

CAA's draft competition guidelines

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Consultation response

Response from Gatwick airport to the CAA's consultation on its draft guidelines for the assessment of airport competition

Introduction

The CAA published for consultation on 9 February 2011 its draft guidance on the assessment of airport competition. This marks the near completion of one tranche the CAA's "Preparing for a more competitive airports sector" work, which has been in progress since November 2009 when the CAA consulted on the objectives and processes for the project. In the time since November 2009, in particular between April 2010 and now, there has been considerable stakeholder engagement by the CAA with airports, airlines and other parties with an interest in the development of these competition guidelines. We have sought to actively engage throughout this stakeholder engagement process and we hope that the CAA has found our contributions helpful.

The development of these competition guidelines is, in our view, particularly timely with the sale by BAA of Gatwick to Global Infrastructure Partners (GIP) in December 2009. As we have previously noted to the CAA, we consider it important that the CAA conducts a full and robust analysis of airport competition in the south east prior to it proposing the detailed architecture of any economic regulation to apply to airports operating in that market beyond the end of the current Q5 price controls. Only with the benefit of such a competition assessment can the CAA be confident that economic regulation beyond Q5 is targeted to identified competition problems (if any) and most importantly, to the benefit of passengers.

The remainder of this paper sets out our response to the draft competition guidelines. These comments are in addition to the comments made by Gatwick airport in various submissions on the development of competition guidelines, throughout the CAA's stakeholder engagement process.

Assessment framework

We agree with the positions set out by the CAA in this chapter of the draft guidelines. In particular:

- We welcome the unambiguous statement that the CAA considers that the economic concept of significant market power (SMP) is equivalent to the legal concept of dominance. As we have previously stated, we consider this to be an appropriate interpretation of the two concepts. Moreover, the unambiguous statement significantly reduces regulatory uncertainty related to this point.

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- We welcome the CAA's view that it will treat the question of collective dominance in a market in a manner consistent with relevant UK and EC case law. Again, in the context of airports, we consider this to be appropriate and it also acts to reduce regulatory uncertainty.
- We welcome the CAA being clear as to how it will conduct ex ante assessments and the associated need to take account of evidence of future developments. As noted by the CAA, particular importance should be attached to such forward-looking evidence when conducting an ex ante assessment.

Market definition

Purpose of market definition

We agree with the CAA's summary of the purpose of market definition. In particular, we agree with the point that all relevant constraints need to be taken into account in the competition assessment. That is to say that the consideration of constraints should not necessarily be restricted to constraints within the market, when relevant constraints emanate from outside the market.

The hypothetical monopolist test (HMT)

We have no comments on this section of the draft guidelines.

The competitive price level for airports

As noted by the CAA, it is critical to the proper functioning of the HMT that the competitive price level is used when assessing substitution in response to price changes. We welcome the CAA stating that the presence of regulation might mean that historic or prevailing price levels are not indicative of competitive price levels. We also welcome the CAA recognising that the capital intensive nature of airports and that it expects to estimate the long-term average price level using measure of long-run, forward-looking costs, incorporating the opportunity cost of the use of scarce capacity, as opposed to costs reported using accounting conventions.

The link between scarcity of capacity and competitive price levels is important and this is an issue on where we have submitted written comments to the CAA through stakeholder engagement. We welcome the CAA recognising this link in its competition guidelines.

Interdependence between demand from different user groups

We have previously submitted written comments on this issue. We welcome the CAA explicitly recognising in its draft guidelines that airport markets can be multi-sided and the potential for this to introduce additional constraints. We consider there could be benefits, in terms of additional clarity, that when the CAA discusses the HMT in the context of multi-sided markets, that the CAA makes explicit that the price rise is raised from the competitive price level.

Product market definition

We have no comments on this section of the draft guidelines. We consider this provides a sufficiently comprehensive overview of the relevant issues to be taken into account when defining airport product markets.

Geographic market definition

We consider that this section of the draft guidelines would benefit from the CAA explicitly stating that the geographic scope of the relevant economic market should be defined in reference to the previously defined product market. This is because product market definition is logically prior to the definition of the geographic market.

We also consider that this section could benefit from further explanation of how the CAA envisages incorporating the multi-sided nature of airports into the geographic market definition exercise.

We agree that the assessment of the ability of passengers and passenger airlines to switch in response to relative price changes from the competitive level will be central to the geographic market definition exercise.

Market structure and market shares

We have no comments on this chapter of the draft guidelines.

Barriers to entry and expansion

We agree that expansion is likely to be a greater source of constraints than outright new entry. However, we consider the draft guidelines would benefit from recognising that barriers to entry and expansion are likely to be lower when assessed against competitive price levels compared to when they are assessed against prevailing regulated price levels. This is because prices which are kept artificially low relative to competitive price levels will dampen incentives on new entrants to enter the market, or for competitors already in the market to expand.

Scarce capacity and capacity constraints

We have previously submitted written comments on this issue and agree that in the competition assessment, it is important to distinguish between different causes of scarcity. In particular, we agree that where capacity increase the costs of entry and/ or expansion, then this will not by itself indicate the presence of SMP. As noted by the CAA, even in a market with scarcity there can be considerable rivalry between suppliers, driving innovation and improved service quality, for example, as well as providing adequate choice for consumers, such that no operator has SMP.

We also agree that evidence of an operator actively engaging in behaviour to artificially restrict the release of capacity into a market could be indicative of SMP. This is particularly so where the costs of making additional capacity available are relatively low.

We consider that the draft guidelines could benefit from the CAA making clear that where there are other sources of non-transitory scarcity (i.e. not artificial scarcity) which reflect the underlying fundamentals of the market and are outside the control of the airport operator, then this would not necessarily indicate an operator has SMP. For example, as has been discussed during the CAA's stakeholder engagement, in a number of markets there can be enduring (non-transitory) constraints on releasing additional capacity but this does not lead to SMP being found in a market. The distinguishing feature of whether an operator active in a market has SMP or not is whether there is sufficient rivalry between the operators already present in the market such that some or all of the operators do not have SMP.

Airline buyer power

We agree with the CAA that the assessment of airline buyer power will be an important aspect of the airport competition assessment as such buyer power is potentially a significant constraint on an airport. As such these constraints need to be assessed and fully taken into account.

We have previously set out some suggestions of other sources of evidence relevant to the assessment of airline buyer power. We would welcome these being incorporated into the final version of the guidelines.

Other factors

Long-term contracts

We have no comments on this section of the draft guidelines.

Evidence on behaviour and performance of airports

We have previously submitted written comments on your working paper: “Empirical methods for assessing behaviour, performance and profitability of airports”. We would welcome the final version of the guidelines reflecting the comments that we made there.

Impact of regulation

Economic regulation, by its intent and design has a significant impact on markets and competitive outcomes. It is therefore important that the CAA’s competition assessment abstracts from the presence of regulation designed to address market power ex ante.

However, when conducting a competition assessment for the purpose of identifying whether ex ante economic regulation is required or not, then it is not appropriate to abstract from regulations which are exogenous to the question of whether or not an airport has SMP. The constraints that these regulations introduce should be fully factored into the competition assessment.

Substitution to and from other types of transport

We have no comments on this section of the draft guidelines.

Other activities at airports

We have no comments on this section of the draft guidelines.

Looking forward

With the finalisation of these guidelines, focus will now shift to how the CAA will implement them in carrying out its competition analysis. We have recently raised some questions as to how the CAA envisages applying the analytical framework contained in the guidelines. We look forward to engaging with the CAA on these issues to help ensure that the CAA’s approach to its competition analysis is properly informed by UK and EU competition law precedent.

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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