment, if the CAA considers that this information is limited to the extent implied then it should provide a more adequate explanation as to why this is indeed the case.
- We agree that expansion is an important source of competitive constraint on airports, including from the those airports that might be considered to be the 'competitive fringe'. Linked to this, the CAA should recognise that binding regulation could undermine the prospects of effective constraints emerging from such airports.
- Airline buyer power is a very important source of competitive constraints on airports and we welcome that the CAA indicates that this will be a key part of its competition analysis. We also agree that sources of evidence include past behaviour and that this should be assessed on a

YOUR LONDON AIRPORT

Gatwick

case by case basis. We also consider that an analysis of airline buyer power needs to assess the impact of an airline switching on the profitability of an airport.

- We agree with the CAA that an assessment of airline buyer power should not be limited to a complete withdrawal of services by an airline but might also be limited to a partial withdrawal. In addition, it is important that the analysis takes into account the potential for simultaneous (related or unrelated) threats by airlines to withdraw and the constraining effect that this would have.
- We agree that the behaviour and performance of airports will be an important indicator of airport market power. As noted above, the appropriate price benchmark for a market power assessment is the price level associated with full economic costs, not the efficient operator costs. As discussed, these might diverge where there is scarcity and can be seen in a variety of markets.
- Important airport behavioural aspects include innovation, a focus on delivering for passengers and airlines, service quality, seeking to maximise availability/utilisation of existing facilities e.g. runway capacity etc. and for a regulated airport, how it has performed against regulatory requirements. We note that the CAA will publish a paper on this in due course.

Understanding the effects of an increase in airport charges in the short and long run

We agree with the CAA's view on the model presented by Ryanair of the impact of changes in airport charges on airfares set by airlines. In particular we consider it to be too simplified to be useful and that the assumptions included in the model drive the results.

Comments of detail

We note and have previously discussed with the CAA that non transitory in the context of the HMT generally implies a period of one year and not six to twelve months, as noted by the CAA.

We believe there is a typographical error in paragraph 3.26 which should refer to aircraft parking and not car parking.

Contact details

We hope that you find this response helpful. If you would like to discuss any issue raised or seek clarification please use the contact details below. We are happy for you to publish this response.

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